Restart the reform engine to help the recovery in Lithuania

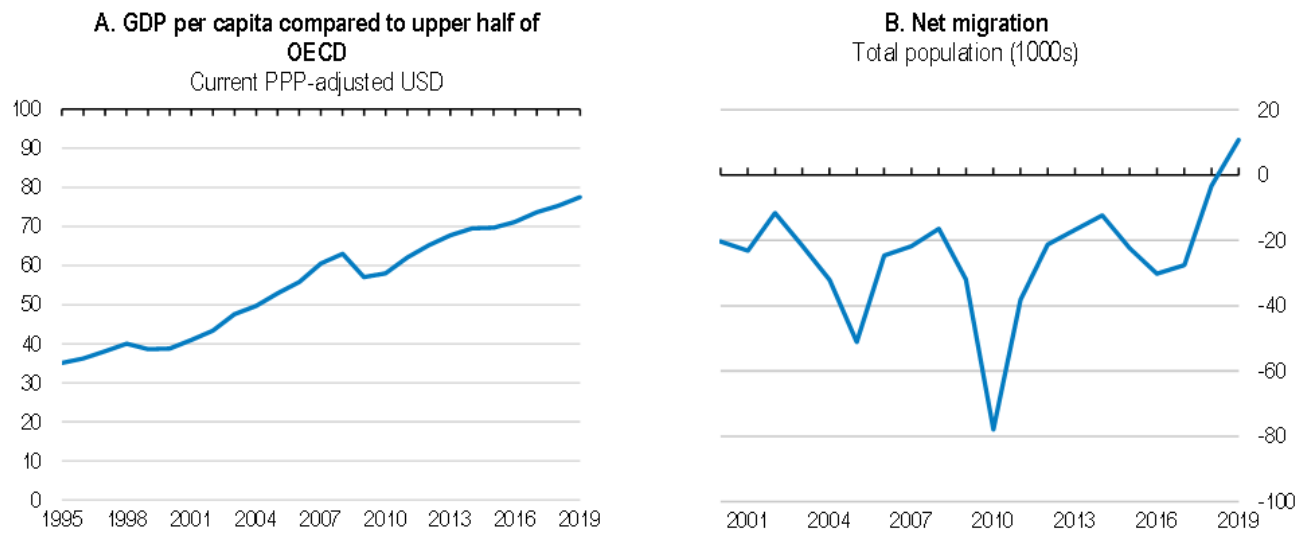
by Hansjörg Blöchliger and Vassiliki Koutsogeorgopoulou

The COVID-19 crisis was less severe than elsewhere but a second wave looms

Lithuania weathered the COVID-19 shock well, thanks to effective containment measures, a well-functioning health system and swift public support to firms and households. With GDP projected to decline by around 2% in 2020, the economy contracted less than in almost any other OECD country. The recent surge in infections is however worrying and carries significant health and economic risks. Against this background, the country should continue to protect the most vulnerable from the fallouts of the crisis.

Before the pandemic, the economy performed strongly and was converging rapidly towards the wealthiest OECD countries. Success was driven by strong export and investment and supported by sound financial and fiscal policies and a friendly business climate. Key policy initiatives such as a completely revamped insolvency framework, lower labour taxation and a simplified innovation system helped sustain growth, and they will underpin the recovery. As income prospects continued to brighten, immigration exceeded emigration for the first time since renewed independence.

FIgure: **Lithuania is converging rapidly, and Lithuanians are coming back**



Source: OECD Economic Outlook 107 database; and Statistics Lithuania.

Past fiscal prudence has provided room for strong fiscal support

Fiscal policy has been prudent over the past decade, providing space for support to households and firms amounting to some 10% of GDP in 2020. To ensure a sustainable recovery after the pandemic, the "DNA Plan for the Future" will invest an additional and highly welcome 4% of GDP into education, innovation, digital transformation and climate action.

Still gross public debt will rise sharply. As a small open economy, Lithuania is highly vulnerable to external shocks. To maintain fiscal space, the government should set a long-term numerical debt target and establish a credible debt reduction path once the recovery is well on its way.

Public companies proliferate and underperform

Public companies (or state owned enterprises, SOEs) are widespread, and their governance remains weak. Many SOEs do not reach the financial targets the government sets for them. Although professionals are gradually replacing politicians on SOE boards, their share remains low at around 60%. Municipal SOEs proliferate, often violating competition rules. The government should subject all SOEs to the same laws, regulations and market constraints as private companies. If no compelling reasons persist to maintain public ownership, SOEs should be sold to private investors.

Further reading:

OECD (2020), *OECD Economic Surveys: Lithuania 2020*, OECD Publishing, Paris,
https://doi.org/10.1787/62663b1d-en