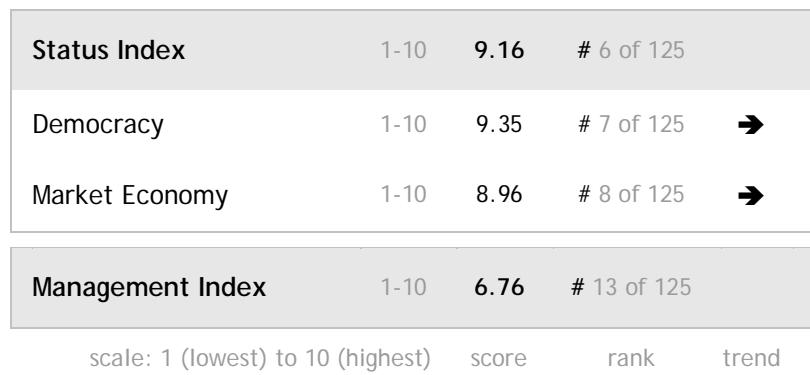


# BTI 2008 | Lithuania Country Report



This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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### Key Indicators

Population	mn.	3.4	HDI	0.86	GDP p.c.	\$	12,895
Pop. growth <sup>1</sup>	% p.a.	-0.6	HDI rank of 177	41	Gini Index		36.0
Life expectancy	years	71	UN Education Index	0.97	Poverty <sup>3</sup>	%	7.8
Urban population	%	66.6	Gender equality <sup>2</sup>	0.64	Aid per capita	\$	-

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

## Executive Summary

Lithuania's economic miracle continues unabated. With one of the highest growth rates in Europe and a marked decrease in unemployment, the country now enjoys the benefits of reforms implemented during the 1990s. EU accession in 2004 further bolstered the country's continuing economic miracle. However, inflation rates a fraction (approximately 0.1%) above the Maastricht criterion at the time of evaluation kept Lithuania from joining the euro zone as planned in 2007, although it met the other criteria within a significant margin. Although Lithuania has made headway in developing civil society, there are shortcomings that persist. Still too few Lithuanians acknowledge the potential of personal involvement in non-profit organizations or grassroots movements. Political culture in Lithuania is still evolving; political scandals have prompted many observers to question the strength of the country's civil society. Whereas the battle against corruption and a "corrupt" mentality has achieved some encouraging results, it has not yet been won. According to corruption surveys, Lithuania continues to suffer from a relatively high level of corruption in comparison with other EU states. Political scandals continue to shake the political system. Public trust in politicians has not risen; populist parties are still able to get many votes during the elections. The minority government that came into power in the summer of 2006 represents a new phenomenon in Lithuanian politics, which has, since 1990, seen only governments with a majority in parliament. Compared with the political system, the economic system is showing significantly better performance. This is certainly good news, as democracy needs the pillars of a socially responsible market economy. A new challenge for the years to come is to halt the emigration of the young, highly educated labor force to other EU states. Between 2001 and 2005, around 126,000 people left Lithuania, and between January and December 2006, 9,500 persons officially emigrated from Lithuania. To increase Lithuania's attractiveness for these professionals, the domestic conditions for a knowledge-based economy must be further

improved. If economic development is to be sustained, further structural reforms in areas such as education and health care are needed.

## History and Characteristics of Transformation

Lacking not only the structures for transformation, but also statehood itself, Lithuania began completely anew in 1990. Occupied and annexed by the Soviet Union in the 1940s, Lithuania was a Soviet Republic for almost 50 years. Soviet rule had comprehensively reshaped the country, its resources, economy and above all, its people. Lithuanians often use the term “rebirth” to describe their return to statehood, which represented the starting point of transformation and set the goal of becoming a free and independent state within the community of European democracies. With accession to the European Union on 1 May 2004, and to NATO in March 2004, Lithuania has achieved the goals and aspirations it set in 1990. Because the creation of a democratic republic amounted to the end of foreign occupation, the change of the political system met with no opposition. The fight for independence and the founding of the new state provided a common popular basis of identity. The legitimacy of Lithuania’s democratic order is thus closely tied to the Baltic revolution and the victory of the independence movement that was supported by the vast majority of the population. Political transformation progressed smoothly with few problems. The population voted for the constitution in 1992, and in 1993 a multiparty system emerged, marking the successful end of the first phase of political transformation. The constitution provided for pluralism under the rule of law and established a Constitutional Court – a first in Lithuanian history. The political system has proven itself reliable. All actors have accepted transfers of power and the impeachment of President Paksas demonstrated both the viability of democratic institutions and the degree to which established rules have been accepted. However, the will of the electorate itself remains subject to fluctuations. Since 1990, no government has succeeded in winning elections and staying in power. During the Republic’s first decade, the moderately fragmented party system appeared to oppose any new challenges under the constant shifts of voter support. Since 2000, however, the situation has changed as populist parties have made striking gains. The newly founded populist Labor Party achieved 28.44% during the parliamentary elections in 2004, and even became part of the government. The coalition with the Social Democrats ended in summer 2006, when two ministers of the Labor Party resigned amid allegations of corruption. Economic transformation led to massive social inequalities and imposed severe social burdens on most of the population. The Soviet legacy has proven an especially heavy load to bear. The problem here was not merely the planned economy, but the economy’s orientation toward a system of planning defined by the regions of the Soviet Union. Some sectors of Lithuania’s industry were too large, some too small

and others almost nonexistent. Much of its technology was antiquated and several production processes relied heavily on human resources. At the start of the 1990s, the country attempted to pursue transformation without imposing heavy social costs. This strategy clearly backfired, as it initially slowed economic transformation and privatization. Like all reform-oriented states in Eastern Europe, Lithuania experienced an economic and social crisis characterized by a sharp decline in GDP and soaring unemployment figures. The worst was over by 1994. After a slump in 1999 (the “Ruble crisis”), Lithuania’s GDP has shown strong growth since 2000, unabated in the years from 2004 to 2006.

## Transformation Status

### I. Democracy

Established in 1990, the former Lithuanian Socialist Soviet Republic has evolved into a consolidated democracy by 2007. Adequately observed rules of the game for democracy have been established; these rules are ingrained and accepted within society. NATO and EU accession, in March and May 2004 respectively, symbolize the democratic achievements of the Lithuanian Republic.

#### 1 | Stateness

There is clarity about the nation's existence as a state, with adequately established and differentiated power structures. There is virtually no competition with the state's monopoly on the use of force.

Monopoly on the use of force

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

State identity

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

No interference of religious dogmas

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

Basic administration

#### 2 | Political Participation

There are no constraints on free and fair elections in Lithuania. The populace decides in free elections who rules. The municipal, central legislative bodies and the president are elected by direct vote.

Free and fair elections

There are no veto powers; leaders have the effective power to govern.

Effective power to govern  
Association / assembly rights

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

Unrestricted freedoms of opinion and of the press and the media are guaranteed by the constitution and function in practice. Private media comprise a diverse selection of print and electronic outlets. There are five national daily newspapers.

Freedom of expression

The press is investigative and is trusted by the people as a kind of “fourth” power that keeps politicians and bureaucrats in check.

### 3 | Rule of Law

There are no restraints on the basic functions involved in the separation of powers, especially mutual checks and balances. The impeachment of President Paksas in 2004 showed the working ability of the legal system.

Separation of powers

The judiciary is free of both unconstitutional intervention by other institutions and corruption. There are mechanisms for judicial review of legislative or executive acts. Above all, the Constitutional Court is highly esteemed and has a reputation for safeguarding democratic values.

Independent judiciary

The fight against corruption has intensified in recent years and now shows encouraging results. However, the level of corruption remains relatively high, despite the implementation of anti-corruption laws and institutions. In December 2005, there were even allegations of corruption against Prime Minister Brazauskas. Only the threat of resigning as a member of parliament stopped the formation of a special commission by the Seimas. Lithuania’s 2006 CPI score is 4.8. EU membership has had a positive effect on Lithuania, too. Within the EU framework, new anti-corruption programs and anti-corruption ethics were initiated and implemented.

Prosecution of office abuse

There are no restrictions on civil rights.

Civil rights

### 4 | Stability of Democratic Institutions

The ensemble of democratic institutions works effectively and efficiently. As a rule, political decisions are prepared, made, implemented and reviewed in legitimate procedures by the appropriate authorities. However, the scandals of recent years (the impeachment of President Paksas, the dubious behavior of some members of the populist Labor Party, the resignation of ministers due to corruption allegations in summer 2006) did not strengthen the image of the parliament and the political parties.

Performance of democratic institutions

All relevant political and social players accept democratic institutions as legitimate. Even the new populist groups never question constitutional democracy as the legitimate form of government.

Commitment to democratic institutions

## 5 | Political and Social Integration

The party system is fundamentally established, yet remains subject to some fluctuation. In recent years, new populist parties and leaders have achieved amazing victories. A low voter turnout and high volatility underscore the challenges to the party system that lie ahead. The polarization of the party system, previously moderate, increased rapidly during Paksas' impeachment. Despite the recent political events and scandals in Lithuania, the party system is rooted in society. However, according to popular surveys, parties are not trusted by the population. During the last parliamentary elections, only 46% of the electorate cast their vote; in 2000, almost 60% participated in the elections. There is no doubt that Lithuanians are disappointed with the behavior of the politicians and are abstaining from political participation. There is a visible trend of voter apathy in Lithuania, too. Clearly, Lithuanian parties and leaders have to win back the confidence of part of the population in the years to come.

Party system

Interest groups are growing in number. Article 35 of the constitution guarantees the right to freely form societies and associations, provided their aims are lawful. Grant-giving procedures and NGO management have been simplified, and many operational constraints have been removed. Yet, a few strong interests dominate among them, which creates the latent risk of pooling conflicts. However, some sectors of society remain under-represented due to the legacy of forced participation in organizations showing societal commitment under Soviet rule. With these experiences still fresh in public memory, some Lithuanians mistrust such organizations. Therefore, public awareness about civil society groups remains rather low in Lithuania. But as the networks and the number of interest groups grow, it appears that Lithuania is on the threshold of enjoying a close-knit network of interest groups that are fundamentally cooperative, reflect competing social interests and tend to balance one another. The organizational and managerial capacities of NGOs have improved, too. Efficient project administration, good management and constituency building are increasingly viewed as key elements of sustaining an organization.

Interest groups

Consent to democracy in principle is high, and political protests tend not to call the constitutional framework into question. There is strong criticism of the daily practice of democracy and the moral and ethical values of the ruling political class. Low voter turnout in the last parliamentary election indicates that some Lithuanians have lost faith in believing they can influence the political system. Deep mistrust of the state's executive institutions is clearly another Soviet legacy. Its impact, however, is waning gradually. Institutions that did not exist during the Soviet era (e.g., the army, the Constitutional Court, the new social security system Sodra) are receiving better results in opinion polls.

Consent to democratic norms

Volunteering is a rare form of support, mainly because Lithuania lacks a strong tradition of independently donating one's time to a cause. Therefore, Lithuania has yet to achieve the status of a consolidated civic culture, but has made some headway in recent years. The country's EU membership has strengthened this development. There is a robust but heterogeneous web of autonomous groups, associations and organizations, and solid trust among the population. The legal and regulatory framework for NGOs reached EU standards.

Associational activities

## II. Market Economy

### 6 | Level of Socioeconomic Development

In principle, the country's level of development permits adequate freedom of choice for all citizens. Social exclusion is limited quantitatively and qualitatively and not structurally embedded. The GDI of the United Nations Development Program is 0.856, which ranks the country 35th in the world (2004). In recent years, much has been done to combat poverty, particularly among the elderly. The state was able to considerably raise wages and pensions. However, there are still deep rifts between urban areas and the countryside, between young citizens and the older generation. Around 16% of the population enjoy only a minimum standard of living or are at or below the poverty threshold. Fifty-seven percent of the poor live in rural areas, and more than half of the dispensable income in the countryside is spent on food. The poorest 10% of citizens share only 3.2% of income and consumption. The Gini-Index is at 31.9 (2004).

Socioeconomic barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	14,128	18,548	22,456	<b>25,625</b>
Growth of GDP	%	6.8	10.5	7.0	<b>7.5</b>
Inflation (CPI)	%	0.3	-1.2	1.2	<b>2.7</b>
Unemployment	%	13.8	12.4	11.4	-
Foreign direct investment	% of GDP	5.0	1.0	3.4	<b>4.0</b>
Export growth	%	19.5	6.9	4.2	<b>14.3</b>

		2002	2003	2004	2005
Import growth	%	17.7	10.3	14.8	<b>15.9</b>
Current account balance	\$ mn.	-720.7	-1278.4	-1724.6	<b>-1831.2</b>
Public debt	\$ mn.	2,484.9	2,120.9	2,514.1	<b>1,510.8</b>
External debt	\$ mn.	6,156.0	7,464.8	9,482.3	<b>11,200.9</b>
External debt service	% of GNI	9.3	12.2	8.1	<b>10.3</b>
Cash surplus or deficit	% of GDP	-1.3	-1.2	-1.6	<b>-0.4</b>
Tax Revenue	% of GDP	17.3	17.1	17	<b>17.5</b>
Government consumption	% of GDP	19.4	18.4	17.9	<b>16.8</b>
Public expnd. on edu.	% of GDP	5.9	5.2	-	-
Public expnd. on health	% of GDP	4.8	4.9	4.9	-
R&D expenditure	% of GDP	0.7	0.7	0.8	-
Military expenditure	% of GDP	1.7	1.6	1.7	<b>1.2</b>

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

## 7 | Organization of the Market and Competition

The fundamentals of market-based competition are functioning. The legal and institutional framework was adapted to EU standards before May 2004. The role of the state is limited to guaranteeing compliance with the rules of market competition. The informal sector plays a role. The 2006 Index of Economic Freedom for Lithuania is 2.14 (rank 23 worldwide); the country is classified as “mostly free.” Compared with 2004 (2.19), this means that only slight progress was achieved. Significant shortcomings include the informal sector: the CPI Score in 2006 is 4.8, which puts Lithuania at rank 46 worldwide. Efforts to battle corruption within the EU network are slowly beginning to show the desired effects. Burdensome regulations for establishing and running a business still hamper the market economy in Lithuania, although according to the World Bank survey Doing Business 2007, Lithuania has been ranked 16 out of 175 countries and the best among the new EU member states. Tax administration has been acknowledged as a further problematic area in the public-private nexus. The informal sector that still has a share in the Lithuanian economy can easily evade taxes.

Market-based competition

There is a coherent and effective anti-monopoly policy supported by trade policies that are consistent with non-discrimination principles. Nevertheless, there are some complaints that there is a bias in government and administration in favor of big business.

Anti-monopoly policy

Lithuania adopted the trade policies of the European Union in May 2004. The country therefore imposes unified import duties on the imports from the third countries and other measures such as non-tariff trade barriers established by the European Union.

Liberalization of foreign trade

The institutional foundation for a solid banking system oriented toward international standards has been established. This foundation includes functional banking supervision, minimum capital requirements and market discipline. Capital markets are open to domestic and foreign capital, and they are sufficiently resilient to cope with speculative investment. Scandinavian banks dominate the financial sector in Lithuania, in which foreign banks account for almost 90% of banking capital. Sophistication in Lithuania's financial sector is relatively high and increasing. Government policies do not intervene in the free flow of financial resources or the allocation of credit.

Banking system

## 8 | Currency and Price Stability

A consistent budgetary and monetary policy is one source of Lithuania's economic miracle. Lithuania has a currency board pegging its litas to the euro. The inflation rate in 2006 was 2.7%. Lithuanian hopes for introducing the euro in 2007 came to naught, because they missed the inflation criteria by a fraction (around 0.1% above the convergence criteria of 2.6%). The introduction of the euro would have been a further asset for economic development. The European Central Bank estimates a further rise of the Lithuanian inflation rate in the years to come, which is jeopardizing the introduction of the euro in the near future. The introduction of the euro is now planned for 2010.

Anti-inflation / forex policy

In some sense, the stability oriented policy experienced a psychological setback with the failure to introduce the euro. Many Lithuanians are disappointed in the rigidity of EU bureaucrats, in particular, for not taking into account the country's sound fiscal indicators, which are better than those of many euro area members, and they are disappointed in the lack of help the country has received from West European capitals. Nevertheless, budgetary discipline will remain on a high level, but some demands for an extension of public spending in social services by leftist parties are likely.

Macrostability

## 9 | Private Property

EU accession helped Lithuania, as it did in many other areas, to overcome structural deficits. Property rights and the regulation of the acquisition of property are well defined in terms of acquisition, benefits, use and sale; they are limited only by basic liberal rights. The unfinished land reform aiming to restore property rights is among the main factors that still inhibit the land market from functioning properly, although it is planned to be completed by 2008. The relative weakness of the judicial system was considered a deterrent for foreign investors trying to enforce their rights in local courts. However, with EU membership, the reform of the judiciary system has made tremendous headway. The judicial system strengthened its independence and streamlined procedures to clear up the backlog of criminal cases.

Property rights

Private companies are seen as the primary engines of economic production, and are given appropriate legal safeguards. Seventy five percent of the Lithuanian economy is in private hands, making the private sector the main engine behind the country's economic miracle. There are still some bureaucratic obstacles stemming from lower level bureaucrats. The tax administration has an especially bad reputation, although it has been clearly improving in recent years. The use of land, construction permits and labor relations are among the other relatively over-regulated areas.

Private enterprise

## 10 | Welfare Regime

There is a solid network to compensate for social risks, especially national health care. However, problems persist, particularly for those who retired during the Soviet era and for farmers, although the latter now benefit from significant EU financial support. Low pensions for these individuals, coupled with the rising prices of food, heating, public transport, etc., have had dire consequences. Pensions and wages have risen in recent years and new social safety nets accepted by the population (e.g., Sodra, the national social security system) have been established and are viable. The pension reform is expected to create long-term conditions for private social safety instruments. Nevertheless, much work still needs to be done. Family and village structures, particularly in rural areas, provide a special kind of "social welfare" not visible in standard statistics. There are several institutions tasked with compensating for gross social disparities, yet their influence still remains inadequate.

Social safety nets

There are sufficient institutions to compensate for gross social differences. The rights of ethnic and religious minorities are protected by the constitution. The access to higher education and public office is determined by one's ability. Nevertheless, socioeconomic status is a major influence on student performance.

Equal opportunity

This suggests that schools need to spend more on socioeconomically disadvantaged students. It is said that about 35% of students at Lithuanian universities receive scholarships. The Lithuanian State Science and Studies Foundation is the most important institution to establish equal opportunities. The rural population is suffering from poorer access to public services, as reflected in lower educational attainment and health indicators.

## 11 | Economic Performance

Lithuania enjoys strong output growth, driven by domestic demand and improving exports. Households benefited from substantial wage increases and a lower unemployment rate. Investment was supported by large inflows of EU funds. Notwithstanding the overall rosy picture, there are still areas in need of improvement, such as the dependency of GDP growth on low-tech exports, or the ongoing loss of productive labor to the larger EU countries (although the reduction of unemployment and emigration has been paralleled by growing employment).

Output strength

## 12 | Sustainability

Although ecologically compatible growth is considered in essential aspects of economic life, it is often subordinate to growth efforts. Awareness of environmental protection as an issue is clearly overshadowed by the economy's upswing, the change in urban areas, and the population's changing attitudes. At the state level, Lithuania complies with international agreements. Some environmental standards are even more restrictive than in the European Union, including provisions on evaluating the impact of planned industrial activities on the environment, waste recycling and defining dangerous manufacturing byproducts or practices.

Environmental policy

The state and private sector ensure a national system of education and training, a dynamic research and technology sector, and a viable infrastructure. Due to a strict budget policy, state investment in education and training, research and development is average (2004: 5.2% of GDP). Lithuania's well-educated labor force is a strong incentive for foreign investors. There are regional disparities within the country and there are shortcomings in tertiary education, which suffers from too strong a focus on quantity rather than quality. The potential for lifelong learning is still limited in Lithuania. A gradual improvement in quality and efficiency can be expected as a result of market pressures, and a natural change in staff, reforms and initiatives undertaken by individual departments.

Education policy / R&D

## Transformation Management

### I. Level of Difficulty

Lithuania lacks raw materials and is dependent on importing consumables from Russia. Another serious problem is the difference between urban and rural areas; the rural population is lagging behind in education, wages and opportunities. There is a strong gap between rural and urban areas, between modernity and tradition, the young and old.

Structural constraints

Lithuania does not have a strong historical tradition of a civil society. Before 1990, Lithuania experienced democratic statehood only once, from 1919 to 1926. However, civic engagement is now on the rise. The pervasive memory of forced participation in “social” institutions during the Soviet era slightly hinders civic involvement. Civil society has developed steadily in recent years, and the legal and regulatory framework for NGOs has improved. Since 2002, NGOs have been exempt from the profit tax; corporate donations of up to 40% of taxable profits are tax-exempt. The image of NGOs has risen in recent years among the public. Another important step ahead is the growing number of NGOs in rural areas, compensating for the lack of development between Vilnius, Kaunas, Klaipėda and the rest of the country. For example, almost two-thirds of women’s organizations (around 60) are not based in the five large cities. Another asset is that ethnic groups are becoming more and more active in the country’s civic and cultural life as well. One Soviet legacy remains dominant; a significant sector of the population continues to demonstrate distrust in all government agencies. Absenteeism from civic activities still is a traditional habit of many Lithuanians. Only a minority of the population donates to charity. Even so, a tax reform in 2003 empowered Lithuanian taxpayers to allocate up to 2% of their income tax to private or public non-profit entities.

Civil society traditions

In contrast to neighboring Baltic states, Lithuania has no ethnic, religious or social conflicts. Native Lithuanian speakers constitute approximately 80% of the population; ethnic minorities (mainly Poles and Russians) and the majority of the nation have developed a good working relationship. Some complaints expressed by minorities are aimed at reform within the system, not against the system. Minority rights are guaranteed by the constitution.

Conflict intensity

## II. Management Performance

### 14 | Steering Capability

The political leadership is committed to constitutional democracy and a socially responsible market economy. Its policies give these goals priority over short-term expediency. One of the country's clear advantages throughout the last 15 years has been the tacit agreement on the country's strategic goals among all governments. These strategic priorities were maintained through periods of crisis and stalemate. As a member of the European Union and NATO, Lithuania is committed to the strategic goals of these transnational institutions. Another example is the Lithuanian Strategy for Sustainable Development 2003-2020, which was approved in 2003 and aims to balance environmental protection, economic and social development concerns.

Prioritization

The government can clearly achieve its reform goals, although there are some restrictions focusing on over-regulation and intervention. According to the accession monitoring reports of the European Commission, Lithuania has been among the best prepared of the new EU members to implement EU norms. EU accession hastened many changes, although strategic priorities have been somewhat absent since accession, and little has been achieved in reforming higher education and science as well as health care policies. After implementing new civil and labor codes and completing judicial reform, there was some fine-tuning to laws (e.g., regarding NGOs), but the reform wave in the last years before EU accession has now come to an end. The civil service has been overhauled, but a comprehensive approach is needed to achieve more efficiency, responsibility and accountability. Decentralization is still an important theme on the reform agenda; the trend toward centralization (symbolized in the booming capital of Vilnius) is clearly visible. Given the social problems in rural areas, the local authorities should be granted more autonomy from the central administration. Public administration reform has some shortcomings that illustrate the reform process in Lithuania. The implementation of these measures has been piecemeal and sometimes contradictory. The transparency of the central government has not improved, and the bad practice of submitting draft laws and resolutions for government approval at the last moment, without properly consulting stakeholders and broader society, continues. Private enterprises complain about frequent long delays in the preparation and adoption of secondary legislation and about the quality of this legislation. The absence of

Implementation

regulatory impact assessments, despite recent government decrees requiring the evaluation of draft legislation, is another problem. Also, despite important changes made in the past few years to labor laws, they still do not allow enough flexibility. The new labor code did not change the essential nature of the detailed and extensive labor regulations. Little room is left for negotiations between the parties to reach contract agreements, which is a major flaw of strict regulations.

The ambivalence of Lithuanian policy lies within the political elite. A series of political scandals including President Paksas' impeachment, the scandal surrounding the leader of the Labor Party, Mr. Uspaskich, and some cases of corruption within the highest political echelons, shook the establishment and tarnished both parliament's and the government's image in the eyes of the voters. Only 46% of the electorate turned out for the last parliamentary elections in 2004. The political leadership showed no determination to pursue a new policy, thus fostering an upsurge of populist parties. The flexibility of the Lithuanian political system, on the other hand, was illustrated by the fact that the Social Democrats, together with their Prime Minister Brazauskas and the New Union/Social Liberals, formed a coalition with the Labor Party, thus integrating the populists within the political system. The fourth partner in this coalition is the Union of the Farmers and New Democracy. This coalition lasted until summer 2006, when it was replaced by the first minority coalition government since the restoration of independence. Lithuania's record on economic, social and administrative reforms is much better. Political actors demonstrated flexibility and the ability to respond to new challenges in these areas. Reforms here have yielded results, and the country has changed radically within the last 16 years.

Policy learning

## 15 | Resource Efficiency

The government uses most available resources efficiently. The 2002 law on public administration defines the responsibilities of public employees and those overseeing them. Comprehensive administrative reforms are still needed to enhance efficiency, responsibility and accountability in public administration. Soviet style bureaucrats that hamper the creation of a new administrative service remain at the mid- and lower levels of administration. Public officials generally seem to lack adequate capacity to interpret and explain the new business regulations. But the massive training that came with EU accession is now paying off in a growing customer orientation within public service. In addition, the Lithuanian Public Administration Institute continues to provide specialized training. The responsibilities of local government are delegated as independent functions and duties. These include municipal development, primary and secondary education, primary health care, environmental protection, social

Efficient use of assets

services and public utilities. The professional skills and managerial abilities of local officials vary significantly. Civil servants are inclined to intervene and are influenced by political connections and cronyism. During EU accession, the government focused on legislating rather than performing properly, which bred uncertainty among private enterprises and the potential for bureaucratic errors. One case in point is the tax administration. Private enterprises have criticized the administration because the tax administrators allegedly not only have unnecessarily broad powers to interpret tax laws and regulations, but apply those laws and regulations unevenly.

The government coordinates its policies effectively and acts in a coherent manner. The end of the coalition with the Labor Party came after the president dismissed two ministers of this party due to corruption allegations. This led to the resignation of all ministers of the Labor Party in the cabinet. The political strategy of the Labor Party, obviously aimed at new elections, backfired when the conservative Homeland Union backed a minority government led by the Social Democrats. However risky and unstable the new minority government may be, the political leadership succeeded in maintaining a coherent policy. Furthermore, the leadership found a way out of the possible deadlock following the Seimas election in autumn 2004 and the formation of the minority government in summer 2006. The conservatives now support a government led by the Social Democratic Party, their archenemies in the 1990s. This shows pragmatism on both sides of this old political rivalry. Generally, trade-offs between policy goals are balanced and reflect the variety of political forces and parties.

As in the report for 2005, corruption remains a serious problem in Lithuania. Lithuania has made special efforts to combat corruption. These include a National Anti-Corruption Program, a Law on Corruption Prevention, and a Law on Public Procurement. According to the Law on Civil Service, civil servants are not allowed to sit on corporate boards, represent enterprises or make contracts with related entities. But corruption is present in all layers of state governance and public administration, especially in the middle and lower tiers. After the parliamentary elections in 2004, the parliament established a new audit committee that monitors the implementation of recommendations made by the state audit office. While Lithuania has certainly made substantial progress in the fight against corruption, much work remains to be done. In connection with EU financial support (only about 50% of the population have heard about it), 17% of the Lithuanian public and 9% of public servants believed in April 2006 that corrupt deals are likely when it comes to EU support allocation priorities. Around 0.7% of the revenues are still paid in bribes (the so-called bribe tax), which is quite high. Corruption is pervasive within Lithuania's extensive regulatory system, especially in the issuance of permits and licenses. The main

Policy coordination

Anti-corruption  
policy

focus of a desirable anti-corruption policy in Lithuania is on eliminating legal loopholes, such as simplifying the issuance of permits, licenses and custom procedures, and instituting a one-stop-shop system in public institutions. Since the Lithuanian CPI is still lower than the average of 5, it cannot formally be recognized as a country where corruption is sufficiently contained.

## 16 | Consensus-Building

All major political actors clearly agree on building a market-based democracy.

Consensus on goals

Veto actors are rare in Lithuania. The most outspoken populist slogans do not criticize the democratic system in principle, but emphasize a slower, more socially oriented path. Even the Labor Party defines itself as occupying the midpoint of the party spectrum and decidedly counters any attempts to portray the party as “leftist” or (less often) “rightist.”

Anti-democratic veto  
actors

Until the Paksas scandal, the overwhelming consensus on the strategic goals to be achieved had been a key asset of Lithuania’s polity. Political divisions were contained and disagreement dispassionate. Paksas’ impeachment changed this state of affairs. The vast majority of Lithuanians, the intelligentsia, the media (except one Paksas-oriented newspaper) and the entire political class stood in defiance of those in support of the president’s narrative of conspiracy and innocence. There is a split within Lithuanian society dividing the pro-Paksas supporters and their opponents, who make up a clear majority. This rift reflects to some degree the social divisions of the country; most supporters of the impeached president live in rural areas and have a low level of education. For the first time in the history of Lithuania’s democracy, a clear rift divided the population between “us” and “them.” There is some sentiment of bitterness and distrust among Paksas’ supporters, who feel that they were deliberately excluded from the political system, and that their idol fell victim to a dirty political intrigue. The Paksas scandal led to new partnerships, as the minority government now in power, headed by the Social Democrat Mr. Kirkilas, is backed by the conservative party in parliament.

Cleavage / conflict  
management

The political leadership thus assigns an important role to civil society actors in deliberating and determining policies. Re-elected President Adamkus, who has spent most of his life in exile in the United States, is an outspoken champion of civil engagement in Lithuania. President Adamkus has repeatedly emphasized the importance of civil society over independence, free elections and individual rights. NGOs have some influence; interest groups may take part in the political process through policy advocacy, counseling and other forms of participation. Business associations, and, to a lesser degree, trade unions, are the most active and influential players in the policy-making process. The problem lies with the

Civil society  
participation

credibility of the political class as a whole in Lithuania. Riddled by scandals, unimpressed by criticism, the image of the greedy politician found its way into the public sphere. Lithuanian politics lost its credibility in the eyes of many citizens.

The relatively pragmatic view of the Soviet past has helped Lithuania to reconcile with its people in the 1990s. Historical research has shed light on collaboration and resistance during Soviet rule. Nowadays, the communist past plays no role whatsoever, with the important exception being those Lithuanians who had ties to Soviet security organs, especially the KGB.

Reconciliation

## 17 | International Cooperation

EU accession clearly proves the high regard for international cooperation among the political leadership and the population in Lithuania. In May 2003, Lithuania's population illustrated their commitment by voting 91% (63% turnout) in favor of EU accession. During Lithuania's long and sometimes painful path to EU membership, the country learned to use the support of international partners to improve its domestic reform policies.

Effective use of support

Embedded within the foreign policy of the European Union, Lithuania has earned a special role as a neighbor of the Russian exclave in Kaliningrad. The autocratic regime in Belarus is another Lithuanian neighbor on the international agenda for Lithuania. For the time being, Lithuanian policy succeeds in acting as a credible and reliable partner in international affairs, and the esteem of Lithuanian mediation is high.

Credibility

Lithuania is interested in regional organizations. Lithuania's role in the Council of the Baltic Sea States is one example: there, the country is an outspoken advocate for closer regional cooperation within the Baltic Sea area.

Regional cooperation

## Strategic Outlook

Although denied the euro in 2007, the country is nevertheless determined to introduce the European currency as soon as possible. A second denial of the euro due to higher inflation rates would constitute a major political and economic setback and would serve a serious blow to Lithuania's still booming economy. Lithuania has been able to maintain its international competitiveness, thanks in large part to its low labor costs and the growing productivity of its labor force. But it faces significant new challenges with its entry into the EU single market and with the liberalization of the global textile market. Given that Lithuania still specializes in low-tech exports and assuming that labor costs may not remain competitive for long, the country must make the leap to a high-tech and value-added economy. Lithuania has a sound financial sector, but the economy as a whole would benefit if more funds were to flow to small companies, which make up most of the corporate sector. Despite these indicators of continuing economic growth, the trend of economic emigration to other EU countries (especially the UK and Ireland) still continues unabated among young, highly educated Lithuanians. Reversing this trend is a key issue to be resolved in the near future. Another unsolved problem is the state of affairs in rural areas. The agricultural sector still employs around 16% of the labor force, and both labor and agricultural productivity are low. This is due to small farm size, pervasive uncertainty about support programs, and low levels of capital investment and complementary recurrent expenditures. Therefore the rift between urban and rural is widening rather than diminishing. This rift separates the people and their opportunities in education, career and standard of living. Although gains have been made in developing civil society, still too few Lithuanians have confidence in civic engagement. It is up to the political actors to show the electorate that they too have understood what is at stake. The rise of populist parties and a voter turnout lower than 50% are serious issues to be considered. The fight against corruption must continue. Whereas the battle against corruption and a "corrupt" mentality has yielded some encouraging results, it is far from over. Lithuanian civil society still lacks depth and a full commitment to the possibilities of modern democracy. In foreign policy, emergent issues include the development of the oil and gas sector in Eastern Europe. Russia's strong position, symbolized in the state-owned Gazprom company, must be considered by Lithuanian policy. There are some fears of being blackmailed by its neighbor to the east, and such concerns do not seem entirely unfounded.