

The impact of the European structural and investment funds for Lithuanian economy in 2014- 2020 and the evaluation of development priorities for the 2021-2027 programming period

Summary

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The evaluation was made according to service contract No. 14P-8, signed in 8 February 2017, between the Ministry of Finance of the Republic of Lithuania and UAB "ESTEP Vilnius"

It is the first strategic report which evaluates the economic-social tendencies of Lithuanian economic growth till 2027, examines the impact of European structural and investment funds (ESIFs) in 2014-2020 and sets out proposals on investments for the 2021-2027 programming period. The evaluation was participatory based and involved the stakeholders of a programme in the evaluation process. This report is the primary document for further discussion at the national level and for the negotiations with the European Commission. It is expected that early discussions on the use of ESIFs will help to develop a clear national and regional strategies for economic growth and investment for the 2021-2027 programming period.

EU Cohesion Policy and the EU funding is considered to be one of the main advantages of Lithuania's membership in the EU, while the investments of the ESIFs are one of the most important factors for the growth of Lithuanian economy. The results of this evaluation confirm the fact that in the 2014-2020 programming period the development of Lithuanian economy and the country's economic convergence will be strongly encouraged by the EU funds' investments. Econometric modeling results allow to estimate that the ESIFs in the period of 2015-2020 will determine on average of 0.9 percent points higher annual nominal GDP growth in Lithuania. It is estimated that 1 euro of ESIFs investment will generate 2.4 euros of additional GDP by 2030. The return on investments is higher compared to the previous programming periods and this is determined by several factors: first, it is predicted that Operational Programme (OP) will be implemented in a stable macroeconomic environment; second, the larger impact on GDP and other fundamental macroeconomic variables will be generated by a more active diversion of resources of the EU funds to productive investments and R&D compared to the period of 2007-2013.

From the macroeconomic point of the view the primary and the strongest effect of implementation of the OP will be seen on the formation of fixed capital. It is estimated that formation of fixed capital will be €10.5 billion higher by 2023. The enhancement of investments will have positive effect on the labour productivity growth – it will increase 0.3 euro per hour by 2023. The growth of capital investment will cause secondary effects of domestic (household and government) consumption. Econometric modelling results show that the implementation of the OP will increase the household consumption about €7.2 billion by 2023. On the other hand, the extra share of

government consumption expenditure will be relatively low: about €1.5 EUR by 2023. Increased consumption of government will mainly be related to the expenditure of co-financing cost of the projects. According to econometric modelling, secondary effects generated by the ESIFs will cause only a minor increase (0,1 percentage points) in the GDP deflator and consumer price index (CPI).

On the other hand the impact of ESIFs for the Lithuanian trade balance will be negative, because it will affect the volume of import more (especially during programme implementation period) than the export. Because of the assistance from ESIFs, the import will grow almost by €9.8 billion, while export – by about €3.0 billion. The impact of ESIFs' investments on the increase of import flows from the main contributors to the EU budget – Germany, France, Italy and the Netherlands – could be seen as an important argument in the negotiations on Multiannual Financial Framework after 2020. The results of the evaluation show that due to the ESIFs' investments Lithuanian import flows from the net-contributors will increase up to €EUR 3.5 billion by 2030. In other words, Lithuania will pay-back more than a half (52 percent) of total ESIFs received in the programming period 2014-2020 to the net-contributors countries.

The analysis of econometric modeling shows that in 2014-2020 the investments of the ESIFs will have a significant social effect. Due to the EU investments, 27,000 jobs will be created or saved by 2023 and the overall unemployment rate in Lithuania will be 2 percent points lower compared to the situation 'without the investments'. This impact for the labour market will result in wage increase of about €35 per month. On the other hand, the impact for the employment of current OP will be decreased by huge limitations of labour market (disadvantages of labour supply). Thus, the investments of the ESIFs are more conducive to jobs support or redistribution in the country's labour market instead of the growing number of persons employed. Moreover, a lot of jobs which are created by the ESIFs will be temporary and related with the implementation of projects. Therefore, after the end of current funding period, the impact on employment will become weaker and almost disappear by 2030.

At the level of economic sectors, the main long-term beneficiaries (measured according to investment payoffs) will be industrial and private services sectors. Analysis of econometric modeling revealed that the gains associated with growth in

value-added, preservation of jobs, attraction of investment and export of goods and services have been most significant in these sectors. In 2015–2023, the ESIFs investment payoffs in both industrial and private services sectors as measured by the effectiveness coefficient will be twice as high as investments made. In the short run (so long as the largest infrastructural projects were financed), construction sector will be the biggest beneficiary of the ESIFs assistance.

Econometric analysis at regional NUTS-3 level revealed that that the implementation of the OP will positively affect the impact of economic and social development for all Lithuanian counties, however it will not impact the territorial cohesion measured by GDP per capita. On the contrary, it is estimated that implementation of current OP will even increase economic disparities between leading and lagging Lithuanian regions. The results of econometric analysis show that the ESIFs' investments made in the Capital region will foster economic convergence with the EU average by 3.5 percentage points in 2023, while in the rest of Lithuania – by 2.1 percentage points. These results of Lithuanian regional divergence confirm OECD findings that the regional financial transfers are not a sufficient measure to encourage convergence between the regions. Therefore, such transfers must be associated with the implementation of structural reforms. The evaluation identifies few reasons, which will reduce the number of successful regional investments in the current programming period. Firstly, an important factor that can encourage social and economic development of municipalities is the emphasis of territorial capital (regional specialization) and its empowerment with necessary competence and financial resources. However, during this programming period, the integrated territorial development programmes which are developed and financed by the ESIFs, do not have any territorial specialization and financing needs are not associated with the potential development of the territory (with the exception of Vilnius and Klaipėda). Therefore, success of regional investment will depend mainly on institutional capacity in specific municipalities. Secondly, under the current regulatory arrangements, Lithuanian municipalities have no financial motivation to attract more investment and create new jobs.

Long-term impact of the ESIFs investment depends not only on the structure of the investment or the size of it, but also on the effectiveness of investment, the use of the

results and the continuity of the investments. In order to strengthen the effectiveness of the ESIFs investments in the 2014-2020 programming period the following key measures were set in the EU regulations: 1) greater thematic concentration of funds; 2) link with European Semester and sound economic management; 3) ex-ante conditionalities; 4) performance review; 5) technical assistance for management, monitoring, evaluation, information and communication actions. The evaluation has shown that the ex-ante conditionalities have contributed to a better programming process in Lithuania, however, the following factors lowered the impact of this new instrument. Firstly, an introduction of the ex-ante conditionalities in the programming cycle has been done too late. Prolonged fulfilment of ex ante conditionalities in the investment priorities of information society, education and health care is one of the reasons why the implementation of the OP is delayed. Secondly, to adopt the strategic planning documents is not enough for successful investment, the quality and relevance of these documents should be ex-ante assessed. Following the lessons learned from the current programming period the exercise of strategic planning should start no later than first half of 2019 and before strategic planning documents are confirmed, the ex-ante impact analysis should be conducted.

The analysis of possible scenarios for the allocation of the ESIFs after 2020 shows that the decision to divide Lithuania into 2 administrative NUTS-2 regions is optimal if Lithuania wants to maximize the financial benefits from the EU budget and to enhance regional convergence between leading and lagging Lithuanian regions. The econometric modeling results show that different regional investment strategies in the 2021-2027 programming period would positively contribute to greater regional convergence in the country. The strongest impact for the convergence with the EU will be in 2028, when due to the ESIFs' investments the region of Western-Central Lithuania will have 4.5 percentage points faster convergence and the Capital region – 2.8 percentage points.

While conceptualizing the strategy of investments of the ESIFs after 2020, the main goal will be similar to previous programming periods - to promote social and economic well-being of Lithuania. The investment strategy should be focused on a limited number of key priorities. The analysis shows that Lithuania, in order to be competitive, still must invest in economic infrastructure and public sector services.

However, the investment in infrastructure has to be constantly reviewed in the light of the economic logic of investment criteria and etc. On the other hand, Lithuania's structural transition from the middle to higher income countries group can only be achieved through the shift to higher value-added economy. Therefore after 2020, it will be vitally important to improve the indicators, which determines Lithuanian economic efficiency and innovation (e.g. education, life-long learning labour market efficiency, innovation). It requires not only sufficient investments, the effective structural reforms and adequate institutional capacity are more important. Thus, the efficiency of public administration is the necessary condition for the effective use of ESIFs.

The evaluation report states that one of the main tasks for the 2021-2027 programming period is to identify the regional specialization of each Lithuanian county and to address the investments to solve territorial challenges. In order for the EU investments to contribute to individual territories' social and economic development, it is of utmost importance that these investments are in accordance with demands of these territories, thus strengthening territorial capital which, in turn, influences not only the results of the EU investments but also territorial development. Specific recommendations for the programming process and investment priorities in each of Lithuanian NUTS-2 level region are provided in the evaluation report.