

PARLIAMENTARY ELECTIONS IN LITHUANIA

What can international investors expect from the change of government?

28 October 2020

On October 25, Lithuania held the second round of its parliamentary elections. 73 MPs were appointed in the first round on October 11th, with voters then electing the remaining 68 single district MPs to the Seimas, the country's unicameral parliament, in round two¹.

As was widely expected, Lithuania's largest opposition party, the centre-right Homeland Union-Lithuanian Christian Democrats (TS-LKD), won the election after securing 50 of the 141 seats across the two rounds. Gaining close to 25.8% of the popular vote, the party secured 23 seats in the nationwide multi-member constituency (of the total 70) and another 27 seats in the country's single-mandate electoral districts (of the total 71). The victory comes after a growing level of social anxiety over the impact of the coronavirus crisis: unemployment has soared and support for the Government's handling of the crisis flagged in recent months.

Defeating the incumbent Lithuanian Farmers and Greens Union (LVŽS) in both the multi-member and single-mandate constituencies, the Homeland Union now looks set to form a coalition with two liberal parties – the Liberal Movement, a former coalition partner between 2008 and 2012, and the Freedom Party, a newly founded liberal formation which has campaigned for issues such as legalising same-sex marriage, carbon neutrality by 2040 and drug decriminalisation. With the Liberal Movement securing 13 seats and the Freedom Party 11, the three parties would have a slight but comfortable majority in the 141-member legislation.

While some expected LVŽS to remain in government, rising criticism of its pandemic response proved fatal to its chances: support for the party fell from 22.4% of the popular vote in 2016 to 18.1%, while growing for Homeland Union from 22.6% to 25.7%. These are significant changes given the multi-party nature of Lithuanian politics, with 8-9 parties generally active on the national arena, although LVŽS has retained enough support to command an important role in opposition.

Below, we take a deeper look at the election results, as well as what it means for Lithuania's immediate policy direction and the likely impact on the business and investment communities.

¹ Under Lithuania's two-round parliamentary election system, 71 MPs of the 141-seat Parliament are elected in single mandate constituencies in a majority vote. The remaining 70 members are elected in a nationwide constituency based on proportional representation, meaning that voters cast two ballots: one for a candidate in their electoral district and one for a national party list. In single mandate districts, a second-round ballot is held between the two frontrunners two weeks after the first vote if no candidate receives more than 50% of the vote. In the current election, only three district races were called in the first round, while the remaining 68 proceeded to a run-off on October 25.

TABLE: ELECTION RESULTS

Political Party	Popular Vote (%)	Number of MPs	Share of MPs (%)
Homeland Union - Lithuanian Christian Democrats (TS-LKD)	25.8	50	35.5
Lithuanian Farmers and Greens Union (LVŽS)	18.1	32	22.7
Social Democratic Party of Lithuania (LSDP)	9.6	13	9.2
Liberal Movement (LRLS)	7	13	9.2
Freedom Party (LP)	9.5	11	7.8
Labour Party (DP)	9.8	10	7.1
Electoral Action of Poles in Lithuania (LLRA)	4.97	3	2.1
Social Democratic Labour Party of Lithuania (LSDDP)	3.3	3	2.1
Freedom and Justice (LT)	2.1	1	0.7
Green Party (LŽP)	1.7	1	0.7
Independents		4	2.8

Turnout: 47.8% (first round), 39.7% (second round run-offs). Source: Election Commission of Lithuania.

The incumbent Lithuanian Farmers and Greens Union (LVŽS), the largest member of the outgoing governing coalition and Homeland Union’s long-standing electoral rival, came in second and will have 32 representatives in the Seimas, down from 54. Its former coalition partners, as well as confidence and supply parties – including the Social Democratic Party of Lithuania (LSDP) and the LLRA, the ethnic party of the local Polish community – emerged significantly weaker from the election than four years ago. Support for the LSDP, which left the coalition following a party split in 2017, fell by more than 5%, while the LLRA fell short of the 5% threshold needed to enter parliament and secured only three single-mandate seats.

All three leading parties have expressed interest in setting up a coalition swiftly, with former Finance Minister and Homeland Union’s lead candidate Ingrida Šimonytė widely expected to become Lithuania’s next prime minister. Previously the deputy head of the Bank of Lithuania, Šimonytė served as Finance Minister of the Homeland Union-led Government between 2009 and 2012 and is credited with implementing one of the toughest austerity measures in Europe after the 2008 global economic crisis and putting the country back on an upward economic trajectory. Although she unsuccessfully ran for President in 2019, Šimonytė has remained popular and promised a fresh approach to handling the pandemic and changes to the Government’s “management model.” An immediate challenge for her Government will be to decide on whether and how to implement a nationwide lockdown policy.

IMPLICATIONS FOR FOREIGN INVESTORS

The incoming Government's agenda will be dominated by dealing with the economy, health and social impacts of the pandemic, as well as defining Lithuania's relationship with neighbouring Belarus; the political turmoil there is increasingly a factor on the domestic political landscape. Below we outline a number of likely scenarios and policy directions for the coming period:

- › **A conservative-liberal government with possible fractures within the coalition in the long run.** Given the crisis, we expect coalition talks to proceed relatively smoothly in the coming weeks, with a new Homeland Union-led Government in situ relatively soon. The Freedom Party is now extensively lobbying for gaining control over the Ministry of Education, while the Liberal Movement is focused on positions related to finance and the economy.

At the same time, the new Government could be characterised by internal disputes over a range of issues, currently overshadowed by the Crisis, but which may resurface as the economic recovery continues. One example is the stance of the three parties on same sex marriage: while the two liberal parties strongly support it and the Freedom Party vowed to push through with a corresponding amendment to the Lithuanian Constitution, the Homeland Union does not seem to have a clear position: Šimonytė has said the issue should not be part of the coalition deal and instead should be settled by Parliament. Coalition clashes are also expected over the Freedom Party's proposal to relax the criminalization of drug use.

Disputes between the members of the ruling coalition have long been a characteristic of Lithuania's multi-party politics. The LVŽS-led Government of outgoing Prime Minister Saulius Skvernelis, for example, was challenged by a split within its coalition partner LSDP in 2017. Nonetheless, concerns over the country's economic recovery and the handling of the pandemic should ensure a solid coalition.

- › **A business-friendly attitude as Lithuania braces for an economic recovery.** All three incoming ruling parties have loudly supported a more pro-business economic policy direction. Within a wide range of policy promises, the Homeland Union has pledged to:
 - › develop the country's digital economy, with the aim of promoting Lithuania into the top ten of the EU's Digital Economy and Society Index (where it is ranked 14th currently);
 - › increase the share of businesses in the R&D sector;
 - › introduce a five-year investment plan worth 10 billion euros;
 - › reduce the dependence of the central budget on indirect taxes, including VAT and excise duties – a goal that largely coincides with the tax-cutting intentions of both the Liberal Movement and the Freedom Party. More specifically, the Liberal Movement aims to cut the country's standard VAT rate from the current 21% to 18% and personal income tax by 1.25% to 15% by the end of the upcoming legislative term, while the Freedom Party wants to create a greater level of economic freedom and fair competition. In the long run, the Homeland Union wants families to be taxpayers instead of individuals, however, this electoral goal is likely to be, if not contested, at least debated by the junior coalition partners.
- › **The health crisis and the economy are clear priorities.** Even though Lithuania - as most European and indeed global economies - is on course for an economic downturn in 2020, the contraction is likely to be among the smallest in the European Union. GDP dropped by only 0.8% during the first half of the year, with officials in Vilnius now expecting a mild, 1.5-2% downturn for 2020 and a 3-4% rebound in 2021. According to the latest figures provided by the IMF, Lithuania's GDP will contract by 1.8% this year and grow by 4.1% next year – a major improvement on the previous IMF forecast just five months ago, which predicted an 8.1% downturn.

The upward trajectory is largely due to the initially efficient economic crisis management by the outgoing, LVŽS-led Government, particularly its 6.3 billion euros economic stimulus package, supported with European funds. Perhaps the greatest challenge for the new Government will be to maintain this stimulus, which – according to the Bank of Lithuania – could be achieved by directing funds towards sustainable long-term growth, such as investing in the circular economy and digitisation.

- › **At the same time, constraints over fiscal policy and the employment market continue to overshadow the economic outlook.** The budget deficit is almost certain to reach 10% of GDP (the 2021 budget was drafted with a 3.9-billion-euro deficit), while public debt is expected to jump by 10% to 50% by the end of the year. Unemployment grew from 9% in February to 14% in October.

With massive increases in both debt levels and unemployment, investment into job creation and support for job protection schemes are expected to be at the top of the future coalition's agenda. In particular, the Liberal Movement promised to create some 50,000 jobs in the circular economy by 2025, the Freedom Party aims to modernise the public sector, while the Homeland Union wants to focus on increasing labour productivity.

- › **While the incoming Government remains dedicated towards supporting businesses, investors and stakeholders are advised to brace for tougher coronavirus restrictions as the second wave of the pandemic continues to spread across the country.** Under Lithuania's "traffic light" system introduced to tackle the outbreak, 21 municipalities – including Vilnius, Kaunas and Klaipėda, the country's three largest cities – have been under a two-week quarantine as of October 26. Among so-called red-zone restrictions affecting businesses are measures to manage or curb client flows and limited opening hours. Following the outgoing cabinet's move to propose a ban on nearly all events and gatherings on October 26, the new Government will immediately come under pressure to impose nationwide restrictions (on October 27, the number of COVID-19 cases reached 11,000 with more than 136 fatalities in a country of less than 2.8 million).
- › **Severed ties with Minsk and Moscow as the crisis in Belarus continues.** Lithuania has emerged as the loudest critic of Alexander Lukashenko after the Belarusian strongman claimed a hotly disputed and – according to the EU, the US and others – a fraudulent victory in the August Presidential elections (please click [here](#) and [here](#) for our earlier memos on Belarus' political crisis).

Amid civil unrest over the disputed vote and Lukashenko's crackdown on the opposition, the Lithuanian Government granted asylum to Svetlana Tikhanovskaya, Lukashenko's presidential election rival, individually sanctioned 30 Belarusian officials (including Lukashenko himself) and has taken a leading role in expanding the sanctions of the Baltic countries, as well as in advocating for an EU-level sanctions regime. The Seimas was also the first parliament to recognize Tikhanovskaya as Belarus's legitimate leader. Most recently, the outgoing Government blocked a 5.8 million euros EU payment to Belarus for a cross-border development scheme, due to concerns that the funds could be misused by Minsk.

Besides sanctioning more than 100 Baltic officials in retaliation and running joint military exercises with Russia, Lukashenko has threatened to redirect all Belarusian trade flows and the transit of foreign goods (mainly oil products and potash fertilizers) across its territory from Lithuanian ports to Russian ones. Belarusian authorities stopped imports from Poland at the end of September, increased checks on goods arriving from the Baltics and are actively discussing this issue with their Russian counterparts, but so far there has not been an official move from Minsk to reorient the trade flows from Lithuanian ports². At the same time, a potential trade war with the Baltic states cannot be ruled out entirely should Lukashenko manage to overcome the civil unrest and remain in power.

² According to informal information from Belarusian officials, some 40% of land cargo into Belarus comes from or via Lithuania.

An additional factor in the dispute with Belarus is the Russian-built nuclear power plant in the Belarusian city of Ostrovets, just 50 kilometers from the Lithuanian capital. The plant was scheduled to be operational from November, but Belarus postponed the launch of the first reactor amid ongoing opposition to the plant from the Baltic countries (on both geopolitical and safety grounds) and a refusal to purchase from it. In early October this year, the Baltic nations secured 720 million euros in EU funding for the continuation of a project designed to synchronise Baltic grids with the rest of Europe and reduce their dependence on Russia.

CONCLUDING THOUGHTS

Due to increasing social unrest and the ongoing impact of the pandemic, we expect the Homeland Union and its two potential coalition partners to step up negotiations and finalise a coalition agreement quickly. A new economic stimulus package will be a primary concern, focused on investing into growth-fueling sectors and particularly job creation, as Lithuania looks to continue its economic recovery from the pandemic. As the second wave continues, however, the need to implement tougher health restrictions or even a nationwide quarantine is expected to dominate the political agenda in the coming weeks, a fact that could significantly impact any planned recovery measures from the incoming government. For these and other reasons, it promises to be an uncertain time for the business community, although the forecast at a macro level looks *relatively* stable given the ongoing crisis.

The pandemic will force the three parties to put “secondary issues” aside and continue to focus on crisis management, although cracks could emerge among the ranks of the coalition over ideological or policy issues, as outlined above. As the turmoil in Belarus continues, the new Government will continue to pursue an active foreign policy in its Eastern neighbourhood. Further political (or even economic) clashes with the regime in Minsk look inevitable if Lukashenko remains in power.

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About Kesarev

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