



Project „Evaluation of Lithuanian Development Priorities in the European Union Structural Support Programming Period of 2014-2020” financed under the operational programme of Technical Assistance 2007-2013

Evaluation of Lithuanian Development Priorities for the EU Structural Assistance for the period 2014-2020

Summary of the Final Report

22 April 2009

The evaluation was commissioned at the request of the Ministry of Finance of the Republic of Lithuania under service provision contract No (1.35)-14P-041 concluded between the Ministry of Finance and Ekonominės konsultacijos ir tyrimai UAB and Public Company Europos socialiniai, teisiniai ir ekonominiai projektai in implementation of Project VP4-1.3-FM(TI)-01-V-01-004. The evaluation report was drawn in compliance with requirements of the Style Guide of European Union Structural Support Evaluation Reports prepared by the Ministry of Finance of the Republic of Lithuania.

The evaluation of Lithuanian development priorities for the EU structural assistance for the period 2014-2020 was aimed at assessing the economic development tendencies in Lithuania up to 2020 and providing proposals on structural support investment priorities in 2014-2020 in Lithuania. A need for such evaluation was conditioned by the Fourth Report on Social and Economic Cohesion published by the European Commission in May 2007, where several the most important challenges limiting the EU regional development in the mid-term perspective were distinguished: globalisation, energy security, climate change, demographical changes and social polarisation, as well as by the attempt to have a better preparation for negotiations with the European Commission on the new financial perspective and cohesion policy expenditures to Lithuania.

The evaluation was based on several methodological assumptions. First of all, the scope of the EU structural support for Lithuania in 2014-2020 was considered to be the same as in the period of 2007-2013, i.e. LTL 23 billion. Secondly, the investment expediency was estimated by the gross domestic product (GDP), i.e. by a combinations of investment areas, which would have the most effect on the GDP growth per capita. Thirdly, all Member States usually direct the received EU structural support to finance national development priorities (e.g. improvement of social, health and educational infrastructure) which are not necessary related to the GDP growth and the efficiency of which is often difficult to estimate.

The evaluation analysis employed quantitative (analysis of statistical data, quantitative modelling of economic analysis) and qualitative (interview with stakeholders, expert panel, analysis of secondary sources, SWOT) methods. The main methodological limitations of the evaluation were conditioned by a relative reliability of quantified modelling results, which was determined by long evaluation period and rapidly changing macroeconomic situation in the Lithuanian economy since the second half of 2008. In attempt to reduce these limitations additional expert panel was held where modelling results were verified and approved by expert opinion.

EU Structural Support Programming Period of 2007-2013

The report discusses three possible scenarios of the absorption of the EU structural support funds 2007-2013: inefficient, efficient and totally efficient. It was estimated that the general indicator of the EU structural support impact – the GDP growth – varied from 1.12 per cent (in case of inefficient use of funds) to 4.61 per cent (in case of total efficiency). The most likely impact was estimated in the scenario of efficient absorption – 2.12 per cent. The table below presents indicators of the EU structural assistance impact in 2007-2013 in more detail.

Table 1. Average annual macroeconomic impact of the EU structural assistance

Use of funds	Real GDP growth (billion of LTL)	Change in the GDP deflator (percentage)	Change in consumer prices (percentage)	Increase in employment (percentage)	GDP growth (percentage)	Change in private consumption (percentage)	Change in public consumption (percentage)	Change in investments (percentage)	Change in export (percentage)	Change in import (percentage)
Inefficiency	1.47	2.52	1.54	1.05	1.12	0.52	12.05	1.57	-1.53	0.63
Partial efficiency	2.79	0.50	0.41	1.78	2.12	1.67	5.64	3.07	0.57	1.06
Total efficiency	6.07	-0.19	-0.12	3.60	4.61	3.26	8.05	11.07	2.16	1.61

In case of the efficient use of the EU structural support a positive impact of the absorption of these funds is felt by all economic sectors, however, the greatest impact is on construction, transport, storage and communications, real estate, electricity, gas and water supply, education. The inefficient absorption of funds would determine relative losses for many activities (especially agricultural and industrial ones).

Despite significant changes in the Lithuanian economy, which started in 2008, there is no necessity for a radical revision of eligible areas under the EU structural support priorities 2007-2013 and funds planned for them. Given current needs and issues of the Lithuanian economy, the following key factors and their limitations, which will determine the development of the Lithuanian economy in the short-term perspective, should be distinguished:

Factors promoting economic development	Limitation of factors in the short-term perspective
<ul style="list-style-type: none"> Competitiveness of Lithuanian enterprises and foreign trade 	In the near future Lithuanian foreign trade volumes will reduce because of the situation in export markets.
<ul style="list-style-type: none"> Foreign direct investments (FDI) 	Limited attraction of foreign direct investments to Lithuania and especially to high value-added exportable areas slows down the development of the Lithuanian economy.
<ul style="list-style-type: none"> Efficient labour market (conformity of labour force supply and demand) 	Sudden increase in unemployment in Lithuania, which, according to the forecasts of the Ministry of Finance of March 2009, may reach 15.4 per cent by 2010, as well as increasing flows of economic migrants back to Lithuania will have a significant negative effect on the economic development in the short run.
<ul style="list-style-type: none"> Flexibility of the financial market and capital availability for economic development 	Limitations of the availability of financial resources have been noticed since the second half of 2008. They are likely to be temporary, however, their impact may be very important in the short-term perspective.

As a result of the two last factors (labour market and financial market) the situation has changed since the drafting of Operational Programmes 2007-2013, therefore, it is recommended to make certain reallocations to solve the increasing issue of unemployment and on order to improve the capital availability – to direct more funds to financial engineering instruments. To promote the other two factors (competitiveness and foreign direct investments) Operational Programmes 2007-2013 provide for required measures and sufficient funds, hence, there is no need for revision in the short run. On the other hand, economic changes in 2008-2010 in Lithuania and Europe may have a crucial effect on the structure of the Lithuanian economy and create new conditions (at the moment there is no possibility to foresee them), which may require to reconsider EU structural assistance priorities and funds planned for them.

Two possible scenarios of Lithuanian economic development were formulated taking into consideration the main factors influencing the development of the Lithuanian economy and impact assessment of the EU structural support.

Optimistic scenario of the country's development

The State Government immediately executes reforms: rearranges public finances and stabilises their condition; removes red-tape limitations to the business development; introduces effective investment promotion system paying special attention to the attraction of export-directed FDI; reforms public sector; develops provision of public sector services to SMEs; executes a programme of rational development of the energy sector and energy saving. Moreover, economic relations with Russia remain pragmatic; the global economy recovers rather quickly. In case of the optimistic scenario, the strengthening of the FDI flows and improvement in business expectations may be expected even in 2010. This would slow down the capital drain from the country and promote material investments. Export would start significantly expanding at the end of 2010 or first half of 2011 and the internal consumption would start increasing within a year. Lithuania's accession to the Eurozone would be possible in 2012, in case of favourable conditions – in 2011. It would give an additional positive impulse for the state's financial market and the economy in general. In case of such scenario, Lithuania would meet new phase of the EU structural assistance allocation in the growth period and possible support allocation priorities would be similar to the ones of the period 2007-2013. A need for the public sector development, infrastructure would remain, some funds could be directed to the business development and improvement of the economic competitiveness.

Pessimistic scenario of the country's development

Despite the economic crisis in the country, which requires firm actions, essential reforms of the public sector are stalled, attempts significantly to improve the investment climate fail, capital and brain drain only intensifies, and Lithuania is still unattractive for foreign investors. Due to the ongoing global economic stagnation, demand in the EU market hardly increases within several years, thus, aggravating the export development in Lithuania, meanwhile political tension in relations with Russia prevents from the effective use of possibilities provided by the market of this country. A lack of financial resources and qualified labour force significantly slows down the modernisation of production, some of Lithuanian producers do not stand competition of Asian enterprises. Emigration intensifies once again, expectations of business and households remain low. In case of this scenario, the economic stagnation in the country will continue at least until 2012 and its recovery will be slow. As a result, the EU structural assistance would be required mostly for the modernisation of certain economic sectors and improvement of the public sector. In addition, such scenario would also mean the inefficient absorption of the EU structural support funds, which would lead to a fundamental revision of the EU structural assistance priorities.

At the moment it is difficult to determine which scenario is more likely. Given the reforms executed in the country, the optimistic scenario would be more probable. However, Lithuania is still very dependent on global processes and changes in the world and Europe may condition significant changes for the Lithuanian perspective. In any case, the year of 2011 is foreseen as the year of breakeven point which will allow a more specific identification of economic development perspectives in Lithuania. It is suggested to revise the EU structural assistance priorities according to the situation in 2011. At that point the key economic development direction should be clear. It is likely that in 2012 or even in 2013 there will be favourable conditions for a substantial specification of the situation assessment and a more detail definition of the EU structural assistance allocation priorities for 2014-2020 in attempt to maximise the use efficiency.

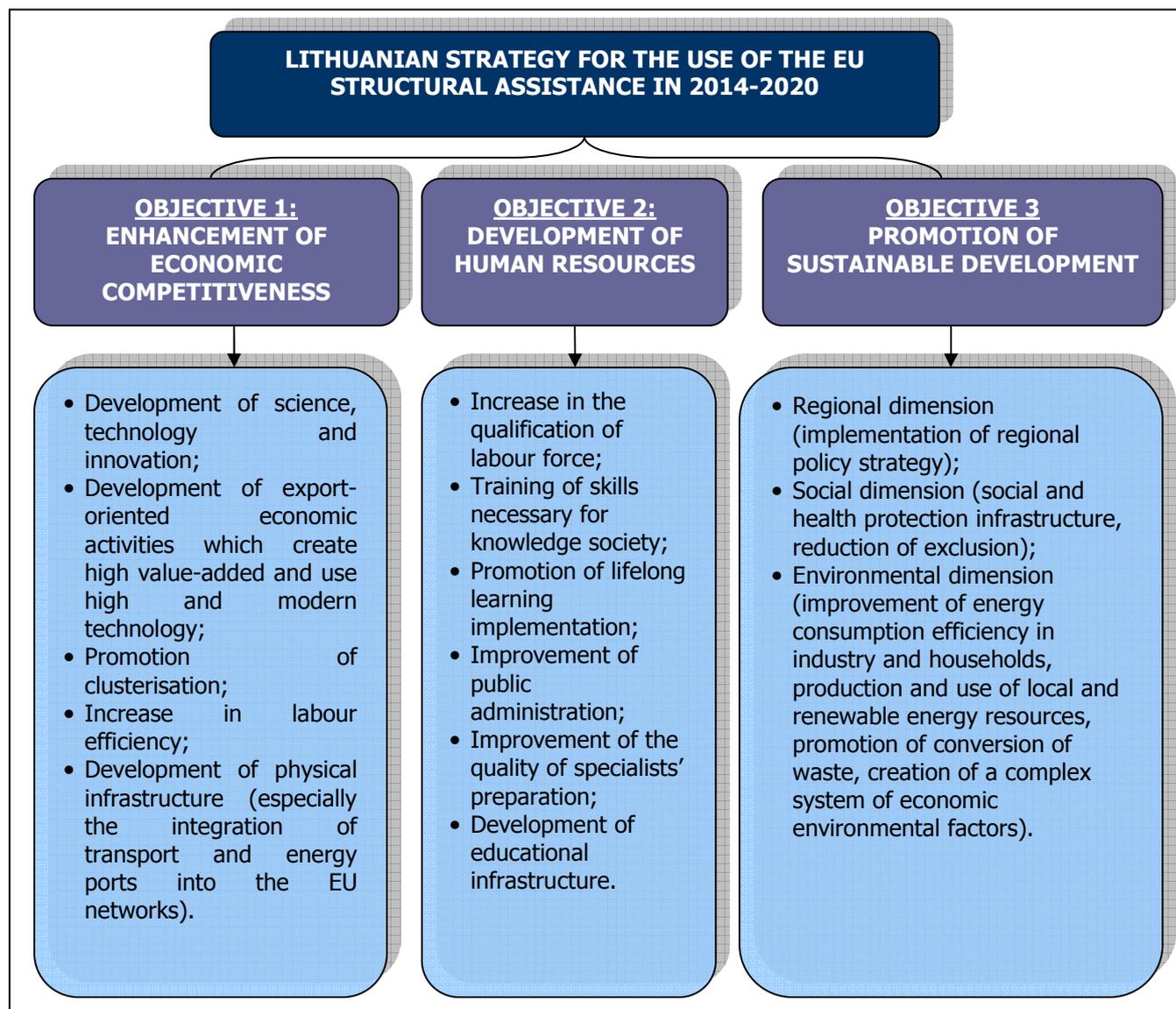
EU Structural Assistance for the Programming Period 2014-2020

Challenges, the solution of which the European Commission suggests to adapt the cohesion policy after 2013, outlined in the Fourth Report on Economic and Social Cohesion and common for all EU regions, is only partially relevant to Lithuania. The analysis carried out reveals that it will be expedient to use EU structural support allocated for Lithuania in 2014-2020 for the diminishing of two common challenges, i.e. globalisation (which can be mainly minimised by further implementation of priorities of the Lisbon Strategy) and energy. The analysis also shows a great importance of demographical challenges for Lithuania, meanwhile challenges of social polarisation and climate change will not be relevant in the mid-term perspective yet. On the other hand, in the period of 2014-2020 other development priorities, which were not distinguished in the Fourth Report on Cohesion, will be relevant for Lithuania as well. Thus, for instance, a great demand for investments is likely to be still felt in the improvement of health, education and social infrastructure, public management. Respectively in the period of 2014-2020, in attempt to find an optimal combination of the use of the EU structural assistance funds it is necessary to ensure greater flexibility of the Member States in selecting specific intervention areas in national strategies for the EU structural assistance use.

One of the key questionnaires of the study was the EU structural assistance allocation in 2014-2020. It was attempted to find the optimal option of the EU structural support distribution by applying the general equilibrium model. In this case, the optimal option is the one with the biggest real GDP growth. The modelling shows that in the event of efficient fund absorption, investments into human capital have the greatest effect on the growth in the productivity of production factors. Therefore, in case of total efficiency of funds, it would be expedient to pay attention to the formation of efficient human resources. Nevertheless, it is this investment area that is especially risky in terms of the efficiency of the fund use. As a result, the EU structural assistance priorities provided are only partially based on modelling results.

Lithuanian economic development priorities until 2020 should be focused on several directions: integration into a global economic system, global value creation chains and networks; expansion of exporting economic branches; attraction of foreign direct investments, especially of high value-added, to export increasing areas; management of demographical processes; reduction of regional socio-economic inconsistencies. Given it, the Lithuanian strategy for the use of EU structural assistance in 2014-2020 should distinguish three investment axes (similar to the ones formulated for the period of 2007-2013):

Figure 1. EU structural assistance priorities for the period 2014-2020



Source: Prepared by the authors.

For the purpose of the enhancement of economic competitiveness, first of all, threats of relevant challenges faced by Lithuania (globalisation and energy dependency) should be minimised and economic growth of Lithuania ensured. This objective is clearly related to a further implementation of the Lisbon Strategy (the importance of which will only strengthen in EU cohesion policy guidelines). In planning priorities of this objective, it is suggested:

- Paying a special attention to and using the EU structural support for the attraction of investments (especially FDI) to sectors creating high value-added and oriented to export (especially in areas related to applied researches);
- Supporting the formation or production of clusters and technology centres (innovation centres closely related to production and aimed at the improvement and installation of products, technologies and activity methods);
- Refusing and relatively reducing direct support for business enterprises in order the public intervention would be performed more via business environment improvement measures rather than via direct distribution of the EU structural support funds to specific business entities;
- When planning the distribution of the EU structural assistance, paying attention that the share of SMEs in the country's export is growing, meanwhile big enterprises more often face difficulties.

For the purpose of the development of human resources, first of all, preconditions should be created for a successful implementation of the first objective. Economic competitiveness is directly dependent on such factors as high qualification of labour force, possession of skills necessary for knowledge society, sufficiency of required infrastructure. In implementation of priorities of this objective it is essential to improve the quality of specialists' preparation, enhance infrastructure of R&D and ensure cooperation between scholastic and scientific institutions and economic entities. The improvement of public administration, especially in strategic planning, should also be one of more important priorities of this objective.

For the purpose of the promotion of sustainable development, threats such as increasing differences in regional development, irrational use of energy sources, unfavourable ageing and emigration processes should be neutralised. This objective should be clearly related to territorial, social and environmental dimensions of the Goteborg Strategy.

More elaborated guidelines for the absorption of the EU structural assistance in 2014-2020 are being drafted with reference to the priorities provided, identification of possible optimal absorption of structural funds by modelling, challenges posed by the EU, the analysis of key factors affecting the Lithuanian economy and expert evaluation. The table below presents the distribution proposed.

Table 2. Proposed distribution of the EU structural assistance funds in 2014-2020, %

Operational programmes and priorities	Distribution in 2007-2013	In case of the optimistic scenario	In case of the pessimistic scenario
Efficient human resources for knowledge society	13.80%	13.6%	9.0%
1. Quality occupancy and social coverage	5.50%	6.7%	5.0%
2. Lifelong learning	3.76%	2.5%	1.0%
3. Researchers' capacity building	1.74%	2.1%	1.7%
4. Administrative capacity building and increase in the efficiency of public administration	2.50%	2.0%	1.0%
5. Technical assistance	0.30%	0.3%	0.3%
Competitive economy	45.74%	50.0%	53.6%
1. Research and development (R&D) for competitiveness and growth of the economy	10.00%	10.5%	13.6%
2. Increasing business productivity and improving environment for business	6.82%	5.5%	6.0%
3. Information society for all	3.54%	3.3%	3.3%
4. Basic economic infrastructure	8.66%	14.0%	14.0%
5. Development of trans-European transport networks	16.05%	16.0%	16.0%
6. Technical assistance	0.66%	0.7%	0.7%
Sustainable development	39.09%	35.0%	36.0%
1. Local development and urban development, preservation of cultural heritage and nature, adaptation to tourism development	11.14%	8.0%	7.0%
2. Quality and availability of public services (health, education, social services)	10.63%	11.3%	12.3%
3. Environment and sustainable development	16.65%	15.0%	16.0%
4. Technical assistance	0.66%	0.7%	0.7%
Operation programme of Technical Assistance	1.38%	1.4%	1.4%
Total	100.00%	100.00%	100.00%

The table presents the allocation of the EU structural assistance taking into consideration two possible scenarios of the economic development in Lithuania. In both cases it is suggested to increase funds for the enhancement of competitiveness. Here greater attention should be paid to the increase in crucial economic infrastructure and development of R&D. What concerns sustainable development, it is suggested focusing on the improvement of quality and availability of public services as well as environmental and sustainable

development. Should the Lithuanian economy turn towards the pessimistic scenario, it is recommended to pay much greater attention to the promotion of competitive economy via the development of R&D, improvement of crucial infrastructure and development of public services.

Due to ever accelerating changes in the global economic environment, at the time of the drafting of the evaluation report it was not possible to identify specific economic sectors or areas, the financing of which from the EU structural assistance funds 2014-2020 would be inexpedient. Nevertheless, when planning new generation operational programmes illegible areas should be identified by two common features. The EU structural assistance funding would be inexpedient for (a) economic areas or entities operating in non-framework branches directed to a competitive local market; (b) economic areas or entities operating in low value-added areas, where competitiveness is based on relatively lower labour force costs.

The efficiency of the use of the EU structural assistance 2014-2020 will be determined not only by targeted investments, but also by effective assistance planning and allocation. The report suggests that in 2014-2020 the EU structural support operational programmes should be drawn for Lithuania as one NUTS level 1 region under eligible areas of the Convergence Objective, taking into account forecasts that in 2011 Lithuania's GDP will still be lower than 75 per cent of the average EU GDP. However, having in mind the importance of globalisation challenges, more structural assistance should be allocated to centres with the strongest international competitiveness potential, primarily to the capital region. To this end, it is recommended to distinguish an individual measure in future operation programmes, which could be implemented by financial engineering instruments. The use of the latter ones in the new programming period should be especially promoted because of two reasons: bigger leverage effect and renewable nature of financial resources, which may be of crucial importance after 2020, when payments from the EU budget to Lithuania will significantly reduce.