



COUNTRY BRIEFING LITHUANIA

Vienna Institute for International Economic Studies

Industrial Policy for a New Growth Model

Country Briefing Lithuania

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Please find all the publications of the programme under its webpage:

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CENTRAL AND EASTERN EUROPE NEEDS INDUSTRIAL POLICY TO ESCAPE THE MIDDLE INCOME TRAP

Since the early 2000s, the EU member states of Central and Eastern Europe (EU-CEE) have achieved an impressive economic catch-up process. However, the previously successful model of taking over labour-intensive production steps as an 'extended workbench' of Western corporations has reached its limits. Combined with major global challenges such as decarbonisation and digitalisation, this makes it essential for EU-CEE to develop a new, innovation-based economic model. Only then will these states be able to complete the catch up with Western Europe in terms of productivity and living standards. The situation is exacerbated by the economic consequences of the war in Ukraine, such as permanently higher energy prices and higher inflation, which pose grave challenges for the region's external competitiveness.

The problem is that the central technological competences and those parts of production with the highest added value are located in the 'headquarter economies' of Western Europe. Meanwhile, the EU-CEE countries – Poland, Czechia, Slovakia, Hungary, Slovenia, Croatia, Romania, Bulgaria and the three Baltic states – are still extremely specialised in labour-intensive production. They depend heavily on lower labour costs, and this restricts their prospects of catching up economically with Western Europe. A good example of this is the car industry, which is so important for the region as indicated by its high share of value added, jobs and exports, especially in the Visegrád states, Romania and Slovenia.

The study shows that the EU-CEE countries have so far lacked a constructive approach to industrial policy in their development trajectories. They have had a very broad ranging FDI promotion policy, weak investment environments for start-ups, and the activities of state-owned enterprises have not been aligned with the greater development goals. In general, there is a lack of state entrepreneurship in these countries that could nurture promising industries. This is particularly challenging for regions that are lagging behind within countries, as they lack the technical capacities for industrial policy. Due to these factors, the study argues that the EU-CEE countries are struggling to get out of their middle income trap.

Their EU membership offers unique opportunities for industrial policy, but also challenges. On the plus side are access to funds, participation in research networks and the opportunity to shape industrial policy on the EU level. Important-

ly, industrial policy in the EU has taken a much more prominent role in recent years as shown by initiatives such as the European Chips Act or the Important Projects of Common European Interest (IPCEI). This provides some momentum for the development of industrial policy in the EU-CEE countries. Strict state aid rules and an EU competition policy that gives preference to free market principles, on the other hand, are challenges for an effective industrial policy.

As discussed above, the growth model of the EU-CEE countries must be made fit for the future. Decarbonisation, digitalisation and a shrinking labour force require massive efforts to be made. For countries like Poland, the green transition is a major challenge. This transition can only be managed through huge public investments in green technologies and digitalisation, combined with the right conditions for private enterprise to thrive, to create a fully joined-up approach combining the best of the public and private sectors and academia. This means more money for education, research and development, as well as active labour market policies to manage the transition.

Above all, however, the countries of the region need a strategically oriented industrial policy to support the emergence of more globally competitive companies and to emphasise their own economic strengths. While a true "entrepreneurial state" may be too ambitious for many EU-CEE countries in the coming years, steps in this direction are the way to go. We propose eight steps, that should be taken:

1. Create a national innovation system in each country, bringing together the private sector, universities, key ministries, and business agencies. Within this biotope, new ideas can be developed, tested, and financed. Each country should define which sectors and specialisations are promoted, rather than relying solely on external market forces.
2. Make full use of EU funds and maximise participation in EU research initiatives to advance industrial policy goals. Governments should also get more involved in industrial policy debates at the EU level. Greater participation in the EU's Horizon Europe research funding programme or in the EU's Important Project of Common European Interest (IPCEI) initiative would also be particularly important for the region's technologically less advanced countries.

3. Learn from each other's successes stories to emerge as frontrunners in the digital economy. Estonia is generally well prepared in this area and often raised as an example. However, there are also other positive cases in the region. Romania and Croatia have a particularly high proportion of graduates in ICT, relevant for digitalisation. Czechia shines with its digital start-ups, the Baltic states with the quality of their digital public services. The Visegrád countries and Slovenia have highly digitalised and automated industries.
4. Harmonise investment schemes to attract foreign companies with national industrial policy. Instead of providing blanket support for all investments by foreign companies, national governments should strategically consider which sectors and parts of the value chain they want to attract, and create incentives that maximise the potential for spillovers from foreign giants to domestic firms.
5. Identify and exploit promising niches. Given the lack of technological experience, the establishment of the semiconductor industry in the EU-CEE countries, for example, would not be very promising. However, each country has traditional strengths that should be built upon.
6. Institutional reforms. In some states of the region, the quality of public institutions has declined significantly in recent years. This is worrying. Countries in East Asia have a lot of experience in building adequate institutions for an active industrial policy, even if the framework conditions there partly do not meet Northwest European standards. This experience should be used.
7. Structural change must be cushioned socially in order not to lose the support of the population. EU-CEE countries should aim for a flexible labour market to ease the transition from old to new jobs, but underpin this with extensive retraining programmes and a social safety net that means that workers themselves do not bear the costs of the transition.
8. Each country needs a tailor-made industrial strategy adapted to its specific needs. While the Baltics, for example, are well positioned for the digital transformation, they are struggling above all with distribution problems and a shrinking population. Czechia, Poland or Slovenia are industrially the most advanced, but must make the transition from 'extended workbench' to innovative economy. For the less developed parts of EU-CEE such as Bulgaria and Romania, the priority should be on maximising the transfer and knowledge and innovation from big foreign investors.

COUNTRY BRIEFING LITHUANIA

COUNTRY OVERVIEW

Lithuania is one of the less industrialised countries in the EU-CEE, though one of the most developed socio-economically. The country's service-orientation is reflected by the various indicators of industrial competitiveness. The country has got the highest share of low-tech industry within manufacturing value added in the EU and the lowest share of high-tech industry. This is also an outcome of the lowest ratio of FDI in the manufacturing sector in comparison to GDP within the EU-CEE, as most inward FDI went to the service industries.

Similar to the other Baltic states, one core activity in the economy is the processing of wood, which accounts for 9.2 per cent of total employment in manufacturing, while downstream production of furniture is even more important with 14.7 per cent of total employment. In general, small- to medium-sized companies prevail in most industrial sectors. Freda is the only large-size company producing furniture. Given its strong export-orientation, food production is the largest single sector employing 16.8 per cent of the industrial workforce. Rokiskio Suris is with about 1,500 workers the second largest industrial enterprise in Latvia, producing cheese and dairy products. Some of the largest manufacturing companies cluster around petroleum and gas processing. Orlen Lietuva, which is polish-owned is the only petroleum refinery in the Baltic states. Achema is producing nitrogen fertilizers as well as chemicals like Thermo Fisher Scientif-

ic. SCT Lubricants is producing engine oils and Lietpak, Neo Group and Orion Global PET all produce plastics of different kind. For all those companies, the issue of high dependence on Russian energy and inputs in general is obviously a particular challenge for industrial competitiveness currently and in the coming years.

The human capital situation can be described as middle-rate in comparison to the EU-CEE, however in term of tertiary educated workforce the country is a front runner in the region. The economy's main shortcoming given the megatrends lies in the environmental transition: material use, resource productivity and circular material use are areas that need more attention.

INDUSTRIAL COMPETITIVENESS – SWOT

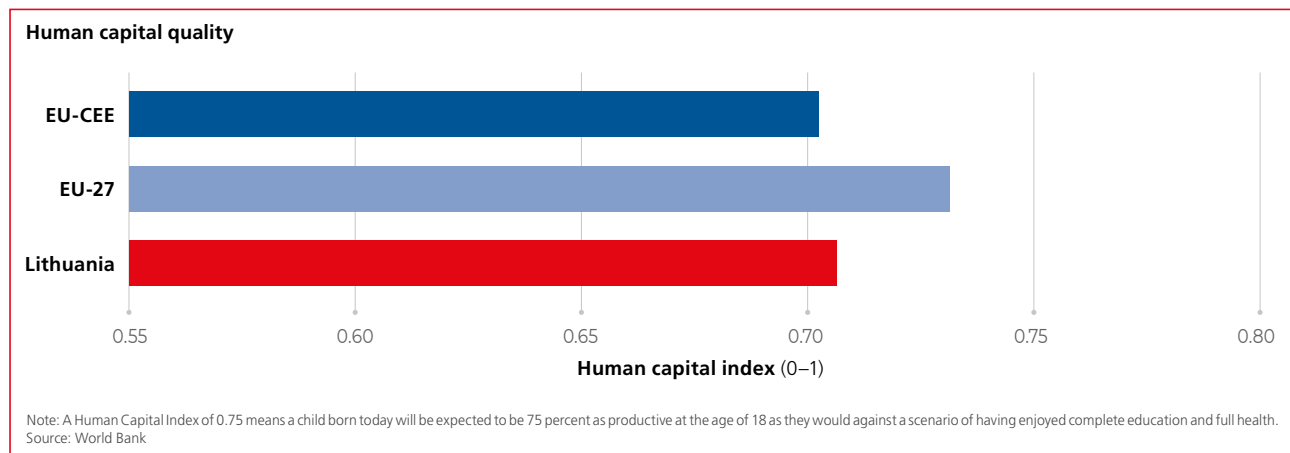
Strengths

- Lithuania has a rather high share of population with tertiary education in general and with basic digital skills in particular as well as a high share of ICT graduates among students in comparison to other EU-CEE countries
- The highest share of SME's with at least basic level of integration of digital technology within the EU-CEE (57 %) (also above EU average) shows the adaptability of the economy in the course of technological transformation

Industrial development – I

	Competitive industrial performance index	Manufacturing value added (MVA) (% of GDP)	Medium- and high-tech MVA (% of total MVA)
Lithuania	0.08	18	29
EU-27	0.14	15	41
EU-CEE	0.10	17	38

Note: 2020 values. The CIP index assesses the strength and complexity of an economy's industry, with Germany claiming the maximum score in 2020 at 0.42.
Source: UNIDO



- Lithuania's innovation performance increased quite strongly, more than the EU average, in the past 7 years. The share of innovators is rising as well as enterprises investing in non-R&D innovation expenditure as well as the availability of venture capital
- Institutional quality is among the highest in the EU-CEE, behind the leader Estonia but in line with the Czech Republic, Slovenia and Latvia, offering solid pre-conditions for state entrepreneurship

Weaknesses

- Lithuania shows one of the lowest levels of industrial competitiveness within the EU due to the relatively small country's impact on the global market
- Public support for business R&D is low, which results in a limited innovative capacity of enterprises.
- In terms of material use Lithuania is the least country in the EU except for Finland in 2020 and showed a decline in performance in the past decade

Opportunities

- Venture capital expenditures are relatively high and among the fastest growing in EU-CEE, offering opportunities for innovative start-ups. In terms of startups per capita, Lithuania is second in the EU, only falling behind Estonia.⁶
- Similar to the other Baltic states also Lithuania ranks above the EU average in digital public services for businesses and particularly in services for citizens
- The share of renewables in total energy consumption increased strongly in the past decade. However, more has to be invested to reduce the dependence on oil and gas, which offers opportunities in the area of green transformation.

Threats

- The low and recently declining share of new doctorate graduates compared to the EU average is likely to hamper the development of the research and innovation capacity of the Lithuanian economy
- Lithuania is among the EU Member States that have assigned the least spectrum for 5G – only 5 per cent, compared to the EU average of 56 per cent, which is critical to foster 5G development
- Greenhouse gas emissions per capita are still below the EU average but increased over the past decade. Lithuania has to step up efforts to achieve the climate goals.

- The working age population is about to shrink in the coming years. Skill shortage is already for a longer time a serious issue for the manufacturing sector

INDUSTRIAL POLICIES AND STRUCTURAL REFORM DEVELOPMENTS

FDI promotion and value chain upgrading

- FDI policies have been rather passive in Lithuania. Not recently, but in the past, the country has established seven Free Economic Zones, which offer companies six years of exemption from corporate income tax, 50 per cent reduction during exemption from real estate tax and no tax on foreign company dividends.

New technologies, digitalisation, innovation

- A high share of 31 per cent of the Recovery and Resilience Facility (RRF) is allocated to digital transformation, supporting particularly science-business cooperation for innovative technologies, investment in broadband infrastructure to reduce the urban-rural digital divide, a digital upskilling of the workforce to reduce the shortage in IT specialists and a faster development of the 5G infrastructure in Lithuania.
- The Smart Specialisation Strategy (S3) updated in 2019 by the Lithuanian government, focuses on seven priority domains, which consider areas with existing or potential competitive advantage. These are e.g.: energy and sustainable environment, health technologies and biotechnology, agro-innovation and food technologies or smart, green and integrated transport.

Green transformation of industry

- A high share of the RRF is allocated to green transition, however the measures are not directed towards industry but horizontal. Most important are the development of offshore wind infrastructure and of onshore plants for renewable energy sources, the creation of energy storage facilities and the support for phasing out the most polluting road transport vehicles.

¹ <https://dealroom.co/uploaded/2021/10/Dealroom-Google-Atomico-CEE-report-2021.pdf?x64504>

COUNTRY-SPECIFIC RECOMMENDATIONS

In the main part of this study, we identified Lithuania as a fairly digitally advanced country by EU-CEE standards, and therefore well prepared for this half of the “twin” transition. The core focus for policymakers should therefore be to maximise advantages in the digital sphere, address the distributional implications of this type of growth, take steps to maximise the growth potential of the green transition, and address the extremely challenging issue of labour supply.

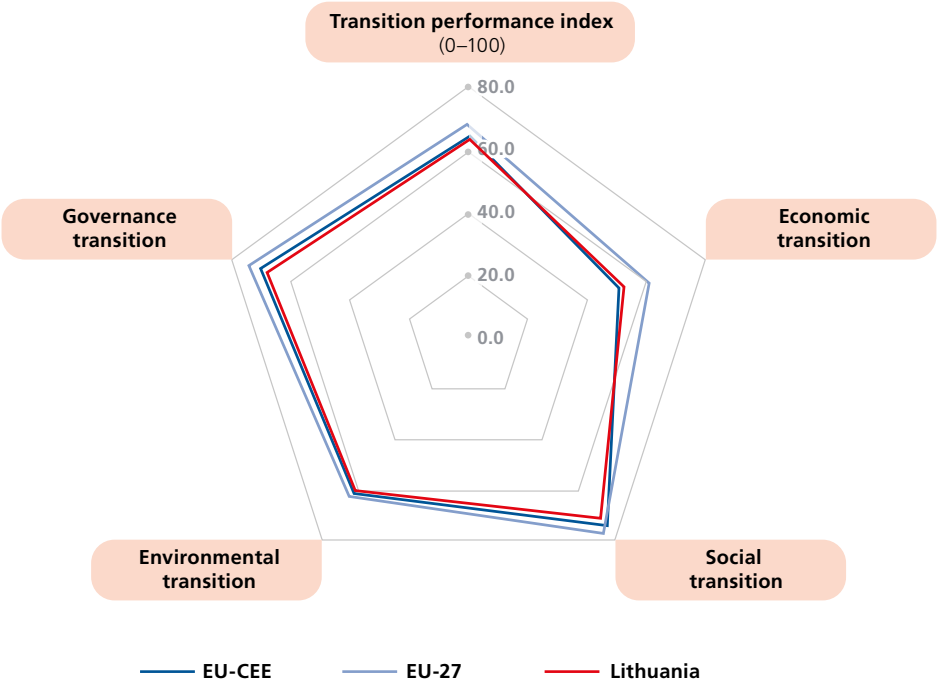
- **Take a more proactive approach to foster innovation capacity of the economy via the establishment of a national innovation strategy and development of an entrepreneurial state.** As a relatively advanced country by EU-CEE standards in per capita GDP terms, and with a fairly high level of institutional development in the regional context, Lithuania is in a position to target the development of an entrepreneurial state. Lithuania has among the highest scores in EU-CEE for government effectiveness and regulatory quality according to the World Bank Worldwide Governance Indicators. Strengthening business-research collaboration on innovation is the main priority, by creating networks involving key ministries, academic and the private sector (see policy recommendation 5.1 in the main report). The government should also increase further the innovation capacity of firms by making R&D tax incentives more effective.
- **Invest more in reaping the benefits of digital transformation.** Lithuania has a good standing concerning digital skills of its population. However, it has still room to improve towards its Nordic peers and even Estonia. Since ICT seems to be a good niche for smart specialization (see policy recommendation 5.5 in the main report), the government should invest more in the reskilling and upskilling of its workforce including training of unemployed and people out of the labour force. Where relevant, the example of Estonia should be followed, in order to ensure further digitalization of industry and the public sector (see policy recommendation 5.3 in the main report).
- **Preserve the strengths of having a skilled workforce by fostering education, training and attracting human capital.** Like its Baltic neighbours and much of the rest of EU-CEE, Lithuania faces negative demographic trends and this will be an ever-greater constraint on the economy’s growth potential. Although there is no solution to solve the issue entirely, there are various measures that the government could take. A key priority should be active labour market policy, to ease the transition of workers from more routine tasks to more productive jobs (see policy recommendation 5.7 in the main report). The government should invest more in the upskilling of the existing workforce and foster vocational education and training. In order to speed the transition, exit and entry restrictions for employment should be minimized, while a higher minimum wage would push the private sector to automate routine tasks more quickly. The government should also ensure an adequate social safety net to cover the period of transition between jobs. Moreover, immigration policy should attract much needed skilled workers in particular sectors.
- **Implement a tailored FDI promotion policy which would complement the national innovation strategy.** Lithuania could do more to attract FDI actively, and this remain a key channel by which the economy absorbs innovation. FDI policy should be aligned with strategies for national innovation and economic development in general, with incentives for foreign investors tweaked to encourage capital to enter priority sectors, and to attract the kind of investment that will also generate more domestic spillovers (see policy recommendation 5.4 in the main report). This could also help to develop the areas of the country’s smart specialisation (S3) strategy, in particular agro-innovation and food technologies, transport, logistics and information and communication technologies (ICT).

Industrial development – II

Sector	% of manufacturing employment
Food products	16.8
Furniture	14.7
Wood and products of wood, cork, straw, etc. except furniture	9.2
Fabricated metal products, excl. machinery and equipment	8.1
Wearing apparel	6.6
Repair and installation of machinery and equipment	4.7

Note: 2021 values.
Source: Eurostat Structural Business Statistics.

Transition performance scorecard



Note: 2020 values. The TPI scores countries based on 4 pillars of a transition to a more sustainable, inclusive and resilient economy.
Source: European Commission

INDUSTRIAL DEVELOPMENT

The core activities are the processing of wood and the production of furniture as well as food production. High dependence on Russian energy and inputs.

[illegible]A graphic illustration featuring stylized leaves in shades of green and yellow, positioned above a simplified building facade with a grid pattern and a chimney.

- ## WEAKNESSES

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- ## THREATS

- Below-average share of new doctorate graduates is likely to hamper the development of the research and innovation capacity.
- Very low assigned spectrum for 5G so far.
- Greenhouse gas emissions increased over the past decade. Lithuania has to step up efforts to achieve the climate goals.
- Shrinking working age population and high and growing skill shortage in manufacturing.

COUNTRY-SPECIFIC RECOMMENDATIONS

- **Take a more proactive approach to foster innovation capacity of the economy via the establishment of a national innovation strategy and development of an entrepreneurial state.**
- **Invest more in reaping the benefits of digital transformation, investing further in the reskilling and upskilling of its workforce.**
- **Preserve the strengths of having a skilled workforce by fostering education, training and attracting human capital while incentivizing automatization via a higher minimum wage.**
- **Implement a tailored FDI promotion policy which would complement the national innovation strategy.** Lithuania could do more to attract FDI actively, and this remain a key channel by which the economy absorbs innovation.

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Industrial Policy for a New Growth Model: A Toolbox for EU-CEE Countries

This country briefing is a short summary of a much broader study that deals with the perspectives of industrial policies in Central Eastern and Southern Eastern Europe and the question how these countries can avoid to get stuck in a middle-income trap. The study has been authored by a team of experts from the Vienna Institute for International Economic Studies on behalf of Friedrich-Ebert-Stiftung.

The study argues that the EU-CEE countries have so far lacked a systematic approach to industrial policy in their development trajectories. They have had a very broad ranging FDI promotion policy and weak investment environments for start-ups, while the activities of state-owned enterprises have not been aligned with the greater development goals.

Hence, the growth model of the EU-CEE countries must be made fit for the future. Decarbonisation, digitalisation and a shrinking labour force require massive efforts to be made. This transition can only be managed through public investments in green technologies and digitalisation, education and infrastructure, combined with the right conditions for private enterprise to thrive.

The study includes eleven country profiles that analyse the economic and industrial structures for their strengths and weaknesses and identify possible courses of action for an active industrial policy.

The full study can be found here:

<http://library.fes.de/pdf-files/bueros/budapest/20260.pdf>



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