BTI 2010 | Lithuania Country Report

Status Index	1-10	**9.04**	**#** 7 of 128	
Democracy	1-10	9.30	# 8 of 128	➔
Market Economy	1-10	8.79	# 7 of 128	➔
Management Index	1-10	**6.94**	**#** 10 of 128	
scale: 1 (lowest) to 10 (highest)		score	rank	trend

This report is part of the Transformation Index (BTI) 2010. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 128 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	**3.4**	HDI	**0.87**	GDP p.c.	$	**17830**
Pop. growth	% p.a.	**-0.5**	HDI rank of 182	**46**	Gini Index		**35.8**
Life expectancy	years	**71**	UN Education Index	**0.97**	Poverty[2]	%	**<2**
Urban population	%	**66.8**	Gender equality[1]	**0.64**	Aid per capita	$	**-**

Sources: UNDP, Human Development Report 2009 | The World Bank, World Development Indicators 2009.
Footnotes: (1) Gender Empowerment Measure (GEM). (2) Percentage of population living on less than $2 a day.

Executive Summary

During the period under review, Lithuania's economic boom, originally stimulated by structural reforms implemented in the early 2000s and regulatory reforms aimed at meeting EU membership requirements, came to a sharp halt. The end of the economic boom (and the expected sharp contraction of the economy in 2009 and continuing negative growth in 2010) was further exacerbated by the global financial crisis and the center-left minority government's indecisiveness in pursuing anti-cyclical fiscal policies. Maintaining macroeconomic stability is thus the new center-right government's main priority. While the experiment with a minority government was beneficial to maintaining political stability on the whole and eventually helped to consolidate the performance of established political parties in the 2008 parliamentary elections, the minority government itself was weak and did not deliver on its promises (in the areas of anti-corruption policy, energy security and efficiency, and higher education reform). The new center-right government was elected on the promise of real reforms in many public policy areas and also because the voters saw the leading party as a better crisis manager. As far as the development of civil society is concerned, only marginal (if any) progress was made in terms of civic engagement. Trust in political institutions (political parties, government and parliament) remains very low, and decisive steps to fight corruption are necessary. Restrictions on political advertisements in the media produced welcome results in the 2008 elections, as candidates were forced to reach out to voters directly and engage more in policy debates. Still, further progress will be needed to make party finances more transparent. As regards regulatory reform, there has been virtually no significant progress in implementing the government's Better Regulation Program, and the environment for small- and medium-sized businesses has not improved. Lithuania's development benefited significantly from EU financial assistance, which it managed to absorb well and which will provide an important cushion in the current credit drought. It remains to be seen whether the Lithuanian government will turn the crisis into an opportunity for reform, as it did in the late 1990s. However, the coming economic downturn will be much more severe, which may hinder otherwise well-designed reform plans.

History and Characteristics of Transformation

Lacking not only the structures for transformation, but also statehood itself, Lithuania began completely anew in 1990. Occupied and annexed by the Soviet Union in the 1940s, Lithuania was a Soviet Republic for almost 50 years. Soviet rule had comprehensively reshaped the country, its resources, economy and above all, its people. Lithuanians often use the term "rebirth" to describe their return to statehood, which represented the starting point of transformation and set the goal of becoming a free and independent state within the community of European democracies. With accession to the European Union on 1 May 2004, and to NATO in March 2004, Lithuania has achieved the goals and aspirations it set in 1990. Because the creation of a democratic republic amounted to the end of foreign occupation, the change of the political system met with no opposition. The fight for independence and the founding of the new state provided a common popular basis of identity. The legitimacy of Lithuania's democratic order is thus closely tied to the Baltic revolution and the victory of the independence movement that was supported by the vast majority of the population. Political transformation progressed smoothly with few problems. The population voted for the constitution in 1992, and in 1993 a multiparty system emerged, marking the successful end of the first phase of political transformation. The constitution provided for pluralism under the rule of law and established a Constitutional Court – a first in Lithuanian history. The political system has proven itself reliable. All actors have accepted transfers of power and the impeachment of President Paksas demonstrated both the viability of democratic institutions and the degree to which established rules have been accepted. However, the will of the electorate itself remains subject to fluctuations. Since 1990, no government has succeeded in winning elections and staying in power (except for the Social Democratic Party, which succeeded in forming a ruling coalition for two consecutive periods, the first from 2001 to 2004 and the second from 2004 to 2008). During the Republic's first decade, the moderately fragmented party system appeared to oppose any new challenges under the constant shifts of voter support. Since 2000, however, the situation has changed as populist parties have made striking gains. The newly founded populist Labor Party achieved 28.44% during the parliamentary elections in 2004, and even became part of the government. The coalition with the Social Democrats ended in summer 2006, when two ministers of the Labor Party resigned amid allegations of corruption. Economic transformation led to massive social inequalities and imposed severe social burdens on most of the population. The Soviet legacy has proven an especially heavy load to bear. The problem here was not merely the planned economy, but the economy's orientation toward a system of planning defined by the regions of the Soviet Union. Some sectors of Lithuania's industry were too large, some too small and others almost nonexistent. Much of its technology was antiquated and several production processes relied heavily on human resources. At the start of the 1990s, the country attempted to pursue transformation without imposing heavy social costs. This strategy clearly backfired, as it initially slowed economic transformation and privatization. Like all reform-oriented states in Eastern Europe, Lithuania experienced an economic and social crisis characterized by a sharp decline in GDP and soaring unemployment figures. The worst was over by 1994. After a slump

in 1999 (the “Ruble crisis”), Lithuania’s GDP has shown strong growth since 2000, unabated in the years from 2004 to 2006. Thanks to EU accession, Lithuania has managed to create a market economy that is anchored in principles of social justice and equipped with modern regulatory institutions that are nearly free of political pressures. This was also a factor in the economic boom, which came to a sharp end in early 2009. In order to regain competitiveness and growth, Lithuania’s economy will need financial stimulation as well as structural and regulatory reforms.

Transformation Status

I. Democracy

In 2007 and 2008, political developments in Lithuania were mainly affected by two elections, namely the municipal elections in February 2007 and parliamentary elections in October 2008. The municipal elections did not produce big surprises, nor did they affect the party system in any significant way. They were won by two biggest Lithuanian parties, the Social Democratic Party, with 19.48% of popular vote and 302 out of 1550 mandates in the municipal councils, and the Homeland Union (Lithuanian conservatives), with 16.52% of the popular vote and mandates). They were followed by the Liberal and Center Union, with 11.74% and 182 mandates, Law and Order (formerly the Liberal Democratic Party of the impeached president Paksas), with 11.68% and 181 mandates, and the Peasant People's Party, with 9.1% and 141 mandates.

In 2007, national politics was characterized by the first functioning minority government ever, led by Prime Minister Kirkilas of the Social Democratic Party. The main opposition party, the Homeland Union, supported his stay in office in order to maintain political stability and prevent populist parties from ascending to power. The Homeland Union withdrew its support in the second half of 2007, but the minority government managed to survive until the scheduled parliamentary elections in the fall of 2008 by exploiting disagreements among opposition parties in parliament (especially as regards early elections) and by co-opting the New Union (social liberal) party back into the ruling coalition in early 2008. Bringing in the New Union party assured the necessary votes for the newly established energy company, LEO LT, which was created in order to build the new Ignalina nuclear power plant and power bridges between Lithuania and Poland, as well as between Lithuania and Sweden.

The parliamentary elections in October 2008 produced some unexpected results. First, two parties from the ruling coalition – the Peasant People's Party and New Union party – were lost their parliamentary seats as they did not reach the 5% electoral threshold. There was no decrease in the overall populist vote, but it this time was split among the three parties: Labor, Law and Order and the newly created National Resurrection Party. The elections were won by the opposition Homeland Union, which obtained 19.72% of the popular vote and received 45 seats (including those of single-member districts). Its chairman, the previous opposition leader Andrius Kubilius, formed the new government of "Change" with a coalition of the

Homeland Union, two liberal parties (the Liberal Movement and the Liberal and Center Union) and the National Resurrection Party (which came in second in the elections with 15.09% of the vote and 18 seats).

During this period, Lithuania successfully experimented with minority government in the name of political stability. The unfortunate trade-off was the absence of any important reforms. Thus, anti-corruption efforts did not produce any tangible results, higher education reform was stalled, and neither budgetary expenditures nor credit expansion were curbed. The economy's expected soft landing turned into a steep decline in the wake of the global financial crisis. The new government has sufficient backing in parliament to implement the crisis response package, tightening the budget and stimulating the economy, and may have enough support to embark on some promised structural reforms. As to the implication to the party system, Voting patterns continue to be volatile, and as yet, the party system has not been definitively consolidated, nor have voters been persuaded to turn away from populist platforms.

1 | Stateness

Monopoly on the use of force

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

State identity

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

No interference of religious dogmas

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

Basic administration

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

2 | Political Participation

Free and fair elections

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

Since 2000, parliamentary elections are no longer monitored by the Organization for Security and Co-operation in Europe (OSCE) (previous monitoring was done by the OSCE's Office for Democratic Institution and Human Rights). Representatives of the various political parties monitor procedural fairness, and the validity of the two past elections was not questioned.

The number of claims about alleged irregularities (such as vote-selling or the unlawful advertising of candidates) submitted to the Central Electoral Commission

of Lithuania remains limited. For example, during the 2008 political campaign for parliamentary elections, the Commission received 14 such claims and found a few of them to be substantiated.

Amendments made in 2007 and 2008 to the law on the conduct and financing of political campaigns, especially the limits on political advertisements in the mass media, had a welcome effect on the last parliamentary elections. Party finances remain the weak link; the ability of the authorized institutions (State Tax Inspectorate) to effectively monitor them is insufficient. At the time of reporting, a court was still investigating a case against the Labor Party, which was accused of false accounting of party finances (underreporting of LTL 25 million) and tax evasion (of LTL 3.8 million), which enabled the party to receive a state subsidy of LTL 6 million greater than that to which it was entitled. The court's decision is still pending.

The newly appointed center-right government has pledged to introduce the direct election of municipal mayors, as well as to enable candidates to run for election independent of party lists as early as the 2011 municipal elections. In February 2007, the Constitutional Court decided that the law on municipal elections, which allowed the election of municipal councils only by party lists, was unconstitutional.

The direct election of mayors has been controversial for many years. The new president spoke in favor of direct elections, not only of mayors but also of local administrators (of the smallest administrative entities within municipalities), who now are simply appointed by municipal councils. The main reason for suggesting these changes is to overcome voter apathy, and a secondary motivation is to reanimate stagnating municipal party politics. The potential for populist political agitation was reduced by recently passing laws restricting political advertising (the laws severely limit candidates' spending on political advertising on TV and billboards and posters).

The main stumbling block for political parties to come to an agreement on direct elections has been the scope of authority given to directly elected mayors – i.e. whether they will wield executive power or merely run the municipal councils. Currently, the latter is the case, and executive power is concentrated in the council-appointment administration of municipalities. In any case, the constitution will have to be changed, so a decision will not be easy and may not be passed (or advanced) at all.

As to the control of party finances, the government has pledged to empower a designated authority (most likely, a special unit within the State Tax Inspectorate) to deal effectively with the problem.

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

Effective power to govern

Association / assembly rights

Citizens have the unrestricted freedom of association and of assembly within the basic democratic order.

The government, however, continues to ban the Communist Party and other organizations associated with the former Soviet regime. In 2007 and 2008, the Vilnius municipality administration refused to grant permits for parades that would have involved gay groups.

Freedom of expression

Unrestricted freedoms of expression and of the press and media are guaranteed by the constitution and function in practice. Private media comprise a diverse selection of print and electronic outlets. There are five national daily newspapers: Lietuvos rytas (circulation of approximately 60,000), Vakaro žinios (75,000), Respublika (33,000), Kauno diena (34,000), and Lietuvos žinios (20,000). A total of 340 newspapers and 418 journals were published in Lithuania in 2006.

There are 30 commercial television stations and one public service TV station, Lietuvos televizija. Four of them are national broadcasters: TV3 (28% of viewers), LNK (22%), LTV (13%) and Baltijos TV (7.5%) (as of September 2007). There are 48 radio stations in Lithuania, of which 10 commercial stations and 1 public broadcaster (Lietuvos radijas) operate nationwide; 7 operate regionally and 30 locally. The state-run Lietuvos radijas has the largest audience (22% percent in summer 2007).

According to the Global Press Freedom Survey 2008 announced by US-based non-governmental organization (NGO) Freedom House, Lithuania and the Czech Republic share second and third place (both countries were rated 18) in Central and Eastern Europe, including former Soviet states, in press freedom. Estonia ranked first (rating of 16). These countries, together with the slightly lower-rated Hungary, Latvia, Slovakia, Slovenia and Poland, were rated as nations that enjoy press freedom. Several Lithuanian newspapers are of a poor journalistic quality, tabloids control a large share of the print media market, and one major newspaper, Respublika, has published anti-Semitic articles.

The rapid growth of Internet media is expected to change public attitudes by enhancing media credibility, as public trust in the “Fourth Estate” has declined in recent years.

3 | Rule of Law

Separation of powers

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

Independent judiciary

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

However, long-standing attempts to reform the judiciary by balancing the independence it enjoys with greater openness and public trust were only partially successful. In June 2008, the parliament voted in favor of partial amendments to the law on courts, including a decision that court cases be assigned randomly (by computer) to judges. However, it fell short of establishing more strict and universal criteria for the professional selection of judges, nor did it establish a planned system for rotating the chairmen of various courts.

Public trust in the judiciary remains very low – according to the latest public opinion poll by Vilmorus, only 19% of Lithuania's citizens trust the courts while 41% do not.

Importantly, the chairman of the Supreme Court was not dismissed from his duties after the expiration of his term in June 2008 due to a standoff between the parliament and the president. This situation has not been resolved at the time of reporting.

Prosecution of office abuse

There were several high-profile cases of office abuse during the reporting period. In March 2008, Artūras Zuokas, former mayor of Vilnius and Vilnius city council member, was convicted of attempting to bribe a city council member during the mayor's election in 2003. Nevertheless, Zuokas was elected to the parliament later in 2008 and enjoyed parliamentary immunity during his appeal. In early 2008, the Supreme Court found his two accomplices guilty.

In March 2008, Viktoras Muntianas, speaker of the parliament, resigned due to allegations that he bribed a deputy governor of Kaunas County to receive assistance for a relative's business. The deputy governor of Kaunas County resigned too, and an investigation has been opened.

The Special Investigation Service (Lithuania's anti-corruption authority) charged the deputy mayor of Vilnius and two other members of the city council with corruption related to business development. The investigation is ongoing. The mayor and two other high-ranking officials of Trakai municipality were charged with similar offences in February 2008.

In 2007, however, several ministers were found to have conflicts of interest with regard to their use of public funds for political and personal publicity campaigns. The ministers challenged the High Commission of Ethics in Office's decision in court, which overruled the decisions. Thus, the ministers and other high civil servants neither resigned nor were they otherwise reprimanded. In a recent case, in late 2008, the former advisor to the prime minister was forced to resign from the newly created board of LEO LT (an energy company) following the High Commission of Ethics in Office's finding that his transfer from a political post to the newly created board constituted a conflict of interest.

According to various reports, primarily by Transparency International, public procurement tenders, property restitution and land planning are the most corruption-prone regulatory areas. Other areas especially prone to corruption include environmental services, health, sanitation, and food inspection, and fire and building inspections.

Corrupt office holders are generally prosecuted under established laws, but occasionally, they slip through political, legal or procedural loopholes.

Civil rights

There are no restrictions on civil rights. The constitutional right to the free practice of religion is respected in practice. In June 2008, the parliament amended the law on equal rights, making discrimination based on ethnicity, religion, sexual orientation, age or disability illegal. This expanded the existing list of illegal discrimination based on gender, race, nationality, language, origin, social status or beliefs. Importantly, this law (in line with EU directives) has placed the burden of proof on the person against whom a complaint is lodged.

During the reporting period, however, there were continued instances of ethnic intolerance. In the first three quarters of 2008, the prosecutor general initiated 84 investigations into instances of discrimination and incitement to racial or ethnic hatred (37 in 2007). There were a number of incidents involving attacks on black athletes, a popular singer and exchange students. In 2007, the ombudswoman of equal opportunities received 23 complaints about discrimination based on race or ethnicity (20 in 2006), 4 complaints of discrimination based on religious beliefs (7 in 2006), 18 complaints of discrimination based on sexual orientation (2 in 2006) and 44 complaints based on gender discrimination (32 in 2006). Interestingly, men have started to file as many complaints as women.

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

4 | Stability of Democratic Institutions

Performance of democratic institutions

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

Commitment to democratic institutions

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

5 | Political and Social Integration

Party system

The party system is fundamentally established even though its fragmentation has increased since the 2000 national elections. Nevertheless, political parties fall clearly into three ideological camps (conservative, social democratic and liberal), are well-established and represented in the parliament, and have clearly identifiable voter (socio-demographic) profiles. Electoral volatility remains quite high (by western European standards), and during the last decade, populist parties have been able to attract many votes. They have now been either co-opted into the system or contained outside of it. During the last parliamentary elections, the populist (non-systemic) parties gained about 35% of vote in total, split among three parties. Only one was co-opted into the ruling coalition led by the Homeland Union (Christian democrats). Low turnout continues to be a problem. Only 41% of eligible voters cast ballots in the municipal elections of February 2007, and only 49% voted in parliamentary elections in October 2008, only a marginal increase in comparison to 2004, and a mere 32% voted in the run-off elections in single-member districts.

Trust in political parties has not increased, remaining very low. The latest public opinion surveys (by Vilmorus in early 2009) found that only 3.6% of respondents trust political parties, while 76.4% distrust them. Political parties enjoy the least trust among 17 surveyed institutions; 4.7% of respondents trust the parliament; 11.4% trust the government.

Interest groups

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. The influence of these groups on the decision-making process is much stronger in comparison to that of the third-sector, or NGOs. Business associations continue to be the most influential non-governmental players by far, followed by the trade unions (which represent about 15% of the workforce).

In the public debate, there is an increasingly heated discussion about the disproportionate access of some business groups to policy-making, notably in the energy and development sectors, which tend to dominate municipal politics.

The legislative framework does not inhibit the development of NGOs. Citizens' involvement in civil society remains low, however, despite Lithuanian NGOs' good organizational and managerial capacities. Various reports cite poor financial conditions and a lack of public outreach as the main reasons for this. EU membership-related funding has opened up new opportunities in this area.

Lithuanian society remains poorly organized. Although the number of NGOs almost doubled in the past decade (in 2005 it was estimated to have been over 14,000) public participation in the activities of NGOs did not change much and remains low. According to the most recent available data (by Pilietinės visuomenės institutas), in 2007 only 8.5% of the population participated in NGO activities in the twelve months prior, 17.4% participated in local community activities and 2.8% participated in the activities of political parties. A similar study commissioned in 2005 showed that about 20% of the population participated in NGO or civil movement activities over the six years prior.

In the past several years, access to EU structural funds has improved community organization (in the villages through the LEADER program), as have development projects that allegedly threaten public interests. In early 2009, there were more than 1300 village communities in Lithuania. In 2008, 388 of them applied to Ministry of Agriculture for financial support, and 350 applications received grants (up to LTL 25,000 each) totaling of LTL 7 million (LTL 5 million were allocated in 2009, less than allocated in 2008 due to hard budgetary constraints).

During the reporting period, independent public advocacy groups gained strength. In addition to the long-standing Lithuanian Free Market Institute, several other institutes and movements are prominent on the public scene, including Piliečių santalka, the Human Rights Monitoring Institute, Lietuvos Sąjūdis, and Pilietinės visuomenės institutas.

Consent to democratic norms

There is a broad consensus that a democratic regime is the most acceptable form of governance; the existing constitutional framework is questioned neither openly nor latently. Public opinion surveys on this issue are rather outdated (the World Values Survey of 1999 and Baltic Barometer of 2001). Public satisfaction with the Lithuanian democratic regime's efficacy fluctuates with the country's economic outlook of the country and remains low overall. Satisfaction appears to correlate closely with the respondent's subjective perception of his/her personal welfare, his/her prospects for the future and overall economic outlook. In the fall of 2007, 44% were satisfied with the way democracy functions in Lithuania, while 54% were not. In the fall of 2008, this ratio dropped to 32/58, and in early 2009 it had dropped further to 20/70. A deep mistrust of the Lithuanian state's executive institutions persists, as reported in the last BTI report. Among all surveyed institutions, political parties, parliament and the government still receive the lowest trust scores, which are very low. Institutions that did not exist during the Soviet era (the army, the Constitutional Court, the new social security system Sodra) receive better results in opinion polls, a trend that remains consistent. This is partially compensated by a much better assessment of Lithuania's membership in the European Union – support has been consistently very high at about 70% – and a greater satisfaction with the efficacy of EU democracy.

Associational activities

Volunteering is a rare form of support, mainly because Lithuania lacks a strong tradition of independently donating one's time to a cause. The 2007 study by Pilietinės visuomenės institutas (Civil Society Institute) shows that only 7% of the population during the past year donated their time to a civic campaign. Charitable donations increased, mostly through the 2% income tax redirection (tax-payer donations to non-profit organizations), which was introduced in 2004 to support civil society. The number of donors is rising, however. It rose from 370,000 in 2005 to 500,000 in 2007 and 519,000 in 2008, which constitutes 34% of the working population. Total donations amounted to LTL 60 million in 2008 (LTL 53 million in 2007) to 14,000 non-profit organizations (12,000 in 2007). These donations mostly go to underfunded municipal institutions and schools. Municipal organizations received LTL 19 million (32% of all donations), LTL 17.6 million (29%) went to associations and LTL 7.8 million (13%) to public institutions. Lithuania has yet to achieve a consolidated civic culture although it has been making slow progress toward this goal. The web of autonomous groups, associations and organizations is robust but heterogeneous, and it enjoys the population's solid trust. As mentioned above, the legal and regulatory framework for NGOs is solid.

II. Market Economy

6 | Level of Socioeconomic Development

Socioeconomic barriers

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.

While the economic boom years (including 2007 and to some extent 2008) improved the overall standards of living for all strata of society, existing socioeconomic disparities did not diminish significantly, as demonstrated by data below.

The last available Human Development Index (HDI) of the United Nations Development Program for Lithuania is 0.862 (2005), ranking it 43rd out of 177 countries assessed. In 2004, its HDI was 0.835 (35th).

In 2005, Lithuania's Gini coefficient was 36.0, having increased from 31.9 in 2000. In 2003, the poorest 10% of citizens had an income totaling 2.7% of the all income and consumption.

Thanks to strong economic growth since 2001, the employment rate increased from 62.6% in 2005 to 64.9% in 2007, while unemployment decreased from 8.3% in 2005 to 4.3% in 2007. GDP grew by 7.8% both in 2005 and in 2006, and by 8.9% in 2007, and although growth significantly slowed down in 2008, it is still expected to be positive. In the context of the sharp economic contraction of 2008 and forecasted negative growth for both 2009 and 2010, however, unemployment rates have risen again and are expected to exceed 8% (10% according to some analysts). Nevertheless, during the economic boom, the percentage of citizens at risk of poverty improved slightly from 20.5% in 2005 to 19.5% in 2007. (Data taken from the latest report of the Department of Statistics of Lithuania on Sustainable Development Indicators).

According to household surveys carried out by the Department of Statistics of Lithuania, the share of disposable income spent on food has improved for both urban and rural inhabitants. It declined from 53% in 2003 to 44% in 2007 for rural inhabitants, from 34% to 30% for urban residents and from 32% to 27% for the residents of big cities. The gap between urban and rural residents has increased, however, as rural inhabitants' total monthly expenditure stood only at 65% of that of city dwellers and 71% of that of big city residents in 2003. In 2007 these figures were only 63% and 68% respectively.

Geographic disparities in development did not decrease even during the period of high economic growth. In terms of GDP per capita, only the counties of Vilnius (155% in 2007) and Klaipėda (103%) exceeded the Lithuanian average. Kaunas county came close to the average at 96%. The remaining counties were below the average, with Tauragė (47%), Marijampolė (60%) and Alytus (66%) counties falling significantly far below the national average. This uneven distribution of economic development has been observed since at least 2000, with Vilnius county continuously rising and Alytus and Tauragė declining.

The average pension has increased from LTL 477 in 2006 to LTL 811 in January 2009. The minimum wage increased from LTL 600 in 2006 to LTL 800 in 2008.

Economic indicators		2004	2005	2006	**2007**
GDP	$ mn.	22551.5	25962.3	30088.5	**38893.8**
Growth of GDP	%	7.4	7.8	7.8	**8.9**
Inflation (CPI)	%	1.2	2.7	3.8	**5.7**
Unemployment	%	11.4	8.3	5.6	**4.3**
Foreign direct investment	% of GDP	3.4	4.0	6.1	**5.2**
Export growth	%	4.4	17.7	12.0	**4.3**
Import growth	%	14.9	16.4	13.7	**11.6**
Current account balance	$ mn.	-1724.6	-1831.2	-3218.1	**-5692.4**
Public debt	$ mn.	-	-	-	**-**
External debt	$ mn.	-	-	-	**-**
Total debt service	% of GNI	-	-	-	**-**
Cash surplus or deficit	% of GDP	-1.7	-0.5	-0.1	**-0.9**
Tax Revenue	% of GDP	17.0	17.3	17.9	**17.9**
Government consumption	% of GDP	19.4	18.7	19.3	**18.2**
Public expnd. on edu.	% of GDP	5.2	5.0	4.9	**-**
Public expnd. on health	% of GDP	3.9	4.0	4.3	**-**
R&D expenditure	% of GDP	0.8	0.8	0.8	**0.8**
Military expenditure	% of GDP	1.8	1.6	1.6	**1.5**

Sources: The World Bank, World Development Indicators 2009 | UNESCO Institute for Statistics | International Labour Organization, Key Indicators of the Labour Market Database | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security.

7 | Organization of the Market and Competition

Market-based competition

The fundamentals of market-based competition were fully established in 2001, when the European Commission finally recognized Lithuania as a functioning market economy. The legal and institutional framework was further strengthened before Lithuania became an EU member in 2004. As in all EU member states, the role of the state is limited to guarantee compliance with the rules of market competition.

According to the Department of Statistics of Lithuania, the country's unobserved economy (as defined in EU legal documents and which is uniformly, but not regularly, measured in EU member states) made up 14.4% of GDP in 2005, with the services sector making up about one half. This indicator does not include inherently illegal activities, such as smuggling or narcotics trading.

According to the Eurobarometer survey of 2007, 11% of Lithuanian respondents had received their wages partially or fully "under the table" during year prior. The EU average was 5%. 10% of the Lithuanian respondents used services for which they paid "under the table." 49% of respondents (the second-highest percentage among the EU-25) believed that the risk of being caught for illegal employment is very high.

According to a survey of the Lithuanian Free Market Institute, Lithuanian experts estimate that the informal economy's share is shrinking. It was estimated to have been 18.5% in 2007 and was expected to further decline to 17.3% in 2008, mainly because of a shortage of labor (and thus more legal employment), as well as successful concerted action by the tax and labor inspection authorities against illegal employment and unreported wages.

In the World Bank's (IFC) 2009 Doing Business rankings, Lithuania ranks 28th out of 181 countries for ease of doing business, somewhat worse than its 2007 rank of 16th out of 177 countries. Among the new EU member states, Estonia (22nd) surpassed Lithuania.

Contrary to the widespread belief that regulatory and tax burdens and uneven or heavy handed tax administration are the biggest obstacles to doing business – a view found in the previous BTI assessment – the Lithuanian Business Employer's Association's survey in late 2007 showed that the biggest obstacles Lithuanian companies face were corruption and the informal economy, especially in the construction and services sectors.

Anti-monopoly policy

There is a coherent and effective anti-monopoly policy supported by trade policies that are consistent with non-discrimination principles. It is enforced by the Competition Council of Lithuania, while the legal and institutional framework fully complies with the norms of EU law. There are some complaints from the representatives of small and medium-sized businesses that the government and administration could speak and act in a more pronounced way against perceived monopolistic behavior, but overall, the legal and institutional framework ensures that cartel behavior is punished.

Liberalization of foreign trade

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

Lithuania is an open liberal economy, and its export/import volume ratio to GDP

exceeds 100% (112% in 2006, 115% in 2008, according to the data of Lithuania's Department of Statistics).

Banking system

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

According to the last Economic Freedom survey, "the free flow of financial resources and the market allocation of credit are assured." There were nine commercial banks in 2007; the three largest account for about 70% of assets. Branch networks of Lithuania's commercial banks are well developed across the country, providing easy access to banking services. Lithuania's most commercial banks are now foreign-owned. Over the last decade, the share of capital held by foreign investors in Lithuanian banks has increased by over 450%. Banks may now offer investment funds to a wider array of clients. Foreign firms dominate the insurance sector. Capital markets are well-developed but small.

Lithuania's banking system has not been hit as badly by the global financial crisis as Latvia's, thanks to the prudent credit policies of the Scandinavian-owned banks. However, both the previous government and Central Bank were criticized for not doing enough to restrict the import of cheap credit from Scandinavian- and German-owned banks and thus to prevent the construction bubble (and to some extent inflation), which burst as the economy contracted sharply.

8 | Currency and Price Stability

Anti-inflation / forex policy

Lithuania has pursued a consistent budgetary and monetary policy. Since 1994, Lithuania's Litas has been under a currency board regime, which has been pegging the Litas to the Euro for over a decade. Lithuania narrowly missed the Maastricht criterion for inflation in 2006, and since then, the combination of a somewhat looser, pro-cyclical, expansionary budgetary policy, the credit boom and the corresponding import of cheap credit from Scandinavian mother banks, and the steep rise in demand for primary energy sources (oil and gas, all of which Lithuania must import) has led to a rise in inflation to 5.8% in 2007 and to 11% in 2008.

Its fiscal deficit is estimated to have reached the Maastricht threshold of 3% of GDP in 2008, partly because of pro-cyclical budgetary policy during the economic boom until 2008, and is expected to surpass it in 2009 and 2010 (3.4% of GDP is predicted for 2010), according to the European Commission.

The new government has not yet set a firm date for introducing the Euro, but most analysts state that it is unlikely to be before 2013. The government's financial stabilization plan, which will include big budgetary cuts in the 2009 budget as

adopted in December 2008 and further cuts planned for the first quarter of 2009, an increase of VAT by one percentage point to 19% and the elimination of almost all VAT exemptions, is directed towards preserving macroeconomic stability and, most importantly, the Litas.

Macrostability

The global financial crisis and resulting economic contraction, which adversely affected a very open and liberal Lithuanian economy, posed a threat to Lithuania's macroeconomic stability. At the same time, the previous center-left government's expansionary public spending, which was based on the false premise of continued, albeit slower, economic growth (Despite the Law on Fiscal Discipline passed in the Seimas in 2008), also threatened stability. The new center-right government swiftly made the necessary fiscal corrections through tax reforms and sharp cuts in public expenditures. The preservation of macroeconomic stability is the new government's main priority, and at the time of reporting, it seems to be handling it competently overall. This policy is consistent and is in part supported by institutional (self-) constraints.

9 | Private Property

Property rights

Property rights and the regulation of the acquisition of property are well-defined in terms of acquisition, benefits, use and sale - they are limited only by basic liberal rights. Land restitution was not completed by the target date of 2008. According to National Land Service data under the Ministry of Agriculture, 97.18% (3,894,000 ha) of all claimed land had been restituted (as per titles) in rural areas (mainly of the agricultural land) by 1 January 2009, up from 65.27% on 1 January 2007. 87.4% of the claimed land had been properly registered in the land cadastre and could be effectively used by the owners. In cities, the corresponding figure was 64% of titles (27,200 ha), up from 54.18% in 2007.

In terms of protecting foreign investors, the World Bank's 2009 Doing Business in Lithuania country report shows that Lithuania maintained its (aggregated) index of 5 (out of 10 possible) from 2007. However, the lack of progress meant that it fell in the overall world ranking from 84th to 88th, behind all comparable (regional) economies.

Private enterprise

Private companies are seen as the primary engines of economic production, and are given appropriate legal safeguards. According to the data of the Department of Statistics of Lithuania, 81% of GDP was generated in the private sector in 2007, up from 79% in 2006 and 77% in 2003. It is the main engine of economic growth. Small and medium-sized enterprises (SMEs) make up 99.4% of the total number of enterprises, and they generate 74.1% of total employment (70.6% in 2004). The regulatory burden, especially for SMEs, did not improve during the reporting period, as noted by Freedom House's latest country report on Lithuania and the European Commission's assessment of Lithuania's 2008 National Reform Program

to implement the Lisbon strategy. The European Commission noted that in addition to the ongoing improvement of physical infrastructure for the operation of companies, Lithuania should implement a better regulation agenda, which it has not begun in earnest. The use of land, construction permits and labor relations are among the other relatively over-regulated areas. In 2009, the new center-right government plans to sell its remaining 10% of shares in the oil refinery AB Mažeikių nafta.

10 | Welfare Regime

Social safety nets

There continues to be a solid network to compensate for social risks, and national health care is especially robust. Problems persist, however, particularly as regards targeting social assistance to the most vulnerable groups. During the reporting period, there has been an increase in various social assistance measures, such as the compensation of paternity leave at 100% during the first year and 80% during the second year. Some existing social assistance rose nominally as well; the basic monthly pension increased to LTL 360, making the average monthly pension LTL 811, and the minimum unemployment benefit is LTL 350 per month. These changes may not be sustainable in the current economic slump. The new center-right government took some very decisive steps to include a wide selection of professions into the social security system, such as sportsmen and self-employed individuals, who are included through the "business license" or "author's honoraria" schemes. They will begin making contributions to the state social insurance fund in 2009 and will fully contribute to it starting in 2011. A health care contribution (9% of income before taxes) has been separated from the tax rate and will be channeled directly to the Health Insurance Fund. The above-mentioned individuals will begin full contributions in 2009. Pension reform will suffer a setback when 3.5% of the total contribution rate of 5.5%, which were directed to capital-funded pension schemes, are temporarily (until 2011) redirected back to the pay-as-you-go system in order to finance the struggling state social insurance fund (Sodra).

While these changes are expected to improve the financing of the social security and health care systems and to enlarge the safety net, access to good health care services and of the targeting of social assistance need improvement. Family and village structures, particularly in rural areas, continue to play a role in providing a special kind of "social welfare" not visible in standard statistics.

Equal opportunity

There are sufficient institutions to compensate for gross social inequality. The rights of ethnic and religious minorities are protected by the constitution. Access to higher education and public office are determined by one's ability. Nevertheless, socioeconomic status has a great influence on student performance (see, for example, the Socialiniai tyrimai study by the University of Šiauliai in 2007). This suggests that schools need to spend more on socio-economically disadvantaged

students. It is said that about 35% of students at Lithuanian universities receive scholarships. The Lithuanian State Science and Studies Foundation is the most important institution for ensuring equal opportunities. The rural population is suffering from poorer access to public services, as reflected by lower educational levels and health indicators.

11 | Economic Performance

Output strength

For a number of years up to 2008, Lithuania's economy grew above its potential. Its growth was driven by domestic demand and improving exports. Households benefited from substantial wage increases and a lower unemployment rate. Investment was supported by large inflows of EU funds. The employment level rose.

However, in the fourth quarter of 2008, this came to a sharp end, due to the end of the economic cycle and a negative external environment caused by the global financial crisis. In the context of the currency board regime and a worsening competitive position in many important export markets, Lithuanian companies will be forced to become more efficient.

As a result of the sharp contraction, domestic and external demand will fall in 2009; GDP is expected to shrink by 4.8% in 2009, and it is almost certain the prognosis will be further revised. Furthermore, according to the latest forecast by the European Commission, inflation in Lithuania will drop to 5.6% in 2009 and 4.8% in 2010, though it will remain above the Maastricht criterion. Also, the Ministry of Finance estimates that the final closure of the Ignalina Nuclear Power Plant at the end of 2009 and a substantial higher use of gas as the primary energy input for electricity generation will contribute up to 2 percentage points in inflation growth.

Unemployment will shoot up from the historically low rate of 4.3% in early 2008 to 8.8% in 2009 and 10.2% in 2010. A drop in domestic demand will ease the current account deficit from 15.1% of GDP in 2007 to 7% of GDP in 2009.

12 | Sustainability

Environmental policy

Although ecologically sustainable growth is considered essential to economic activity, it is often subordinate to growth efforts. Environmental protection awareness is clearly overshadowed by the economy's upswing, the change in urban areas, and the population's changing attitudes. According to the most recent Eurobarometer in December 2007, Lithuanians still tend to associate quality of life with economic and social well-being rather than with a clean environment. Only 55% of Lithuanian respondents agree that environmental concerns are important to them personally, and twice less than the EU average think that individual efforts

could help the environment (22%) and sort out waste (30%). Lithuania complies with international agreements. EU membership and state policy are mostly responsible for any improvement in this regard.

Education policy / R&D

The state and the private sector ensure a national system of education and training, a dynamic research and technology sector, and a viable infrastructure. While growing in absolute, state investment in education and training has not changed as a percentage of GDP (5.2% of GDP in both 2006 and 2004). Investment in research and development is slowly increasing, from 0.75% of GDP in 2005 to 0.82% in 2007, though it is still below the national target of 2% for 2010 and the EU average, which was 1.83% in 2007.

Lithuania's well-educated labor force is a strong attraction for foreign investors. The potential for lifelong learning is still limited in Lithuania, and has not changed positively since the last reporting. According to the EU's competitiveness scoreboard, only 5.3% of the population aged 15 to 64 were enrolled in a study program during the last four weeks of 2007 (6.0% in 2005, 4.9% in 2006), while the average in the EU-27 was 9.7% in 2007.

There are regional disparities within the country and shortcomings in tertiary education, which suffers from too strong a focus on quantity rather than quality. All parliamentary political parties agreed already in 2006 that higher education reform is one of the top priorities for Lithuania. However, the reform efforts got stuck in the previous parliament. In early 2009, the new center-right government prepared a legislative package with two principle aims: the change of management principles at the universities by making the rectors less dependent on the university senates (councils) and greater competition among universities, which should result in a consolidation of higher education institutions. Competition among university study programs is expected to increase through the so-called student financing "baskets." At the time of reporting, the reform package has not yet been introduced in the parliament, and there has been a national debate about the reform's implications for fair access to higher education.

Transformation Management

I. Level of Difficulty

Structural constraints

Structural constraints on governance are moderate overall. Some eased during the period of high economic growth, such as unemployment and employment in agriculture, but in general, there were no major changes in the degree of structural constraints to governance in 2007 and 2008.

In addition to the constraints brought by sharp economic contraction and, by the effects of the global financial crisis, energy dependency is said to be a key challenge both in political security and economic terms. Lithuania continues to be dependent on the import of Russian energy resources, drawing 100% of its gas supply from Russia. The forthcoming closure of the Ignalina nuclear power plant at the end of 2009 will increase this dependence, as Lithuania will be forced to switch to conventional electricity generation and will consume even more Russian gas and oil. In 2010, electricity prices are forecasted to shoot up by 45% on 2007 levels, and the capacity of the Russian Gazprom to provide this additional demand has been questioned, as the share of gas will increase from the current 30% in primary energy to 45%. This is compounded by energy-intensive consumption (energy inefficiency), with Lithuania ranking 24th among the EU-25 in this regard in 2004 (250 kWH/m2 to heat 1 square meter compared to the EU average of 160 kWh/m2). On the other hand, oil supplies from Russia through the so-called Druzhba pipeline have been dry since summer of 2006. Lithuania supplies its oil refinery Mažeikių nafta (its majority stake was sold to Polish PKN Orlean at the end of 2006) through the Būtingė oil terminal in the Baltic sea.

Civil society traditions

Though moderate progress is being made, civil society traditions remain weak in Lithuania. According to the recent survey commissioned by the Vilnius-based Civil Society Institute in 2008, civil society's influence in Lithuania is rather low and did not change much in comparison to 2007. There was an increase in charitable donations from 45% in 2007 to 50% in 2008, and the portion of citizens who did not participate in any civic activity decreased from 40% in 2007 to 35% in 2008. Civic engagement remains primarily oriented toward the local community issues and social solidarity and is expressed through passive forms of engagement.

Among other players, the public does not regard NGOs as being influential. On a nine-point scale, their influence is rated to be only 4.8, compared to 8.3 for

members of parliament, 7.6 for civil servants and 7.2 for the president, while respondents rated their own personal influence to be only 2.5. The respondents explain this low influence by the high risks associated with civic activities, including the loss of one's job or public attacks. Demographically speaking, younger urban professionals and students, and those with higher incomes are rated higher civic influence than to less-educated persons, the unemployed, pensioners or persons older than 60 years of age, people with low incomes and rural area residents. Interestingly, the survey revealed that the potential for civic activism is highest among 15-19 year-olds, but that at 10%, this group is least interested in political news and debates. This correlates with explanations of the recent riots in Vilnius (16 January 2009) in protest against the austerity measures of the new government, which some commentators attributed to the post-Soviet generation.

Conflict intensity

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 the Polish names, the restoration of Jewish collective property and Roma settlement in Vilnius, are solved within the existing legal framework. Some human rights watchdogs (such as the U.S. Department of State or EU Agency for Fundamental Rights), however, say that while the Lithuanian legal framework provides the opportunity to file complaints of ethnic discrimination, sanctions are slow to come or insufficient. There has been also a trend of greater racial and ethnic violence and intolerance. According to the U.S. Department of State's 2008 country report on human rights practices, there were 37 pre-trial investigations related to such discriminations and incitement to racial/ethnic hatred in 2007 (17 in 2006). The prosecutor general's office explains this increase as being partially due to more attentive screening of Internet portals.

There are no important anti-systemic political parties or movements in Lithuania. During the last parliamentary elections in October 2008, none of the few parties that used anti-systemic rhetoric in the campaign won any parliamentary seats.

II. Management Performance

14 | Steering Capability

Prioritization

Doubtless, there is a general consensus in Lithuania about the fundamentals of the political and economic system, namely the commitment of all political parties to constitutional democracy and a socially responsible market economy. Even though governments change rather frequently (so far, no government has been able to serve

its full four-year term), the degree of policy continuity has been very high, especially on foreign and defense/security policy. Lithuania achieved all its strategic priorities in 2004 with membership in NATO and the European Union. Lithuania's new strategic priorities include firmly establishing its membership in the EU and NATO (through accession to the Schengen and Euro zones), 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. While these aims are well-established in many long-term policy documents and strategies, implementation has been inconsistent during the reporting period, mostly because of the weak center-left minority government. Lithuania achieved membership in the Schengen area at the end of 2007 but narrowly missed the introduction of the Euro. Despite a favorable assessment of Lithuania's steering capability and administrative capacity by the World Bank in 2006, no progress was made in internal economic and governance reforms, and its record in ensuring energy security and efficiency has been mixed at best. The new center-right government was appointed in December on the promise of driving these reforms forward, but in the wake of financial and economic crisis, it will inevitably be preoccupied with maintaining macroeconomic stability.

Implementation

The government can still implement many of its reforms effectively, although its record is not as good as it was during the years prior to EU accession and the first years of EU membership. While administrative structures are quite strong with sufficient capacity to implement many of the envisaged reforms, the political fragmentation of the previous parliament and the weak minority government prevented the formation of enough political drive for reform. Thus, policy developments proceeded slowly during the reporting period, and progress was mixed on fighting corruption, ensuring energy security and efficiency, and higher education reform – the three hallmarks of the minority government. Many of the conclusions drawn in the previous BTI report on Lithuania remain valid, especially regarding the need to focus on overregulation, efficiency, accountability and responsibility of the civil service, further decentralization of policymaking, transparency of the central government (through a more elaborate process of consultation and impact assessment) and flexibility of labor.

Policy learning

Lithuania's good historical record on economic, social and administrative reforms can be best explained by its aim to become an EU member and the associated policy agenda. In reforming the country, several successive governments did more than just fulfill EU rules, but often managed to internalize them with genuine innovation. The World Bank report on administrative capacity in the new EU member states describes several such instances well. Lithuania was credited to be one of the best-prepared countries for EU accession. However, these reforms came at a price, leaving some sectors unreformed if they were not critical for EU

accession, and an increase in populist sentiments destabilized the party system, especially during the 2003 presidential and 2004 parliamentary elections. This resulted in weak governments that missed several important opportunities, such as the introduction of the Euro and accumulation of fiscal reserves during economic boom times and rising budgetary revenues to cushion the Lithuanian economy for a hard landing or financial crisis. The new government took office in late 2008 and has a chance to return Lithuania to its reform path, but this has yet to materialize.

15 | Resource Efficiency

Efficient use of assets

The government uses most available resources efficiently. Even though there is a debate in the Lithuanian media about excessive bureaucracy from time to time, personnel expenses are in fact not very high relative to the services offered by the state. Since accession to the EU, administrative personnel were expanded, but the government unfortunately explained the need to establish new posts only in the context of EU membership and management of EU structural funds. The new center-right government has declared its intention to scale this expansion back, but it remains to be seen whether this will be a mere budget cutback or an improvement in efficiency. The appointment procedure for civil servants is largely protected from political influences, though there is occasionally pressure from political circles that interferes with recruitment decisions. In general, the state uses its budgetary resources efficiently. During the reporting period, the state audit office was especially outspoken in its audit reports and recommendations to the parliament. According to an agreement among all political parties, the parliamentary audit committee is headed by the opposition. Public administration reforms for more efficient administrative organizations did not advance significantly during the reporting period.

Policy coordination

The government coordinates its policies effectively and acts in a coherent manner. A 2006 World Bank assessment of administrative capacity in the new EU member states acknowledged that the strategic planning system had been well developed in Lithuania since the early 2000s and that this system has been maintained by several governments of various ideological orientations. The variable achievement of policy results should be attributed to the government's political strength and will (or lack of it), rather than to the system itself. The new center-right government declared that it will advance this existing system, especially as regards budgetary efficiency and government capacity to respond to long-term challenges in a timely fashion, such as an ageing population, climate change and energy efficiency. The administration's weakness remains its poor capacity to undertake and implement large-scale projects, such as the construction of the new Ignalina power plant.

Anti-corruption policy

Despite the fact that all integrity mechanisms are in place, functioning, and supported by the government, corruption remains a serious problem in Lithuania.

Lithuania's score in Transparency International's Corruption Perception Index (CPI) has not improved since the last BTI report, measuring 4.8 in 2007 and a slightly lower 4.6 in 2008.

Thus, neither the previous minority government's promise to tackle the issue nor former Prime Minister Kirkilas's personal pledge to resign if the situation did not improve were fulfilled. There have been some partial improvements. The High Commission of Ethics in Office significantly stepped up its activities (and visibility) in passing verdicts in cases of conflicts of private and public interests. Regrettably, many of them were over-ruled by the administrative court. The new government has pledged to shift the burden of proof of lawful acquisitions of any property for persons in office from the law enforcement agencies to the civil servants and to thus make strides in the fight against corruption.

Importantly, the changes in legislation governing political campaigns in the mass media, which were first applicable during the October 2008 national elections, have led to the containment of expenditures by political parties and have made the political debate much more policy- and issue-oriented. The monitoring of party finances, however, needs to be stepped up. Moreover, despite a long ongoing debate, the Lithuanian parliament has not yet moved to substantially increase the state funding of political parties.

According to surveys by Transparency international, administrative corruption remains the biggest problem. The situation has not yet improved in the public procurement sector, though the new center-right government has pledged to increase transparency in this area by introducing electronic tenders, among other measures.

16 | Consensus-Building

Consensus on goals

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

In practical terms, this is expressed through three key documents, namely the Long-term Development Strategy of the State adopted by the Seimas parliament in 2002, the Long-term Economic Development Strategy adopted by the government in 2002, and the National Reform Program, which was first adopted in 2005 and has been updated annually (the new National Program for 2008-2010 was adopted in October 2008). Political parties have continued the tradition of renewing an inter-party agreement on foreign policy priorities for Lithuania every four years or so. Such a document was signed in October 2008, immediately after the national elections, although the Homeland Union (Lithuanian conservatives or Christian democrats) did not sign it for tactical reasons. The Homeland Union, joined later by

the four ruling center-right parties, proposed a national agreement between political parties and socioeconomic partners on long-term state and government priorities. This agreement was allegedly inspired by a similar Irish agreement in the 1980s, which then jumpstarted development in Ireland.

Anti-democratic veto actors

There are no anti-democratic veto actors in Lithuania. The populist parties or parties with clearly identifiable populist appeal have been co-opted into the system and are playing by democratic rules, and some have already been voted out of parliament, such as the social liberal New Union, which relied on populist slogans in the 2000 elections but subsequently became a system-oriented party). On the other hand, the potential for populist or protest votes did not declines significantly in the 2008 national elections, but it was split among several competitors (the Labor Party, Law and Order Party, and National Resurrection Party) and therefore could not be pooled together. Populist influence on policy direction has been minimal. On the other hand, even these parties agree that fiscal adjustment was needed in order to address the impact of global financial crisis on Lithuania and its economy's hard landing. Nevertheless, the Lithuanian party system is not yet immune to such appeals, mostly due to great voter apathy, as national election turnouts remain low (42% in the 2008 national elections, 36.5% in the 2007 municipal elections).

Cleavage / conflict management

The key cleavage indicator would be whether society has overcome the effects of the divisions created during the impeachment of President Paksas in 2004. For most of the first decade after independence, the main conflict line in Lithuanian society (and thus the basis for the party system's structure) was formed by attitudes toward Lithuania's Soviet past. Since then, this dominant line has been replaced by socioeconomic differences, as issues other than the assessment of the Soviet system gained more weight in political orientation. Interestingly, these lines cut across all social groups for a long time and were not cumulative, keeping the polarization of society and the party system moderate. This led to a paradoxical situation in which many transition "losers" tended to support reforms and even faster integration into the European Union. Just before the completion of the transition to a fully functioning democratic and market system, however, the Law and Order party of the impeached president Paksas tapped into the potential of disillusioned voters (losers of transition), thus polarizing both the party system and society.

Five years after the impeachment and two years after the last BTI reporting, the conflict seems to have subsided and is no longer acute, partly because Paksas himself and his party have de facto (though not in rhetoric) accepted the Constitutional Court's and parliament's verdict and seek to redress what they see as an injustice through democratic means. There are no longer two camps ("elites" and "sugar beets"). Other populist pressures were contained by partial co-optation and by a subsequent de facto coalition of the two biggest political parties (the Homeland Union and Social Democrats) in support of the minority government. At best, this partnership produced only a mixed policy record, but it helped to stabilize the party

and political system. The potential for a polarization of society remains, a significant portion of voters did not vote for established systemic parties the last parliamentary elections in 2008. The introduction of austerity measures triggered a series of protests and could exacerbate existing social divisions. Nevertheless, the record of the past two years proves that political leadership depolarizes conflict and expands consensus across the dividing lines.

Civil society participation

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

There have been no major changes in this regard since the publication of the last report. The role of the Tripartite Council in consulting major socioeconomic policy decisions is formally assured. The parliamentary and governmental procedures for civil society's access to decisions are in place (as defined by the BTI), but are not uniformly applied. Lithuania has committed itself to the OECD/Sigma peer review on regulatory management capacities (2006) to improve civil society actors' access to and the quality of public consultations on draft decisions. This, among other regulatory management and transparency issues, was translated into two important internal decisions, namely, the Seimas parliament's November 2007 resolution on the concept of the legislative planning program and the government's Better Regulation Program adopted in February 2008. However, the previous government did not seriously push for implementation of these ideas, though it somewhat increased the transparency of its own activities; all documents submitted to the government's sessions are now publicly available on the office of the government website before the session. However, this is clearly short of the promise. These issues feature high in the new government's program, but it had been in office for only two months by February 2009 and was pre-occupied with fiscal tightening and economic stimulus in the wake of the financial and economic crisis. So far, there has been no major progress.

NGOs do have some influence on decision-making, but business groups and, to a lesser degree, trade unions are more influential players, as noted in the previous BTI assessment. The "third" (NGO) sector's problem has been its inability to set up an influential umbrella association (representative platform) to represent the sector on broader policy issues, though there were attempts to do this in 2006 – 2007.

There are some individual good examples and indeed best practices of proper consultation by the government with various non-governmental actors. For example, the European Commission praised the close cooperation of the government with non-governmental actors in developing the first national reform program (to implement the Lisbon Strategy) in 2005. A 2006 World Bank study on administrative capacity in the new EU member states praised the government's EU membership information management system (LINESIS), which is partially open to non-governmental actors and which allows tracking of Lithuania's positioning on

EU issues and implementation of EU law. Finally, consultations with non-governmental actors on the contents of Lithuania's strategy to absorb EU financial assistance (2007 – 2013) were comprehensive.

The government and individual ministries routinely use the technical expertise of various scientific institutions and individual experts both for broader policy setting, such as the long-term economic development strategy for 2015, and policy issues, such as regulatory impact assessments or policy papers. Most of these studies are publicly available on the ministerial websites or on the website of the office of the government.

Reconciliation

While attitudes toward and assessment of the communist past still vary, Lithuanian society is clearly not divided in any significant way about these issues. Importantly, it has ceased to be the most important cleavage line in party politics. Historical research into resistance and collaboration under Soviet rule continues. Together with some other new EU member states, the government of Lithuania has been an actively promoting the idea within the EU Council that the European Union should officially proclaim Stalinism as a criminal regime. To this end, representatives of Lithuania are actively participating in the working group set up by the European Commission to examine this issue and report back to the EU Council with appropriate proposals.

The only exception to completed reconciliation is the policy toward former KGB agents and reservists. The deadline for voluntary confessions by former agents has been extended several times, while the officially designated Lustration Commission, which acts under the auspices of the State Security Department, complained about access to documents possessed by the State Security Department. Accusations of collaboration with the KGB tend to resurface from time to time and are still occasionally used as a political weapon, although its importance is vanishing.

17 | International Cooperation

Effective use of support

In terms of international financial assistance, Lithuania has changed its status from a beneficiary country to a donor country thanks to EU membership and associated improvements brought by economic development. For example, Lithuania graduated from eligibility to World Bank financial assistance in 2006, switching from recipient status to donor status.

According to the EU's principle of solidarity, its structural assistance policies and accession treaty to the EU, Lithuania is entitled to very significant EU financial support to boost its development and to help close its Chernobyl-type Ignalina nuclear power plant by the end of 2009, as well as to overcome the negative

consequences associated with closure. Lithuania's net average annual receipts (all entitlement minus Lithuania's contribution to the EU budget) amounted to LTL 2.73 billion (3.76% of GDP) in 2004 – 2006 and will amount to LTL 4.34 billion (well over 4% of GDP) in 2007 – 2013.

According to the EU's financial rules, the absorption of the EU's financial assistance allocated to Lithuania for 2004 – 2006 ended on 1 January 2009. According to preliminary reports, Lithuania has been able to use 98.5% of the amount allocated. The process of absorption is being monitored not only by the European Commission and the State Audit Office (external control) of Lithuania, but also by non-governmental actors in Lithuania, notably the Civic Society Institute.

Efficiency of fund use will be analyzed in detail in forthcoming ex-post assessments, but early assessments (commissioned by the Office of the Government) already indicate that EU support has contributed to an additional percentage point in GDP growth during 2004 – 2006 and has been higher than initially forecasted. As the government's borrowing opportunities are very limited in the global financial crisis, EU financial assistance is an important source for stimulating economy.

In the past, there have been several criminal charges of squandering EU financial support, but authorities reacted quickly and no major damage was done.

Credibility

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.

In its 2009 sovereign credit report on Lithuania, Moody's Investors Service noted that Lithuania's A2 foreign and local currency bond ratings are supported by the country's high economic and institutional strength, but the ratings are currently on review for possible downgrade since the severe deterioration in the macroeconomic environment could structurally impair the country's economic model.

Regional cooperation

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 other Baltic neighbors in the framework of the Baltic Council and Baltic Parliamentary Assembly. Cooperation with Lithuania's Nordic neighbors is conducted through regular meetings of the prime ministers of the Nordic and Baltic states. Six-party meetings are held to coordinate positions on EU issues, and eight-

party meetings (with Norway and Iceland) on a range of various policy issues. The Council of Baltic Sea Sates continues to be an important multilateral forum to foster closer regional cooperation in the Baltic Sea area.

Lithuania has been actively cooperating with the Organization for Democracy and Economic Development (of the Black and Caspian Sea states (GUAM)). During the reporting period, the Polish and Lithuanian presidents initiated a series of energy security conferences for the countries of Eastern Europe, the Caucasus and central Asian region. These conferences aim at securing energy supplies to the countries of this region. There have been three summits held, one of which was in Vilnius in October 2007.

In 2009, Lithuania is hosting the OSCE (Organization for Security and Cooperation in Europe) Parliamentary Assembly and will preside over the OSCE in 2011.

Strategic Outlook

Lithuania's seemingly unrestrained economic boom of the last decade has come to an end, and in the context of the global financial crisis, the expected (cyclical) economic slowdown became a sharp contraction. This presents a good opportunity to pursue further reforms and replace somewhat complacent economic, fiscal and administrative policies, as well as the relaxed reform discipline which set in after accession to the European Union.

The governmental program of the new center-right ruling coalition presents a good list of planned and elaborated reforms. However, in contrast to other countries of the European Union, economic recovery in Lithuania is not expected to begin until at least early 2011 and this means that fiscal adjustment and discipline policies will probably dominate the political agenda in the short term.

Maintenance of macroeconomic stability through fiscal discipline and corresponding fiscal adjustments in response to the worsening economic outlook is the only available policy instrument in the context of the currency board (which the government seems to be determined to maintain at all costs). However, should further adjustments be needed to close the budget deficit, the government should be more selective, and not continue its "one size fits all" approach. On the taxation side, there are still unexploited opportunities available, such as the real property tax (which, however, would contribute to the state budget only next year).

Lithuania continues to face challenges to its competitiveness and the need to move from low and medium value-added sectors to higher value added. In this respect, moving higher education reform forward and creating an infrastructure to foster technology and innovation, envisaged through the investment of EU structural fund assistance, is the key. Improving access to and the quality of health care services and continuing preventive measures is essential to assuring sufficient human capital.

Anti-corruption efforts will have to continue in order to bring tangible results, as public perception has not been improving for several years now. Public procurement, health care, and administrative procedures should be the key targets. As Lithuania's economy is very much dependent on small and medium-sized enterprises, improvement of the regulatory environment, by reducing the administrative burden and simplifying the licensing and permit system, would be necessary. Funds should be more broadly available to provide e-government services.

Energy issues will be very important, and this will continue into the medium- and long-term perspective. It is reasonable to view increased energy vulnerability after the closure of the Ignalina nuclear power plant at the end of 2009 in terms of the question of independence. Lithuania will have to improve energy efficiency, which now is one of the worst in the EU-27, particularly by insulating buildings from the Soviet era. This alone might take up to 10 years or more, as there are about 20,000 such buildings. Secondly, the integration of the Lithuanian

(Baltic) electricity system into the UCTE will require real progress in building the envisaged power bridges to Poland and Sweden, strengthening the Baltic internal power links as well as creating the Baltic electricity market. In the long term, the expected increased dependency on imported Russian gas, which is forecasted to make up to 45% of the primary energy balance in 2010, is expected to decrease by building a new Ignalina nuclear power plant sometime between 2016 and 2020. This process has been sluggish and controversial so far.

In May 2009, Lithuanian voters will elect a new president. This will mark the beginning of a new era in the Lithuanian political system, as all key politicians who shaped the country's course since the national rebirth and independence will have left the political arena. Restoring confidence in country's political institutions (political parties, government and the parliament) and increasing voter trust in established and systemic parties will be the key for the future.