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Growing together: making  
Lithuania's convergence  
process more inclusive

**Lilas Demmou**

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**GROWING TOGETHER: MAKING LITHUANIA'S CONVERGENCE PROCESS MORE INCLUSIVE**  
**ECONOMICS DEPARTMENT WORKING PAPERS No. 1308**

By Lilas Demmou

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## Abstract/Résumé

### Growing together: making Lithuania's convergence process more inclusive

Although Lithuania's growth has been impressive, inequality is high, the risk of poverty is one of the highest of European countries, and life expectancy is comparatively low and strongly dependent on socio-economic background. The low job satisfaction reduces well-being and feeds high emigration. Labour market, social and health policies can all contribute to improve both well-being and growth. Priorities include providing more and better jobs for all, especially for the low-skilled, by making work pay while keeping the labour costs under control. More accessible and adequate income support combined with more ambitious job-search support and training programmes would better-integrate out-of-work individuals into the labour market. Strengthening equity, effectiveness and sustainability of health policies is also instrumental to inclusiveness. This Working Paper relates to the 2016 OECD Economic Survey of Lithuania ([www.oecd.org/eco/surveys/economic-survey-lithuania.htm](http://www.oecd.org/eco/surveys/economic-survey-lithuania.htm))

*Key words:* inclusiveness, wage inequality, employment protection legislation, tax wedge, public employment services (PES), active labour market policies (ALMP), unemployment benefits, social assistance benefits, in-work benefits, effective tax rate, life expectancy, healthcare system

*JEL Classification:* I3, I1, J08, J28, J31, J6, H2

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### Partager les fruits de la croissance : rendre le processus de convergence plus inclusif en Lituanie

Bien que la Lituanie ait connu une croissance impressionnante, elle se caractérise par de fortes inégalités, un risque de pauvreté figurant parmi les plus élevés des pays européens, ainsi qu'une espérance de vie relativement faible et fortement tributaire du milieu socioéconomique. La faible satisfaction professionnelle des individus réduit le bien-être et alimente une forte émigration. La politique du marché du travail, la politique sociale et la politique de santé peuvent toutes contribuer à améliorer le bien-être et la croissance. Les pouvoirs publics doivent notamment s'employer en priorité à fournir à tous des emplois de meilleure qualité, en particulier aux personnes peu qualifiées, en valorisant le travail tout en gardant la maîtrise des coûts de main-d'œuvre. Des aides au revenu plus accessibles et adaptées, conjuguées à des programmes plus ambitieux d'aide à la recherche d'emploi et de formation, permettraient de mieux intégrer les individus sans emploi sur le marché du travail. L'inclusivité passe également par un renforcement de l'équité, de l'efficacité et de la viabilité des politiques de santé. Ce Document de travail se rapporte à l'Étude économique de l'OCDE 2016 de Lituanie ([www.oecd.org/fr/eco/etudes/etude-economique-lituanie.htm](http://www.oecd.org/fr/eco/etudes/etude-economique-lituanie.htm))

*Mots clés:* inclusivité, inégalité salariale, législation de protection de l'emploi, coin fiscal, services publics de l'emploi (SPE), politiques actives du marché du travail (PAMT), prestations chômage, prestation de l'aide sociale, prestations liées à l'exercice d'un emploi, taux d'imposition effectif, espérance de vie, système de santé

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## **GROWING TOGETHER: MAKING LITHUANIA'S CONVERGENCE PROCESS MORE INCLUSIVE**

**by Lilas Demmou<sup>1</sup>**

1. Lithuania's convergence process, mainly driven by a catching-up of productivity, has been impressive: GDP per capita rose from one third to two thirds of the OECD average level between 1995 and 2013. This was accompanied by a rise in living standards reflecting better job opportunities, education and health. The employment rate, at almost 66%, is now 7 percentage points above the rate observed in 2001 and is above the European average. Educational attainment is one of the highest in the world, with half of the population having a tertiary level of education. Life expectancy has increased by five years since 1995.

2. However, despite the significant contribution of transfers to reduce it, inequality is high and the risk of poverty is one of the highest of European countries. Poverty appears to be deep-rooted as indicated by the low income of the poor, which is on average 23% below the poverty line. Well-being indicators suggest that getting closer to the average OECD standards will require specific efforts in the areas of the labour market, housing and health (Figure 1) and this is confirmed by a recent study pointing to health and the economic situation as the two main determinants of low levels of well-being (Degutis and Urbonavičius, 2013). Child poverty and individuals' health status remain strongly dependent on socio-economic background and there is a risk of a vicious circle linking socio-economic backgrounds, economic opportunities and life expectancy.

3. High inequality and poverty could even undermine the sustainability of the convergence process, as seen by the recent work of the OECD regarding the negative impact of inequality on growth (Causa et al, 2014; OECD, 2015d). The main mechanism through which inequality affects growth is by undermining education outcomes for children from poor socio-economic backgrounds, lowering social mobility and hampering skills development. Moreover, international experience suggests that the impact of inequality on growth stems from the gap between the bottom 40% with the rest of society, not just the poorest 10% (Cingano, 2014). This suggests the need for a multi-pronged approach going beyond anti-poverty programmes.

4. Against that background, this working paper discusses potential win-win structural policies that could be implemented in Lithuania to deliver both higher growth and stronger inclusiveness in the future. We focus especially on the labour market, social assistance and health policies which are complementary for simultaneously strengthening labour participation and well-being. The main messages from the working paper are the following:

- Good-quality employment is the principal route out of poverty. Further promoting labour market institutions that are conducive to strong job creation, higher employability for the most vulnerable and better job satisfaction are therefore instrumental to promote inclusiveness. Taking measures to further reduce the tax wedge on the low-skilled and to promote lifelong learning will all help in this regard. Establishing an independent commission of experts would help setting the

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1. Lilas Demmou is senior economist at the Economics Department of the OECD in Paris. The author would like to thank the Lithuanian authorities as well as Bob Ford, Alvaro Pereira, Ben Westmore, Andreas Wörgötter and members of the EDRC for valuable comments and discussions. The author would like to thank also Silvia Avram (Essex University), Bert Brys, Romina Boarini, Ian Forde, Alessia Forti, Rie Fujisawa, Herwig Immervoll, Jekaterina Navicke (Vilnius University), Anton Nivorozhkin, Sarah Perret, Sigita Strumskyte and Elena Tosetto. Special thanks to Corinne Chanteloup who provided research assistance, and to Heloise Wickramanayake and Mercedes Burgos who provided technical preparation.

right level of the minimum wage as a higher minimum wage would reduce wage inequality but if set too high it would reduce the employment of low-skilled.

- The risk of unemployment is, however, inherent in a decentralised labour market and is even larger in an economy like Lithuania's, where economic volatility and the convergence process mean labour is frequently displaced. Against this background, reforming the social model in line with a flexicurity approach, as envisaged by the authorities, appears appropriate. However, to be effective and to reduce the risk that job loss leads to poverty, a reform package of the labour market should couple a relaxation of strict employment protection with adequate unemployment benefits and effective active labour market programmes. Those policies require greater resources but they would potentially lead to higher fiscal revenue as labour market outcomes improve.
- Along with people at risk of being temporarily unemployed, there will always be vulnerable individuals with lower job prospects. Adapting the social assistance system to ensure that it provides adequate incentives and it is well-coordinated with the unemployment insurance system is critical. The current social assistance system is the main social protection in Lithuania, but it should be made more effective at alleviating poverty and as a pathway to employment.
- Good health is a prerequisite for the labour market and social policies to be effective at increasing labour force participation and productivity. International experience suggests in particular that better health raises employment, and that unemployment tends to weaken health (Barnay, 2014). Health policies thus appear integral to an inclusive growth strategy in Lithuania. In particular, prevention policies and healthy lifestyle, especially through lower alcohol and tobacco consumption which is comparatively high, can further contribute to reduce premature mortality and improve well-being in Lithuania.

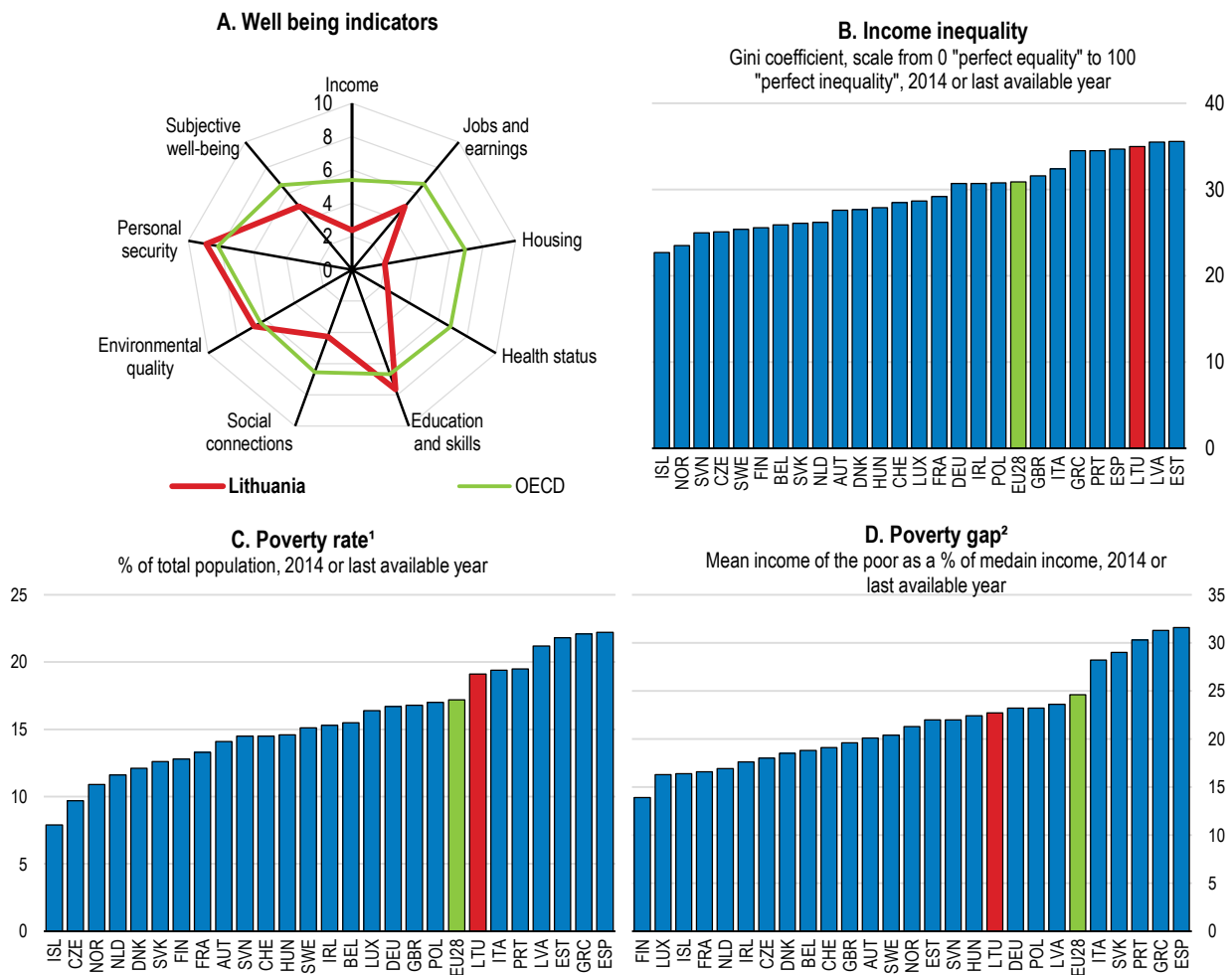
#### **Main findings**

- The legislation on employment protection is strict but not well-enforced. This creates uncertainty for workers and for firms, and may undermine job creation.
- At already 50% of the median wage, the minimum wage is binding and room for further increases without undermining employability of low-skilled is limited.
- The comparatively high share of low wage earners among the high skilled suggests also that informal wage payments ("envelope wages") are common.
- The unemployment insurance system covers only a small share of the unemployed, does not shelter against poverty risk in the case of job loss, and provides insufficient financial support for effective job search.
- Public employment services are understaffed and re-employment programmes are too small to effectively tackle structural unemployment.
- Relatively poor working conditions and underdevelopment of lifelong learning result in poor career prospects for workers and fuel emigration and informality.
- The social assistance system does not sufficiently alleviate poverty risk.
- Disincentives to take a job are comparatively high for social assistance benefit recipients not eligible for in-work benefits and for large families.
- Cooperation between municipalities and public employment services to provide adequate programmes for social assistance recipients is underdeveloped.



- Sanctions on social assistance recipients are too strict and contribute to poverty risks and social exclusion for the most vulnerable.
- Life expectancy is low and strongly dependent on socio-economic background.
- There is still room for restructuring the hospital network, reducing the reliance on hospitalisation and promoting further primary care services.

**Figure 1. There is room to make Lithuania more inclusive**



*Note:* The well-being performance of Lithuania is based on a preliminary assessment considering the available information, reduced compared to the OECD average: household net financial wealth, average gross annual earnings of full-time employees, housing expenditure, time devoted to leisure and personal care, expected years in education and consultation on rule-making data are not available for Lithuania. The OECD dimensions scores have been adjusted to mirror the reduced indicators' coverage of Lithuania.

1. The share of persons with an equivalised disposable income below the risk-of-poverty threshold, which is set at 60 % of the national median equivalised disposable income (after social transfers).
2. Difference between the at-risk-of-poverty threshold (set at 60 % of the national median equivalised disposable income after social transfers) and the median equivalised disposable income of persons below the same at-risk-of-poverty threshold, expressed as a percentage of the at-risk-of-poverty threshold.

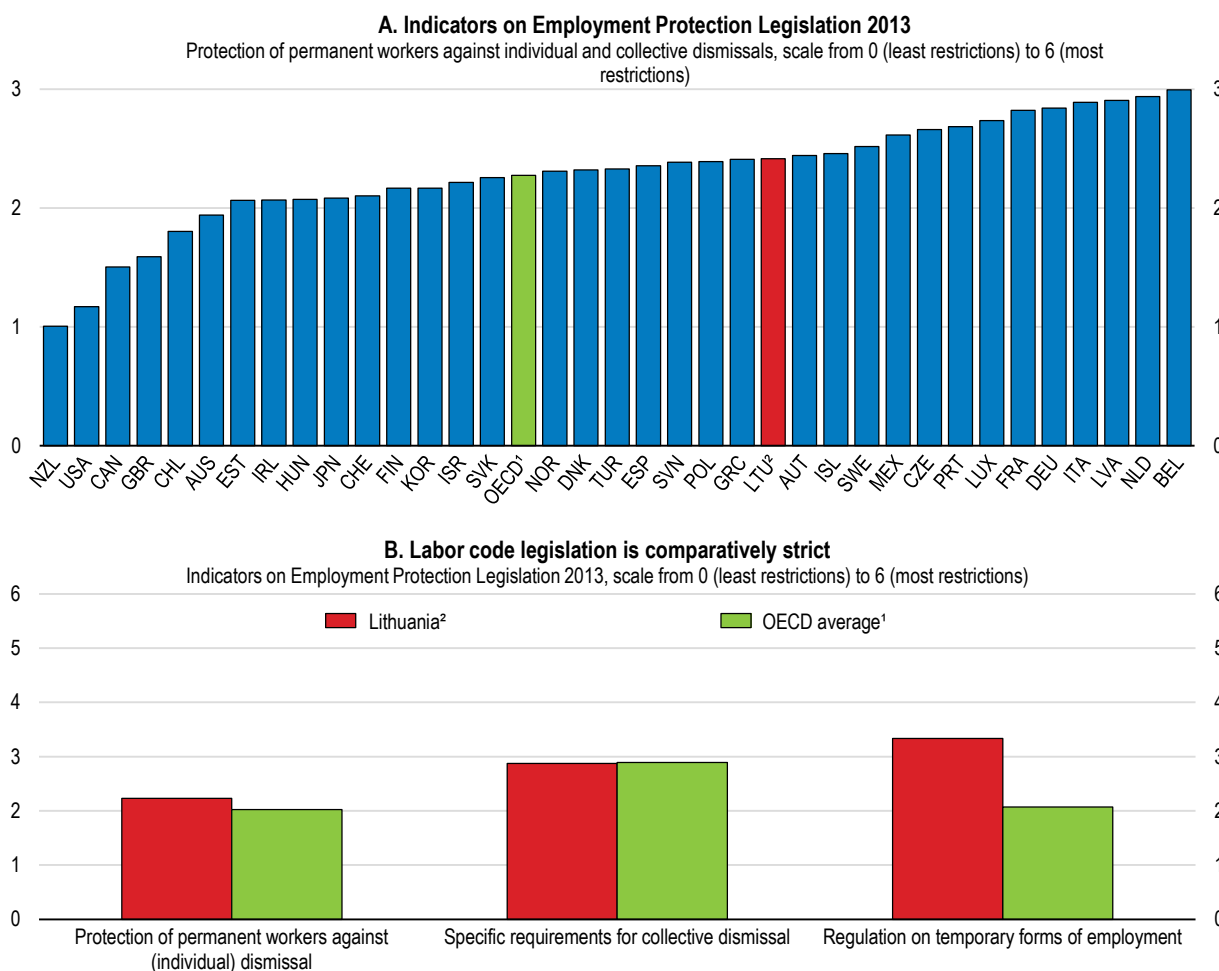
*Source:* Eurostat Population and social conditions database; OECD Better Life Initiative 2015.

## **Promoting more and better jobs for an inclusive labour market**

### ***Establishing a legislative framework conducive to job creation and job mobility***

5. A starting point to promote an inclusive labour market is to establish institutions that are conducive to job creation, because being employed is the principal route for reducing the risk of poverty and social exclusion (Whiteford and Adema, 2007; OECD, 2015d; IFC, 2013). Against this background, comparatively strict labour market legislation in Lithuania may create a barrier to job creation as the catching-up process and the vulnerability to external shocks in a small open economy require quick adaptability to economic changes (Figure 2). For instance, the recovery from the last financial crisis required a substantial reallocation of resources, implying that large numbers of destroyed jobs in the housing sector combined with the expansion and entry of new firms in the rest of the economy. In that context, strict employment protection legislation can hamper the ability of firms to respond to new opportunities and reduce the incentive to hire new workers (Venn, 2009). It can also hamper productivity and income growth by inhibiting the reallocation of resources to the most dynamic sectors (Andrews and Cingano, 2014). Strict employment legislation may also generate incentives to hire workers informally (OECD, 2008). The government has already started to look at the problem. Legislation on temporary work arrangements was changed in 2013 to make it easier to establish such contracts. A “new social model”, under discussion in the Parliament, includes provisions to reform the labour code in order to ease both permanent and temporary contracts, in particular with regard to the rules on individual dismissal and the use of temporary employment.

**Figure 2. Employment protection legislation is stricter than the average of OECD countries**

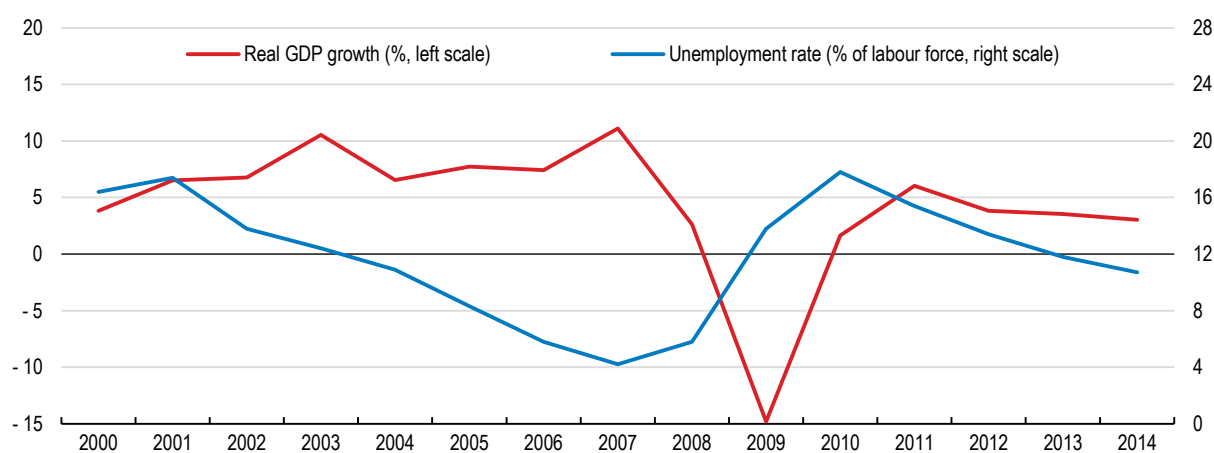


1. OECD unweighted average.

2. Data refer to 2015.

Source: OECD Employment Protection database, 2013 update.

6. The overall impact of the labour code reform on job creation in Lithuania is uncertain, however, as labour regulations are currently not well enforced. For instance, while the law is particularly restrictive regarding redundancy payments, which may amount to as much as six month’s wages, in practice, only 8% to 9% of dismissed women and 5% to 6% of dismissed men received any redundancy payment, and most of these work in the public sector (European Commission, 2015a). Job destruction during the last financial crisis provides indirect evidence of weak barriers to hiring and firing (Earle, 2014). The relationship between GDP and unemployment changes in Lithuania (so-called Okun’s law) is estimated at 0.49 for Lithuania which is similar to the United States (IMF, 2014; Figure 2.3).

**Figure 3. The labour market is in practice flexible**

Source: OECD Economic Outlook 98 database; Statistics Lithuania database.

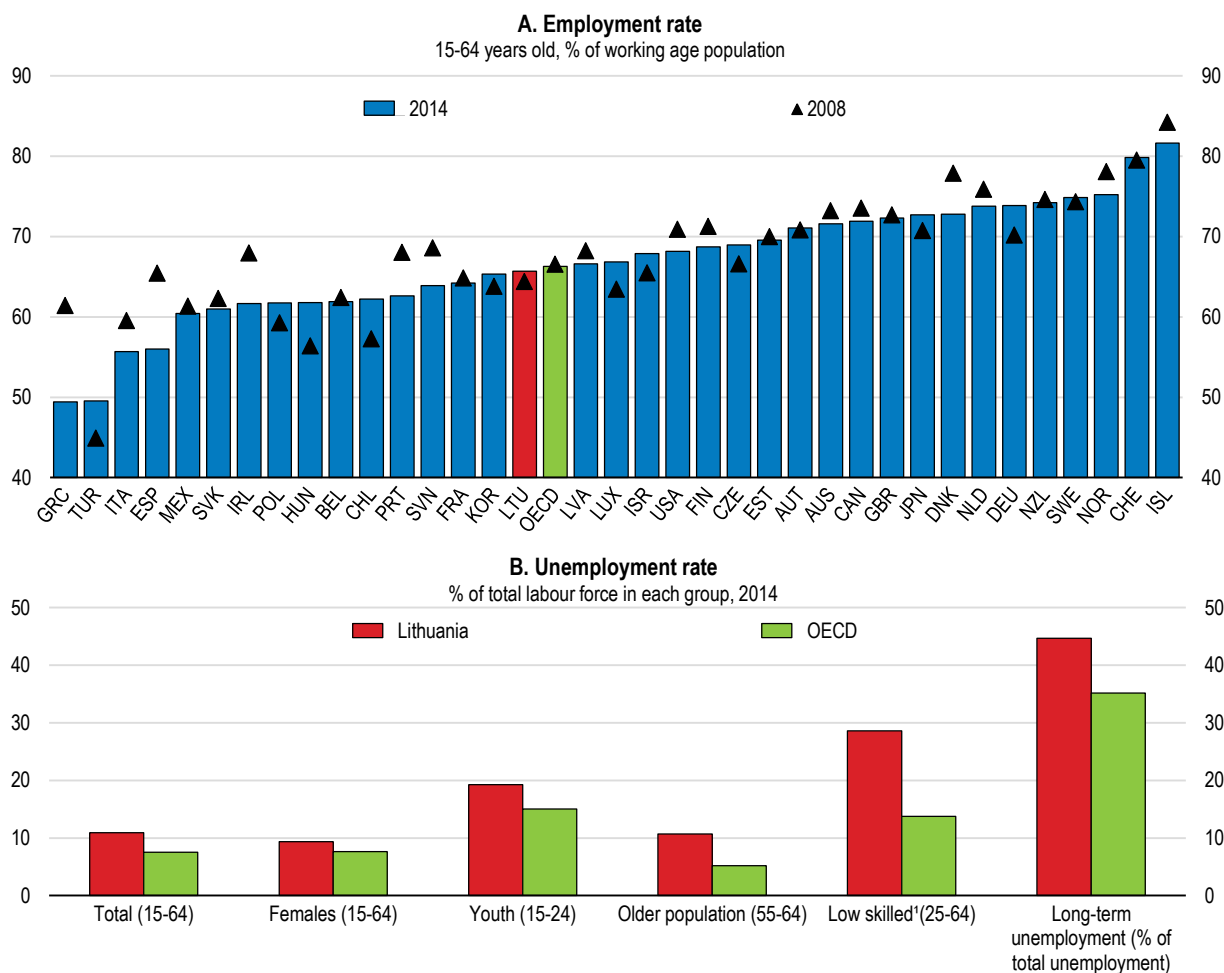
7. A reform that would align legislation more closely with practices and ensure the enforcement of the law is desirable. International experience suggests that ensuring transparent and effective dismissal rules is in the interest of all parties (Venn, 2009). In the current situation, the strict employment law generates judicial uncertainty without reaching its objective: to protect workers and to strengthen employers' incentives to internalise the social costs of excessive labour turnover such as lower investment in staff training (Wasmer, 2002; Amable and Gatti, 2004). While the new labour code will entitle workers to lower level of redundancy payment in case of dismissal, workers could be better protected if this reform was accompanied by provisions that ensure the enforcement of the law. International experience suggests that in countries where the definition of unfair dismissal is narrower, workers are usually compensated while this is not the case when the definition is large or the amount set is high (OECD, 2013a). Reducing judicial uncertainty may also boost the attractiveness of Lithuania for FDI as foreign firms are less aware of work practices and are adverse to uncertainty. Small firms would also benefit from the reform because they generally have less capability to deal with complex legislation, in particular because they don't have a specialised human resources department and because the cost of a dismissed worker accounts for a higher share of the wage bill (OECD, 2015a). This aspect is particularly important in Lithuania where there is a large number of small firms; about 90% of firms have 10 employees or less (Westmore, 2016). The new draft labour code includes specific provisions to reduce the strictness of the legislation for smaller firms, in line with the practices in many OECD countries (Venn, 2009). Such size-dependent policies need close attention however, as they come with the risk of offering firms an incentive to stay small or to underreport workers.

#### ***Providing more job opportunities for the low-skilled***

8. Providing more job opportunities, in particular for the most vulnerable workers, is instrumental to an inclusive labour market. The economy has quickly recovered from the last financial crisis which is reflected notably in an unemployment rate below 9% in 2015, after having peaked at 18% in 2010, and a higher employment rate (Figure 4, Panel A). Several measures targeted at the youth have been successful in improving labour market outcomes, including the promotion of training, wage subsidies and the establishment of a "youth guarantee" which ensures that all youth under 29 get a good-quality offer for a job, training or continued education within four months of leaving education or entering unemployment (OECD, 2015a). Youth unemployment was reduced to 19.3% following a post-crisis peak of 35.7%. However, some groups have not yet fully recovered from the global financial crisis and the unemployment

rates of low-skilled and seniors remain high (Figure 4, Panel B). The employment rate of the low-skilled is the second-lowest rate in Europe and requires particular attention.

**Figure 4. The labour market recovered from the crisis but some groups remain vulnerable**



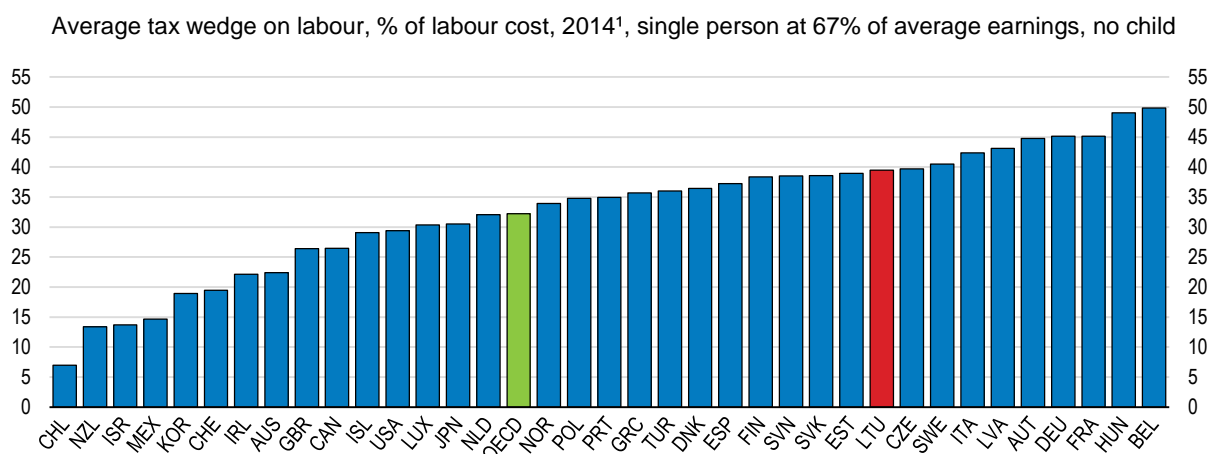
1. 2013 data for OECD (unweighted average).

Source: OECD Labour Market Statistics; OECD Education at a glance database; Eurostat LFS Main indicators database.

9. Reduced tax wedge targeted at low-paid jobs can help boost labour demand by reducing the labour cost for low-skilled workers in line with the level of their productivity (Figure 5). International experience suggests that a reduction of the labour tax wedge can significantly reduce unemployment (Giannella et al, 2008; Duval et al, 2007); a reduction by 10 percentage points can reduce the level of structural unemployment by 2 to 4 percentage points on average (Ebeke and Everaert, 2014). Lowering employer social security contributions could in particular help as they account for 58% of the tax wedge in Lithuania compared to 39% on average in OECD countries. Several OECD countries established social security contribution exemptions or reductions for low-paid jobs while maintaining the entitlement of workers. However, targeting requires reliable information on wages and such policy may come with undesirable effects in Lithuania due to the use of “envelop wages”, i.e. informal wage payments (Eurobarometer, 2014; Schneider, 2015; Talis and Arnis, 2014). Progress in reducing envelop wages is hence instrumental to restraining the budgetary costs of earning-related policy measures. In the current

situation, other criteria are needed to make sure such schemes are not becoming a subsidy to under-reporting earnings. An option is to limit exemptions to employers hiring low-skilled workers that were previously unemployed or inactive. Such an option is already available in Lithuania as part of active labour market policies and could be refined to further reach the most vulnerable (discussed below).

**Figure 5. There is room to reduce the tax wedge**

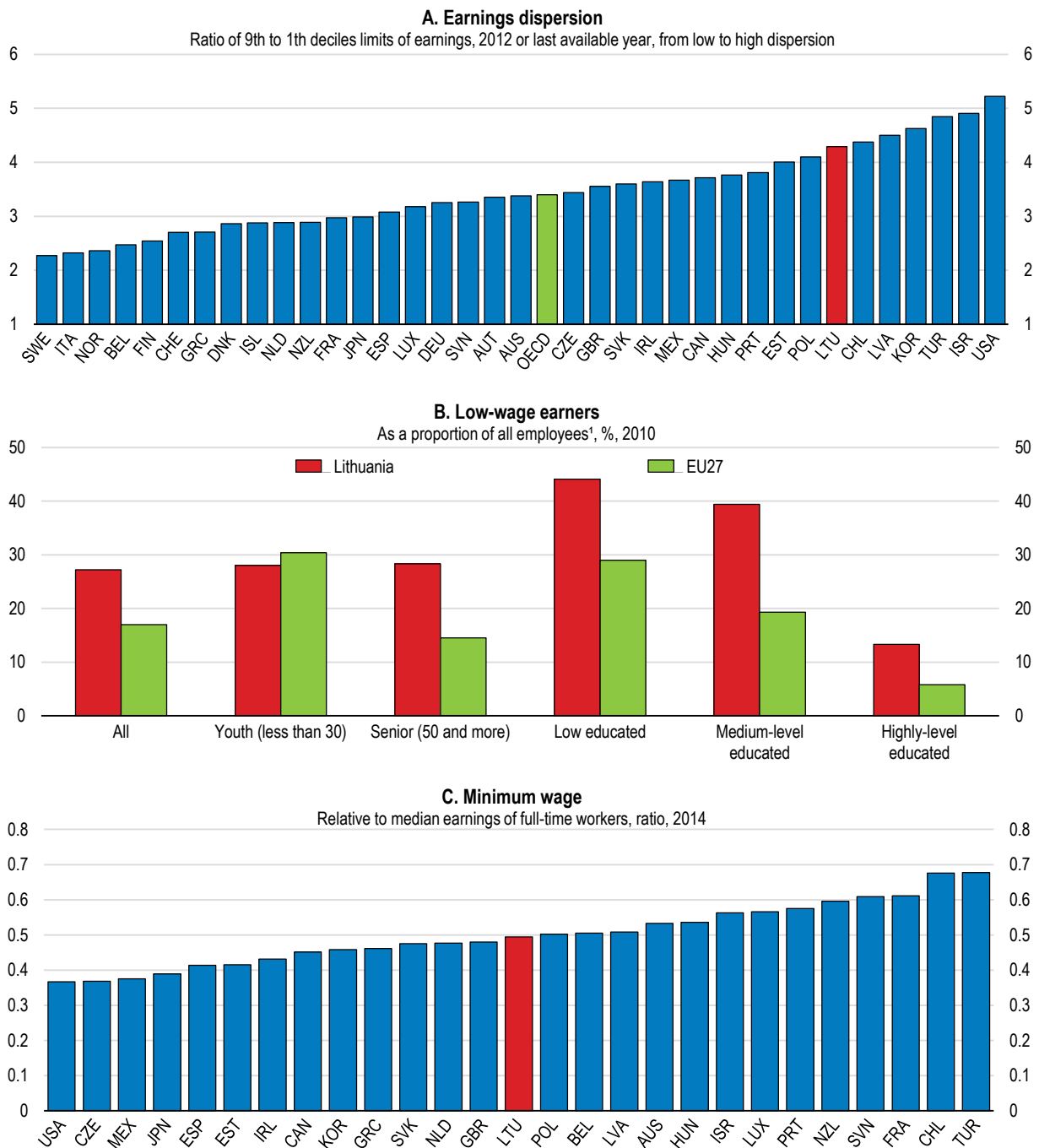


1. 2013 data for Latvia and Lithuania.

Source: European Commission, Tax and benefits database; OECD, Tax-Benefit Models.

10. Poor labour market outcomes for low-skilled workers is also reflected in the large share of low-wage earners and high earnings inequality (Figure 6, Panel A and B). To tackle wage inequalities, the minimum wage was increased (following a four-year freeze) by close to 30% between 2012 and 2015 and by 7% in January 2016. This took it to the absolute level in Estonia and Latvia. While the minimum wage remains low by international comparison, fuelling emigration and undermining the incentive to take-up a job (Table 2.1; Gataulinas and Zabaraukaite, 2014), it amounts to half the domestic median wage, which is about the average observed in OECD countries (Figure 6, Panel C). This suggests that the level of the minimum wage is in line with international differences in productivity and that room to further use it to reduce labour market inequalities is limited. The authorities plan to implement another increase in the minimum wage in January 2016. Such a policy may risk reducing the employability of the low-skilled and new entrants. In that case, the positive effect on income of low-paid earners may be offset at the aggregate level by lower employability of the low-skilled. To reduce this risk, the minimum wage level should be reviewed on a regular basis by an independent expert commission like those existing in Australia, France and the UK. The decision to raise wages is made by the Tripartite Council of the Republic of Lithuania. International experience suggests that ensuring the transparency of decisions through public consultation and the publication of recommendations is beneficial for business activities as it reduces uncertainty by making decisions more predictable (Immervoll, 2015).

**Figure 6. Wage inequality is high but the minimum wage is binding**



1. Low-wage earners are defined as those employees earning two thirds or less of the national median gross hourly earnings.

Source: OECD Earnings Distribution database; Eurostat database.

11. Increasing take-home pay for low wage earners by reducing their taxes is an alternative way to reduce labour market inequalities without hurting the employability of the low-skilled. Personal income tax in Lithuania is calculated on an individual basis using a flat tax rate. However, a general tax allowance that decreases with income and specific allowances for individuals raising children and people with disabilities

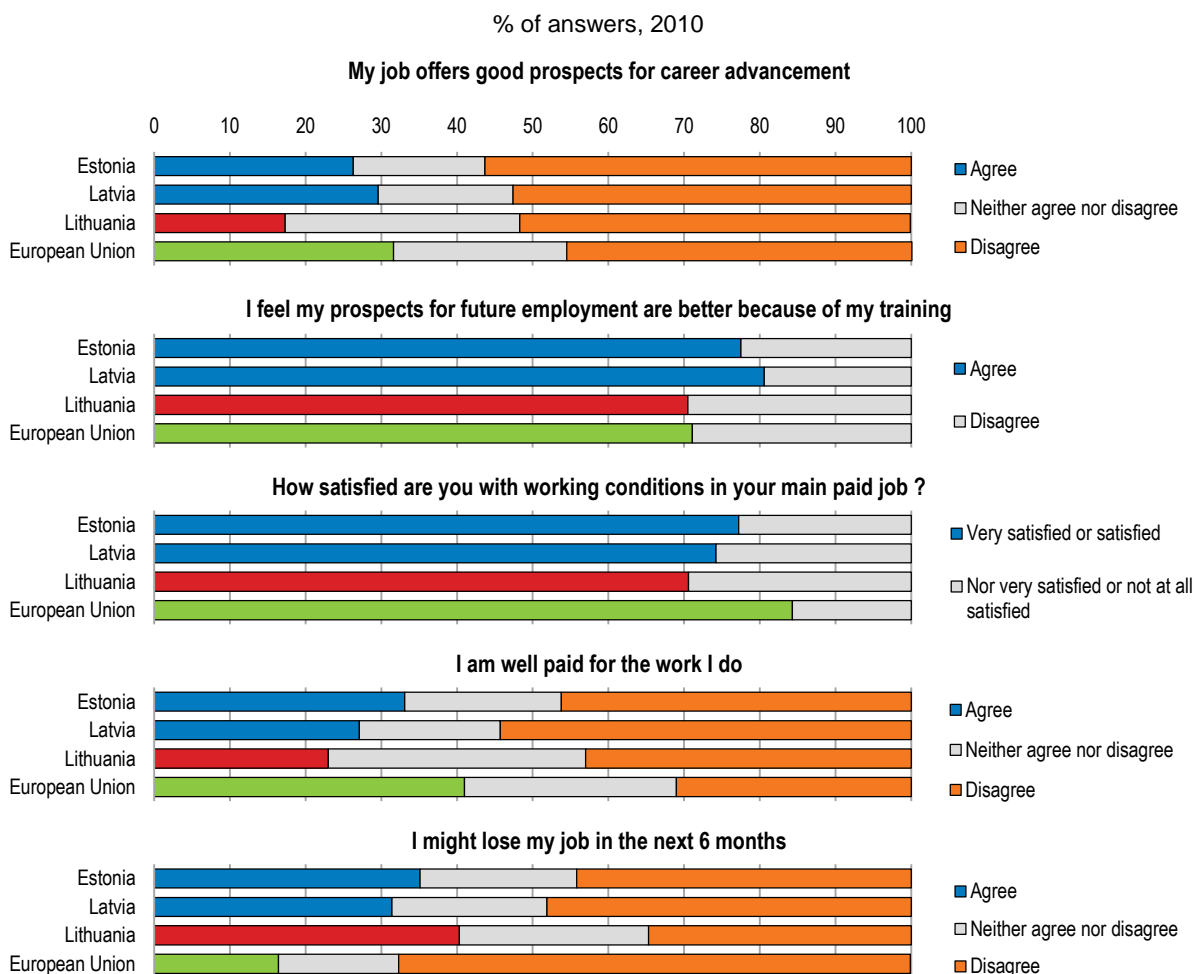
makes the system slightly progressive at the bottom of the distribution (Navicke, 2015). Increases in the general tax allowance and the tax allowance for residents raising a child in January 2014 have also contributed to slightly more progressivity, in particular as large families are more represented at the bottom of the distribution. However, the contribution of taxes to reduce inequalities remains modest (IMF, 2015) and comes with comparatively high fiscal costs because universal tax allowances also support families with high income. Better targeting of such tax allowances would be less costly and make a further contribution to reduce inequalities. Such a reform has already been undertaken for family benefits through the replacement of universal children's benefits with means-tested benefits, which reduced the number of recipients from 550 000 to 150 000 between 2009 and 2012 (Poviliunas, 2014). Going forward, an in-depth analysis of the Lithuanian tax system is needed to assess if the advantages of introducing a progressive tax system in terms of inclusiveness could offset some of its drawbacks (e.g. the risks of wages being underreported or lower attractiveness for FDI). For instance, the Slovak Republic which had a flat tax system in place for 10 years undertook such a reform in 2013 by adding a second tax bracket.

12. In-work benefits schemes targeted at low-paid jobs also provide room to boost net incomes at the bottom of the distribution while keeping labour costs under control. They could be particularly effective in countries such as Lithuania where earning inequalities are high (Immervoll and Pearson, 2009). In addition, because of the desirable effects on incentives to work, it is a cost-effective instrument, compared to other type of transfers. However, as mentioned above, to reduce the risks related to underreporting of wages, those measures should specifically be designed for jobless individuals who take a job. The most effective options are discussed below in the context of out-of-work policies (see Box 4).

### *Offering better career prospects for all*

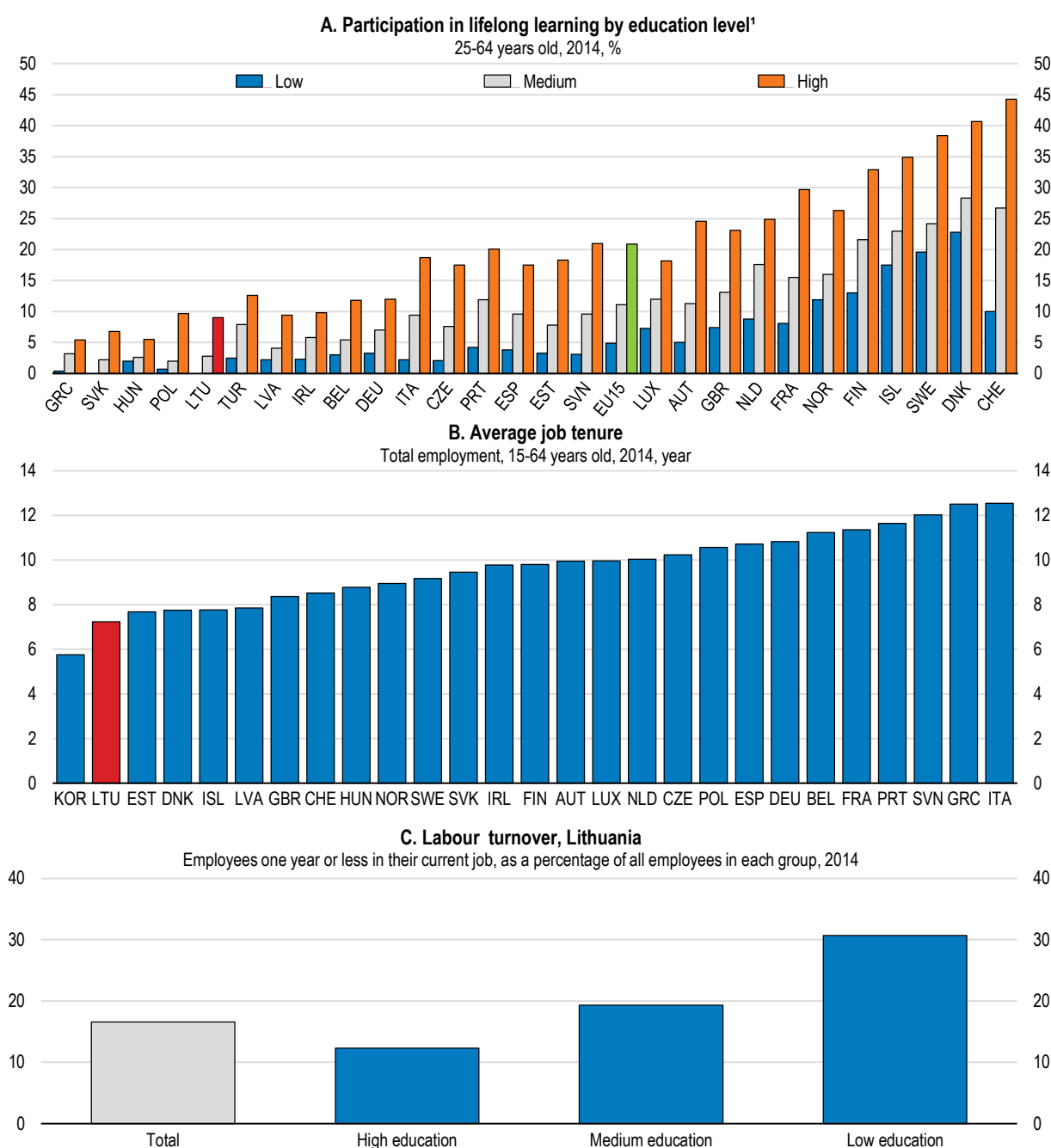
13. Along with more jobs, providing workers the opportunities to advance to better jobs over their careers would make the labour market more inclusive. Recent OECD studies point to the importance of job quality and highlight that there is no trade-off between job quantity and job quality (OECD, 2014a). According to the European Survey on Working Conditions, which assesses the quality of jobs, 30% of Lithuanians are not satisfied with their working conditions. This is significantly higher than the average of European Union countries. In particular, there is a perception in Lithuania of low job security, low wages and weak career prospects (Figure 7, European Commission, 2013). On the positive side, almost three-quarters of Lithuanians assess positively the impact of training on their career, which is as high as the European average. This suggests that the weak participation in training is more a source of concern than its quality. They also report better social relationships than their peers in European countries, had notably more supportive colleagues, benefitted from better management when setting professional targets and enjoyed a better work-life balance (Eurofund, 2012).



**Figure 7. Lithuanians are dissatisfied by their working conditions**

Source: Eurofund, European Working Conditions Survey 2010.

14. Promoting the participation of workers in lifelong learning is instrumental in improving their working conditions in the medium-long term. Underinvestment in skills reduces productivity and opportunities for career advancement (OECD, 2014a; Bassanini et al. 2005). Only 5% of workers are engaged in training activities, which is half the level observed on average in the EU (Figure 8). Low average job tenure reduces further incentives to invest in skills because when labour turnover is excessive, firms may fear losing trained workers to competitors and workers may hesitate to invest in skills that are specific to the firm and useless for the next job (Wasmer, 2002). This may be the case especially for low-skilled workers characterised by high job turnover and may require specific provisions to provide adequate incentives for firms and workers to invest in skills. Plans to entitle workers to 5-10 days of training per year and to establish a new apprenticeship contract are welcome. Considering the current plan to promote the use of fixed-term contracts, specific attention should be given to avoid creating a dual labour market, as observed in some OECD countries where such contracts are largely used (OECD, 2015d). One possibility could be to create training rights for such workers. Along the same lines, tackling informality will also help in reducing dualism in the labour market and contribute to improved prospects for better jobs; non-formal jobs are associated with poor working conditions, no training and no insurance coverage (OECD, 2004; OECD, 2008).

**Figure 8. Low-skilled workers underinvest in skills and experience high turnover**

1. Based on ISCED 2011 levels: low corresponds to less than primary, primary and lower secondary education (levels 0-2), medium corresponds to upper secondary and post-secondary non-tertiary education (levels 3 and 4), high corresponds to tertiary education (levels 5-8).

Source: Eurostat Education and training database; OECD Labour Force Statistics; Statistics Lithuania, Labour Force Survey data.

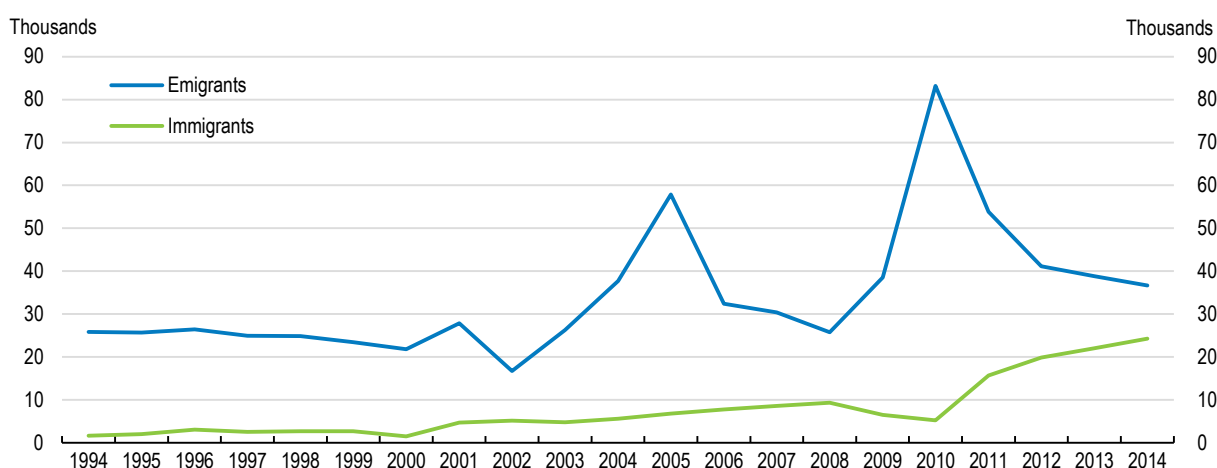
15. An educational system that provides the right mix of skills for youth is an important determinant of good career prospects. The comparatively large share of seniors with low-paying jobs (see Figure 6 Panel B) may be related to skills mismatch and suggests that educational mismatch can have

long-lasting consequences on careers. Firms report significant skills shortages and mismatches, suggesting that the educational system is not yet fully aligned with business needs. Providing more on-the-job training and apprenticeships in secondary and tertiary education will help ensure a better matching (Westmore, 2016). An in-depth review of the education system will also provide a better understanding of the sources of skills mismatch in Lithuania.

16. Providing career guidance to workers could also help them to move toward more productive and rewarding jobs. The Lithuanian public employment services (PES) currently provide guidance services to workers. However, the lack of resources discussed below generates tensions between this “medium-long term approach” activity related to lifelong learning and sustained employability, and other objectives of PES to get the unemployed working as quickly as possible (OECD, 2015b). In addition, the most vulnerable groups may have little incentive to participate as it is on a voluntary basis. To the extent that more resources are available in the future, the authorities could implement pilot programmes to strengthen training courses for low-income workers with the focus on strengthening their job stability.

17. Providing better career prospects and better working conditions would contribute to making Lithuania a more attractive place to live and to reducing emigration flows, which has affected 23% of the population since 1995 (Figure 9; Sipavičienė and Stankūnienė, 2013; Arslan et al., 2014). The main determinants for leaving Lithuania are economic. The majority of emigrants are young and are looking for better job opportunities abroad, in particular as average earnings in Lithuania are about four times lower than in the average European country (Eurostat dataset). The contributing factors driving emigration are various and include high unemployment, poor working conditions, along with dissatisfaction with the education system and attractive job options abroad, in particular for youth who were not employed for more than one year who represent the majority of emigrants (OECD, 2015a). At the same time, according to a recent survey of Lithuanians registered in PES, 60% of the respondents looking for a job abroad would prefer to stay in Lithuania (Gataulinas and Zabarauskaite, 2014). Together with a recent increase in return migration, this suggests some leverage for the authorities to make Lithuania an attractive place to live and work.

**Figure 9. Emigration is high and widespread among the population**



Source: Statistics Lithuania.

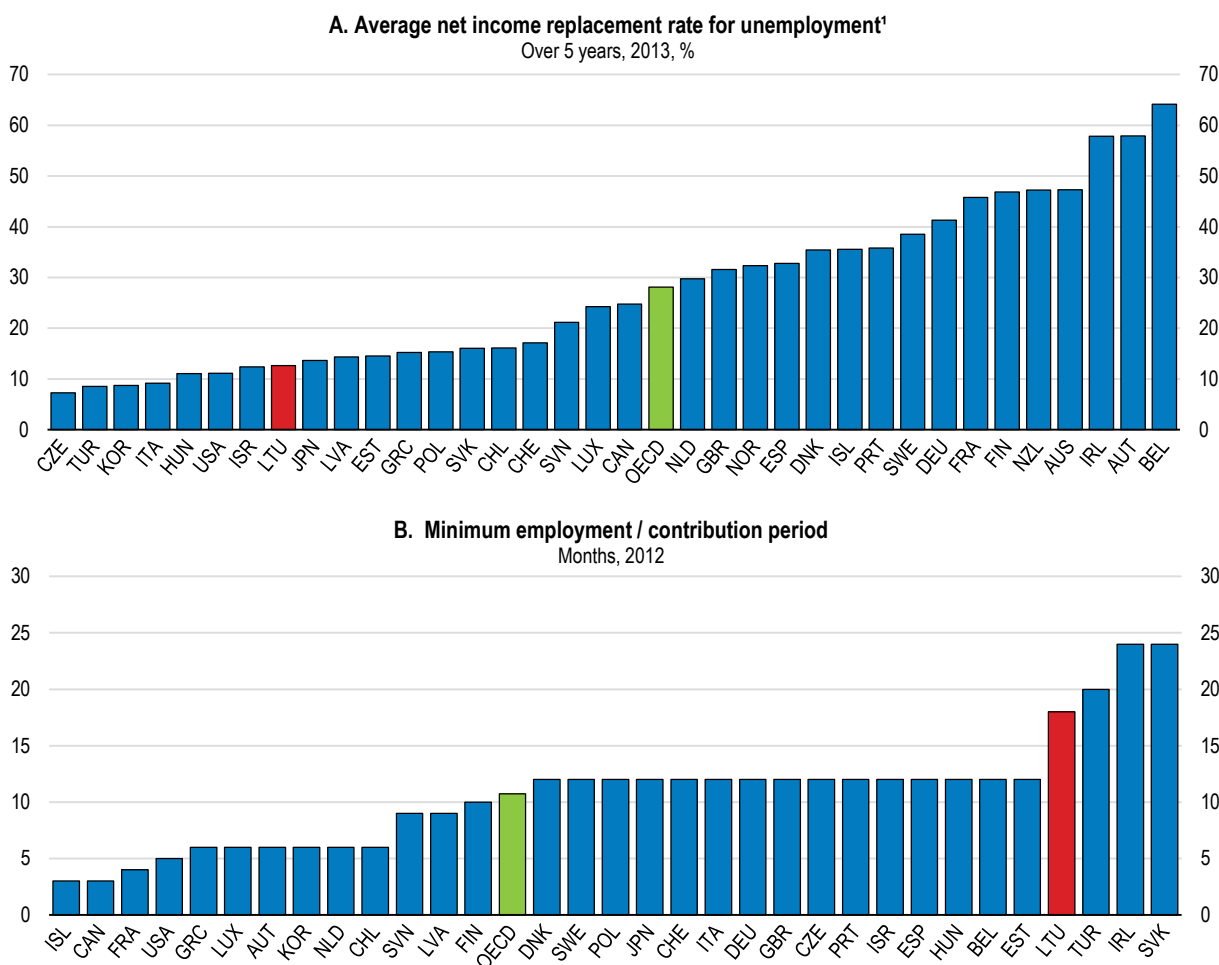
## **Providing more effective support to the unemployed**

### ***Strengthening temporary income support***

18. Weak income security in the event of job loss combined with a flexible labour market contributes to income inequality and vulnerability to poverty. The share of households that falls below the poverty risk threshold (measured at 60% of the median wage) in the case of job loss is estimated at 40% (Lazutka et al, 2013). This high risk of poverty is, in part, explained by the fact that Lithuania has a very restrictive unemployment insurance benefit system compared with OECD countries (Lagenbusher, 2015). It combines strict eligibility criteria, implying a long minimum contribution period, low duration and a low level of benefits (OECD, 2015a, Figure 10):

- Unemployment benefits provide a minimum level of resources during unemployment. The net replacement rate for low-paid earners, calculated over a five year period, is on average at 13% compared with 28% in the OECD (Figure 10). The picture is similar when looking at initial replacement rate (OECD, 2016).
- The benefits are also only weakly linked with previous earnings, and the initial replacement rate is estimated at less than 25% for high-paid workers earning more than 600 euros (2 100 litas) (Lazutka et al, 2013). The weak earnings link can reduce the incentive to work in the formal sector and lead to envelope wages to the extent that workers do not have a specific reward from higher contributions (OECD, 2008).
- The coverage of the system is narrow, with less than 18% of the unemployed entitled to unemployment benefits (OECD, SOCR Database). Youth or people with interrupted careers in particular encounter more difficulty accessing benefits.

**Figure 10. The unemployment insurance system is underdeveloped**



1. Simple average of the net replacement rates for four family types do not qualify for cash housing assistance or social assistance "top up" and two earnings levels at 67% and 100% of the average wage.

Source: OECD Tax-Benefit models, [www.oecd.org/els/social/workincentives](http://www.oecd.org/els/social/workincentives); Carcillo et al. (2015), "NEET Youth in the Aftermath of the Crisis: Challenges and Policies", OECD Social, Employment and Migration Working Papers, No. 164.

19. Increasing the generosity of benefits and the coverage, as is being considered by the authorities, would improve the labour market and reduce the risk of poverty. First, the low level of benefits increases the incentive to look for a job but could also increase skills mismatch if the unemployed, because of financial constraints, have to accept the first job offer and cannot devote sufficient time to job search and preparation. This can result in lower stability in labour market reintegration (Wulfgram and Fervers, 2013; Tatsiramos, 2009). This may be the case in Lithuania where the level of benefits is too low to cover the cost of job search. Second, the payment of adequate benefits, when combined with effective monitoring of job search, could also increase the incentive to take a job in the formal sector in order to benefit from the income security that is associated with formal jobs (OECD, 2004). This is an important element in a country where informal activity is estimated between 18% and 28% of GDP (OECD, 2016). Finally, better coverage would make the unemployed more readily reachable for public employment services. Increasing coverage could, for instance, be achieved by shortening the required length of contribution. International experience suggests that programmes targeted at groups not entitled to unemployment benefits have limited impact due to the associated difficulties of maintaining regular contacts and the fact that

opportunity costs of sanctions are lower with a lower level of benefits (OECD, 2015b). Against that background, planned reforms to increase the level and the coverage of unemployment benefits are welcome (Box 1, Avram et al., (2015)).

### **Box 1. Unemployment benefits: main characteristics and planned reforms**

Unemployment insurance benefits are paid to unemployed persons registered with a regional labour exchange who have not received from the labour exchange any job offer in line with their professional or occupational qualifications and health status or any active labour market measures.

#### ***Current unemployment insurance system***

- The duration of the unemployment insurance benefit depends on the number of years for which unemployment insurance contributions had been paid before registration with the labour exchange. The duration of support is at least six months for unemployment insurance contributions of less than 25 years, and a maximum of nine months for a contribution of 35 years and over.
- The level of unemployment insurance benefits consists of two parts – a fixed part and a variable part.
  - The fixed part of the unemployment insurance benefit is the amount of income eligible for state-supported income which is the reference for social benefits (set at 102 Euros since 2008).
  - The variable part of the unemployment insurance benefit is equal to 40% of the former insured earnings and is reduced by 50% after three months.
  - The unemployment insurance benefit paid during each of the above periods may not exceed 300 Euros.
- The required length of the contribution to unemployment insurance is 24 months during the previous 36 months.

#### ***Main planned changes to the unemployment insurance system***

- The constant part of unemployment benefits will be computed based on a minimum monthly wage (at 30%). This would strengthen the link between labour market insurance and wage developments. Currently, the level of the state-supported income is the basis for social assistance and is determined by political decision.
- The variable part of the benefits will increase: it will be equal to 50% of former earnings during the first three months of an unemployment spell and then be gradually reduced to 40% between the fourth and sixth month, and to 30% between the seventh and ninth month.
- The duration of unemployment insurance would be nine months.
- The eligibility rights will also be extended by reducing the required length of the period of contribution to unemployment insurance to 12 months during the last 24 months.
- The benefit ceiling is set at 75% of the average wage.

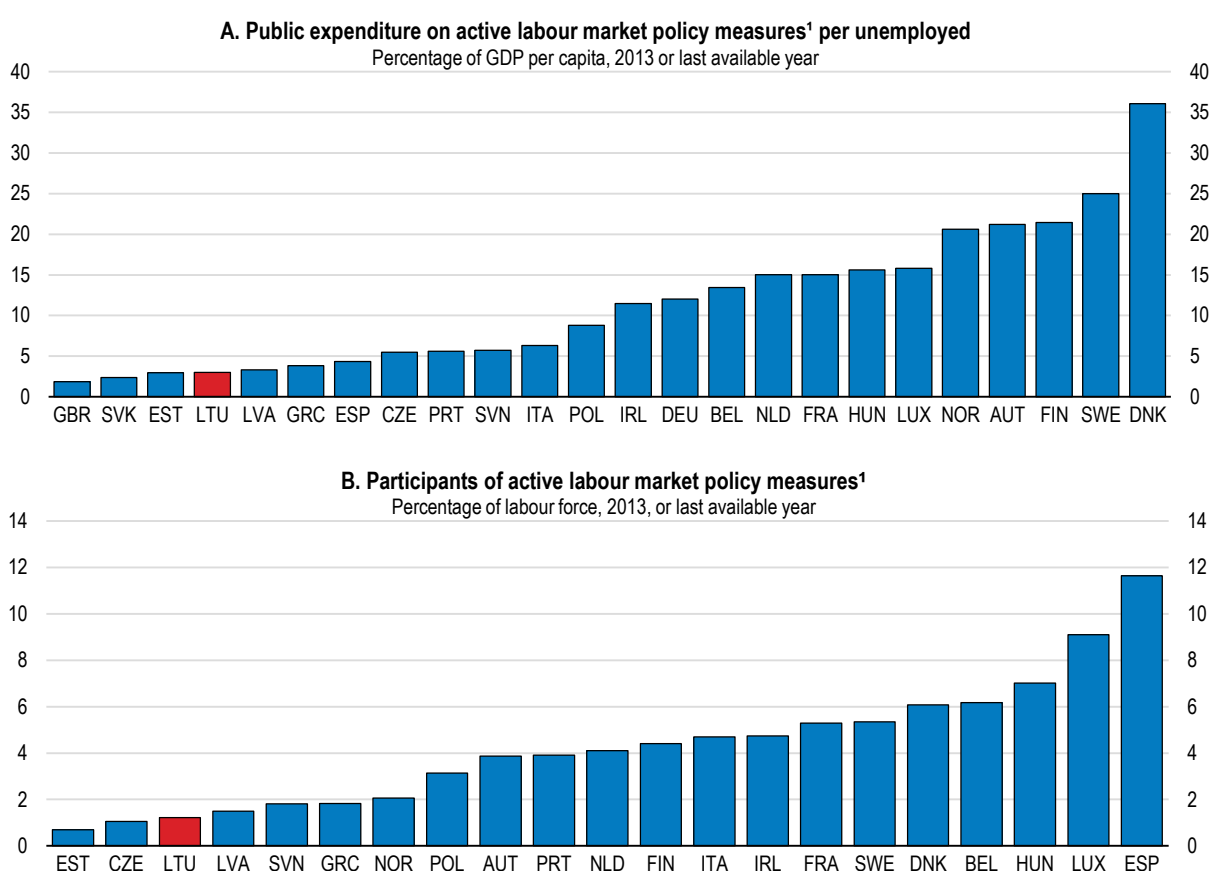
Source: Ministry for Social Security and Labour

### ***Strengthening public employment services***

20. Reform of the social model according to flexicurity principles requires effective employment support policies. This is the third side of the flexicurity triangle, along with flexibility and income security. Effective employment services are instrumental in keeping spending under control and critical in helping the most vulnerable groups in the labour market get jobs. In particular, long-term unemployed account for 45% of the unemployed, which suggests that a large share of unemployed will not reintegrate into the labour market as growth accelerates but require specific attention to tackle the barriers to their

employability. Low-skilled men who benefited from many job opportunities associated with the housing boom require specific attention as they were particularly hurt by the recession and may be more discouraged given the mismatch of their skills with the needs of the labour market. This is a source of concern given the high level of structural unemployment at around 10-12% (Ebeke and Everaert, 2014). Spending in active labour market programmes does not meet the challenges as it amounts on average to only half the resources devoted by other OECD countries (Figure 11, Panel A). In addition, investment in that area has been reduced compared to the pre-crisis period (OECD, 2015a). This results in low participation in labour market programmes (Figure 11, Panel B). Significantly, raising investment in ALMPs and PES is key for Lithuania and should be viewed as an investment with long term returns as recent studies highlight that some programmes can be even self-financing in the long term (Brown and Koetti, 2012).

**Figure 11. Active labour market measures are insufficient**



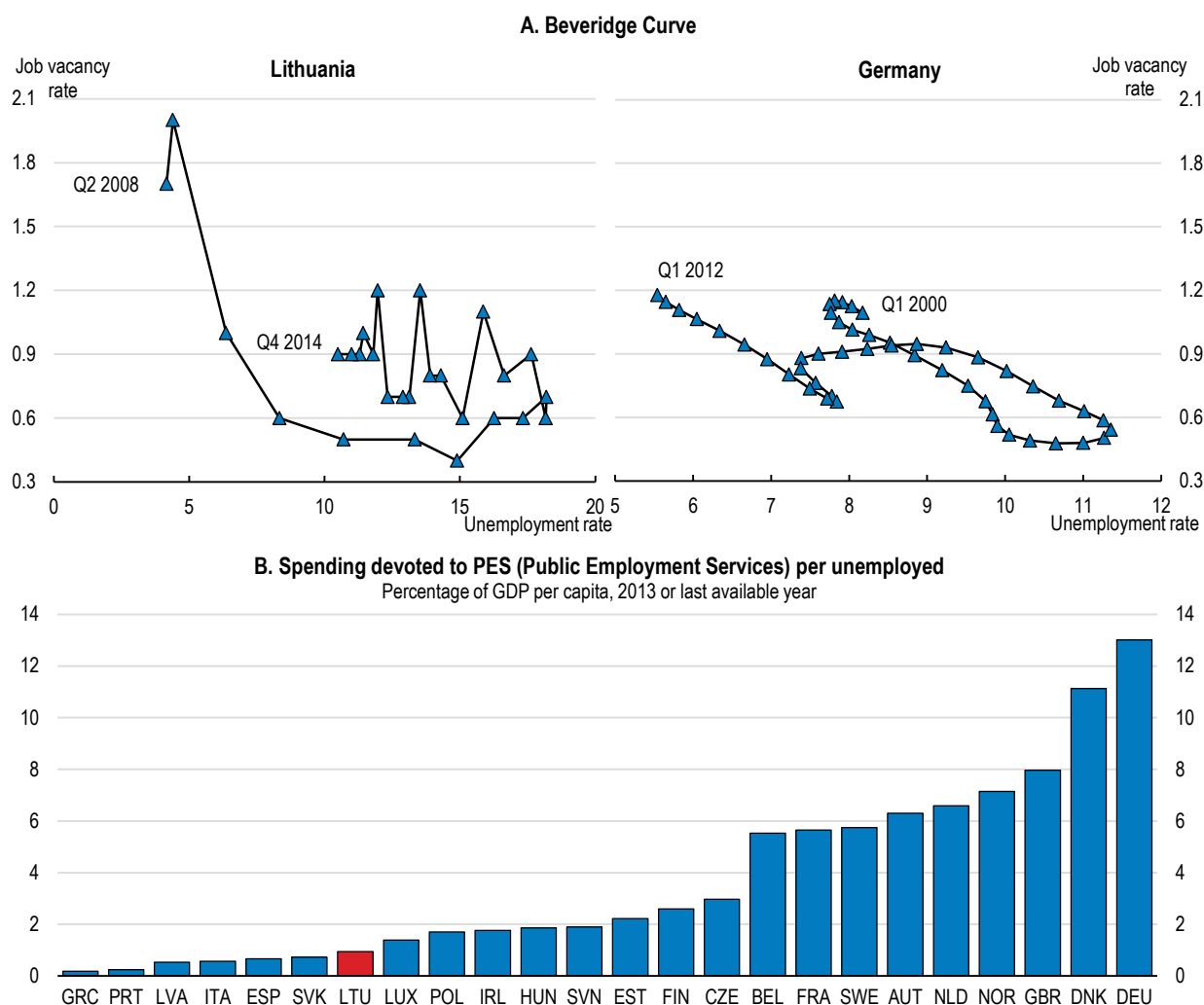
1. ALMP measures (categories 2-7) cover training, employment incentives, supported employment and rehabilitation, direct job creation and start-up incentives.

Source: European Commission, Labour market policies database and OECD Economic Outlook 98 database.

21. Public employment services are understaffed. The caseload of officers dealing directly with jobseekers increased from 141 in 2008 to 300 in 2013 (European Commission, 2014). Such a caseload does not allow an officer to offer personalised services, such as individual interviews and updated action plans over the unemployment spell, although this has proved critical for increasing outflows from unemployment and improving the matching between job seekers and jobs (OECD, 2015b; Card et al, 2015). Germany's experience suggests that the cost of additional workers (the caseloads in 14 PES services

was reduced to an average of one officer per 80 job seekers) may be offset by reduced expenditures for benefits due to lower skill mismatches and a decline in unemployment periods longer than 10 months (OECD, 2015b; OECD, 2012; Figure 12).

**Figure 12. Public Employment Services don't have the capacities to tackle high skills mismatch**



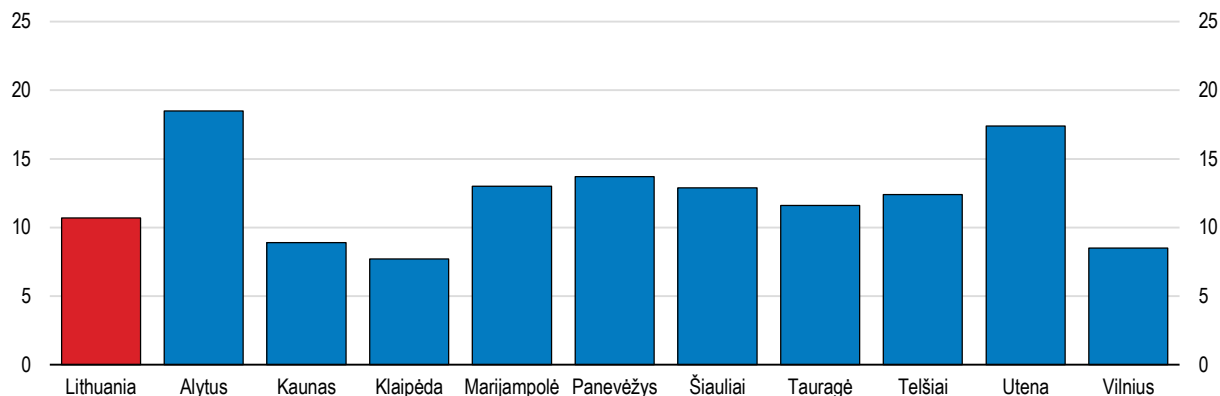
Source: OECD calculations based on data from Statistics Lithuania; OECD Employment Outlook 2014, Figure 1.6; European Commission, Labour market policies database; OECD Economic Outlook 98 database.

22. High regional disparities in unemployment add to the challenge, and risk providing unequal support to the unemployed depending on the labour market situation at the local level. Regional disparities in unemployment are reflected by a difference of 10 percentage points between the most dynamic and the lagging regions. The unemployment rate varies between 7.7% in Klaipeda county and 18.5% in Alytus county (Figure 13). Strengthening the capacities and resources of PES in rural areas is therefore critical. Some interesting experiences have been noted, for instance in the Kaunas region where specialists were gathered in a taskforce working in remote areas (“Mobile groups”) whose goal was to identify the main drivers of unemployment and to stimulate regional mobility of job seekers (OECD, 2015a).



**Figure 13. Regional disparities in unemployment are high**

Unemployment rate by county, % of labour force, 2014



Source: Statistics Lithuania.

23. On the positive side, Lithuanian PES has been very effective at developing e-services. Providing information on job vacancies and jobseekers' profiles is a critical part of the matching process. And recent tools such as an online vacancies database, Facebook profiling and counselling through Skype may help. The former covers three quarters of job openings; this is an important achievement in line with best practices, for instance in Germany where 50% of all vacancies are reported in PES (OECD, 2015a).

#### *Promoting the most effective employment support programmes*

24. Spending on ALMPs should be further regularly monitored and evaluated in order to target resources on the most effective programmes. To increase their effectiveness, international experience suggests that programmes should be tailored in line with country-specific characteristics. This requires strengthening a culture of evaluation based on the implementation of regular ex-post studies and pilot projects. Comparison with international best practices already suggests some directions for reforms.

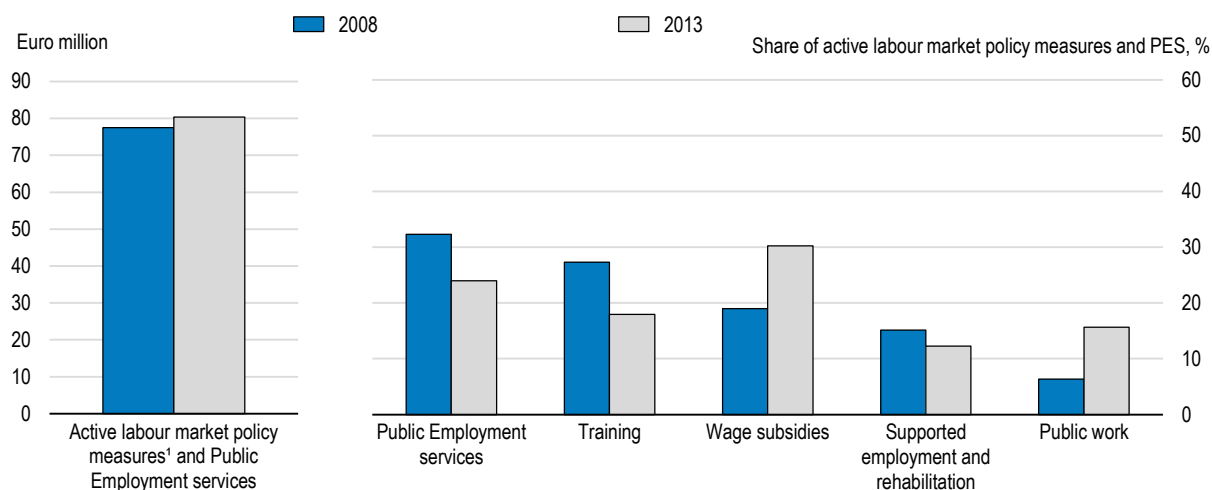
25. Wage subsidies are the most important ALMP programmes in Lithuania (Figure 14). They are an important tool to promote the employability of low-skilled workers in the short term by bringing their labour cost in line with their productivity level. International experience suggests that they are effective at bringing people into the labour market, but they may have only short term effects and come with large deadweight losses, i.e. when hiring would have occurred without the subsidy (Kluve, 2010; Boone and van Ours, 2004). The cost effectiveness of wage subsidy programmes could be improved and potential deadweight losses reduced for instance by targeting wage subsidies to the most vulnerable youth rather than youth in general like in the programme "Support for the first job".

26. Training and re-training programmes help adapting the skills of workers and jobseekers to the needs of the labour market and to technical change. Evidence, however, is mixed on the effectiveness of such programmes to improve labour market outcomes. Training may reduce unemployment outflows in the short term as individuals engaged in such programmes reduce job-search activities, but in the medium-long term, effects have been found to be positive in particular on the quality and stability of the job found (Card et al. 2015; Wulfgram and Fervers, 2013). Training programmes account for 24% of ALMP spending compared to 41% on average in the European countries and even 75% in Germany for instance. A new voucher programme, implemented in 2012, will further promote training activities thanks to greater flexibility, allowing the trainee and the employer to choose the training provider. The efficiency of the new

training programme is high; 90% of people following vocational education found a job within six months, compared with 53% before (EC, 2014). However, care should be taken to avoid a selection bias resulting in low support for the unemployed who are most in need. Progress has been made in this area: long-term unemployed accounted for 20% of participants in training in 2013, compared with 9% in 2012 (NRP, 2014).

27. Public works programmes contribute to alleviating the poverty of individuals with poor employability and to maintaining social inclusion by providing income equivalent to the minimum wage, which is higher than social assistance. However, evidence suggests that their effect on employability for a regular job is limited (Card et al, 2010; OECD, 2009). Nevertheless, such programmes proved particularly useful during the last crisis, when job creation was low. In good times, such a programme maintains a link with the labour market for the most vulnerable and is rightly targeted at the long term unemployed (58%) and the jobless older than 50 (NRP, 2014). Mixed evidence regarding their potential effect in the long term suggests there is scope to reduce them further in favour of programmes that increase employability, such as training.

**Figure 14. Distribution of spending by active labour market policy measure and services**



1. ALMP measures (categories 2-7) cover training, wage subsidies, supported employment and rehabilitation, public work and start-up incentives.

Source: European Commission, Labour market policies database.

### **Making social assistance more effective at reducing poverty and at returning to work**

28. With an underdeveloped unemployment insurance system, social assistance is a key component of the social protection system in Lithuania. Following the 2009 global financial crisis, the number of social assistance recipients increased significantly, to 5% of the population in 2014 after a peak at 6.7% in 2012. At the same time, the number of unemployment benefit recipients remained broadly constant, at about 3½ per cent and half the poor are still not covered by social assistance (see Figure 15, Panel A below). The level of social assistance benefits constitutes another challenge: at less than half the poverty line (measured at 60% of the median income), it is currently insufficient to alleviate poverty. This situation suggests room for better designing support for out-of-work individuals. A reform of the social assistance system, therefore, appears complementary to the reform of the social model currently being debated in Lithuania. In particular, extending the coverage of the unemployment benefit system, as planned, would

provide room for better support to the most vulnerable. This section provides directions for additional reforms that could complement the implementation of the flexicurity model in Lithuania.

### *Strengthening minimum income scheme*

29. During the crisis, the social assistance system was effective in providing a last-resort buffer as reflected in the better coverage and the higher contribution of benefits to support consumption of the recipients and lower leakage of the benefits to non-poor:

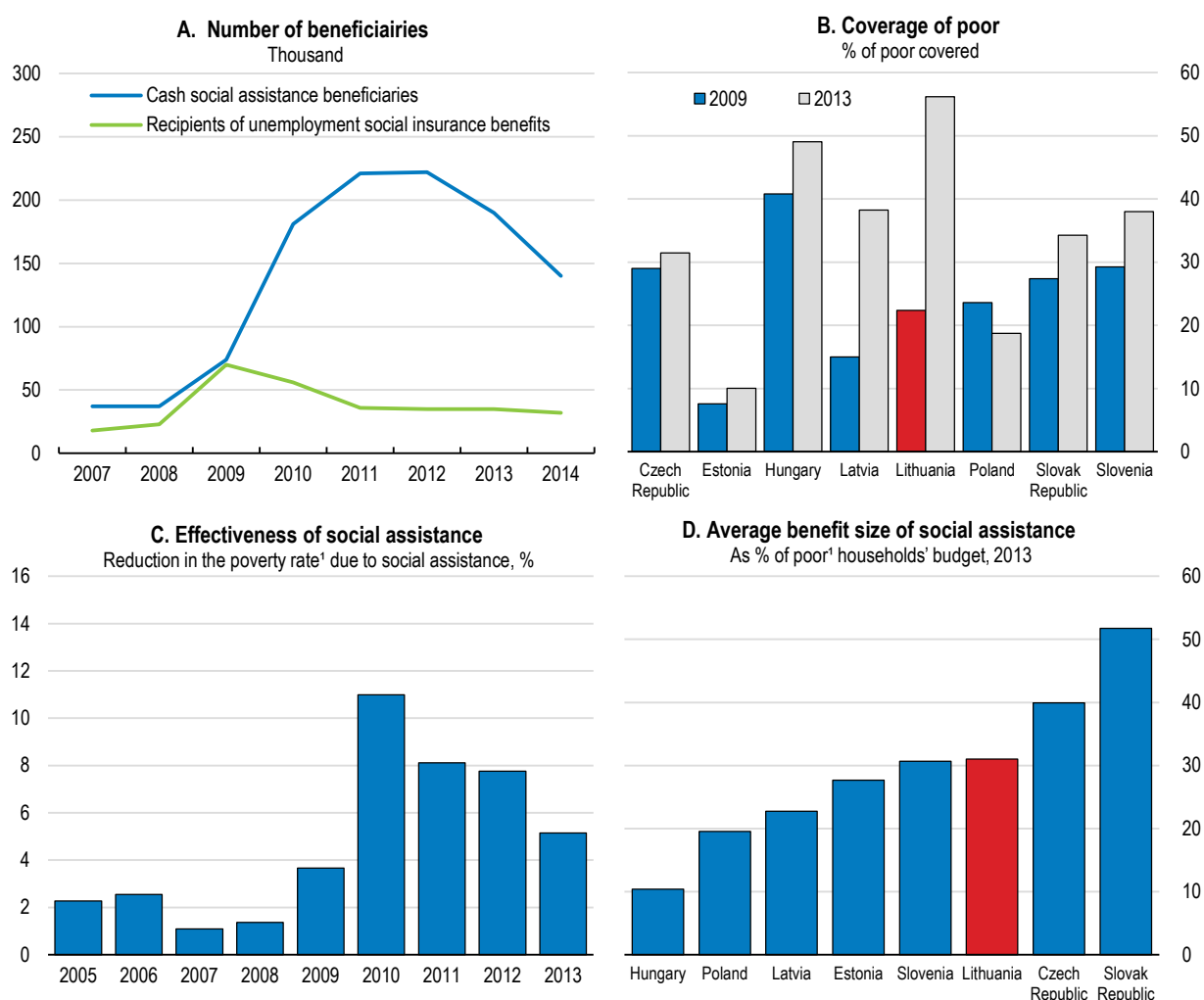
- Eligibility for, and the level of, social assistance benefits are determined by the level of income compared to the Social Income Support (SSI), which sets the maximum level of benefit (Box 2). Increase in the coverage since the crisis has been driven by the increase in the level of SSI just prior to the crisis, combined with the fact that the crisis has pushed more poor below the minimum income threshold below which individuals are eligible (see Table 1; Figure 15, Panel B).
- Similarly, the contribution of social assistance benefits to reduce the poverty gap has increased as the median income of the poor declined: from 9% of the gap on average between 2004 and 2008 to almost 21% in 2012. Social assistance benefits have made an important contribution to support the subsistence needs of the poor: benefits accounted for less than 20% of the poor budget on average between 2004 and 2008, and constituted more than 30% in 2012 after peaking at 40% of the budget in 2009 (Figure 15, Panel C and D).
- The efficiency of the system has also improved. Leakage of support to non-poor has been reduced from 50% in 2005 to 30% in 2012 (Avram, 2013).

**Table 1. The level of the minimum income benefit is low**

SSI:	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Minimum Income (in EUR)	39.1	39.1	47.8	59.4	82.5	101.4	101.4	101.4	101.4	101.4 <sup>1</sup>
Poverty line at 60% median income in EUR, per month	102.9	126.7	163.8	205.6	235.8	201.5	192.9	216.9	234.9	241.2
Ratio, %	38.0%	30.9%	29.2%	28.9%	35.0%	50.3%	52.6%	46.8%	43.2%	42.0%

1. Poverty line calculated each year at 60% of the median equivalised income

Source: SSI based on Resolution of the Government of Lithuanian Republic "Dėl valstybės remiamų pajamų dydžio patvirtinimo"; OECD calculation.

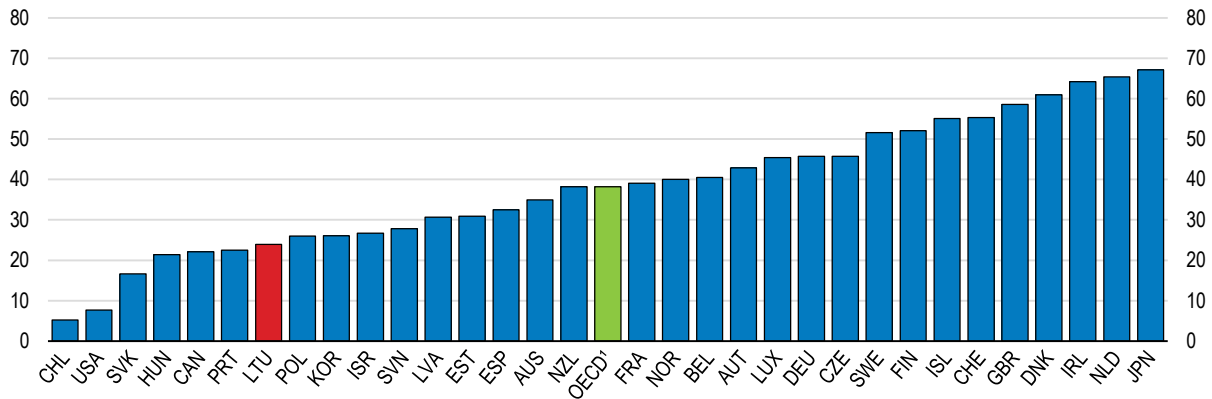
**Figure 15. There is room for providing further protection against poverty**

1. Poverty line calculated each year at 60% of the median equivalised income.

Source: Ministry of Social Security and Labour; Avram (2015), (2013) update based on EU-SILC data. Lazutka (2014a) for Panel A.

30. However, the social assistance system does not provide a sufficient level of income to significantly alleviate poverty. The maximum level of benefits is 24% of median income, compared with 40% on average in OECD countries (Figure 16). This is below the absolute poverty threshold estimated just before the crisis by Zabarauskaitė (2008), which according to the latest estimates by Lazutka (2015), covers only food expenses. In addition, the benefits fell over time for long term recipients (Box 2). This decline is unusual by international comparison as minimum income benefits are typically designed to meet some subsistence needs, which do not depend on the receipt duration. The lack of indexation of benefits adds to the challenge, because the fixed level of state-supported income since 2009 implies a falling support in real terms, though so far this effect has been limited by subdued inflation. All in all, there is scope for increasing the level of benefits accompanied by stronger employment support programmes.

**Figure 16. The level of minimum income is comparatively low**  
 Net minimum income value in % of median household income, 2013



Note: Data for single person, no child, qualifies for cash housing assistance.

1. OECD median.

Source: OECD, Tax-Benefit Models.

**Box 2. Main characteristics of the social assistance programme**

A social assistance benefit is means-tested and paid if the value of the property does not exceed that of the average set for the residential area and if the monthly income is below the level of state-supported income (SSI). Additional conditions on wealth are also set.

The social assistance benefit for the poor is equal to **100%** of the difference between the state-supported income per person per month and the actual income of a family (persons living together), 80% of the difference for the second member and 70% for third and any additional family member. Before 2012, 90% of the SSI income was applied for all members of the family.

Since 2012, the social benefit has been reduced for those beneficiaries who are entitled to it for periods longer than 12 months. There is a 20% reduction if the social benefit is paid 12-24 months; a 30% reduction for 24-36 months; a 40% reduction for 36-48 months, and a 50% reduction for 48-60 months.

The social benefit is not paid for a period of 24 months if the person was entitled to the benefit for more than 60 months (except social benefits paid for children, as well as adult children who study according to the general education curriculum and within the period of completion of the general education curriculum until 1 September of the same year).

Benefits recipients have to register at the local public employment service.

Social assistance system is administrated and funded by municipalities since 2015.

The administration of the municipality has the right to refrain from reducing the amount of the social benefit, provided that the local labor exchange office of Lithuania or the national employment service of another state does not offer a job or participate in the active labor market policy measures during the period when the social benefit was being provided.

Workfare programmes have been established and require social assistance benefit recipients to work for the municipality (40 hours per month).

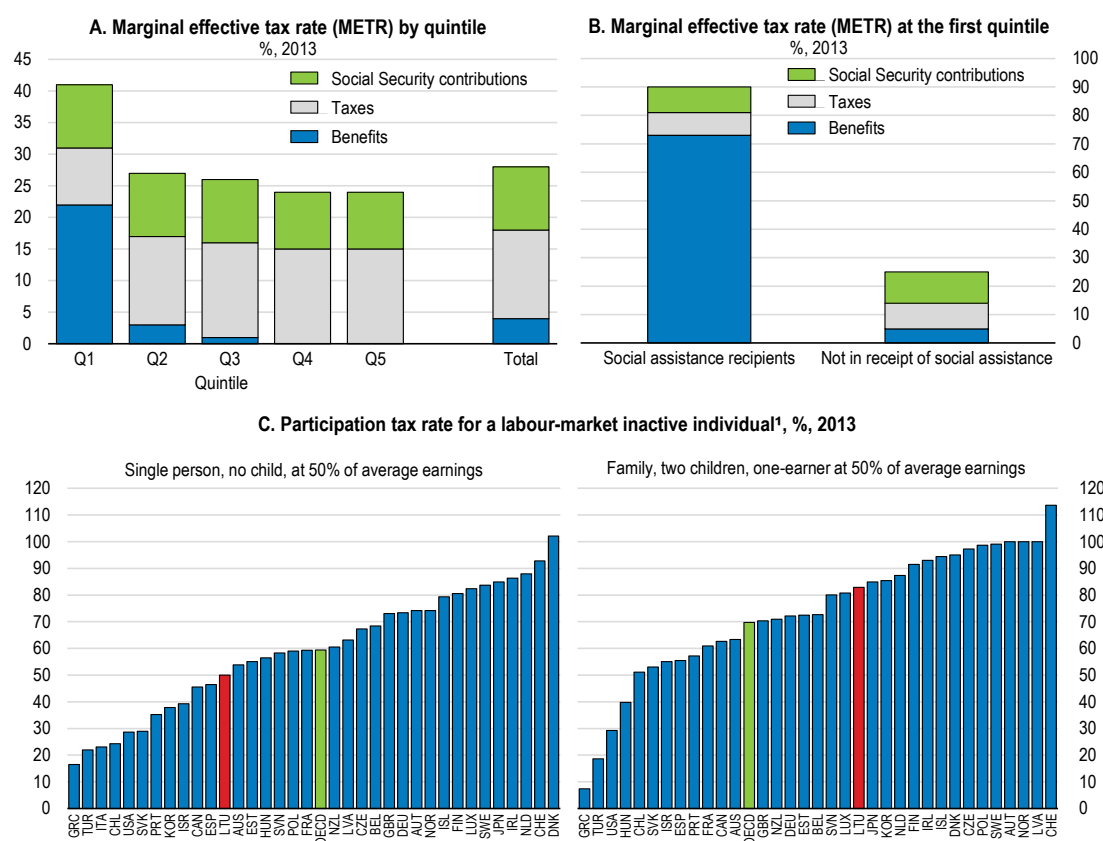
In-work benefits were introduced: they are 50% of previous benefits for six months after long-term unemployment.

Source: Lazutka (2014b) and Ministry of Social Security and Labour (2015)

### Improving financial incentives to take a job

31. Increasing the level of benefits to better protect the poor should not undermine the financial incentives to seek a job. The low level of benefits in Lithuania generates substantial financial incentives to work. However, the full withdrawal of benefits upon taking a job generates financial disincentives. This is in practice equivalent to taxation at 100% of the additional income up to the level of benefits previously received. This effect is strong in Lithuania where the effective taxation at the bottom of the distribution has been found to be higher than for other quintiles (Figure 17; Navicke, 2015, Lutzka and Poviliunas, 2010). In addition, an automatic withdrawal of benefits combined with a low level of support may also generate incentives to complement social assistance support by income drawn from non-formal activity. The establishment of in-work benefits for long-term unemployed recipients of social assistance has contributed to reducing those perverse effects (Box 3). However, the duration of the in-work benefit is limited to six months and it covers only social assistance recipients who were previously long-term unemployed. Extending the duration and the coverage of in-work benefits should be considered by the authorities as long as it is accompanied by strong job search and re-employment programmes.

**Figure 17. The financial incentives to take a job are lower at the bottom of the income distribution and for large families**



1. Average effective tax rates measure the extent to which taxes and benefits reduce the financial gain of moving into work. The estimates here relate to the situation of a person who is not entitled to unemployment benefits (e.g. because their entitlements have expired). Instead, social assistance and other means-tested benefits are assumed to be available subject to relevant income conditions. Where receipt of such assistance is subject to activity tests (such as active job-search or being "available" for work), these requirements are assumed to be met in the out of work situation. Cash housing benefits are calculated assuming private market rent, plus other charges, amounting to 20% of the full-time wage for all family types. The percentage of AW relates to the earnings from full-time employment of the individual moving into work.

Source: Navicke, 2015; OECD, Tax-Benefit Models.

### Box 3. Making work pay - In-work benefits schemes in OECD countries

#### Objective

In-work benefits strengthen incentives to work by widening the income gap between working and non-working. They are typically targeted to low income groups and therefore have to be phased-out at higher earnings level. They may reduce the incentive for recipients to work more hours and move to higher paid jobs. However, the positive effect on the extensive margin (taking up a job) is typically found to be higher than the potential negative effect on the intensive margin (reducing the hours worked). Furthermore, such benefits may reduce the incentive to underreport wages.

In-work benefits may have important distributional effects by reducing in-work poverty and inequality. This is particularly effective when wages inequality is high because targeting is easier. Because of the desirable effects on incentives to work, it is a cost-effective instrument, compared to other types of income transfers.

#### Design

In-work benefits can take several forms including a lump-sum payment, wage related transfers or a tax credit. Different designs exist depending on the objective, reducing the poverty at the family level while increasing incentives to work or increasing mainly the incentives to work for inactive or unemployed individuals.

The amount and phase-out criteria have a strong effect on behavior:

- In-work benefits associated with additional earning income can provide incentives to take up a job for complementary earning but results in a disincentive to work longer hours.
- Steep phase out may imply that working more does not pay; for instance the net income of a German single parent has been found to be similar if she earns 15% or 60% of the average wage.

The duration varies depending on the objective:

- Transitional benefits paid for a limited period after being hired (e.g. Australia, Belgium and Canada). They aim to increase the transition to employment.
- Permanent benefits can be paid, as long as the recipient meets the eligibility conditions (e.g. Belgium, Finland, Germany, France, United Kingdom). They can take different forms such as a tax concession, social security contribution exemptions or a refundable tax credit. Compared to transitory benefits, they have more pronounced effects on in-work poverty and distribution.

#### Size of the potential effect

A 1% change in the income gap between working and non-working is on average found to increase participation by 0.2%. This elasticity is found to be higher for women and lone parents, estimated to be between 0.3 and 1. The presence of children for women and being low educated increases also the elasticity. This elasticity needs however to be taken with caution as it relies on studies covering a period of strong labour market outcomes (Immervoll and Pearson, 2009).

Previous estimates were even higher. Initial studies at the OECD level showed that reducing the METR by 20% raises the probability to move from unemployment to employment by 10%. The strongest effect was found for second earners (OECD, 2005).

The potential effect is higher when the wage level is low.

Source: Immervoll and Pearson (2009), Immervoll and Scarpetta (2012)

32. The risk of entering an inactivity trap also depends on the size of the family (Figure 17, Panels C and D). This is due to the comparatively generous equivalence scales for family members: while the support for single individuals is insufficient at 24% of median income, support for a married couple with two children reaches 42% of median income (OECD, SCOR database). As a result, moving from inactivity to a job at two-thirds of the average wage could generate a loss up to 83% of the additional income for the family while this loss is only 50% for singles (Table 2). Several options are possible to reduce this effect without undermining support for large families which could risk increasing inequalities. First, an increase in the level of the basic benefit, as discussed above, could be accompanied by a flatter scale for the family (Avram et al, 2015). Second, in-work benefits could be designed to favour the second earner who is generally more sensitive to financial incentives to the extent that childcare facilities are provided (Immervoll and Pearson, 2009; OECD, 2005; de Boer et al. 2015).

**Table 2. The financial incentive to take a job depends on family status**

Panel A. Monthly amounts of the cash social assistance benefit for households with no other resource of living

Family type	Euros
Single person	101
Single parent, 1 child	182
Single parent, 2 children	253
Couple without children	182
Couple with 1 child	253
Couple with 2 children	324
Couple with 3 children	395

Panel B. Average effective tax rate when taking a job at 67% of the average wage

	Single person	One-earner married couple	Two-earner married couple	Lone parent	One-earner married couple	Two-earner married couple
	No children			2 children		
	<b>Lithuania</b>	<b>50</b>	<b>75</b>	<b>18</b>	<b>64</b>	<b>83</b>
OECD Average	59	68	26	59	69	35

1. Average effective tax rates measure the extent to which taxes and benefits reduce the financial gain of moving into work.
2. Person not entitled to unemployment benefit but entitled to social assurance.

Source: Latzutka, 2014b, OECD, wages and benefits.

### ***Redesigning employment support policies for the most vulnerable***

33. All social assistance recipients able to work have to register in their local labour exchange office, and this is also mandatory to benefit from public health insurance coverage, which adds another strong incentive. However, PES are responsible for ALMPs and municipalities for social assistance benefits. Stronger cooperation between PES staff and social welfare officers in municipalities would improve effectiveness of return to work programmes, especially for people with significant or multiple employment barriers who may require intensive and well-coordinated support. Such partnerships, developed for instance in Ireland, Finland and Switzerland, have proven to be effective (OECD, 2013b). International



experience suggests that a multi-disciplinary working team is the best response to social exclusion, involving a social welfare officer, health specialist, psychologists and employment counsellors. Recent experience in Norway combining financial support and strong re-employment programmes for individuals at high risk of social exclusion in the context of the Qualification Programme, even though expensive, is interesting as it has increased the employment rate of hard-to-employ participants by 18% (OECD, 2015b).

34. Workfare programmes have been established to tackle the dependency of social assistance recipients on benefits and to fight fraud as workers in the informal sector should have difficulties combining their activity with municipalities' requirements (Lazutka, 2014a). Workfare programmes are targeted at long-term unemployed, non-paid and mandatory for those assigned to this programme by municipalities. As many as one-third of social assistance recipients are involved in such programmes (EC, 2015a). However, international experience suggests that their effectiveness in improving the employability of recipients is limited (Crisp and Fletcher, 2008). Municipalities should hence rather focus in cooperation with PES on engaging recipients in productivity-enhancing programmes.

35. The sanctions on social assistance recipients who fail to comply with requirements appear strict in Lithuania, but severe sanctions may exclude the most in need. In Lithuania, all of the sanctions against claimants imply either suspension for at least three months or termination of benefits (Table 3). This is severe in comparison with other OECD countries, where a reduction of the benefit is applied or, at worst, a suspension until compliance is met. Along the same lines, a failure of social assistance recipients to attend an interview would result in a termination of benefits for six months in Lithuania, but only a suspension in many other OECD countries. This suggests some room to design more balanced sanctions in line with international evidence indicating that the mere threat of relatively minor sanctions can be effective at ensuring compliance with relevant eligibility criteria (Immervoll, 2009). Drop-out of vulnerable recipients is not desirable. Imposing a strong conditionality in terms of job search on the most vulnerable who are not able to work may only lead to a reduction in those applying for benefits, making them even more vulnerable to poverty and social exclusion. Those individuals need further support through the availability of social workers and in some cases, mandatory participation in programmes that increase their employability (Box 4).

**Table 3. Sanctions against social assistance recipients who fail to meet requirements**

Missed requirement	Sanction	Duration
Failure to report change of household composition or change of income	Suspension for adults	3 months
Failure to attend work readiness interviews or training courses, to accept referrals to active labour market programmes, to accept referrals to job offers <sup>1</sup>	Termination	3 months
Received information from public controlling agencies about unreported work and/or unreported income	Suspension for adults	6 months
Failure to use all opportunities to collect income from all possible sources (e.g. alimony from parent living separately, other social benefits from social protection system)	Suspension for adults	Until requirement will be met
Failure to participate in useful for community (some kind of public work without remuneration) activities organised by municipality	Suspension for adults	Until requirement will be met

1. However, The municipality can assess the reasons for non-compliance individually and suspend the sanction.

Source: Lazutka, 2014a, Ministry of Social Security and Labour.

36. The decentralisation of social assistance, begun in 2012, gave municipalities full responsibility for administering social assistance and allocating funds. Since 2015, municipalities have also responsibilities of funding this programme. This has been accompanied by a substantial decline in the number of assistance recipients. The large differences among municipalities in the take-up of social assistance benefits by the poor, even after adjusting for labour market and demographic differences, suggests differences in the way the poor are covered despite what stated the law (Lazutka, 2014a). While decentralisation makes the system more responsive to local conditions, care should be taken that equal access to social assistance is provided. One way to ensure that no one is left behind is to establish a transparent and efficient appeals process. This would help to provide evidence on the frequency of unjustified sanctions, and on the differences in capabilities among municipalities to treat complex cases (Immervoll, 2009). Further analysis behind the decline of social assistance recipient is needed. The current monitoring of social assistance receipt patterns and benefit duration would help to provide a better understanding of the profile of social assistance recipients and benefit spells in each municipality.

#### **Box 4. Strategies for strengthening return to work of social assistance recipients**

##### **Encouraging self-sufficiency while providing adequate assistance**

- Attaching conditions to benefit recipient helps reduce benefit dependency and avoids a vicious circle of weak work incentives and low employability. However, strict eligibility conditions may lead some individuals to leave the system without being employed. This comes with several risks:
  - deeper poverty especially when social assistance plays a role of last resort income provider;
  - lower effectiveness of employment-oriented policies due to reduced access to integration measures;
  - stronger exclusion of the most in need who are willing but not able to comply with requirements.
- The notions of individual responsibility and mutual obligations are controversial when individuals face serious challenges to find paid work. A danger is to apply sanctions for not complying with work requirements to individuals who are not ready to work. International experience suggests a strong need to account for clients' circumstances.

##### **Designing effective re-employment programmes**

- Ensuring strong service capacities is key as social assistance recipients are less likely (compared to the unemployed) to succeed in an independent job search activity.
- Job search requirements backed by moderate sanctions have proven to be effective at promoting transitions to work. For instance, in the Netherlands, temporary sanctions up to 20% of the benefit in Rotterdam resulted in doubling transition rates from welfare to work.
- People who are not ready to work should be engaged in programmes that increase their employability. Mandatory time-intensive counselling in Denmark and Norway have reduced barriers to employment without generating a lock-in effect given the initial weak employability of participants.
- Effects of workfare programmes are mixed. In Germany the effect of "one euro job" is found to be weak for long term employability. By contrast, the UK New deal for young people which was based on employment in the private sector was more successful.

*Source: Immervoll, 2009b*

### **Ensuring longer and healthier life for all**

37. Better health and higher life expectancy for all Lithuanians would directly contribute to well-being, labour utilisation and inclusiveness. International experience suggests that this is a two-way causal relationship: health raises employment, but unemployment tends to worsen health (Barnay, 2014). Along those lines, health policies appear integral to an inclusive growth strategy in Lithuania. The priorities are to strengthen equity, effectiveness and sustainability.

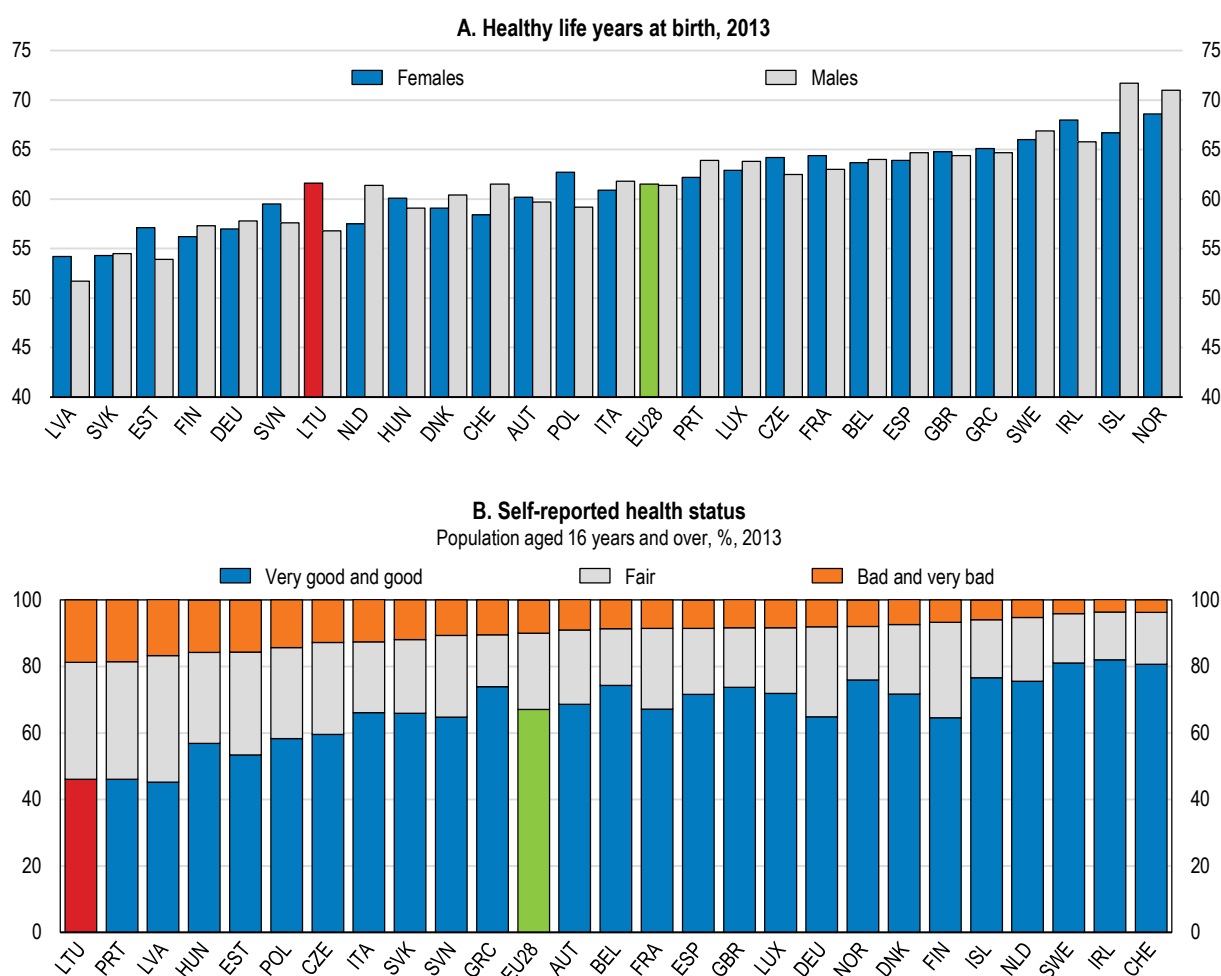
#### ***Life expectancy is low***

38. Lithuania's health care system has undergone big transformations. It has moved from a fully centralised to a decentralised system that provides full coverage of the population (Box 5). Life expectancy has increased by almost five years since 1995 and child mortality is five times lower than in 1995. The authorities have managed to bring the proportion of Lithuanians reporting unmet needs for medical care down from 7% in 2005 to 3.2% in 2012, which was below the EU average of 3.6%. The occurrence of accidents at work is also significantly below the EU average, at 1% compared with 3% respectively.

39. Despite significant progress, important challenges remain. Health issues appear to be a major source of dissatisfaction for Lithuanians when assessing their well-being (see Figure 1). Life expectancy

remains low at 74 years compared with 80 on average in OECD countries. The gender gap is the largest in the EU, with a life expectancy for men at 69 years compared with 78 in OECD countries. Poor health outcomes have a direct impact on labour utilisation as one-fourth of Lithuanians report health-related limitations to their usual activities (OECD, 2014c). Along the same line, healthy life expectancy at birth is comparatively low for men, while women perform similarly to the European average (Figure 18, Panel A). Unhealthy lifestyles contribute to poor health outcomes: one-third of men smoke daily which is 10 percentage points above the OECD average and the consumption of alcohol per capita is above all OECD countries (OECD, 2015e). Overall, less than half of Lithuanians report having good or very good health status compared with more than two-thirds of Europeans on average (Figure 18, Panel B).

**Figure 18. Health indicators suggest large scope for progress**



Source: Eurostat Health Statistics database.

**Box 5. Main characteristics of the health care system funding**

Late 1990s, Lithuania moved away from a system mainly funded through local and state budget to one funded by the National Health Insurance Fund (NHIF).

In 2012, the funding of the healthcare system was mainly based on social security contribution (58%), followed by out-of-pocket payments (32%), general government spending (9%) and private insurance (1%).

All residents and employed non-permanent residents must pay a health contribution (6% of taxable income for employees and 9% for the self-employed), plus there is a 9% payroll tax paid by employers.

The state covers vulnerable groups (children, elderly, disabled, unemployed, maternity leave), which account for about 60% of the population, resulting in a universal coverage system.

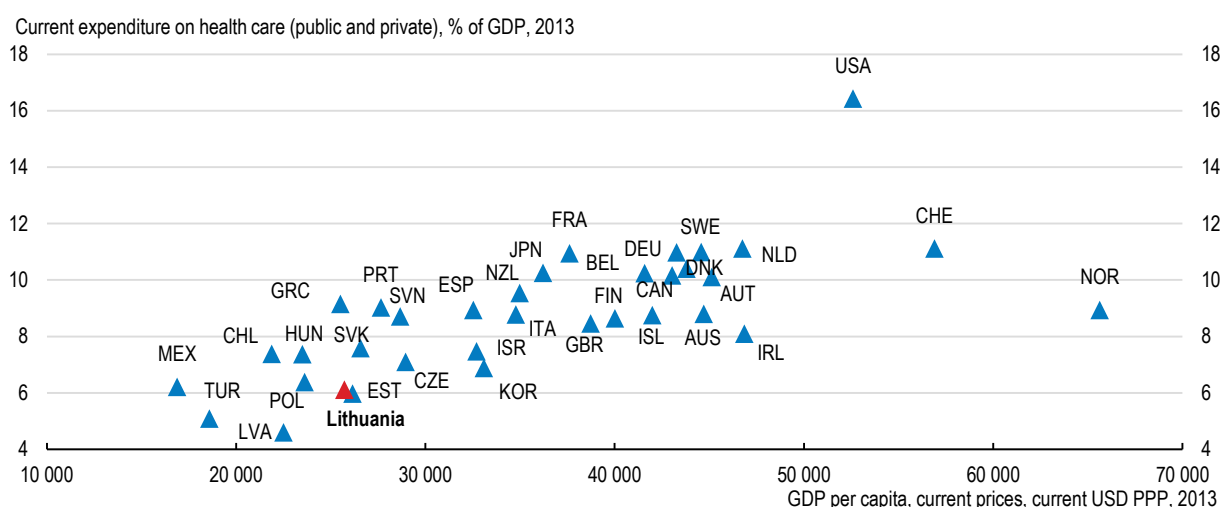
Source: Murauskiene et al., 2013; OECD, 2014c

***Improving the sustainability of the healthcare system***

40. Along with the ability of the healthcare system to improve health status, the sustainability of the system in the long run is also an important issue for Lithuania, as in other OECD countries (Pisu, 2014). The ageing of the Lithuanian population adds to the problem: according to the European Commission, public expenditures related to health care and long term care will increase by 1.8 to 4.5 percentage points of GDP by 2060 (depending on the risk scenario; European Commission, 2015b). Efficiency should therefore be improved, while keeping an ambitious target for life expectancy and avoiding short-term savings that could have high costs in the medium-long term.

41. Lithuanian spending on health care rose to 6.7% of GDP in 2012 from 5.8% in 2005. This is similar to regional peers but low compared with most OECD countries (Figure 19). Important steps have already been taken to raise the efficiency of Lithuania's comparatively limited health care spending, including through the promotion of primary care, the streamlining of the hospital network and the improvement of governance:

- Since 2001 general practitioners have increasingly helped avoid unnecessary hospitalization by acting as gatekeepers. As in other OECD countries, medical technology has reduced the need for hospitalisation and has led to introduction of day care and day surgery. EU funds have been notably used to promote those technologies (Murauskiene et al., 2013).
- The streamlining of the hospital network has contributed to more efficiency and safety for patients. A reform implemented in 2010-2011 requires regional hospitals in particular to meet two basic criteria: ensuring the implementation of more than 1 100 major surgeries and more than 300 childbirths. The number of hospitals was reduced from 8.8 beds per 1 000 inhabitants in 2000 to 7.3 in 2012. Savings made by the reorganisation of inpatient care have been used to strengthen outpatient alternatives in both primary and secondary care which increased by 30% since 2005, partly financed by EU Structural Funds (Stamati and Baeten, 2014).
- Since 2012, the financing method for hospitals is based on diagnostic-related group (DRG), which has contributed to improving cost efficiency in the hospital network as patients within each category are clinically similar and are expected to use the same level of hospital resources.
- Municipal level spending on nursing and long-term care increased during the crisis, and more geriatric services for the elderly population were introduced in 2010. Specific attention was focused on the elderly with the creation of an integrated system of diagnostic, health care, and social services, which also covered surgical operations and dental care (Stamati and Baeten, 2014).

**Figure 19. Spending in health care is low but in line with peers**

Source: OECD National Accounts Statistics; OECD Health Statistics.

42. There is still scope for further consolidating the hospital network. The density of hospital beds, estimated at 7.3 beds per 1 000 inhabitants in 2012, remains higher than the European average at 5.2 beds. The number of hospitals is also comparatively high, at 3.5 hospitals for 100 000 inhabitants compared with 2.7 on average in Europe (WHO database). Since 2015, the authorities have launched the fourth stage of consolidating the hospital network. Measures to ensure equal access to health over the territory should be complementary, with a special attention to rural areas characterised by lower life expectancy (see below). There is also scope for further promoting day care. For instance, 80% of cataract surgeries are performed in day care on average in European countries, with many countries close to 100%. In Lithuania, the number of day care cataract surgeries is closer to 20% (OECD, 2014c).

43. Improving the provision of health facilities and the quality of services requires further governance reforms to strengthen the accountability of healthcare providers and hospitals (World Bank, 2009). The authorities have made significant progress in implementing strategic planning, streamlining existing strategic plans and improving the quality of monitoring and evaluation systems. There is room to further promote the notion of open government, including by making more visible the results of policy actions, by further involving stakeholders and patients, and by further promoting the use of e-technologies in the healthcare sector (OECD, 2015c). Steps have been taken to strengthen the accountability of healthcare providers and hospitals by making information on performance publicly available. For instance, information about waiting times in hospitals has been made public and since 2012 a set of health quality assessment indicators has been collected (Medaiskis and Jankauskiene, 2013). However, an annual ranking of hospitals is not published on a regular basis. There is also scope for further promoting the use of the newly established e-health infrastructure to make it an effective instrument of communication among health care. Promoting the use of electronic records could in particular be a win-win policy that improves the quality of care while controlling spending as it helps coordination between providers, reduces the duplication of tests and allows more control over a potential harmful combination of drugs. While short-term costs constitute barriers to their utilisation, the authorities could look at the experience of Belgium and Denmark which provided incentives to doctors. More importantly, implementing such tools requires the capacity to ensure the security and privacy of patients. Specific attention should be given to those issues.

***Strengthening primary care and prevention policies***

44. Primary care could make a stronger contribution to reduce amenable mortality, or death that could be avoided by early diagnosis. Primary care services are the first point of contact with the health system for many patients. Lithuania's healthcare system during the Soviet period was based on a centralised, highly regulated and hospital-oriented system (*Semashko* organisational model). Since 1995, general practice (GP) and development of prevention services have been promoted. Since 2001, patients are required to register with GPs who act as gatekeepers and coordinators for access to health care (Murauskiene et al., 2013). Those measures have resulted in an increase in the number of family physicians from 5 per 10 000 inhabitants in 2000 to 9 per 10 000 inhabitants in 2012. The development of the primary care network has also contributed to reduce waiting times: about 90% of healthcare centres kept waiting times for consultation below 10 working days (Stamati and Baeten, 2014). The quality performance pay system also provides incentives to physicians to follow prevention policy. About 12% of physicians' earnings are bonuses paid based on indicators such as child care coverage, cancer prevention, and the number of patients visited once a year for a check-up (Jurgutis et al, 2011). However, the culture of prevention needs to be developed further. Despite progress, the Lithuanian healthcare system still relies too much on hospital care (Murauskiene et al., 2013). This is indicated by a hospitalisation rate of 22% which is higher than peers and European countries.

45. The role of nurses in preventive health could also be stronger as practiced in Finland, the United Kingdom and Canada (OECD, 2014c). This has proven efficient at reducing waiting times for minor illnesses and health prevention. In Denmark and the UK, nurses can visit patients with minor health problems and prescribe drugs. Sweden and Denmark have also created nurse-led clinics (Masseria et al., 2009). Some steps in that direction have already been taken in Lithuania. In 2010, home nursing services started treating patients with "special needs" by teaming family doctors with nurses and social care professionals.

***Reducing inequality in access to healthcare***

46. Reducing health inequality would significantly improve the well-being of the most vulnerable as well as their labour market participation. Sharp mortality differentials between various socio-economic backgrounds and difference in health status in Lithuania are a reflection of educational attainment and occupations (Jasilionis and Stankuniene, 2012). About 64% of men and 69% of women with university education assess their health as good compared with 51% of men and 40% of women with secondary education (Murauskiene et al., 2013). Individuals who are unemployed, inactive, and with an education below the lower secondary level, especially manual workers and farmers, are associated with a significantly higher mortality risk. A hypothetical exercise consisting of removing the mortality differential associated with differences in educational attainment suggests the change would mean avoiding 35% of male deaths. The effects are found to be even greater when looking at avoidable mortality linked to occupational group or activity status (Jasilionis and Stankuniene, 2012).

47. The causes of excess mortality of the lower educated are mainly cardiovascular diseases, infectious diseases and diseases of the respiratory system as well as often linked social pathologies (alcoholism, smoking, and violent deaths). This suggests the prevalence of unhealthy lifestyles (smoking and alcohol consumption), poor psychosocial conditions, and lack of access to modern medical treatment and prevention among the lower socioeconomic groups in Lithuania (Jasilionis and Stankuniene, 2012).

48. Excise taxes have proven to be an efficient tool to promote healthy behaviour. International experience suggests for instance that higher taxes have been an important anti-tobacco policy that is particularly effective among younger age groups, indicating that price signals play an important role in the smoking issue. The increase of excise tax on cigarettes, which is still below the European average, may

contribute to tackle the problem of excessive tobacco consumption in Lithuania. However, the room for further increases of excise taxes on alcohol may be limited as it is already above the European average. In addition, the effectiveness of such a tax may be reduced by the proximity to Belarus and Russia (where alcohol is cheaper) and the associated black market for alcohol products.

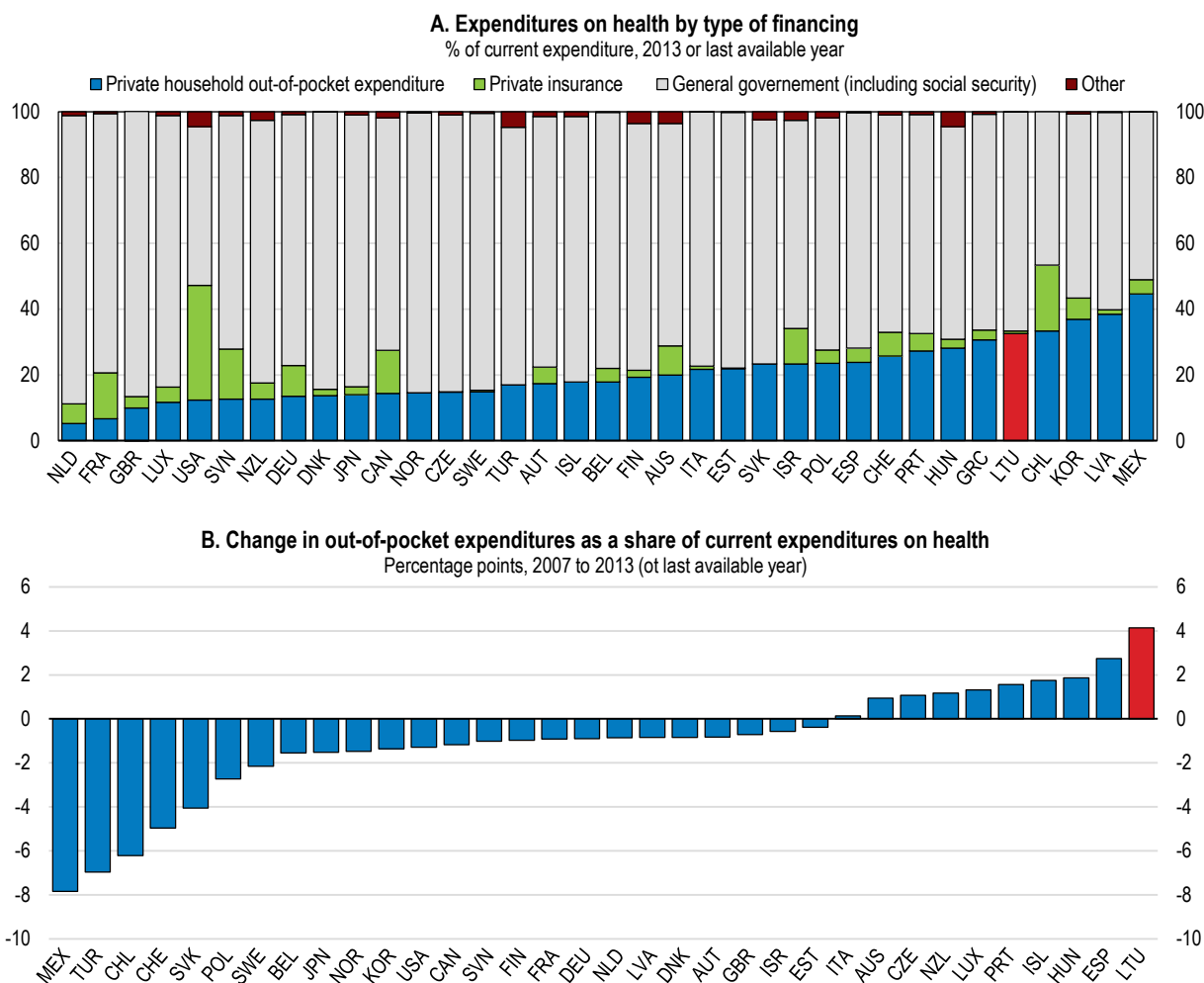
49. The access to high-quality-services in rural areas is an important priority to reduce inequality in health care in Lithuania. Life expectancy is on average three years lower in rural areas, and 23 municipalities (out of 60) have mortality due to circulatory disease which is 20% above the national average (Ministry of Health). The population in rural areas tends to make fewer visits to physicians compared with urban areas (6.2 visits per year on average compared to 10.2 visit). This is likely related to the lower density of physicians which varies by a factor of 7 within Lithuania (Murauskiene, 2013) but also to lower health literacy. The authorities are aware of these issues and have taken some action:

- The Lithuania Health Programme 2014-2025 includes the development of a monitoring system of health inequalities that will help target the at-risk population and the promotion of an integrated health policy involving health, education and social institutions. Specific actions are targeted at municipalities with the highest rate of premature mortality and population at-risk. Since January 2014, public healthcare activities have been promoted in pre-school education, general education and VET. Public health policies were also adopted in 2002 and 42 municipal public health bureaus are now in charge of monitoring and promoting health status at the local level.
- Scarcity of some health equipment may also reduce access to quality healthcare services, especially when it is associated with large regional variation. For instance in 2010, Lithuania had 5 MRI Units per million inhabitants which is half the EU average (Murauskiene et al., 2013). EU funds have made an important contribution to improve the quality of healthcare services in rural areas and to the adoption of technologically advanced facilities and equipment. With an investment in capital of 1.5 billion euros between 2004 and 2013, EU funds have been the main source of investment in the healthcare sector (Ministry of Health) and have in particular allowed bringing the number of MRI and scanners per capita at the European average (OECD, 2014c).
- During the 1990s, municipalities became responsible for providing a substantial share of primary healthcare services through primary care centres, polyclinics and the administration of small- to-medium-sized hospitals (Medaiskis and Jankauskiene, 2013). Since 2011 a return to more centralisation has been experienced by reducing the responsibility given to counties in the administration of hospitals. This reform has likely contributed to improving the quality of healthcare as the 60 Lithuanian municipalities which vary from 5 000 to 500 000 don't always have the capacity to effectively govern these facilities (Murauskiene et al., 2013).

50. The high level of co-payments which is estimated at almost one-third of health care spending in Lithuania can also contribute to inequalities in health outcomes (Figure 20). Three-quarters of co-payments concern pharmaceutical expenditures. Pharmaceutical drugs are reimbursed for certain groups of the population (children, pensioners, disabled and for patients suffering from certain diseases), but others must pay the full cost, leading to large out-of-pocket payments. Several plans have been adopted since 2009 for reducing prices and improving accessibility. This has allowed the average price of a prescription to decrease by about 13% between 2009 and 2011. The price of generic alternatives was cut by 30% and 20 generics were included among reimbursable drugs (Stamati and Baeten, 2014). Measures to reduce pharmaceutical expenditures have involved all players in the pharmaceutical market and have included setting maximum mark-ups, unifying retail prices, more permissive conditions on imports, and prescribing the exact quantity of medical products. Despite such progress, Lithuania is still among the countries that experienced the highest increase in co-payments between 2007 and 2013 (Figure 2.20). Promoting further the use of generics could help reduce out-of-pocket payments (IMF, 2015).

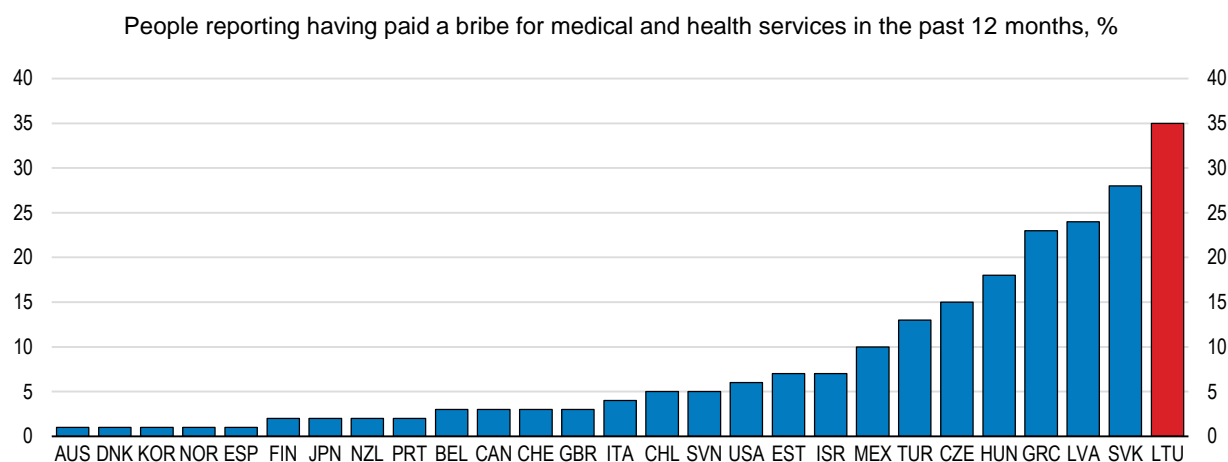


**Figure 20. Out-of-pocket payments in health care are high and increasing**



Source: OECD Health Statistics.

51. Tackling corruption is another crucial area for promoting inclusive health in Lithuania. Recent studies reported that 35% to 50% of Lithuanians have paid a bribe in exchange for health care services (OECD, 2015c, Stepurko et al., 2015, Figure 21). Informal cash payments are sources of inequality because they reflect the failure to provide a standard quality of care for all. The median value of a payment is substantial, estimated to average the annual minimum wage per year (Stepurko et al., 2015). Informal payments are more developed in inpatient than outpatient care (Murauskiene et al., 2013). Tackling corruption in the health sector is among authorities’ priorities and measures already taken have included changing behaviours by reducing tolerance to corruption and gifts; making the declaration of additional income/interest mandatory for doctors, dentists, pharmacy specialists and the establishment of a hot line to report informal payments.

**Figure 21. A large share of Lithuanians report informal payments in the health sector**

Source: Transparency International, Global Corruption Barometer 2013.

### Recommendations for promoting inclusive growth

#### Promoting more and better jobs

- Improve inclusiveness by providing in-work benefits for low-paid jobs and increasing access to lifelong learning.
- Lower employer social security contribution on low-skilled workers while maintaining their entitlements.
- Ease the legislation on employment protection by reducing the restrictions existing on individual dismissal and on the use of temporary contracts, and ensure the enforcement of the law.

#### Providing adequate support to the unemployed

- Implement the plans in the “New Social Model” to reform labour regulations and temporary income support for the unemployed.
- Strengthen active labour market programmes and the capacities of public employment services to implement programmes to get people back to work, in particular training.

#### Making the social assistance more effective at reducing poverty

- Increase the income support to social assistance recipients while strengthening work incentives.
- Extend in-work benefits to a broader range of out-of-work individuals who take a job, in particular the second earners of large families and the social assistance recipients who are currently not eligible to in-work benefits.
- Strengthen the return to work of social assistance recipients by promoting joint programmes between PES and municipalities.
- Revise sanctions against claimants to make sure that recipients willing to comply but unable to do so are not further weakened.

#### Ensuring longer and healthier life for all

- Further promote healthy lifestyles and primary care services, especially in rural areas through general practitioners, greater role for nurses and the recently established network of public health bureaus.
- Increase health sector efficiency and effectiveness of health policy by continuing to merge hospitals and widening the scope for the newly established e-health infrastructure while fully respecting privacy concerns.

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