

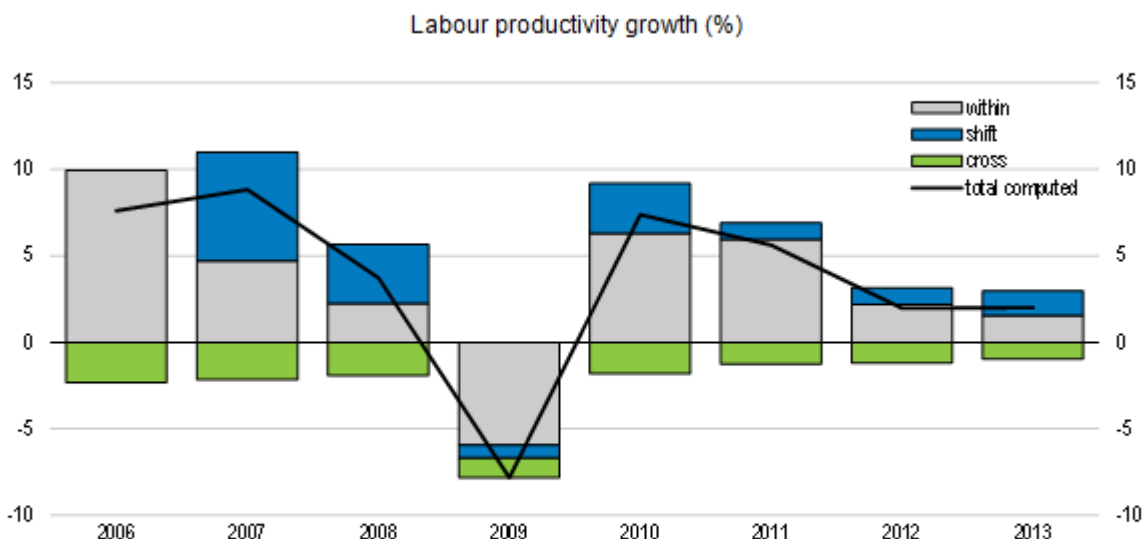
Pump-priming productivity through reform: the case of Lithuania

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In the past two decades, the income level in Lithuania has steadily risen toward that of OECD countries. Between 1995 and 2013, GDP per capita rose from one third to two thirds of the OECD average. Productivity catch-up was critical to this process, aided by enhanced integration into the global economy which enabled the adoption of more advanced production technologies from abroad.

Decomposing Lithuanian labour productivity growth in the 2006-2013 period reveals that both reallocation of resources between sectors and within-sector productivity growth have been important (Figure 1). The latter can be driven by reallocation between firms in the same sector as well as increases in within-firm productivity.

Figure 1. Productivity has benefitted from both within-sector advances and between sector reallocation



Note: "Within" measures the contribution to total labour productivity growth from productivity growth within sectors. "Shift" measures the contribution resulting from the movement of labour between sectors. "Cross" indicates whether the within-sector and between-sector effects are complementary. A negative value for the latter indicates that productivity growth is particularly strong in sectors that have a contracting labour share.

Source: OECD calculations based on data from Statistics Lithuania.

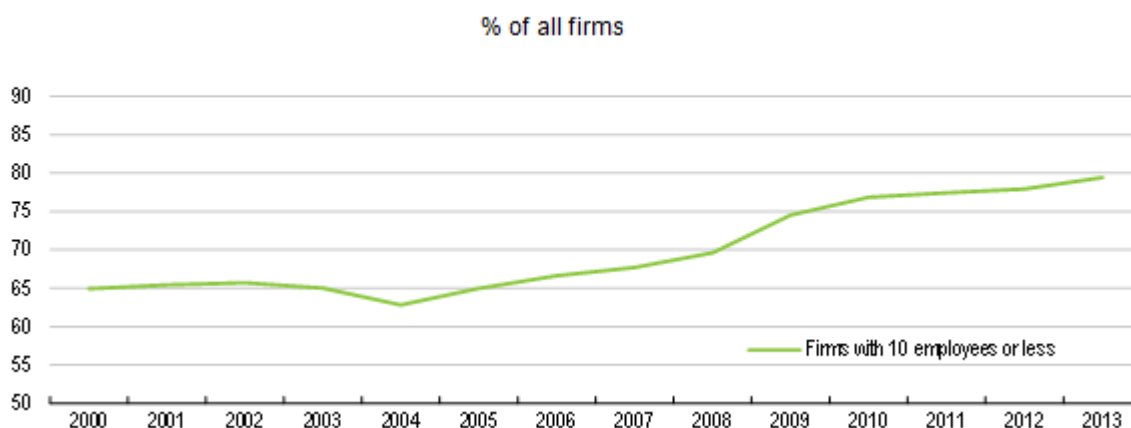
Compared with other countries, the contribution to productivity growth of between sector reallocation (i.e. the "shift" effect in Figure 1) has been large in Lithuania. This may reflect a series of reductions in regulatory barriers to firm entry over the past decade. According to the World Bank *Doing Business* indicators, the cost to start a business fell from 4% to 0.6% of income per capita between 2003 and 2015. Specific reforms included the establishment of a new form of legal company (a "small partnership") that has no minimum capital requirement and a reduced number of regulatory procedures. A one-stop shop for online business registration was also introduced as well as measures to reduce the difficulty of companies to register as a value added taxpayer.

Indeed, new OECD empirical analysis at the industry-level across the 2006-2013 period identifies that these policy changes have been associated with increased contributions to productivity growth through both the "within" and "shift" effect in Lithuania (see Chapter 1 of the Lithuania Economic Assessment for details). One channel through which this likely arose is by such reforms enabling increased entry of young

small firms that subsequently obtained market share at the expense of poorer-performing incumbents. This is consistent with the fact that the firm exit rate in Lithuania was around double the European Union average during the period.

The trends from firm-level data fit this interpretation. Firm-level estimates suggest that multifactor productivity growth in Lithuania would have been around one-third lower over the 2000-13 period without new firm entry. Accordingly, these data show a steep pick-up in the proportion of small businesses in Lithuania during the past decade (Figure 2).

Figure 2. Proportion of small firms



This is not to say that all the necessary reforms in Lithuania have been undertaken. The level of labour productivity is still around one-third below the OECD average. The education system at all levels can do a much better job at producing graduates with the skills required by firms, state-owned enterprises occupy a relatively large share of the economy (and many of these underperform) and innovation in the business sector is low. However, Lithuania's recent record of productivity-enhancing product market reforms gives reason for optimism that policymakers can make the policy adjustments needed to further promote convergence and the living standards of the population.

Find out more:

[Lithuania productivity country profile](#)

OECD (2016), *Economic Survey: Economic Assessment of Lithuania 2016*, OECD Publishing, Paris.

OECD (2016), *Review of School Resources: Lithuania*, OECD Publishing, Paris.

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