

BOX 2

INVESTMENT GEARED TOWARDS LONG-TERM ECONOMIC WELFARE

Public investment is an important government instrument that helps reduce fluctuations in economic cycles during the short term, as well as promotes the long-term growth of the country's economy and welfare. However, existing investment objectives can only be achieved by implementing well-targeted investment projects. Following the Lithuanian government's approval of the €6.3 billion investment plan to be implemented by the end of 2021, and given the historic opportunity to apply for almost €18 billion over the next seven years from the Multiannual Financial Framework and **Next Generation EU**, it is essential to ensure efficient use of these funds.

The choice of investment instruments should be based on their usefulness, while critically assessing and revising investment needs. The usefulness of investment projects must be assessed on the basis of a cost-benefit analysis, which is currently very rarely used in Lithuania and is usually replaced by an impact assessment.¹⁵ A cost-benefit analysis could show the real cost of investments: their benefits for society and budget requirements for sustaining these investments in the future, which would contribute to a more efficient use of limited public resources. The previously defined investment instruments should also be subject to a critical revision. The major part of investments amounting to more than €4 billion had already been planned before the COVID-19 shock. However, the pandemic has also opened up new opportunities, including business intentions to shorten supply chains and relocate certain activities to Europe. The change in the economic situation may also have reduced benefits of the planned investments, thus it may be appropriate to abandon some projects and replace them with more viable ones.

When allocating investment, the state should prioritise areas under its direct responsibility. This includes public order, education, health care, transport infrastructure, urban lighting, public spaces and other public sector areas. The private sector plays only a minor role in the fields attributed to the government functions and public goods. Therefore, it can hardly be expected that the state would be able to maintain sufficient high-quality performance of its functions without the necessary funding.

In light of the aforementioned investment selection principles, recommendations by international institutions¹⁶ and challenges facing the country, the following investment priorities can be identified.

Adapting to COVID-19 induced changes. This investment type should cover challenges related to health care, education and remote work. In terms of health care, it is important to modernise the system by streamlining processes, improve the quality of the services provided, ensure the adequate and timely supply of the necessary medical resources and implement technological solutions to ensure the system's sustainability and safety. The latter need has been reinforced by recent problems encountered after Lithuania's e-health servers had been flooded. Dependence on foreign medical supplies could be addressed by increasing supply on the domestic market through, for example, investment instruments targeted at companies capable of producing the required products. As regards education, qualitative indicators have long been signalling the need to reform the education system, while the COVID-19 outbreak has magnified the existing problems. With the increased demand for distance learning, investment in modernisation of schools and adaptation of the education system to this aim would not only improve the situation in the education system, but also facilitate the smooth organisation of the remote teaching process. With remote work also getting more popular and businesses moving to cyberspace, it is important to increase opportunities to work on a remote basis, digitise the economy and develop the required competencies, as only enhanced skills will allow making good use of emerging technical possibilities.

Addressing demographic and regional challenges. Lithuania's shrinking and ageing population (see Chart A) is posing a number of challenges – from a declining and ageing labour force to infrastructure

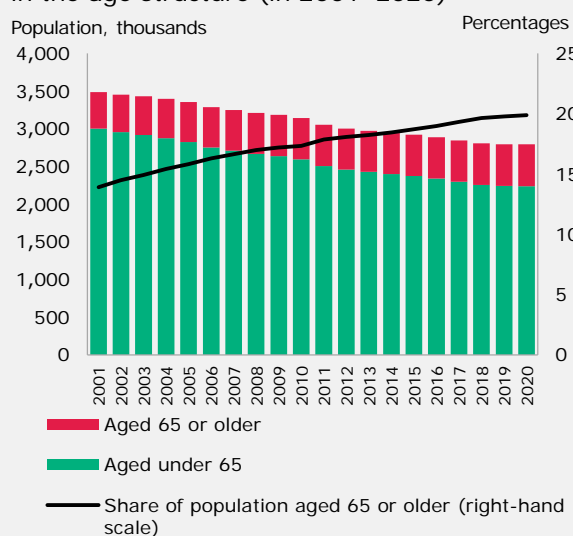
¹⁵ In an impact assessment some economic costs are treated as economic benefits.

¹⁶ IMF (2019, [online source](#)), EC (2020, [online source](#)), OECD (2019, [online source](#)).

unadapted to elderly people. It is thus becoming increasingly important to ensure physical and social infrastructure responding to the needs of the ageing population. Demographic changes also contribute to regional disparities in Lithuania, as the declining number of young and highly qualified people in peripheral regions¹⁷ implies reduced opportunities for economic development in these parts of the country, a widening gap in terms of living standards compared to the major cities, and structural unemployment. The shrinking labour force and the ageing population increase the need for lifelong learning, while the global pandemic has significantly affected the established working practices. It is therefore important to invest in the development of a unified lifelong learning system, distance learning opportunities, programmes focused on providing the necessary skills and competencies, which would effectively help the unemployed, those willing to reskill or elderly people to enter the labour market. Investment in the development of the network of transport services could also help address regional disparities.

Lithuania's population has been rapidly ageing.

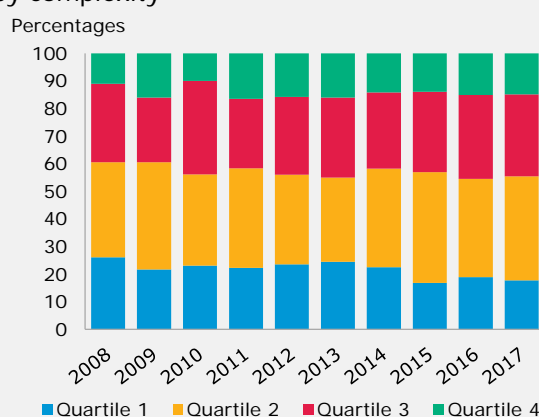
Chart A. Population developments and changes in the age structure (in 2001–2020)



Sources: Statistics Lithuania and Bank of Lithuania calculations.

Exports of low and medium complexity products are predominant in Lithuania, and the structure of exports is changing at a very slow pace.

Chart B. Lithuanian exports* broken down by complexity**



Sources: Statistics Lithuania, The Atlas of Economic Complexity and Bank of Lithuania calculations

* Of Lithuanian-origin goods, excluding mineral products.

** Products are broken down by complexity into 1 to 4 quartiles, where the 4th quartile indicates the share of exports of the most complex products.

Education system reform. Such a reform would make it possible to change the quality of human capital – one of the key economic drivers. Although education expenditure relative to GDP in Lithuania is higher than the EU average, qualitative education indicators show that the situation is still unsatisfactory.¹⁸ With the faltering optimisation of the school network, an increasing share of the education system expenditure is spent on maintenance, whereas the share of expenditure used for the performance of direct educational functions, including wages, has been declining. This makes it difficult to attract talent, which in turn inevitably undermines educational outcomes. In addition to increasing the economic efficiency of the education system, which has recently been widely discussed, it is equally important to improve the educational content and methods, which have so far received much less attention. The reform must also encompass higher education. Although the share of Lithuania's population that has completed higher education is above the EU average, according to the Global Competitiveness Report published by the World Economic Forum, however, Lithuania is lagging behind in terms of such indicators as skillset of graduates (ranking 82nd out of 141 countries) and ease of finding skilled employees (standing 124th).¹⁹ There is a need for an efficient consolidation of universities and a focus on qualitative results achieved by higher education institutions, rather than on merely quantity-based funding. The education reform should also

¹⁷ Peripheral regions refer to regions other than Vilnius, Kaunas and Klaipėda.

¹⁸ Programme for International Student Assessment, 2018, OECD ([online source](#)).

¹⁹ World Economic Forum, 2019. The Global Competitiveness Report 2019 ([online source](#)).

include the establishment and development of reskilling and training programmes in order to create an effective lifelong learning model, which is necessary in the context of the ageing population and changing technologies. As a result of digitisation and robotisation as well as transition to a climate-neutral economic model, the labour market will undergo transformation, some jobs will disappear, which makes it necessary to get ready for this by investing in training of new workers.

High technologies. Exports of low and medium complexity products are still predominant in Lithuania, whereas the share of exports of the most complex goods has remained largely unchanged over the last decade²⁰ (see Chart B). Although such specialisation has not yet put any significant limitations to Lithuania's convergence, this may become a major constraint on sustainable economic development on the back of increasing labour costs. Directing general government investment to the promotion of higher added-value production, development of high technologies (e.g. IT, biotechnologies, pharmaceuticals) and digitisation of the public sector (including introduction of electronic voting and modernisation of bureaucratic procedures) would help increase the value added of goods and services as well as enhance the skills of the labour force. This could in turn accelerate economic transformation that would contribute to further sustainable convergence of Lithuania. The development of high technologies would be supported by investment instruments for companies performing R&D and thinly capitalised firms creating new technologically advanced products, as well as the development of the 5G network and infrastructure for life sciences, while ensuring the possibility to implement commercialisation strategies.

Climate change. The development of green technologies could help Lithuania climb up the value chain ladder, enhance export competitiveness and contribute to further income convergence. Clean energy investment is essential in addressing global climate change challenges and achieving the common EU objectives²¹. This would also bring significant economic benefits, as returns on clean energy are three to eight times higher than initial investments²². Development of renewable energy use, modernisation of public transport infrastructure or that for alternative modes of transport (e.g. an electric vehicle network) and energy efficiency renovation projects for multi-apartment buildings would not only help address climate change challenges, but also contribute to economic modernisation. To this end, the EU is dedicated to devote particular attention and additional funding in the upcoming years. Therefore, it is worth steering Lithuanian incentives for business and science in this direction, as well as searching for climate-friendly solutions, which will be in high demand across the EU.

The Plan for the DNA of the Future Economy prepared by the Ministry of Finance of the Republic of Lithuania identifies the following investment priorities: human capital, digital economy and business, innovation and research, economic infrastructure as well as climate change and energy. These types of investment are broadly consistent and compatible with both the listed priority areas and the priorities of EU funds for Lithuania in 2021–2027.²³ However, with a view to ensuring economic transformation and efficient use of investment funds, of importance are not only investment areas, but their content as well. The selected investment instruments should be aimed at achieving a real impact on the economy. For example, reskilling or upskilling programmes have already been in place for some time, yet the desired results have still not been achieved. It may be pertinent to involve private or foreign consultants and experts in order to develop content-wise high-quality projects that would allow achieving the intended objectives with the allocated funds. There are also certain concerns as some investment instruments are described in the Plan for the DNA of the Future Economy in vague terms, without disclosing their substance, despite sizeable funds being earmarked in certain cases. In order to make efficient use of investment funds, it is also crucial to ensure an effective distribution of responsibilities, which is particularly relevant, for instance, for the reskilling and/or upskilling measure, as it falls under the responsibility of the Ministry of Education, Science and Sport (€18 million), the Ministry of the Economy and Innovation (€42 million) and the Ministry of Social Security and Labour (€5.9 million).

²⁰ Aleknevičiūtė, E. et al. (2020). The Challenges of Lithuania's Economic Convergence and Labour Market. Occasional Paper Series No 31, Bank of Lithuania.

²¹ Becoming a climate-neutral continent by 2050.

²² International Renewable Energy Agency, 2020. Global Renewables Outlook: Energy Transformation 2050 ([online source](#)).

²³ A smarter, greener, more connected and more social Lithuania ([online source](#)).