

# THE DISTRIBUTIONAL DIMENSION IN ECONOMIC INTEGRATION

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## Abstract

The cohesion policy of the European Union provides a framework for financing a wide range of projects and investments with the aim of encouraging economic growth in EU member states and their regions. The three main objectives of the EU's cohesion policy in the period 2007–2013 are: Convergence, Regional Competitiveness and Employment, and European Territorial Cooperation. Cohesion policy can become an effective tool of economic convergence if it is accompanied by a set of financial and non-financial elements such as labor market situation, investment opportunities, etc, which are the results of national policies. Article includes brief analysis of Lithuanian economic environment compared to other member states.

The main objective of the article – the development of EU cohesion policy. The aim of the article – to explore the peculiarities of the EU economic and social cohesion. The research methods used in the work – the analysis of literature and statistical data.

Keywords: EU cohesion policy, redistribution, economic and social cohesion.

JEL Classification: D31.

## Introduction

Since 1957, when the Treaty of Rome was signed, till today European Union growth is based on an aim to create a one strong unit to be competitive world-wide. There is done a lot of effort to achieve competitiveness using regional integration of European Union. European Union regional policy is trying to reduce social and economic disparities between member states. It supports job creation, competitiveness, economic growth, improved quality of life and sustainable development. The Regional policy of the European Union is also referred to as a Cohesion policy.

The main objective of cohesion policy is to diminish the gap between different regions, more precisely between less-favoured regions and affluent ones. It is an instrument of financial solidarity and a powerful force for economic integration. This is endorsed in the Treaty of Lisbon – to “*promote economic, social and territorial cohesion, and solidarity among Member States*” (Article 3.3, Treaty on European Union). Economic, social and territorial cohesion implies attempting to reduce the “*disparities between the levels of development of the various regions and the backwardness of the least favoured regions*” (Article 174, Treaty on the functioning of the European Union). European Cohesion policy is therefore more than a simple redistribution of funds. It is about increasing efficiency in its lagging behind regions. Cohesion must ensure that the European funding that have been allocated contributes effectively to the European policies objectives. It is important to evaluate the financial instruments of European policies contributing to economic and social cohesion of member states.

Competitive markets may generate considerable inequality. It can be reduced by the government intervention by redistribution. The European Union (EU) main objective is to stimulate economic growth and efficiency by integrating the markets of production factors and goods. At the same time the structural changes have negative influence for certain sectors of society: regional or social dimension. So, it is obviously, why distributional issues figure on the European agenda. The redistribution impact has been paramount in the minds of politicians and certain sectors of society as well.

The disparity in national economic development determines the disparities that exist between the regions of the EU. It is important to analyze the ways in which EU has developed its cohesion policy and examine the objectives and theoretical foundations of major dimensions of cohesion policy.

Development of country's industry, incomes and profile of manufacturing depend on capability to compete in the international market. Implementation of the results of scientific researches and of new technologies, renovation of production assortment, increasing of competitiveness of goods and innovations reflect the ability of the industry to accommodate itself to the requirements of market economy. This is the one of the reasons why so much attention is paid to the studies of economy growth in scientific literature of the world. Some signs of the studies of economy growth could be found already in the studies of the researchers of XVIII century where they investigated the aspects of absolute and relative advantages of the countries. Much later theories of economy growth were developed by M. Porter (1990), D.S. Cho (2004),

D.Dumčiuvienė (2011), P.Krugman (2003), A.M.Rugman (2005), W.R.Cartwright (2005) and others. In Lithuania problems of economy growth were analyzed by Z.Lydeka and A.Gineitas (1994), J.Urbonas, I.Maksvytienė (2002-2003), V.Snieška (2008), V.Snieška (2002) and others. Despite huge interest in the problems of economy growth, it's theoretical explanation remains one of the most difficult and most complex questions. This is decided by extent and versatility of concepts of economy growth because this phenomenon is being studied from the different perspectives, environment and context.

The use of the concept of economy growth while talking about regional, national and over national policy still remains the object of discussions. The axis of this polemic was legality of analogies between descriptions of competition of micro economical enterprises and competition of national economy and that affected a clear convergence between the extent of estimation of competition and the union.

In the context of European Union Lithuania is a one unit, which is trying to increase level of development and to create a modern and competitive economy. However, regional policy does not end in the one level of integration. There are disparities among the region inside Lithuanian territory. That is why there should be defined European regional policy and national regional policy of each member state. The results of Lithuania macroeconomic situation analysis shows Lithuania's results on coordinating internal Lithuania regional policy and level of EU fund impact to a internal EU regional policy on Lithuania.

In this paper the authors discussed the effect of European Union cohesion policy on economy growth. More specific attention has been paid to the following sets of measures: redistribution schemes and ways of development, the use of European Union policies in levels of integration, economy growth policy and cohesion.

The object of the research is the aspects of implementation of financial instruments aiming social and economic cohesion in Lithuania.

The aim of the paper is to analyze the impact of European Union funds on development of Lithuanian economy.

### **Redistribution schemes and ways of development**

The distribution of welfare among the partners in an integration process is an important political and economic issue. The main aim is to stimulate grow of poorer countries. The most frequently stated arguments for regional policy are: the easing of adjustment problems in economies undergoing major transformations, the employment of unemployed resources by optimizing the allocation of production. There are theoretical arguments that answering question: whether integration contributes more or towards less disparity.

The theoretical Heckscher-Ohlin-Samuelson model explains that factor returns tend to convergence when markets are opened up. It happens in creation a customs union and common market.

The convergence theory predicts that factor incomes in all regions of an integrated economic area like European Union will eventually converge, because there are sufficiently strong adjustment mechanisms in the form of goods and factor movements within the integration area (Rehme, 2006). It mean, that there is not need for regional policy. Competition policy and liberalization of barriers to the free movement of goods, factors of production and technologies are the only necessary measures in order to eliminate regional disparities.

Another theoretical explanation says, what divergence may occur as well. It depends on initial imbalance of countries (regions) economic development. Favor regions that have technological advantage attract investments. At the same time, labor tends to move to regions or areas with the better job career. Generally speaking, divergence theory predicts the development of a heterogeneous economic landscape within the integration area with significant differences in the factor returns in central and peripheral areas (C.Eckel, 2007). This leads to out-migration of mobile factors from poor to rich regions, which widens the disparities even further. Supporters of divergence theory argue that action by governments is required to bring about regional convergence.

The new grow theory emphasizes on market access, technological change, human capital, international competitiveness, economics of scale, institutional efficiency (Ali M. Kutan, Taner M. Yigit, 2007). Some countries find ways of good combination and grow, others fail to do so.

The redistribution issues may arise within regions, between regions/countries and between persons. Within regions, resources need to be relocated between sectors as firms from non-competitive import substituting sectors must be compensated by increased employment and activity in other sectors. If this reallocation does not take place, integration could result in winners and losers. The inability of regions to

shift resources from one activity to another indicates internal structural rigidities. According to this viewpoint, integration itself would not be enough to bring increased real convergence. A range of other policy actions and instruments would be required (Hall, Smith, 2001).

So, because social equilibrium not always can be reached, governments have policies which influence the distribution of wealth over persons, regions and categories. In defining their redistribution schemes, member states can make use of three main variables: the choice of assisted areas, the aid intensities granted to investments in those areas and the size of the budget allocated to regional policy in total.

There are two reasons for intervention: efficiency and equity. Both they have regional and social dimensions. For example, the government's programme for higher labor mobility, or programme for retraining workers for new conditions in restructured industry (Farrell, 2004).

The schemes of social security may be developed by government in terms of equity.

### **The use of European Union policies in levels of integration and cohesion**

The need for redistribution changes as integration reaches higher stages. The main policies in customs union are the internal liberalization and the development of common foreign trade policy. In this level of integration member states use trade policy instruments. Costs and benefits may be very unequally distributed among countries depending on country ability to materialize the benefits.

The need for redistribution changes as integration reaches higher stages. The main policies in Europe's trade policy seeks to create jobs, investment opportunities and growth for European companies – and for the wider economy - by increasing their opportunities to trade with the rest of the world. European trade policy helps to open new markets for European exports through trade agreements with other countries which reduce the tariffs and other barriers to the markets of potential trading partners. In addition, the European Commission works on a day to day basis to remove specific barriers and obstacles encountered by exporters, to open up new opportunities for European investment, and to reduce counterfeiting and piracy of European goods. An open and fair international trading system is one of the foundations of Europe's competitiveness.

Common market creates the conditions for free movement of production factors (Farrell, 2004). Labour and capital flows to the regions offering the best location for investment. Capital in particular tends to move to those areas that have already the best position. Labor move from low-wage countries. So, these movements may have risk of unbalanced development.

Operation of economic and monetary unit curtails the instruments available to national states. The progress of harmonization depends more on supranational policies and national instruments lose some their power to control regional development. The highest forms of integration use two types of instruments: interpersonal transfers and interregional. The first one deals directly with individual, the second one – with regions. Poor regions may receive more from the central state to finance their programs.

In matters of cohesion there are a range of actors and institutions involved.

The European institutions involved in cohesion policy are European Commission, Committee of the Regions, Economic and Social Committee and employer's organizations.

The policy of the Union is based on a principle of partnership as the main element of good management (Eckel, 2007). Partnership is a set of rules and procedures that prescribe European Commission, national governments, regional authorities and representatives of social actors collaborate closely together and plan, implement and evaluate European Union funded cohesion programs. The management system of all levels which is based on strategic method and includes Union's institutions of national, regional and local authority and the parties concerned helps to ensure that the actions will be fitted to the specific conditions and firmly pledge oneself to seek for the success will be made.

### **The implication of European Union Structural Funds to Lithuanian economic and political environment**

The main potential benefit of EU Structural Funds in Lithuania is the fact that Lithuania making use of EU funds can carry out investment, which would not exist without the EU Structural Funds. Lithuania is a net of EU funds recipient, i.e., from the EU Structural Funds, Lithuania receives more money than pay taxes to the EU budget. This shows that Lithuania is making use of EU structural funds, use of intra-EU redistribution of the more economically developed countries to less developed countries.

EU funds also can be used for transformation of the partially or fully state-owned sector (e.g. education, public administration, social security). This would reduce the tax burden. By using the EU funds,

the private sector has the potential to invest more, to take projects without EU funding not buy. European Union member states imposes different obligations, the EU funds can also be used to implement the mandatory EU standards in Lithuania.

Whether the use of EU assistance reaches its goals depends on many factors. The main benefit of EU structural funds take-up criteria is that the EU funds should be used purposefully and effectively. It is important that the EU funds would be efficient distributed across the state and create a mechanism at national level priorities, not only partially.

Such investments as the EU Structural Funds may cause undesirable economic consequences that characterize public investment and government support. Public investments driven by market forces do not work, the projects are selected according to established criteria rather than by market needs, which is changing while long period of time when funds are requested and projects are done.

Use of EU funds can contribute to different operating conditions for business development. Not everyone gets part of structural funds and only those sectors with priority given to EU support. It becomes much harder to compete in the market for those who did not receive funding. Companies that have received EU support compete with companies which did not receive it. Exceptional conditions are created in sectors which were given the priority to EU support, as well as different operating conditions for an EU contribution of the Lithuanian allocation rules and criteria for each businesses or enterprises are distinguished from each other. EU funds become an instrument by which the government rather than market allocate resources to shape the economic structure.

European Union Structural Funds have affected prices in the country. Rapid Lithuania economic growth has been associated with price increases, there was looking for different ways to stop inflation often suggested to use price regulation mechanisms. When economy slows down, a decline of prices slowing down too, but from the end of 2010 prices started to increase again. This was an effect of big flows of money to Lithuania, so money piece did depreciate.

EU assistance real beneficiaries are often not those players for whom it is given. This kind of support transfer occurs when a large amount of funds to one sector artificially raise the demand for sectors resources, so - and prices. So, for one sector allocated EU funds are also directed towards bringing the benefits and use of resources to these sectors suppliers. This means that the EU support benefits cannot be accurately locked onto a specific sector.

Access to the EU assistance funds may change the motivation of the private sector, i.e. EU funds may not be potential secondary specific business problems solution (lack of skills, marketing skills resolution), while one of the core business objectives and ways to survive. This means that the number of employed productive people is reduced. Resources that could be used to create added value to the economy, is wasting not for competing in quality of goods or services that better meet consumer needs, but competing for the support, which does not create any added value.

In order to benefit themselves, market players may seek to influence the EU funds management entities decisions on the allocation of funds, their use of control and so on. Therefore, the process of absorption of EU funds creates conditions for corruption in the country to emerge.

In 2009 Odysseas Katsaitis and Dimitris Doulos analyzed the EU structural funds and foreign direct investment relationship in the 15 EU countries. The main findings were that the impact of Structural Funds for foreign direct investment is not always positive and depends on the quality of institutional infrastructure in the country. In countries with high corruption levels, low quality of public institutions, the Structural Funds can only worsen the country growth and attracting foreign investment prospects.

Philipp Mohl and Tobias Hagen in 2010 published an article, which studied the use of EU funds for regional development. The article states that the EU Structural Funds often finance projects that are not cost effective, because they are influenced by the operation of the political motives and opaque payments. Also, since all of the EU structural funds projects have to be co-financed, the possibility of using EU funds to support public sector displaces a more cost-effective public investment projects, which would had been taken without EU funding. This may reflect adversely on regional development.

The general conclusion of studies analyzing the impact of EU funds - the EU structural funds benefit very much linked to how and in what economic development environment (fiscal, regulatory and business conditions, government institutions and transparency) of these funds are used.

## The impact of European Union Structural Funds on economy of Lithuania

Eight years have already passed since the day Lithuania became a full-fledged member of the EU. A good number of positive changes took place in the country during this period, while one of the most striking - EU assistance.

Within this period Lithuania disbursed about three billion litas of EU input for various EU-financed areas under the Single Programming Document (SPD) and this was 95% of all EU allocated funds. Also about 3,5 thousand projects were implemented. This has been a conclusive proof that Lithuania lack neither energy, nor knowledge in preparation and implementation of projects. The global objective of the Development Plan 2004-2006 was therefore to: "Strengthen the preconditions for growth in long-term national economic competitiveness and to facilitate the transition to and development of a knowledge-based economy characterized by increasing GDP levels and strong employment growth, leading to higher living standards and increasing well-being for all Lithuania's inhabitants". In 2009 evaluation results of EU SPD impact for GDP of Lithuania showed that for SPD support in 2006 GDP increased by 1,2%, in 2007 – 1,6% and the maximum effect observed in 2008, which amounted to about 2,2%. This and other results of evaluation SDP funds use justify the impact of SPD fund on Lithuanian economy.

It is difficult to evaluate the influence of EU SF support to state economy in terms of quantity. In order to do it, it is necessary to determine the direct and indirect impact of different measures. By the way, last-mentioned may be negative, as it was discussed before: for example, direct companies' support distorts market relation and makes not equal conditions for competition. However, wishing to evaluate the perspectives of state economy reasoned, it is purposeful to review it's development during last years.

Protracted crisis in the euro area does negative influence on Lithuanian macroeconomic situation, also does negative impact to confidence of investors. In beginning of the year 2012 the life in Lithuania is about the coming parliamentary elections, which will be held in 14 of September. The main problem of today government is to cope with budget deficit, which started to get bigger after euro crises started. Lithuania and other EU member states do have to follow signed Stability and Growth Pact, which requires a deficit do not exceed 3% of GDP. In the end of year 2011, government had to decide which of the following measures to choose, after GDP growth prognosis was reduced. The government considered whether to increase VAT rate from 21% to 23%, whether to start collect property tax. Decision was done to collect sum of 1 mil. Lt for budget deficit hole taxing 1% of each citizen's property market value over 1 mil. Lt. In conclusion, the year 2012 release tax burden for small businesses (increased income level for obligation to pay VAT rate and obligation to pay preferential income tax, same level of VAT rate) and complicated the tax burden for citizens (property tax, extended retirement age and no decisions from government about rising minimal monthly wage/pensions).

The World Bank indicates three risk factors, which may significantly worsen the economic situation in Lithuania. One of the biggest threats - the need for borrowing or foreign direct investment to fill the external financing "hole". WB predicts that to cover Lithuania's current account deficit, previous debts and interest return this year there will be needed 16,4% of GDP investments from abroad. Most of this amount (14,1% of GDP) for the previous debts. WB sees a risk that if investors will continue to reduce their portfolio risk (decreases since August last year), some countries (probably emerging markets) will not be able to borrow in international markets. That would threaten the heavily indebted countries to fiscal stability.

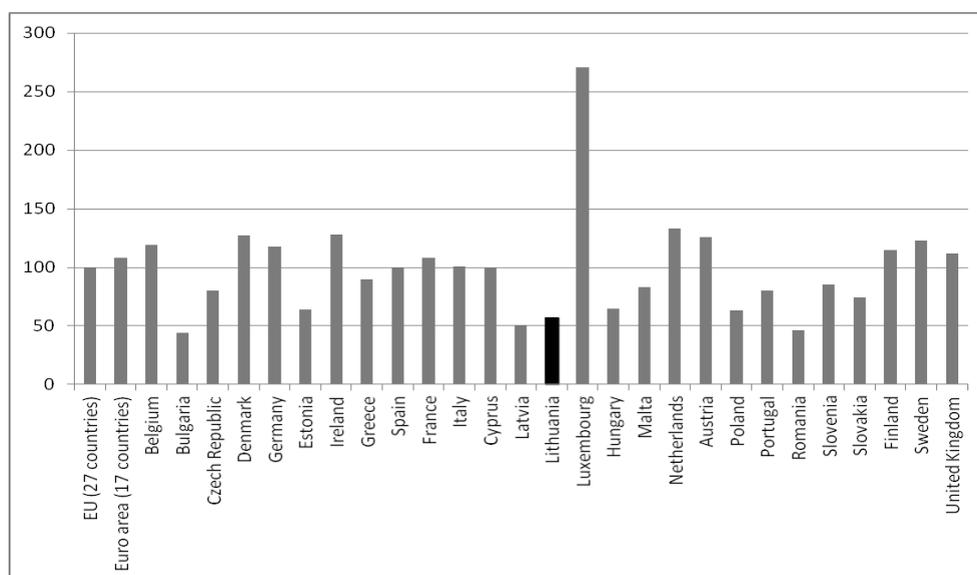
The World Bank refers to the risk of Lithuania's strong dependence on the debt crisis in the euro area. If the crisis spreads to the euro zone, Lithuania directly will feel the negative effects arising from exports, because Lithuania's trade exports to the EU for 2008-2010 accounted for about 70% of total exports. Some alternatives could help here –export diversion to non-EU countries or further growth in the domestic market. But macroeconomists are not very optimistic about last one.

WB also draws attention to the Lithuanian banks dependence on foreign banks. Lithuania loan-deposit ratio is 129%. If the cash flows from holding banks ends, local resources would not change it, multiple banks would be forced dramatically reduce lending to meet capital adequacy requirements.

**Gross Domestic Product (GDP)** over year 2011 amounted to EUR 30 616,5 million (LTL 105 712,5 mil.) (under prices of the day) as in 2010 GDP amounted to EUR 27 535,4 mil. (LTL 95 074,3 mil.). According to statistical data GDP growth of year 2011 compared to 2010 was 5,8%. GDP growth compared with year 2005 in 2011 was 11,38%, in 2010 – 5,2%, in 2009 – 3,7%, in 2008 – 21,8%. These results shows the crisis influenced Lithuanian macroeconomic situation in year 2009, but year 2011 was year of significant growth.

Manufacturing, wholesale and retail sales, transportation and real estate had the biggest influence for GDP's growth in 2010. 16% of country's GDP in 2010 was created by the largest sector of economy in Lithuania – manufacturing. This industry was reduced by 15% percent in 2009 compared with 2008, while manufacturing increased by 8% in year 2010 compared with 2009. Food and beverages production industry was the biggest among other manufacturing industries and had a level of 22% of all manufacturing in 2010. This manufacturing industry is the main component until statistical data available (1995) in Lithuania. Manufacture of chemicals, chemical products and man-made fibres was growing at the a higher pace in 2010 compared to other manufacturing industries - at 26,1% compared to 2009. Food and beverages production increased at 14,7% in year 2010 compared to 2009.

GDP per capita was about EUR 9 496 (LTL 32 78) in 2011, that is 13,35% more than in 2010 and 19,2% more than in 2009, but 1,76% less than in 2008. Despite of the recovering GDP level compared to peak in 2008, economy level in Lithuania still stays 43% lower than in EU and about 55% lower than in Ireland (see Figure 1). Comparing the year 2010 results, we have the better GPD per capita ratio than EU countries: Bulgaria, Latvia and Romania. During year 2010 Lithuania has caught up 2% to EU level, but still misses additional 4% to reach peak in year 2008.

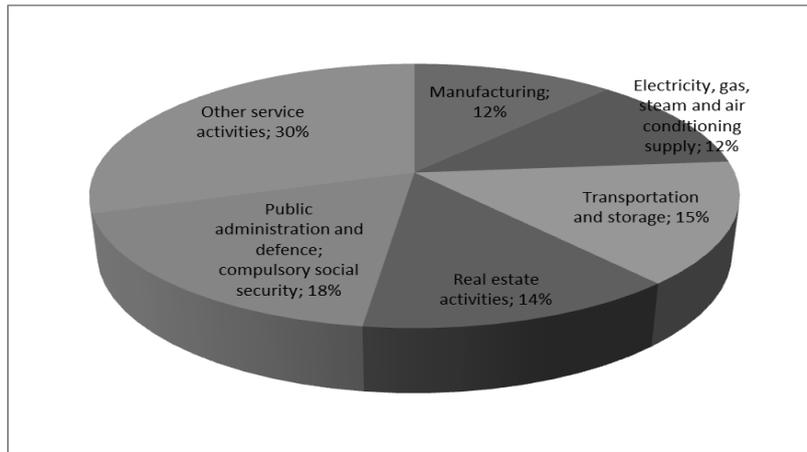


**Figure 1.** Lithuanian Gross Domestic Product per capita year 2010, comparison with EU countries (EU-27=100), (Eurostat, 2011)

**Investments.** Material investments amounted to EUR 2 645 mil. (LTL 9 133 mil.) in 3 quarters of year 2011. 39,8% of material investments were in public sector and 60,2% in private sector. 56% of material investment in this period was to construction and repairs of buildings and civil engineering structure, 38% to acquisition of equipment, machinery, transport vehicles and 6% to other materials. Compared to 3 quarters of 2010 material investments in 3 quarters of 2011 increased by 23% and compared to 2009 same period by 4%.

Material investments during year 2008-2010 decreased year by year. Material investments in year 2010 decreased by 23,3% compared to year 2009, by 58,5% compared to year 2008 and 62,3% compared to 2008. The most significant decrease during these years was in construction sector. Material investments in this sector in year 2010 decrease by 92% compared to year 2007. Sectors, which had reached the peak level of year 2007 in 2010, are electricity, gas, steam, air conditioning supply and water supply, sewerage, waste management and remediation activities.

The main structure of material investments in 3 quarters of 2011 contains 18% public administration and defence and compulsory social security, 15% of transportation and storage, 12% of manufacturing and 14% of real estate activities (see Figure 2). Human health and social work activities grew at a biggest level in 3 quarters of 2011 compared with same period in year 2010, at 128%. It is predicted, that manufacturing, construction, professional, scientific and technical activities and human health with social work activities were sectors, which grew at a highest temp compared to 2010.

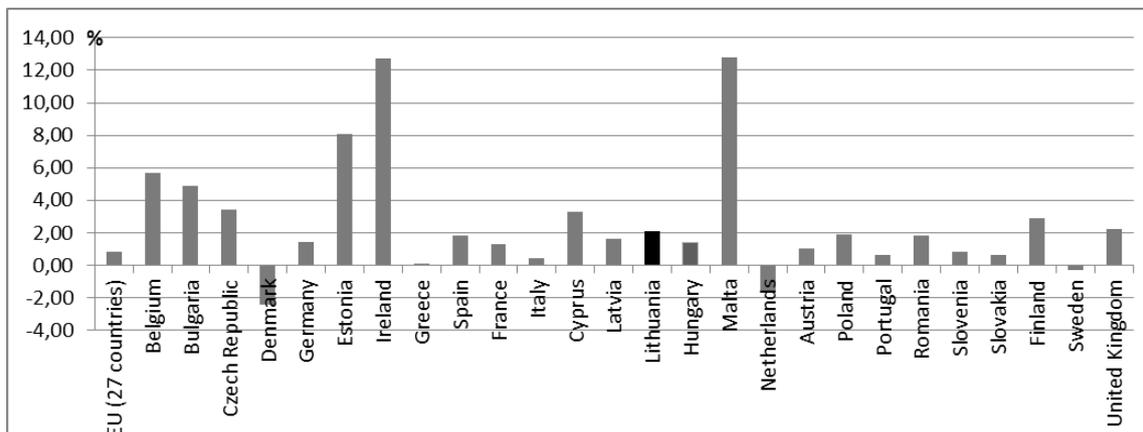


**Figure 2.** Lithuanian material investment in tangible fixed assets at current prices structure, % in 3 quarters of 2011, (Department of Statistics, 2012)

Foreign Direct Investments (FDI) in the end of 3 quarters year 2011 amounted to EUR 10,73 billion (LTL 37,06 billion). During this period it increased by 2,25%. FDI per capita was EUR 3 347,13 (LTL 11 556,97) on October 1st, 2011.

The biggest portion of FDI went towards manufacturing – 31,6%, wholesale and retail – 13,9%, financial services – 12,4%, real estate, rental and other commercial companies – 11,3%, logistics/transportation, storage and communication – 10,9%, energy, gas and water supply – 6,7%. The most significant increase of direct investments was made in manufacturing and wholesale and retail during 3 quarters of year 2011. The biggest investments in manufacturing sector was made to oil and chemical manufacturing – 52%, food, beverages and tobacco production – 11,5%, pharmaceutical products and pharmaceutical preparations production – 11,7%.

On October 1st, 2011 foreign investors by country that made the most significant investments: Sweden (14,35% of all FDI), Poland (13,02%), Germany (9,86 %), Netherlands (8,57%), Russia (6,28 %), Denmark (5,33%). There were 75,35% of all FDI during this period from countries of European Union and it amounted to EUR 8,09 billion (LTL 27,9 billion). From NIS countries there were EUR 738 mil. (LTL 2,55 billion) – 6,87% of overall FDI.



**Figure 3.** Inward Foreign Direct Investment from the rest of the world % of GDP year 2010, (EU-27=0,8), (Eurostat, 2012)

Figure 3 illustrates inward FDI to each EU member from rest of the world in per cents of GDP, where Lithuania rate is equal to 2,1%. Results shows, that Lithuania compared to European Union 27 countries index 0,8% flows are higher from other countries. That means that Lithuania is attractive to investors, but still we lose competition to countries like Estonia (8,1%), Ireland (12,7%), Malta (12,8%) and other. During years 2004-2009 the peak was in year 2006 (6,0%) and it decreased each year till 2009 (0,2%) in Lithuania.

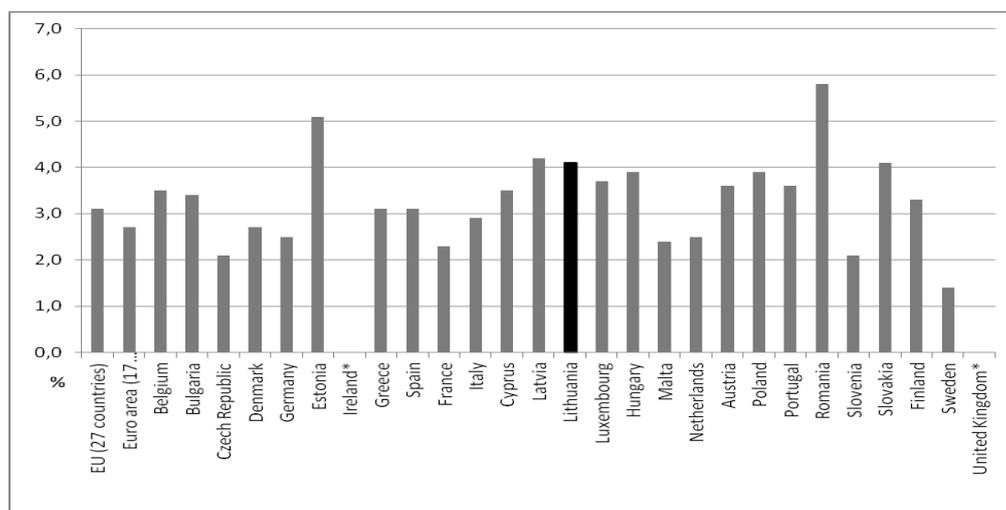
**Inflation.** According to the harmonized consumer price index average annual inflation in 2011 accounted for 4,1% and was 2,9 per cent point higher than in 2010, also 0,7 per cent point estimated the Maastricht inflation criterion (3,4%).

**Table 1.** Changes of goods and services prices (Department of Statistics, 2012)

Groups of goods and services	Annual CPI (2011 12, as compared of 2010 12)	Average annual change in prices of consumer goods and services by COICOP in 2011 12, %
Common	103,4	4,1
Food and non-alcoholic beverages	105,5	8,3
Alcoholic beverages and tobacco	101,6	1
Clothing and footwear	97,5	-1,2
Housing, water, electricity, gas and other fuels	109,4	8,3
Furnishings, household equipment and routine maintenance of the house	101,2	-0,2
Health care	100,6	0,8
Transport	104,7	8,1
Communication	97,8	-3,1
Recreation and culture	98,8	-1,5
Education	100,7	0,5
Hotels, cafes and restaurants	103,9	2,1
Miscellaneous goods and services	101,6	0,8

The annual inflation rate comparing year 2011 to year 2010 was mainly influenced by 5,5% increase in food and beverages, 9,4% increase in housing, water, electricity, gas and other fuels, goods and services, 4,7% increase in transport of goods and services (see Table 1). In 2011 consumer goods went up by 4%, services – 1,5%. In 2011 fish prices went at highest level among consumer goods, by 17,1%, and vegetable prices went down at a highest level – by 11,9%.

From 1991 until 2010, the average inflation rate in Euro area was 2,24% reaching an historical high of 5% in July of 1991 and a record low of 0,7% in July of 2009 (see Figure 4).



\*no data available

**Figure 4.** Lithuanian annual average rate of inflation change in 2011, comparison with EU countries (EU-27=3,1), (Eurostat, 2012)

In 2011 prices went up in all European members. The lowest annual rates were observed in Sweden (1,4%), Slovenia (2,1%), Czech Republic (2,1%) and France (2,3%), and the highest in Romania (5,8%) Estonia (5,1%) and Latvia (4,2%). The European members average annual rate was equal to 3,1% and it rose by 1% compared to year 2010. The annual inflation rate mostly increased in non-euro area countries, because annual inflation rate in euro area was 2,7% and lower than in all EU members.

**International trade.** Production exported during 2011 amounted to EUR 20 169 mil. (LTL 69 642 mil.), production imported to Lithuania for the value of EUR 22 636 mil. (LTL 78 159 mil.). The deficit for Lithuania's international trade amounted to EUR 2 467 mil. (LTL 8 517 mil.). Comparing to 2010 deficit increased by 23,19% and by 86% comparing to 2009.

The most important export and import partners in 2011 were – Russia (16,57% of export and 32,82% of import), Latvia (10,22% of export and 6,64% of import), Germany (9,3% of export and 9,74% of import)

and Poland (6,98% of export and 9,13% of import). The highest level of trade deficit was with Russia and amounted to EUR 4 087 mil. (LTL 14 112 mil.). The highest level of trade balance was with Estonia, and amounted to EUR 704 mil. (LTL 2 431 mil.). During year 2006-2011 Russia was always top of exporter and importer to Lithuania. Comparing to 2010 import increased by 29,02% and export increased by 36,39% with Russia and import increased by 46,86% and export increased by 56,81% comparing to 2009.

Mineral fuels, mineral oils and products of their distillation, bituminous substances, mineral waxes had a biggest amount of export and in the same time biggest amount of import in year 2011. This nomenclature was 25,34% of export and 33,71% of import, it's deficit amounted to EUR 2 520 mil. (LTL 8 701 mil.). The largest amount of this nomenclature was exported to Netherlands (17,17%). The largest amount of this nomenclature was imported from Russia (88,75%).

European Union member's production export during 2010 amounted to EUR 1 347 948 mil., production imported to European Union amounted to EUR 1 506 934 mil. The biggest exporters were Germany (28,1% of all export), France (11,4%), Italy (10,7%) and United Kingdom (10,5%). The biggest importers were Germany (19,4 % of all import), Netherlands (13,8%) and United Kingdom (13,6%). The main EU partner for export and import was United States (18% of all export and 11,3% of all imports), China (10,4% of all export and 19,4% of all imports) and Russia (6,4% of all export and 10,5% of all imports). The main product groups of export was machinery and transport equipment (42,4%) and chemicals and related products (17,4%). The main product groups of import was machinery and transport equipment (29,5%) and mineral fuels, lubricants and related materials (25,4%).

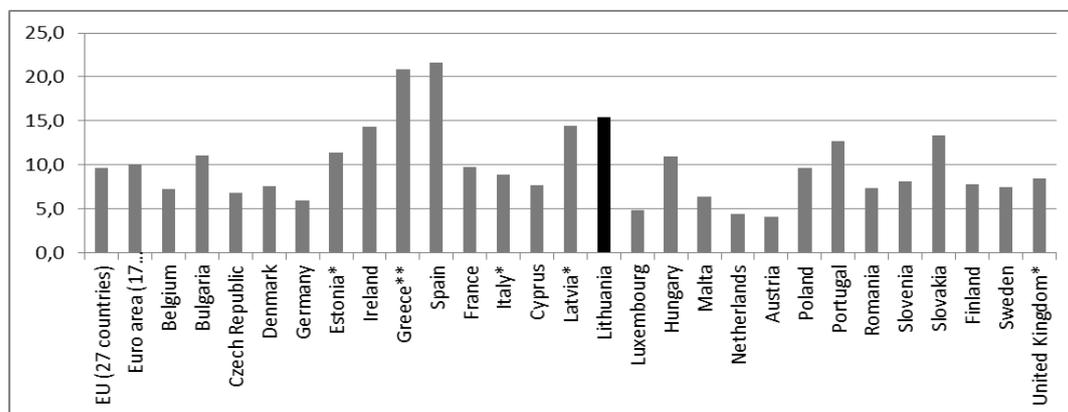
**Job market.** Economic crisis was one of the factors stipulating decrease of employment as well as increase of unemployment.

1619,7 thousand Lithuanian residents were employed in 2011, this is about 1% less than in 2010 and 1,3% more than in 2009. In 2011 there was 248,8 thousand unemployed residents in Lithuania. It declined by 42,3 thousand or 14,5% comparing to 2010. This difference was 23,7 thousand, it increased by 10,5% compared to 2009.

During 2010 there was lower number of unemployed female residents than male residents. Proportion of unemployed female residents was 47,7%, male residents – 52,3% in 2010. Proportion of unemployed woman in year 2009 was 37,9% and men – 62,1%. This means that in the year of crisis peak there was more men who lost their jobs, women unemployment number increase less compared to men.

Level of unemployment was declining in Lithuania during year 2011. Unemployment level in 2011 was 15,4%, in 2010 and 2009 – respectively 17,8% and 13,7%. Unemployment was declining in the whole country in 2011 comparing to ratio of the unemployed persons to the working age population in year 2010. In year 2011 the lowest ratio was in Kaunas (10,9%) and Klaipėda (10,7%) districts, the highest ratio was in Utena (14,3%) and Alytus (14,5%) districts. There is a big dispersion among mean – Lithuania ratio at 11,7%, this means there are disparities among districts in Lithuania.

Today one of the biggest problems related with unemployment is youth unemployment rate in Lithuania. Youth unemployment rate is much higher than EU average (22,1%). Lithuania on youth unemployment in the EU is in the fourth place from the end, there are Slovakia, Greece and Spain with higher youth unemployment. According to Department of Statistics, youth (15-24 years people) unemployment in the third quarter of in 2011 is 31,7%.



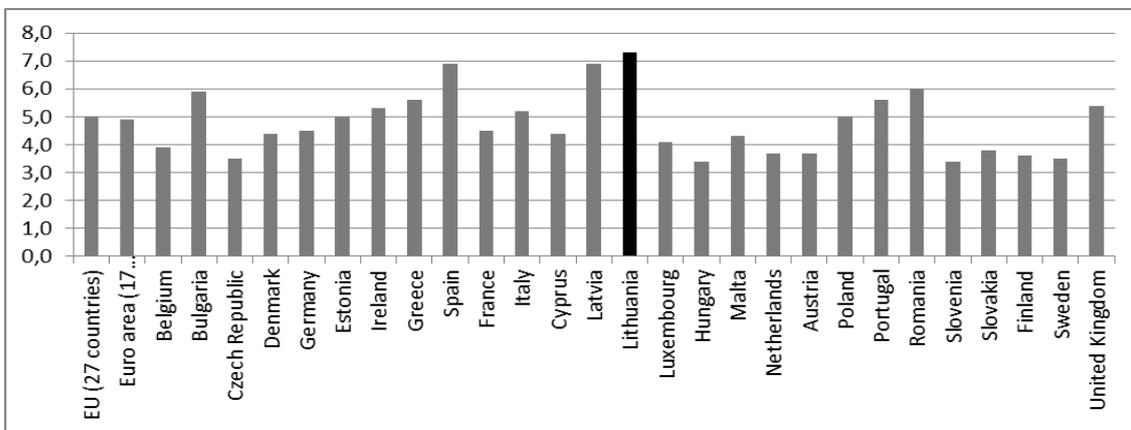
\*2011 December data; \*\*2011 November data

**Figure 5.** Lithuanian unemployment rate year 2011, comparison with EU countries (EU-27=9,6), (Eurostat, 2012)

European Union unemployment rate in year 2011 was equal to 9,6%. This is 0,1% less than in year 2010 and 2,5% higher than in year 2008. Lithuania had one of the highest unemployment rates among members (see Figure 5). Estonia was the country that during year 2011 decreased unemployment rate with a highest level compared with year 2010 – from 16,9% to 11,4%.

**Incomes.** The average net monthly earnings in Lithuania according to data from 2007 to 2011 increased in EUR 69,39 (LTL 239,6) and was equal to EUR 591,4 (LTL 2042). Compared to 2010, earnings increased 2,7%, and compared to 2009 decreased 0,6%. Minimal monthly salary was increased to LTL 800 (EUR 231,7) (33,33% increase) since January 1st, 2007. The most significant influences for changes in salary were: increasing demand for workforce, growing productivity, and increase of minimal monthly salary.

Today Lithuania has one of the lowest minimal wages among European union members. There are lower minimal wage just in Bulgaria (EUR 138,05) and Romania (EUR 161,91). Estonia (EUR 290) and Latvia (EUR 285,92) have one of the lowest minimum wages among members too. Highest minimum wages have Luxembourg (EUR 1801,49), Ireland (EUR 1461,85), Netherlands (EUR 1446,60) and Belgium (EUR 1443,54). This is about 6,5 times more than in Lithuania. Some members (Denmark, Germany, Italy, Cyprus, Austria, Finland and Sweden) do not limit minimal wage.



**Figure 6.** Lithuanian inequality of income distribution - S80/S20 quintile ratio year 2011, comparison with EU countries (EU-27=5), (Eurostat, 2012)

Figure 6 illustrates the ratio of total income received by the 20 % of the population with the highest income (top quintile) to that received by the 20 % of the population with the lowest income (lowest quintile). As results show, Lithuania has the highest ratio of inequality of income distribution (7,3) compared to other EU members. This means, that there is a big gap between people from income point of view. Other countries with high ratio – Latvia and Spain (6,9). The lowest level of ratio is in Hungary (3,4), Slovenia (3,4), Czech Republic (3,5) and Sweden (3,5).

**Migration.** In 2010 his departure declared more than 83 157 people. It is nearly four times more than in 2009. Such a sharp rise in emigration declared is essentially related to the Health Insurance Law as amended. Under this law, all residents registered in Lithuania must pay the state health insurance premiums. Emigrants, who were not declared their departure, had to pay these premiums. To avoid such payments, and even a few years away, but officially declaring his departure, emigrants rushed to do so in 2010. Therefore, in 2010 emigration has increased so dramatically. Although these changes became more reliable migration statistics, it is important to note that not all emigrants declared his departure from Lithuania before. In 2011 emigration decreased, there were 53 863 people, who declared departure.

The main reasons for emigration in Lithuania are relatively low wages and high unemployment. However, the IOM Vilnius office study found that the decision to emigrate affect for the other socio-economic factors too, such as social insecurity, the lack of justice, unsatisfactory conduct by employers to employees, as well as better career prospects abroad. Most of the emigrants lost their jobs, for example, 85% individuals declaring his departure in 2010 indicated that prior to departure, they were unemployed for one year or longer.

In 2010 about 50% of all emigrants went to Great Britain and 15% to Ireland, Norway (5,8%), Germany (4,6%) and Spain (4,3%). Prior to joining the EU, Lithuania most people immigrated to the Russian Federation, the Common wealth of Independent States countries and United States of America.

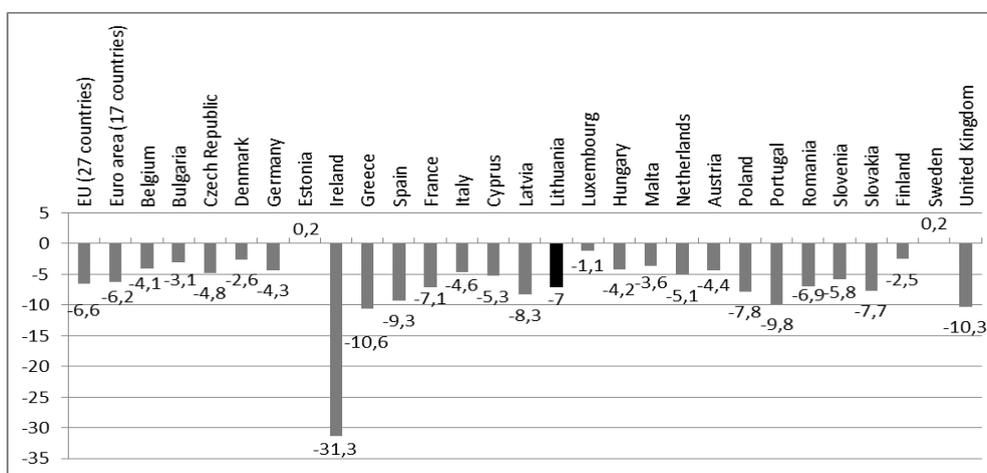
Emigration trends may change in the near future. In May, 2011 its labor market to citizens from Lithuania opened Austria and Germany. They may become attractive target countries to immigrants from Lithuania. In 2010 typical expatriate of Lithuania was a young with no family an educated person (male or female) mostly leaving to Great Britain.

Meanwhile, the number of immigrants to Lithuania is relatively small. Over the last decade in Lithuania per year came about 6 500 people. Most of them were returning citizens of Lithuania.

**Indicators of government sector.** In 2010 Lithuanian general government deficit was -7% of GDP according to ESS'95 methodology. Rate decreased by 2,5% compared to year 2009 and increased by 3,7% compared to year 2008. Governmental sector's debt increased from 29,4% GDP in 2009 to 38,0% GDP in 2010, in year 2008 this rate was equal to 15,5%.

According to Maastricht Treaty, Government deficits were limited to be no larger than 3% of GDP and Government debt was limited to be no larger than 60% of GDP. Today most members do not meet these limits of Maastricht Treaty.

In 2010 European union governmental sector's debt was equal 80,1% GPD, countries like Belgium (96,2% GPD), Germany (83,2% GPD), Ireland (92,5% GPD), Greece (144,9% GPD), France (82,3% GPD), Italy (118,4% GPD), Hungary (81,3% GPD) and Portugal (93,3% GPD) had a biggest debts in year 2010 (see Figure 7).



**Figure 7.** Lithuanian general government deficit/surplus as percentage of GDP year 2010, comparison with EU countries (EU-27=-6,6%), (Eurostat, 2012)

Just few countries did meet the limit of government deficit. Biggest problem with deficit is in countries Ireland (-31,3% GPD), Greece (-10,6%), United Kingdom (-10,3%), Portugal (-9,8%) and Spain (-9,3%). Problems with this rate started in year 2009, then this rate was equal to -6,9% in EU. In 2010 this rate seeks -6,6% GPD in EU.

According to Ministry of Finance, public debt at the end of 2011 amounted to LTL 41,7 billion. (39,4% of GDP). At the end of 2011 the central government debt amounted to LTL 38,5 billion, local government debt – LTL 1,6 billion, social security funds' debt – LTL 1,6 billion.

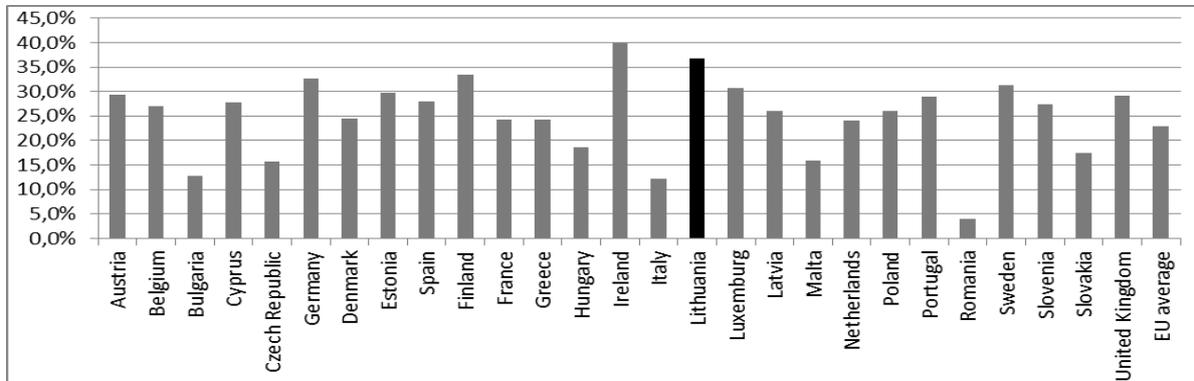
**EU funds assimilation.** The total amount of investments to be made into growth of Lithuania's economy stands at LTL 25 654 mil. (EUR 7 430 mil.), including LTL 23 389 mil. (EUR 6 774 mil.) of EU funds allocations for 2007-2013.

According to details from the institutions charged with administrating the EU's support in Lithuania, from the launch of Lithuania's EU structural assistance to Lithuania for year 2007 to 2013, a total of nearly 9 689 applications have been received, requesting assistance in an aggregate amount of LTL 27 640 mil. (EUR 8 005 mil.), which is 107,74% of funds allocated for funds implementation during this programming period.

All of the applications are being checked for compliance to EU structural assistance to Lithuania priorities and goals, the baseline screening criteria, the projects are being assessed for quality, continuity potential, economical efficiency, etc. In principle, the stages of project assessment and screening are already complete, nearly all of support agreements have been signed and every effort is now being made to guarantee the appropriate implementation of the projects.

By February 29, 2011, a total of 5 542 agreements have been signed for an amount of LTL 23 870 mil. (EUR 6 913 mil.) and LTL 11 505 mil. (EUR 3 332 mil.) sum of funds paid out to the projects.

There are four operational programmes for projects to be signed: Operational Programme for the Development of Human Resources (VP1), Operational Programme for Economic Growth (VP2), Operational Programme for Promotion of Cohesion (VP3), Technical Assistance Operational Programme (VP4). First 3 programmes have already received more request for funds than there are allocated and for these programmes are about 45% funds already paid out. VP4 has less popularity and there are just about 31% allocated funds paid out for projects.



**Figure 8.** EC payments made of all part of the EU Structural Funds allocated to country, 1 December, 2011 (*EC Directorate-General, 2012*)

At 1st of December, 2011 funds paid by the European Commission to Lithuania were about 36,8%. Across the European Union only Ireland (39,8%) exceeded Lithuania. The European Commission payments made to members from all parts of the EU Structural Funds in 1 of December, 2011 was about 22,8% (see Figure 8). However Lithuania still fails to comply with the plan provided for the absorption. It is important that the impact of EU funds in Lithuania's economy is growing, i.e. account for an increasing share of gross domestic product. In 2008 Lithuania absorption was approximately LTL 559 mil. EU support, which amounted to about 1% that year's GDP. 2009 and 2010 absorption was respectively LTL 2 659 mil. and LTL 3 047 mil., which accounted for about 3% that year's GDP. In 2011 was expected to absorb LTL 5 300 mil. and that would had led Lithuania to a plan at the end of year 2011 be absorbed about 50% of allocated EU structural funds, but compared to results of 1 of December, 2011 (36,8%), likely Lithuania did not meet the plan. In 2012 the plan is to get over LTL 7 000 mil. European Union funds and it will be absolutely the largest amount of EU funds spent in Lithuania during the entire period of Lithuania accession to the EU. According to European Commission Directorate-General, Lithuania successfully uses European Union's support for business development and transport infrastructure, but most difficult sectors are education and development, information and technology (IT) and the environment.

The problem of EU funds absorption occurred, when European Commission on 10 of February, 2012 stated that Lithuania absorbs EU structural funds with the unauthorized breaches, and suspended the payment of EU funds from the European Regional Development Fund and Cohesion Funds. Support will be updated when Lithuania will develop a plan to avoid damage. Lithuania reports estimates that the infringements were 1,93% of the total funds, but European Commission services consider four potential violations not included. In their inclusion, the infringement amount exceeds 4,36%. In addition, the EC is concerned about the damage, that can be systemic, which means - they can recur. Thus, the Lithuanian authorities have asked two months to prepare an action plan for the similar cases prevention.

## Conclusions

Lithuania, aborting EU structural funds, is using intra-EU reallocation of the more economically developed countries to less developed countries.

EU funds in Lithuania provide the opportunity to use them for investment, partially or completely restructuring state-owned sector, stimulate private sector investment results, which could not occur without EU support, or pay back would be less because of their high price. It is argued that the purposeful use of funds increases country's competitiveness and create conditions for faster economic growth.

EU Structural Funds can also cause undesirable economic consequences, which are characteristic of public investment and public support: the distortion of competition, crowding out private investment, higher

prices, lower efficiency of budget funds, demotivation of private sector, resource referral to a non-productive activities and creation of preconditions for corruption and abuse.

Although the absorption of EU funds in Lithuania, compared with other EU countries is sufficiently fast, in the same time Lithuania lags behind the intended plan. It is necessary to have in mind the fact that in the coming years it is planned to absorb more funds. It is necessary to assess the risk that not all EU Structural Funds will be absorbed in a timely manner. In this case, in order to improve the absorption of EU funds, it should be reconsidered EU funds transfers between different measures of operational programs or priorities.

According to the statements about the potential benefits of EU assistance and the possible negative consequences of EU funds, EU funds reallocation also should achieve more benefits of development assistance, while at the same time should minimize the negative consequences of using EU funds.

Lithuania's economy has grown rapidly since joining the EU, in the same time allocating funds through the structural funds: compared with 2005 GDP grew throughout the year later, in 2010 Lithuania got one of the largest foreign direct investment flows in relation to GDP than other EU member, over the years changed trade relations with Russia – Lithuania diversified trade with other partners.

In 2009 Lithuania, as well as other Baltic States, survived economic crisis smoothest than other members. Today also, as the debt crisis has hit Europe, the Lithuanian government deficit is 7% of GDP, public debt accounts for about 39% of GDP. At the same time, EU member states such as Ireland, Greece, Italy, Portugal and other do not meet most of the Maastricht criteria. It is important while shaping the policy of Lithuanian economy rely on other members' experiences.

Review the absorption of EU funding priorities can be a tool to solve the most acute Lithuanian economic problems – youth unemployment, emigration, the uneven distribution of income and others.

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