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STABILITY PROGRAMME OF LITHUANIA FOR 2019

24 April 2019

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ABBREVIATIONS

CCB	countercyclical capital buffer
CHIF	Compulsory Health Insurance Fund
Constitutional Law	Constitutional Law of the Republic of Lithuania on the Implementation of the Fiscal Treaty
CREM	Central manager of State's real estate – State owned enterprise "Turto bankas"
DBP2018	Lithuanian Draft Budgetary Planof 2018
DBP2019	Lithuanian Draft BudgetaryPlan of 2019
DBP2020	Lithuanian Draft Budgetary Plan of 2020
ECB	European Central Bank
EC	European Commission
EDC	Economic development scenario developed by the Ministry of Finance
ESA	2010 European System of Accounts
EU	European Union
Eurostat	Statistical Office of the European Union
Ministry of Finance	Ministry of Finance of the Republic of Lithuania
Fintech	financial technologies
Fiscal institution	Lithuanian independent fiscal institution whose functions are performed by the Budgetary Policy Monitoring Department under the National Audit Office of Lithuania
GDP	gross domestic product
Government	Government of the Republic of Lithuania
GS	government securities
HICP	average annual inflation calculated according to the consumer price index methodologically harmonized with other EU Member States
i.SAF	Subsystem of electronic invoicing of the Smart tax administration information system
i.VAZ	Subsystem of consignments of the Smart tax administration information system
IMF	International Monetary Fund
Law on the Budget for 2018	Law of the Republic of Lithuania on the Approval of the Financial Indicators of the State Budget and Municipal Budgets for 2018
Law on the Budget of 2019	Law of the Republic of Lithuania on the Approval of the Financial Indicators of the State Budget and Municipal Budgets for 2019
National Audit Office	National Audit Office of Lithuania
NRA	National Reform Agenda
PIT	personal income tax
Programme	Stability Programme of Lithuania for 2019
Recommendation for Lithuania	Council Recommendation of 23 May 2018 on the 2018 National Reform Programme of Lithuania and delivering a Council opinion on the 2018 Stability Programme of Lithuania

Seimas	Seimas of the Republic of Lithuania
SGP	Stability and Growth Pact[1]
Social model	Lithuanian legal administrative model of labour relations and state social security
SP2017	The Stability Programme of Lithuania for 2017 approved by Resolution No 315 of the Government of the Republic of Lithuania of 26 April 2017 on the Stability Programme of Lithuania for 2017
SP2018	The Stability Programme of Lithuania for 2018 approved by Resolution No 387 of the Government of the Republic of Lithuania of 25 April 2018 on the Stability Programme of Lithuania for 2018
SSIF	State Social Insurance Fund
STI	State Tax Inspectorate
Structural balance	Structural balance indicator of the general government sector
VAT	value added tax

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[1] Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (OJ *special edition,* 2004, chapter 10, volume 1, p. 84, as last amended by Regulation (EC) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 (OJ 2011 L 306, p. 12); Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ *special edition,* 2004, chapter 10, volume 1, p. 89, as last amended by Regulation (EC) No 1177/2011 of the European Parliament and of the Council of 8 November 2011 (OJ 2011 L 306, p. 33).

SUMMARY

In 2018, national economy of Lithuania has grown by 3.4% - almost twice as fast as the Eurozone average. In 2019-2020, GDP will grow on average by about 2.4% per year. Domestic demand will be the main engine of Lithuanian economy growth in the medium-term. It is expected that the output gap will not be negative throughout the medium-term.

In 2018, for the third consecutive year, a Lithuania's general government surplus amounting to 0.7% of GDP was recorded. In 2018, there was no deviation from the medium-term objective – the structural balance accounted to 0.5% of GDP. In 2019-2022, a general government surplus will, respectively, account to 0.4% of GDP, 0.2% of GDP, 0.1% of GDP, and 0.1% of GDP.

The medium-term objective of Lithuania is set in accordance with the SGP and the Constitutional Law. The medium-term objective of 2019-2021 established by the Seimas[2] – the structural balance not exceeding -1% of GDP at current prices. In the light of the European Commission's recommendations of 21 November 2018 for the European Council recommendation on the economic policy of the euro area[3], the Recommendation for Lithuania, as well as of the state of Lithuanian economic cycle, the broadly neutral fiscal policy is expected to be continued in the medium-term by gradually improving the structural balance from -0.4% of GDP in 2019 to 0.1% of GDP in 2022. The general government debt at the end of 2018 accounted to 34.2% of GDP and was 5.2 percentage points lower than in 2017. At the end of the medium-term, the general government debt will account to 32.9% of GDP. The Programme identifies positive and negative risks that could change the Economic Development Scenario (EDS) and the general government fiscal projections if they would come true.

The EDS was approved by the fiscal institution. The Programme presents fiscal projections of the general government that are based on the 2019-2022 EDS.

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[2] The Seimas Resolution No XIII-1058 of 22 March 2018 "On a Medium-Term Objective".
[3] The European Commission's recommendation for the European Council recommendation on the economic policy of the euro area (https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1547734022733&uri=CELEX%3A52018DC0759).

PART I
INTRODUCTION

The Stability Programme of Lithuania for 2019 is the Lithuanian medium-term fiscal policy document which covers the period 2018-2022 and is prepared every year, as provided for in the procedure for strengthening the budgetary surveillance of the Member States of the European Union and the coordination of economic policies that is established by the Stability and Growth Pact. The programme presents information on the updated Economic Development Scenario that was published on 21 March 2019 on the website of the Ministry of Finance, medium-term fiscal objectives and the general government fiscal projections.

The Programme is dovetailed with Lithuanian reform agenda for 2019[4] which was drafted in accordance with the Council of Europe Recommendation for Lithuania of 23 May 2018[5], in accordance with the requirements of the Code of Conduct of 18 May 2017 regarding the content and presentation format of the stability programme[6].

The Government of the Republic of Lithuania approved the Lithuanian Stability Programme for 2019 by the Resolution No 385 of 24 April 2019[7]. The Lithuanian Stability Programme for 2019 is presented to the members of the Committee on European Affairs of the Seimas of the Republic of Lithuania and of the Committee on Audit. The Fiscal institution evaluates the fiscal indicators provided in the Lithuanian Stability Programme for 2019. The Programme of 30 April 2019 is presented to the European Commission and to the Euro Group.

In compliance with Article (1) of Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessing deficit of the Member States in the euro area (OJ 2013 L 140, p. 11), Member States in the euro area shall make public their national medium-term fiscal plans in accordance with their medium-term budgetary framework. The Lithuanian Stability Programme for 2019 presents all this information. The Programme also presents brief information on the institutional set-up of general government finances and its latest amendments.

PART II
ECONOMIC OUTLOOK

It is indicated in the conclusion of the Fiscal institution of 29 March 2019 on the approval of the EDS that "*The scenario developed by the Ministry of Finance is determined*

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[4] The Government of the Republic of Lithuania plans to approve the National Reform Agenda for 2019 on 30 April 2019

[5] The Council Recommendation COM(2018) 514 of 23 May 2018 on the 2018 National Reform Programme of Lithuania and delivering a Council opinion on the 2018 Stability Programme of Lithuania (https://ec.europa.eu/info/sites/info/files/file_import/2018-european-semester-country-specific-recommendation-commission-recommendation-lithuania-en.pdf).

[6] Code of Conduct (http://data.consilium.europa.eu/doc/document/ST-9344-2017-INIT/en/pdf).

[7] https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/cd2d9f51681211e99684a7f33a9827ac?positionInSearchResults=14&searchModelUUID=ebf5ccd2-7b13-4b49-a3ca-ac893d9a0fe9

by selected and named assumptions, it is based on the available statistical data and it does not contradict economic patterns. The Fiscal institution approves the economic development scenario of 2019-2022 that was made publicly available on 21 March 2019 on the website of the Ministry of Finance of the Republic of Lithuania. The economic development scenario is appropriate for the preparation of the Lithuanian Stability Programme for 2019 and of the budgets belonging to the government sector.[8]" The EDS and the conclusion were made publicly available and discussed in the Committee on European Affairs, in the Committee on Budget and Finances, and in the Committee of Audit of the Seimas of the Republic of Lithuania.

SECTION 1
EDS ASSUMPTIONS

The key assumptions for the external economic environment (trading partner development, oil prices, the euro-dollar exchange rate) correspond to the projection under EC's 2019 winter forecast and the January 2019 outlook of the IMF.

Perspective of Lithuania's major export markets is the most important assumption of the EDS.

Table 1. Key assumptions

Indicator	2018	2019	2020	2021	2022
Lithuania's short-term interest rates (annual average)	–	–0,2	–0,1	0,1	0,3
Lithuania's long-term interest rates (annual average)	1,1	1,0	1,2	1,3	1,5
USD/EUR exchange rate (annual average)	1,2	1,1	1,1	1,1	1,1
Nominal effective exchange rate	4,8	–1,0	0,0	0,0	0,0
Exchange rate vis-a-vis the euro (annual average) (for countries not in euro area or ERM II*)	–	–	–	–	–
World GDP growth (excl. EU), %	3,9	3,8	3,8	3,8	3,8
EU GDP growth, %	1,9	1,5	1,7	1,7	1,7
Growth of key export markets, %	2,0	1,7	1,9	1,9	1,9
World import growth (excl. EU), %	4,8	3,9	3,6	3,6	3,6
Oil prices (*Brent*, USD/barrel)	71,5	61,2	61,2	61,2	61,2

Sources: Ministry of Finance, EC (2019 winter forecast), IMF.
*Exchange rate mechanism II.

SECTION 2
MEDIUM-TERM ECONOMIC DEVELOPMENT SCENARIO (EDS)

Having assessed changes in the external environment, it is provided for in the EDS that Lithuania's GDP in 2019 could increase by 2.6%. Lithuania's economy is expected to

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[8] Conclusion of the fiscal institution No BP-1 of 29 March 2019 on the Approval of economic development scenario (http://www.vkontrole.lt/bp/isvada.aspx?id=10286).

grow faster than the economy of the euro area, and the growth in the medium-term will amount to 2.4% every year.

Domestic demand, specifically household consumption and investment, will be the main engine of economic growth. Domestic demand will be stimulated by the Government decisions related to increasing income of the population and strengthening the incentives to invest, implementation of foreign direct investment projects and projects financed with the funds of the EU and other international financial support, and by the ongoing transformation of a cheap labour-based business model. To optimize profits, Lithuanian entrepreneurs should continue investing in automation of operations, technological upgrade, innovations and other measures intended to increase operational efficiency and productivity.

Fig. 1. Changes in real GDP
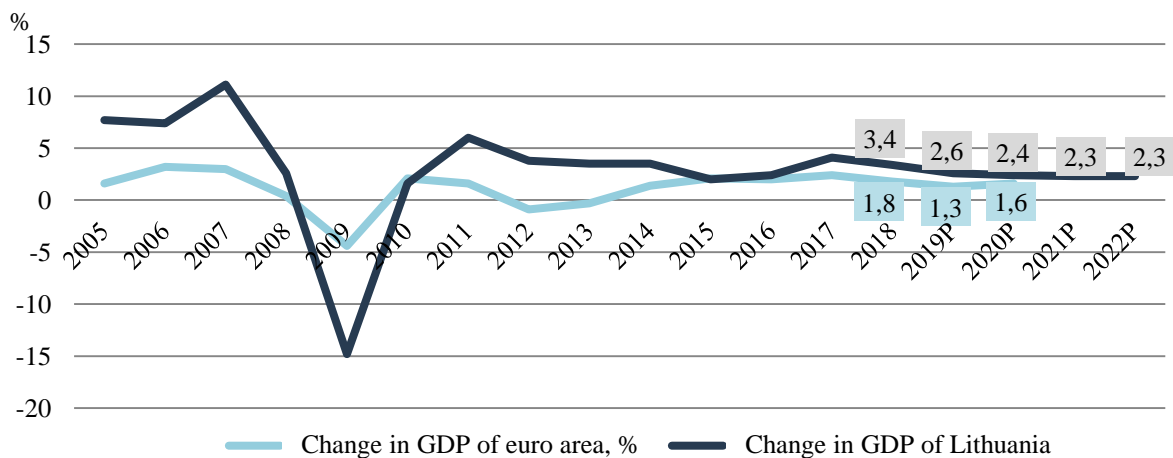
Sources: Lithuanian Department of Statistics, Eurostat, EC (winter 2019), Ministry of Finance.

Slower growth in external demand will negatively affect Lithuanian foreign trade. Lithuanian exporters in the medium-term will have to continue to adapt to changing economic circumstances, to invest in order to increase competitiveness and manage currency related risk, to make decisions that reduce production costs and increase operational efficiency. Persistent strong diversification of export of goods and many years of experience of Lithuanian exporters of work in a rapidly changing environment impart reserved optimism regarding export prospects.

Table 2. Macroeconomic indicators

Indicator	ESA code	Indicator value in 2018, million EUR	Change in %				
			2018	2019	2020	2021	2022
GDP, chain-linked volume	B1g	37 199,0	3,4	2,6	2,4	2,3	2,3
GDP, at current prices	B1g	45 133,6	7,0	5,0	4,7	4,5	4,4
Components of GDP (chained volume statistics)							
Household consumption expenditure + consumption expenditure of non-profit institutions serving households (NPI	P.3	24 609,7	3,9	3,9	3,8	3,5	3,5

Indicator	ESA code	Indicator value in 2018, million EUR	Change in %				
			2018	2019	2020	2021	2022
Government final consumption expenditure	P.3	5 690,0	0,6	0,9	0,5	0,4	0,4
Gross fixed capital formation	P.51	7 645,2	6,5	5,5	4,9	4,0	4,0
Changes in stock and acquisitions less disposals of valuables, % of GDP	P.52 + P.53	–	–	–	–	–	–
Exports of goods and services	P.6	33 694,2	4,9	4,1	4,4	4,3	4,3
Imports of goods and services	P.7	33 693,6	4,3	5,0	4,8	4,5	4,5
Contributions to real GDP growth, percentage points							
Final domestic demand		37 924,1	3,9	3,8	3,6	3,2	3,2
Changes in stocks and acquisitions less disposals of valuables	P.52 + P.53	–	–	–	–	–	–
External balance of goods and services	B.11	0,6	0,6	–0,6	–0,2	–0,1	–0,1

Sources: Lithuanian Department of Statistics, Ministry of Finance.

Annual inflation in Lithuania has been falling since October 2017, and at the end of 2018 inflation stood at 1.8% and was the lowest in the past 2 years. Average annual inflation in 2018 was 2.5%, or 1.2 percentage points less than in 2017 (3.7%). It is expected that change in HICP in 2019 and 2020 will be 2.2%. In the later years of the medium-term, the rate of price changes should remain close to the short-term inflation rate – 2.1% in 2021 and 2% in 2022. With the slowing down rate of wages growth, and after prices of goods reached levels close to the EU average, a slower price growth rate is expected in the country. Changes in technical assumptions about oil prices (lower by 10.6 USD/barrel) will offset the impact of price-increasing administrative decisions that were adopted after the EDS of 2018 Autumn of the Ministry of Finance was made publicly available.

Fig. 2. Inflation rate will remain close to the multiannual rate

Sources: Lithuanian Department of Statistics, Ministry of Finance.

The level of prices for consumer services in Lithuania has not yet reached half of the EU average - in 2017 it constituted 47.3%, and the share of such services in household consumption expenditure which is used when calculating HICP in 2019 constituted 27.5% - much less than an average share of expenditure on services in EU countries (43.1%). As wages grow faster than in the EU, the level of service prices and the share of services in household consumption expenditure will gradually move towards the average EU values. For

this reason, in the medium-term services will remain one of the key drivers of inflation. However, it is foreseeable that in parallel to the slowing down rate of wages growth in the country, the rate of increase in service prices will also slow down.

Table 3. Price indicators

Indicator	Indicator value in 2018	Change, %				
		2018	2019	2020	2021	2022
1. GDP deflator	121,3	3,4	2,3	2,2	2,1	2,0
2. Household consumption expenditure deflator	114,8	2,4	2,2	2,2	2,1	2,0
3. HICP (average annual)	107,1	2,5	2,2	2,2	2,1	2,0
4. General government consumption expenditure deflator	129,1	5,5	5,1	4,0	4,0	4,0
5. Gross fixed capital formation deflator	113,8	0,8	1,3	1,3	1,3	1,3
6. Exports of goods and services deflator	110,1	3,6	–0,2	1,2	1,2	1,2
7. Import of goods and services deflator	106,7	4,6	–1,2	1,3	1,3	1,3

Sources: Lithuanian Department of Statistics, Ministry of Finance.

Taking into account the improved migration and employment indicators in 2018, and decreased tension in the labour market, it is expected that in 2019 and 2020 number of employed population will grow at a moderate rate (respectively, 0.5% and 0.2%). Since there will be slower growth in labour force participation rate from 2021, the number of employed population will start decrease.

Based on the data of the Labour Force Survey, the unemployment rate in 2018 was 6.2%. With the qualified labour resources becoming scarcer, the medium-term, the unemployment rate will remain stable and will amount to 5.9%.

Fig. 3. Development of unemployment rate and number of employed population

Sources: Lithuanian Department of Statistics, Ministry of Finance.

After the labour force participation rate has reached new historic levels and migration trends have improved, in 2018 the labour force in the country's economy grew by 0.1% (in 2017, decrease of 1.3% was recorded), and the number of employed population increased by 1%. Recently, changes in wages in the country's economy have been driven by employee-favourable labour market situation – a gap between labour demand and supply led to rapid wage growth in the private and public sectors. Wages that are growing faster than labour productivity reflect strong negotiating power of employees and convergence of the country's wages towards pay rates of the common EU labour market.

Fig. 4. The rate of wages growth will further exceed inflation
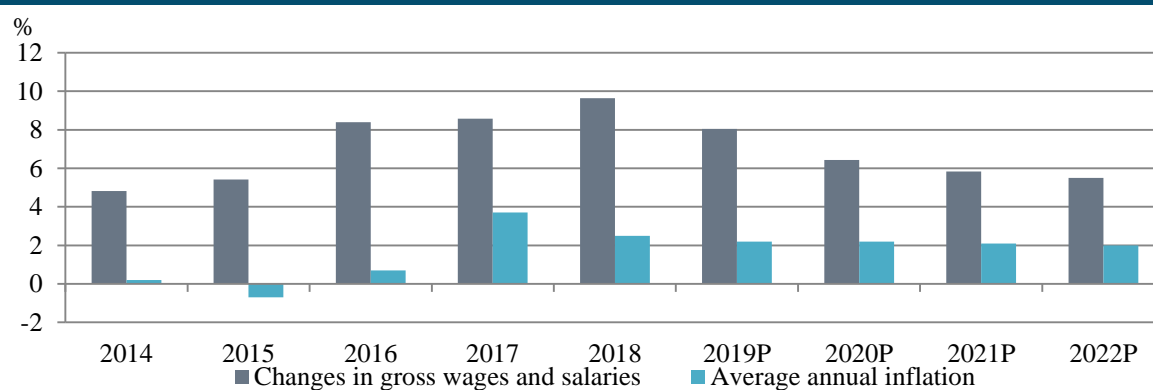
Sources: Lithuanian Department of Statistics, Ministry of Finance.

In the medium-term, tension in the labour market will be lower compared to that observed in recent years, and pressure to raise wages will be weaker. Consequently, it is expected that in 2019 average monthly gross earnings in the country could grow by 8%, and in later years of average period – on average by 5.9% every year.

Taking into account the growth rate of average monthly gross earnings calculated under the current order, that is projected for 2019 (8%), and after transferring to the employee the obligation to pay social security contribution calculated at a rate of 28.9%, the average monthly gross earnings in 2019 would amount to EUR 1283.2.

Table 4. Labour market indicators

Indicator	ESA code	Indicator value in 2018	Change, %				
			2018	2019	2020	2021	2022
1. Employment, persons, thousand		1 368,4	1,0	0,5	0,2	–0,1	–0,2
2. Employment, hours worked, thousand		2 536 234	1,6	–	–	–	–
3. Unemployment rate, %**		6,2	6,2	5,9	5,9	5,9	5,9
4. Labour productivity (gross value added at constant prices per person employed), thousand EUR		27,2	2,4	2,1	2,3	2,4	2,5
5. Labour productivity, hours worked (gross value added at constant prices per hour worked), EUR		14,7	1,8	–	–	–	–
6. Compensation of employees, million EUR	D.1	20 164,9	9,2	8,6	6,6	5,7	5,3
7. Compensation per employee, EUR		16 690,0	7,7	8,0	6,4	5,8	5,5

Sources: Lithuanian Department of Statistics, Ministry of Finance.
* Value of the indicator.

SECTION 3
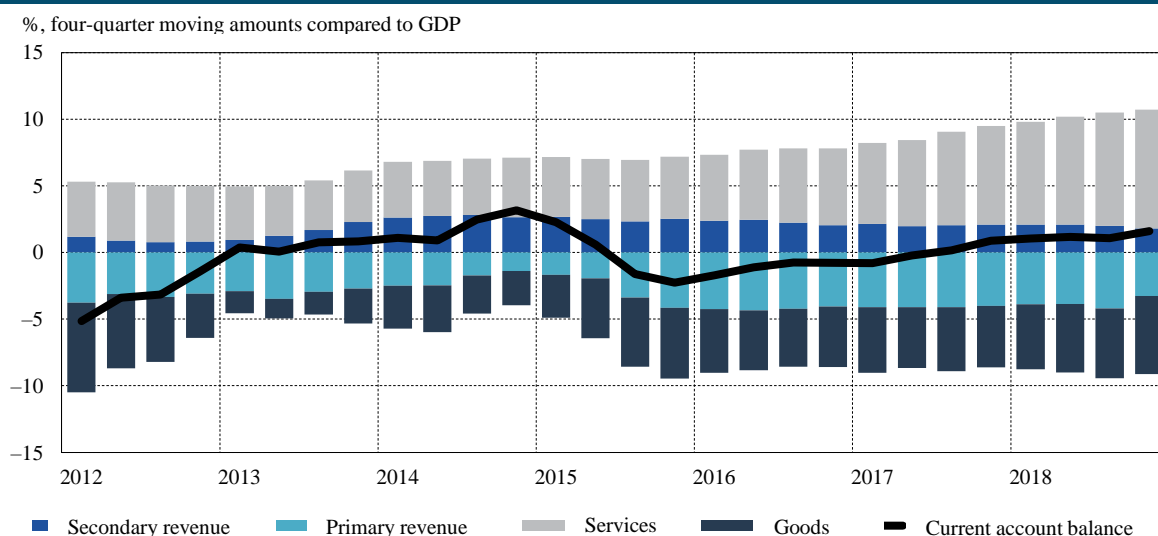## LITHUANIA'S BALANCE OF PAYMENTS

In 2018, the current account was positive, it accounted for 1.6% of GDP. The foreign trade balance improved - the surplus on the services balance increased significantly, it compensated for the increase in the goods deficit. The increase in the foreign trade balance

was, however, lower than in 2017, the primary income balance deficit decreased, while the surplus of the secondary income balance was lower than in 2017.

The further increasing exports of services represent the reason for increase in service balance surplus. Exports of services grow faster than imports. Trade balance indicators of most service groups improved, and the largest increase was in the transporationt service indicator. This sector continued to invest actively in capacity increases and employed a large number of persons from non-EU countries. Excluding the transportation sector, the balance of manufacturing and other services improved the most.

The goods balance deficit increased mostly due to greater trade deficit in mineral products and increased trade deficit in machinery, facilities and vehicles. The balance was also negatively affected by a lower agricultural trade surplus. Higher oil imports were probably caused by oil prices that increased over the year, while low levels of agricultural exports were caused by a poor harvest. On the other hand, deficit of trade in chemical products and plastics has decreased, while surplus of trade in timber and its products was higher than in 2017. This is mostly associated with greater surplus of trade in furniture and tobacco products. In the future, trade deficit in goods should grow due to growing domestic demand.

Fig. 5. Components of the current account balance

%, four-quarter moving amounts compared to GDP

Legend: Secondary revenue, Primary revenue, Services, Goods, Current account balance

Sources: Lithuanian Department of Statistics, Bank of Lithuania and calculations of the Bank of Lithuania.

Deficit of the primary income balance has decreased. Balances of compensation for employees, interest from portfolio investment and interest from debt instruments remain generally unchanged, while balance of dividends improved. The balance of reinvested earnings was lower, which may mean that more revenue of foreign capital undertakings remained in Lithuania. In recent years, the financial situation of the Government of the Republic of Lithuania has continued to improve, the need for additional borrowing was becoming scarcer, and therefore, non-residents' income related to public debt was decreasing as well. In the future, development of the primary income balance will mostly depend on the

development of foreign direct investment in Lithuania and the profitability of foreign capital undertakings, as well as on the financial situation of the Government of the Republic of Lithuania.

The secondary income balance has changed slightly - the surplus was slightly lower than a year ago. All the main comeponents of secondary incomebalance - the balances of the government, personal fund transfers and other, remained at a similar level as in 2017. In the near future, development of the secondary income balance should not change significantly. The capital account surplus increased significantly. In 2018, it was about one third higher than in 2017 and slightly higher than in 2016. The increased use of EU investment funds had the greatest impact on this. The structure of the financial account was greatly influenced by a quantitative easing programme conducted by the ECB. Net purchases of assets under this programme were made until the end of 2018. As a result, liabilities of the Bank of Lithuania to non-residents and its portfolio investments increased. Reinvestments under this programme are planned for quite some time, i.e. to reinvest for quite some time after the ECB starts increasing key interest rates. The ECB Governing Council announced that they will not change the key interest rate at least until the end of 2019.

Table 5. Sectoral balances

Indicator	ESA code	% of GDP				
		2018	2019	2020	2021	2022
1. Net lending/borrowing	B.9N	1,2	1,8	1,1	0,9	0,6
including:						
balance of goods and services		2,5	2,6	2,2	2,0	1,7
balance of primary and secondary income*		–2,8	–2,5	–2,6	–2,6	–2,6
capital account*		1,5	1,7	1,5	1,5	1,5
2. Net lending (+) / borrowing (–) of private sector		0,5	1,3	1,0	0,8	0,5
3. Net lending (+) / borrowing (–) of general government	B.9N	0,7	0,4	0,2	0,1	0,1
4. Statistical discrepancy		0,0	0,0	0,0	0,0	0,0

*Sources: Ministry of Finance, * Bank of Lithuania.*

SECTION 4
ECONOMIC CYCLE ASSESSMENT

In order to assess the economic cycle, the Ministry of Finance of the Republic of Lithuania calculates the estimates for the potential GDP and the output gap. The concept of potential GDP refers to a theoretical economic output level attainable which would be attained if the output factors, i.e. labour and capital, were utilised to their full potential without pressure on prices and wages. The output gap measures the difference between the actual output of an economy and its potential output. The potential GDP and the output gap are unobservable indicators, statistical as well as econometrical methods are applied to their assessment. For this reason, their estimates are very indistinct. In applying different methods, parameters or assumptions, significantly different estimates of the potential GDP level are obtained, which

determine different output gap evaluations. Differences in estimates are also due to different lengths of data time series used for the calculations, different indicator projections (forecasts) and their horizon lengths, different smoothing measures for data time series (and their parameters), different statistics on indicators known at the time of calculation, statistics revisions.

To reduce indeterminacy of estimates of the potential GDP and output gap, and to maintain their comparability with the estimates of the EC and other EU Member States, and to ensure their compliance with the provisions of the SGP, the Ministry of Finance calculates the estimates of these indicators by applying the potential GDP calculation methodology[9] approved and being improved by the EC, and harmonized with other Member States that is based on Cobb-Douglas production function. Estimates calculated by the Ministry of Finance and the EC are not identical, differences between them are due to different projections (forecasts) of economic indicators used for calculations, different length of their time series (of the Ministry of Finance – up to $T + 3$ years, of the EC – up to $T + 1$ year spring, up to $T + 2$ year autumn, when T is current year); the EC applies the "closing" Rule $T + 5$ years of output gap; scheduled revisions of national accounts statistics whose deadlines (dates) for completion do not coincide with the deadlines for concluding the EDS of the Ministry of Finance and for calculating the potential GDP.

Fig. 6. Estimates of output gap
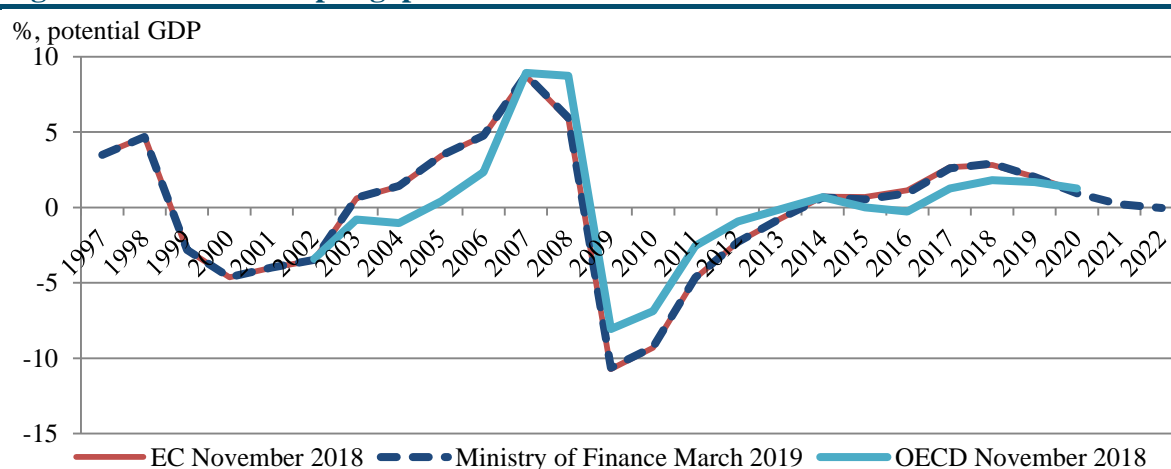
Sources: Ministry of Finance, EC, Organization for Economic Cooperation and Development.

Results of the estimations that were performed in March 2019 by the Ministry of Finance show that since 2019 output gap will gradually decrease. In 2019, this gap will amount to 2% of the potential GDP, and at the end of medium-term will disappear. In calculating the estimates of the potential GDP, the most recent (published in February 2019) demographic projections of Eurostat's "0 migration" scenario were used.

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[9] A detailed description of the methodology published in the EC publication *The Production Function Methodology for Calculating Potential Growth Rates & Output Gaps*, Economic Papers 535, 2014.

PART III
FINANCIAL SITUATION AND PROSPECTS OF THE GOVERNMENT

SECTION 1
GENERAL GOVERNMENT FINANCES IN 2018-2019

In 2018, the general government surplus amounts to 0.7% of GDP. The Law on the Budget of 2018[10] set the target indicator - the general government surplus of 2018 should be no worse than 0.6% of GDP. In 2018, the fiscal discipline rule established in the Article 3(1)(2) of the Constitutional Law was observed – the structural deficit of 2018 (0.5% of GDP) was lower than the structural deficit of 2017 (0.6% of GDP). The SGP provisions regarding structural balance were also observed – the structural deficit was lower than the medium-term objective which is – 1% of GDP.

The balance of the central government in 2018 amounted to –8.4% of GDP, while the surplus of the social security funds amounted to 8.8% of GDP. Such balances were determined by the fact that on 1 January 2018 the total 3 682.3 million EUR amount of unrepaid loans of the SSIF that generated until 31 December 2017 and amount of EUR 3 million of accrued interest were taken over to the State Treasury.

The government targeted surplus of 0.4% of GDP is established in the Law on the Budget of 2019[11]. This surplus is matched by the budgets of the state, social security funds approved by the Seimas, the indicators of municipal and other budgets attributed to the government sector. The state budget for 2019 is expected to remain in deficit. The 2019 state budget is expected to remain in deficit. The sub-sectors of the local government and social security funds are expected to be in surplus. The surplus budgets of the municipalities and CHIF are projected observing the fiscal discipline rules and taking into account the still existing economy-friendly times. The projected surplus of the SSIF budget is determined by the rising income share due to rapid wage growth, as well as by the impact of the tax reform that was launched in 2019 – the suspended transfer of funds to the second pension pillar budgets from the SSIF budget has a significant impact on the surplus formation.

It is planned that the state budget revenue[12] in 2019, compared to 2018, will increase by 27.4%. Such a significant increase in revenue is mainly due to the fact that some of the social security contributions have been transferred to the PIT due to changes in the taxation of labour. In the first quarter of 2019, the state budget plan was exceeded by 1.5%, an amount of revenue that is bigger by EUR 426.9 million (27.6%) than in the same period a year ago was collected (Fig. 7).

Having reviewed the latest budget execution data received by the Ministry of Finance by 8 April 2019, as well as projections of revenue and expenditure of the state, municipal, social insurance funds that were updated according to the new EDS, the local government

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[10] Law of 2018 (12 December 2017, No XIII-868; https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/193f1dc1e18b11e7b4d1bdd5f1a9ff0e/OrTyLgzbna).
[11] Law on the Budget of 2019 (11 December 2018, No XIII-1710); http://finmin.lrv.lt/uploads/finmin/documents/files/2018-12-11%20XIII-1710.pdf).
[12] State budget revenue is analysed excluding EU and other international financial support funds.

balance trends, in 2019, the general government surplus should be no less than the planned one.

Fig. 7. Implementation of the state budget for the 1st Quarter of 2019, million EUR
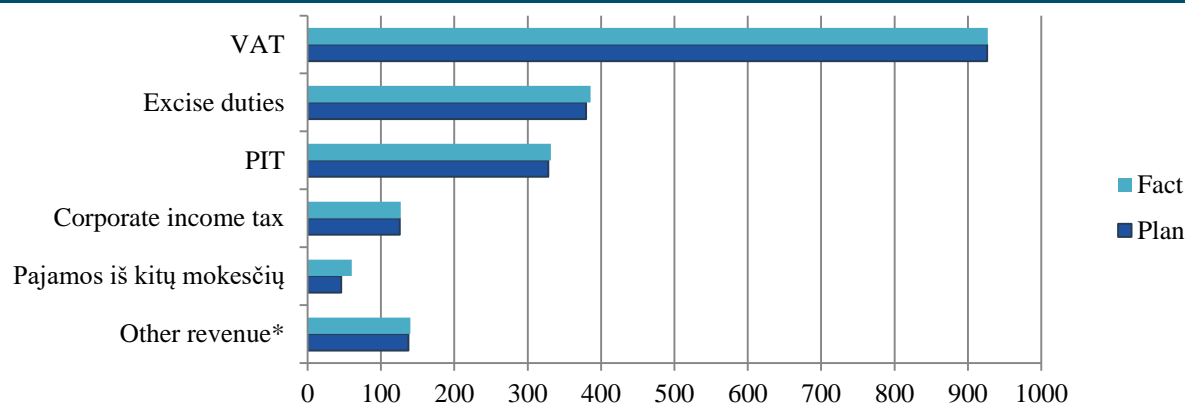
Source – Ministry of Finance.
* Dividends, revenue from state-owned natural resources, state-owned land lease, property sales, etc.

The general government balance indicators for the year 2019 and for the remaining years of the medium-term that are presented in the Programme may deteriorate if the risks regarding the EDS realization or other fiscal risk will materialize in 2019. Information about fiscal and other risks is given in part VI of the Programme.

SECTION 2
GUIDELINES FOR MEDIUM-TERM FISCAL POLICY

In the light of the European Commission's recommendations for the European Council recommendation on the economic policy of the euro area, Recommendations for Lithuania and the state of the Lithuanian economic cycle, a broadly neutral fiscal policy will be implemented during the period 2019-2022. The ambition is to find a balanace among three targets: exploit the economic conditions that are still favourable to further gradually accumulate fiscal reserves, to implement structural reforms, to fulfil other strategically important obligations.

As the external uncertainty and the internal challenges of demographic processes persist, it is important throughout the entire medium-term to ensure by means of revenue and expenditure policy the compliance with the national and SGP fiscal discipline rules. The rules laid down by the Constitutional Law require to pursue surplus general government sector in favourable economic times, while the rules of the SGP require to limit expenditure and not to deviate from the medium-term objective. Observance of the rules creates preconditions for sustainable situation of government finances over the medium term, contributes to strengthening long-term financial sustainability.

The accumulated financial reserves (Fig. 8) and as low as possible debt level would create conditions necessary to support aggregate demand and investment level in unfavourable economic circumstances and to fulfil social obligations to the residents.

Fig. 8. Financial reserves

%, GDP
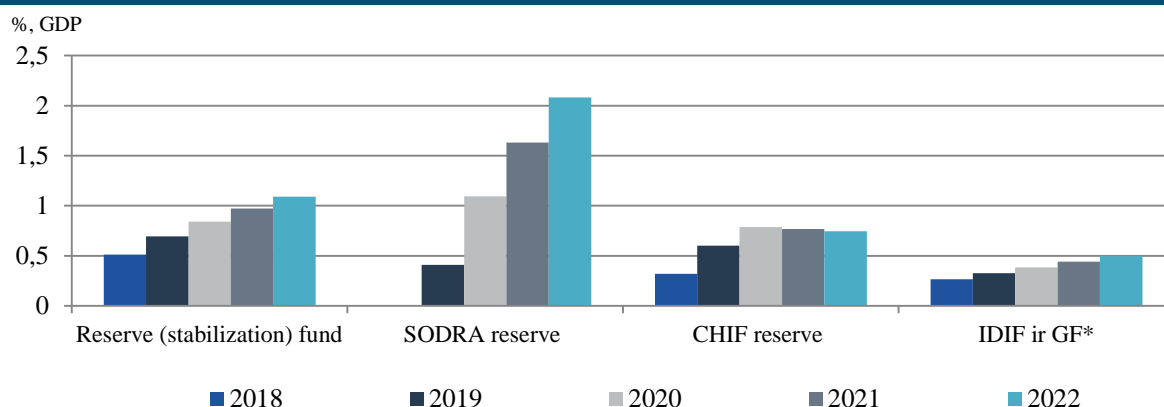
Sources: Ministry of Finance, SSIF.
* IDIF – Long-term Work Benefits Fund, GF – Guarantee fund.

Improved tax collection, implementation of measures to reduce shadow economy, increased taxation on products that are harmful to the environment and human health will help achieve fiscal objectives. In search for internal financial resources, a comprehensive review of expenditure in the areas of health, education and social security will be carried out. The budget orientation to results that is being increased, the principles of medium-term budgetary planning at institutional level that are being strengthened, the state asset management that is being optimized and the public finance quality that is being improved by other means will also contribute to the development of internal resources (more information on this topic is available in part IV of the Programme "Quality of public finances").

The government finance projections (Table 17) are prepared according to the EDS, statutory government obligations, including the measures provided for in the NRA, the fiscal discipline rules laid down by the Constitutional Law and the SGP. To achieve the target government balances that are specified in the projections, in preparing the budget for 2020-2022, the policy measures for revenue and expenditure will be provided for, and they will be presented in LBP2020.

In the medium term, the SGP general government expenditure growth limitation and structural balance rule will be applied as well as the national rule of surplus general government. The national rule limiting general government expenditure growth will not apply in the medium-term. Non-applicability is determined by the positive arithmetic average of the general government balance indicators for the last five years.[13] Taking into account the government balance indicators projected for 2019-2022, an average of the balance indicators will remain positive over this period.

Lithuania which is implementing a structural reform - a social model that is designed to improve long-term financial sustainability and to increase potential economic growth has been given the flexibility under the SGP. In assessing Lithuania's compliance with the rules on fiscal discipline established by the SGP, during the period 2017-2018 the 0.4% of GDP was taken into account, and in 2019 the costs of implementing the social model of 0.5% of

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[13] In accordance with Article 3(3) of the Constitutional Law.

GDP were taken into account. During the period 2016-2018 Lithuania was also subject to an exception of 0.1% of GDP due to the implementation of the systemic pension reform.

In February 2019, the EC updated the methodology designed for calculating the minimum requirements that apply to the structural balance (*minimum benchmark*) (hereinafter – the MB). The MB is the criterion for determining whether or not there is the possibility to grant SGP flexibility to the state that carries out significant structural reforms[14]. Following the change in the MB calculation methodology, the MB that applies to Lithuania have become tougher from 1.3% of GDP to 0.9% of GDP. This MB will apply in 2020-2022. Since Lithuania's medium-term objective is 1% of GDP, and the MB is 0.9% of GDP, in 2020 and in later years of the medium-term Lithuania will not have a possibility to apply for SGP flexibility structural reforms clause.

SECTION 3
NOMINAL AND STRUCTURAL INDICATORS OF THE GENERAL GOVERNMENT BALANCE OF 2019–2022

In 2019, a government balance of 0.4% of GDP is projected. Accordingly, the structural balance will amount to -0.4 % of GDP. In 2019, a broadly neutral fiscal policy is maintained where aggregate demand is neither stimulated nor suppressed remarkably. The 2019 structural balance is in line with the rule established by the Constitutional Law, under which it should improve in 2019 compared to 2018.

Fig. 9. General government balance indicators and the output gap in 2018-2022

- Nominal general government balance
- Structural general government balance
- Medium-term objective when the SGP exception is applied
- Medium-term objective
- Output gap

Source – Ministry of Finance.

In 2020–2022, when it is projected that the output gap will not be negative, but economic growth will slow down, it is planned to manage government finances in such a way that the planned government balances would ensure the improvement of the structural balance throughout the medium-term (tables 6 and 18).

Table 6. Economic cycles

Indicator	ESA code	GDP % *				
		2018	2019	2020	2021	2022
1. GDP growth / chain linked volume growth		3,4	2,6	2,4	2,3	2,3

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[14] After granting exemption under SGP, the compliance of the state with the EU statutory rules on fiscal discipline is assessed in the light of costs of implementing the reform incurred in the medium-term.

Indicator	ESA code	GDP % *				
		2018	2019	2020	2021	2022
2. Net lending (+) / borrowing (–) of general government	B.9	0,7	0,4	0,2	0,1	0,1
3. Interest expenditure	D.41	0,9	0,9	0,7	0,5	0,3
4. One-off and other temporary measures		0,0	0,1	0,0	0,0	0,0
including:						
one-off measures – general government revenues		0,1	0,1	0,0	0,0	0,0
one-off measures – general government expenditure		–0,1	0,0	0,0	0,0	0,0
5. Potential GDP growth, %		3,1	3,5	3,5	3,1	2,5
of which:						
labour		0,4	0,6	0,5	0,0	–0,4
capital		1,5	1,5	1,5	1,5	1,4
total factor productivity		1,2	1,4	1,5	1,5	1,5
6. Output gap		2,9	2,0	0,9	0,2	0,0
7. Cyclical budgetary component		1,2	0,8	0,4	0,1	0,0
8. Cyclically-adjusted balance (2 – 7)		–0,5	–0,4	–0,2	0,0	0,1
9. Cyclically-adjusted primary balance (8 + 3)		0,4	0,5	0,5	0,5	0,4
10. Structural balance (8 – 4)		–0,5	–0,4	–0,3	0,0	0,1

Source: Lithuanian Department of Statistics, Ministry of Finance.
* For some years, due to the rounding, the sum specified may not coincide with the values of calculated indicators.

SECTION 4
INSTRUMENTS FOR IMPLEMENTING MEDIUM-TERM FISCAL POLICY

Since 2019, structural changes in such fields as education, health care, shadow economy reduction, innovation, social security (pensions) and tax regulation were introduced. The NRA provides detailed information on these reforms. They are aimed at achieving qualitatively better results in these fields, which would enhance the country's competitiveness, would lead to more transparent and optimal use of public resources, strengthening of long-term sustainability of public finances[15]. Other important priorities of the Government include raising the income of the least-earning people, promoting employment in response to labour market needs, supporting families with children, and fulfilling obligations to NATO.

The projections of the government revenue and expenditure under the no-policy change scenario are presented in Table 19.

Measures under revenue policy

The government aims to improve the structure of the tax system in a direction that is favourable to economic growth, and to optimize the tax base. In implementing the Recommendation for Lithuania, tax burden, whilst ensuring the clarity of the tax system, is shifted from taxation of labour to sources less detrimental to economic growth. Additional

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[15] Detailed information on the reforms is available on the Government Internet Account: http://lrv.lt/lt/aktuali-informacija/xvii-vyriausybe/prioritetiniai-darbai/strukturines-reformos.

measures are also foreseen that are designed to reduce gap from potential tax revenue. To implement these aims, in June 2018, legislation that legitimates structural reforms in tax and shadow economy reduction were adopted in the Seimas. At the same time, Plan for Implementing Major Tax Changes for 2019-2021 that ensures greater predictability and stability of the tax environment was approved. All the discretionary measures of the revenue policy provided for in 2019-2021 will increase revenues by about 251.5 million euros (Table 21 and LBP2019).

The social security contributions were consolidated to make the system of labour taxation clearer and such which would allow employees to more easily assess tax burden on their income. Payment of social security contributions payable by employer was transferred to employee, leaving for employer only responsibility to pay social security contributions for accidents at work and occupational diseases and unemployment. Gross wages were recalculated accordingly after the transfer of the responsibility to pay contributions. It is expected that these changes will allow employees to understand more clearly that all social security contributions form a part of the employee's salary which is deferred until the insured event occurs to the employee. At the same time, the consolidation of contributions will become an instrument by means of which employees who receive part of their wages by circumventing obligation to pay taxes on them will be able to assess the extent of the loss of social guarantees. In order to finance the general part of the pension from the state budget, the share of the social insurance contributions that ensures the general part of the pension was transferred to the personal income tax. After assessing all these changes, the rates of personal income tax and social security contributions were recalculated accordingly.

Fig. 10. An example of changes in labour taxation in case a gross monthly salary of EUR 800 is paid (to a person who does not save pension in the second pension pillar funds)
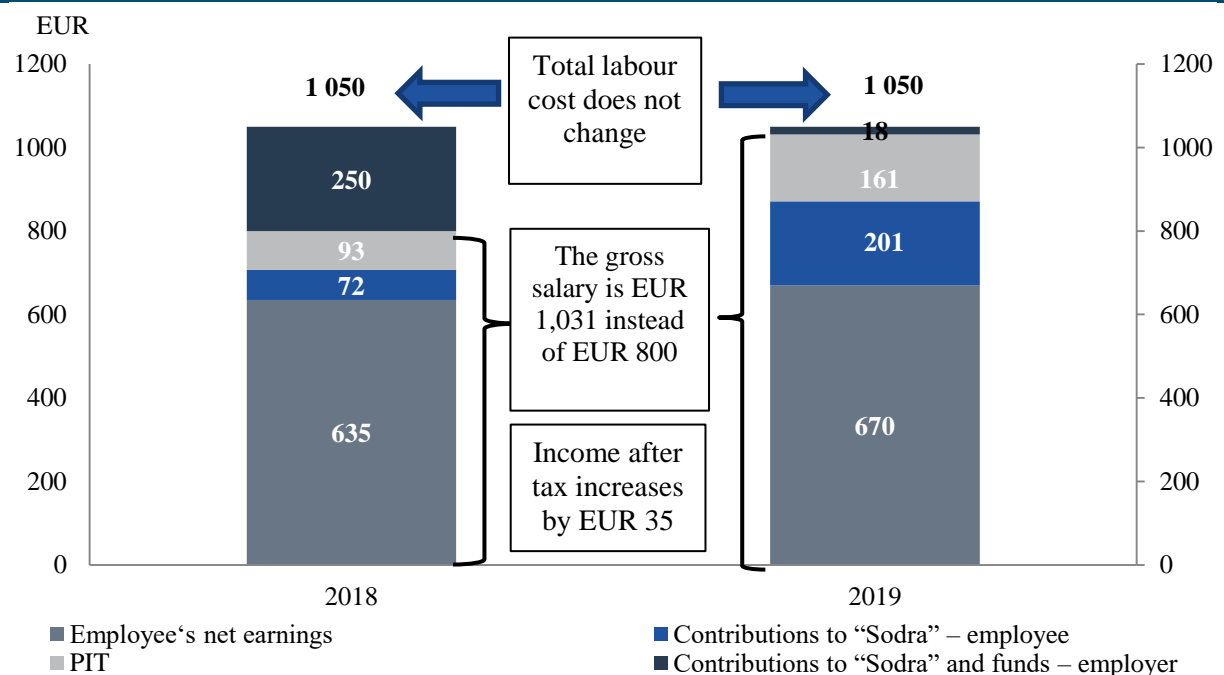
Source – Ministry of Finance.

As part of the pension reform, the decision was made to change the financing scheme of the second pension pillar funds. Transfers from the SSIF to the private second pension pillar funds were terminated and were replaced with contributions to be paid by employees themselves. To ensure that the decision to save additionally for old age in the second pension pillar funds would not reduce employees' net earnings, in 2019, the PIT and social security contribution rates were reduced by a total of 1.55 percentage points. In addition, since 2019, the scope of application of the non-taxable income, which ensures progressiveness of income taxation, was expanded, its consistent annual growth in 2019, 2020 and 2021 was established. Thanks to this decision, the tax burden will decrease not only for the low-income earners but also for the average-income earners. In addition, decrease in tax burden of low-income earners was ensured through a systematic increase of non-taxable income for several years in a row.

Fig. 11. The tax wedge before and after the reform
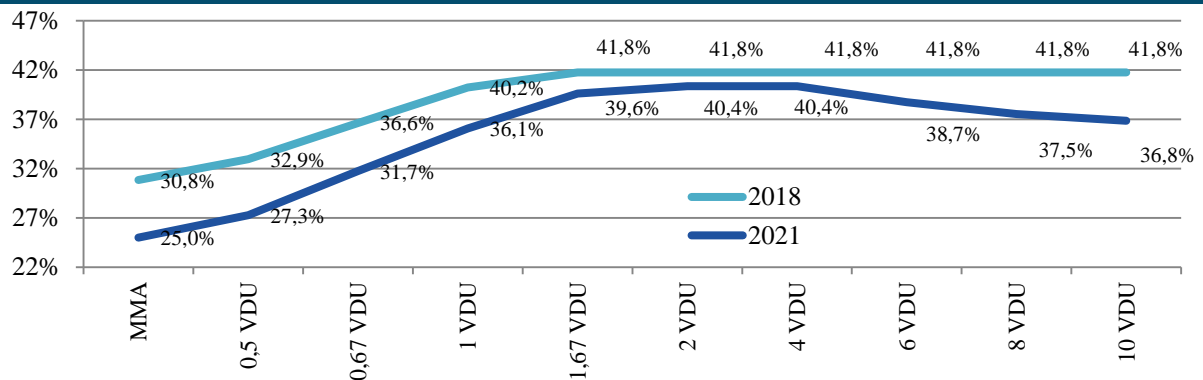
Source – Ministry of Finance. MMA - minimum wage (MW), VDU - average wage (AW).

To create preconditions for attracting and retaining particularly well paid high-level professionals and having assessed the fact that ceiling for social security benefits applies, in 2019 ceiling for social security contributions was also established for the first time, and further decrease in this ceiling is foreseen for 2020 and 2021. In order to partially offset the negative impact of ceiling for social security contributions on budget revenue, and having assessed the transfer of financing of the general part of pensions from the SSIF budget to the state budget, in 2019 progressive rates of personal income tax for employment-related income or income from relations that correspond to the essence of employment relations were introduced for the first time. Progressive rates of personal income tax were also established for other annual income (except for income from self-employment and dividends) that exceeds the established ceiling for social security contributions. To expand the base of taxes that are less detrimental to economic growth and to increase the budgetary impact of such taxes, in 2019 excise duties on ethyl alcohol, cigarettes, cigars and cigarillos and smoking tobacco are increased (at the same time heated tobacco products are classified separately). At the same time the plan for further increasing excise duties on tobacco products in 2020 and 2021 is established. Excise duties are also imposed for the first time on e-cigarette liquid. The

Government's proposal to increase the taxation on real estate of natural persons is under consideration at the Seimas (where taxation applies to second and subsequent residential property) thus contributing to the regulation of the housing market.

Revenue projections

In forecasting the medium-term government budget revenue, the most recent EDS and tax changes that came into force since 2019 were assessed. The State budget revenue is expected to grow by 6% in 2020, by 6.1% in 2021 and by 5.2% in 2022.

Main taxes. In 2020–2022, revenue from four main taxes, i.e. VAT, PIT, excise duties and corporate income tax, will constitute about 91% of the total state budget revenue. In forecasting revenue from all four main taxes, changes in tax policy approved for 2019–2021, including the expected positive result of shadow reduction reform, as well as loss of revenue due to the existing tax exemptions were taken into account. The recent tax changes have the greatest impact on revenue from PIT – due to changes in taxation of labour (expansion of the scope of application of non-taxable income and transfer of a part of social security contributions to PIT) revenue from this tax to the state and municipal budgets has increased by more than EUR 1 billion. This factor was the main reason behind the increase in revenue of the State and municipal budgets specified in the Programme, when compared to the revenue specified in SP2018.

Revenue from PIT is forecasted taking into account the dynamics of the ratio of revenue from this tax with the wage fund, and the forecasted annual growth of wage fund. This revenue will grow slower in 2020 and 2021 than wage fund due to the increase of non-taxable income.

Revenue from VAT is forecasted having considered the expected change in final consumption expenditure and the dynamics of percentage of the tax base of final consumption expenditure and VAT. Taking into account the forecasted revenue from administrative improvement measures, the growth of revenue from VAT in 2020 and 2021 will reach on average 8%.

The forecast of revenue from excise duties was made taking into account the projected sales of excise goods, multiannual data on the interaction between changes in the sales of excise goods and household consumption expenditure / final consumption expenditure, as well as excise duty rates. As result of the planned increase in excise rates on tobacco products in 2020 and 2021, the rate of

Fig. 12. Key factors that affected the 2020 and 2021 revenue forecasts of the Programme compared to SP2018
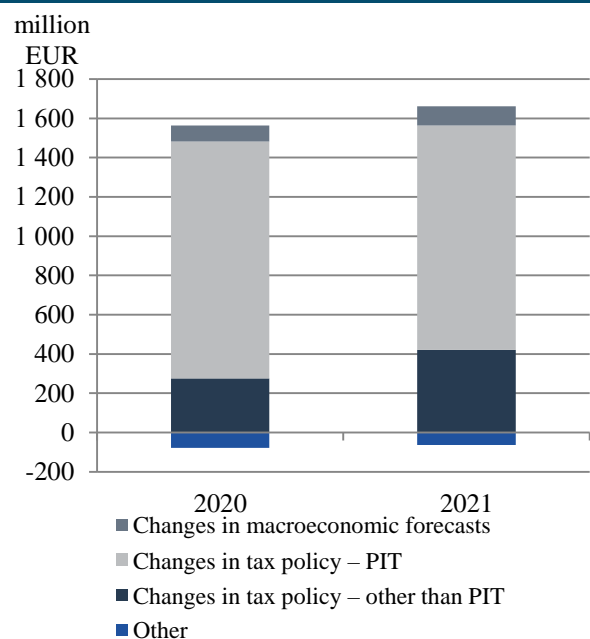
Source - Ministry of Finance.

increase in excise tax revenue is expected to be about 1.6 percentage points higher than in 2022.

Revenue from corporate income tax, having taken into account the forecasted GDP growth and the expected trends of advance payment of corporate income tax, is expected to increase by an average of 10% annually.

Other revenue. In forecasting other government budget revenue for 2020–2022, no substantial changes are expected compared to the planned revenue for 2019.

Expenditure policy measures

Priorities of the Government expenditure policy for 2019-2021:

- Implementation of the reforms to achieve fundamental changes in the areas of education and science, health care, social security, innovation;
- implementation of strategic projects included in the Government-approved strategic project portfolio[16];
- national defence funding to fulfil NATO membership-related obligation;
- increase of wages for employees of state and municipal institutions, statutory servants, judges and other public sector employees.

In implementing the said reforms and other Government priorities, in 2019, the following discretionary expenditure policy measures of the state budget are provided for:

- to allocate about EUR 187 million in the social security area for increasing benefits for children, for increasing bases of social assistance benefits and of targeted compensations, officials' pensions, social benefits, for increasing basic salary and minimum monthly wages, for supporting social undertakings, for social workers – for services of a case manager, for housing support for low-income and young families;
- to allocate about EUR 96 million in the education and science area for increasing salaries of teachers, lecturers, researchers and investigators;
- to allocate about EUR 90 million in the health protection area for contributions for individuals who are insured from the state budget, for increasing salaries of public health professionals and trainee doctors.

As part of the social security reform, since 2019, a part of pension that is not related to pension social insurance contributions is financed from the state budget. For this reason, the state budget spending on social security has increased significantly (fig. 13).

In planning the budget for 2020-2022, the same course of the state budget expenditure policy are planned to be observed: to continue the implementation of structural reforms and other strategic projects, to ensure the financing of national defence which is in line with the obligations to NATO, and to start implementing the strategy of increasing public sector wages. The concrete expenditure policy measures, the costs and sources for implementing of those measures will become evident during the 2020-2022 state budget negotiations and at the

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[16] http://lrv.lt/lt/aktuali-informacija/xvii-vyriausybe/prioritetiniai-darbai/strateginiu-projektu-portfelis.

time of preparation of Draft Law on Approval of Financial Indicators of the State Budget and Municipal Budgets for 2020.

Fig. 13. Structure of the state budget expenditure*
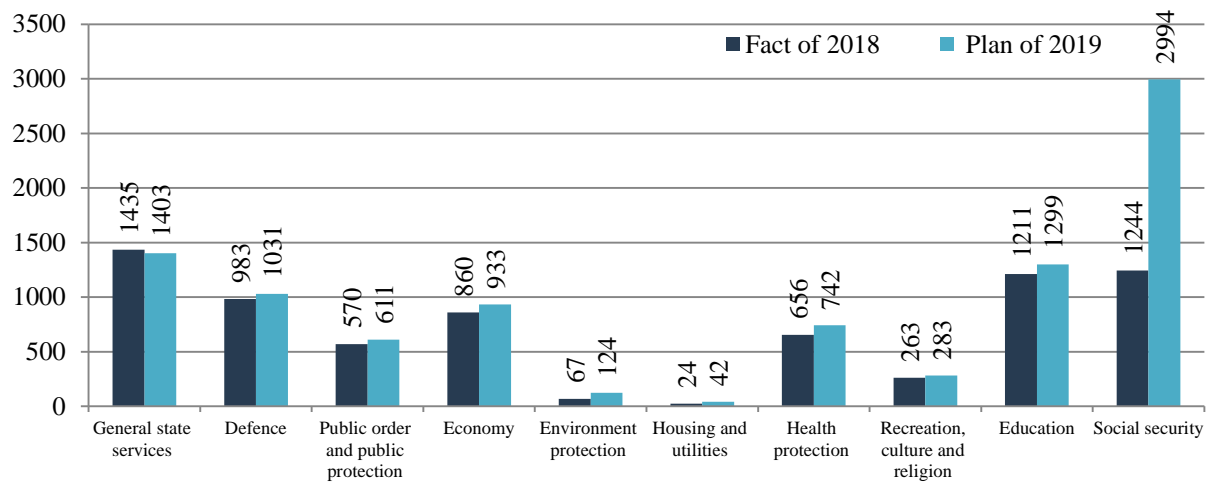
Source – Ministry of Finance.
*Excluding the EU and funds of other international financial support.

SECTION 5
GENERAL GOVERNMENT DEBT AND ITS PROJECTIONS

Government debt level, structure, dynamics and risk management

At the end of 2018, the general government debt, after financial derivatives, accounted for 34.2% of GDP and was 5.2 percentage points lower than at the end of 2017 when it reached 39.4% of GDP. This indicator was positively affected by eurobonds redeemed in February 2018, for which the total of EUR 1.3 billion was accumulated in 2017.

Fig. 14. Government debt and change of its ratio to GDP
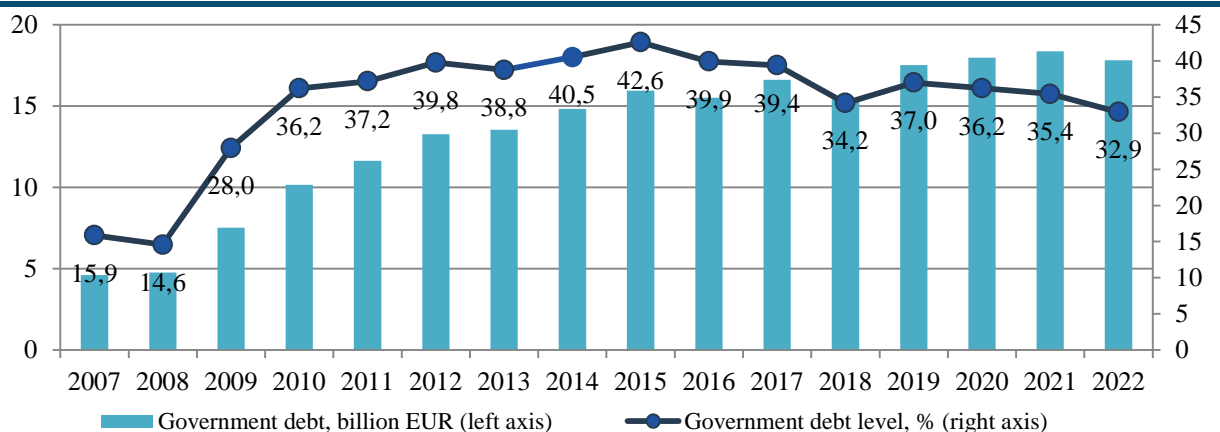
Source – Ministry of Finance.

In the medium-term, the government debt level is expected to maintain a downward trend and at the end of 2022 it will reach about 33% of GDP. The dynamics of debt-to-GDP ratio is in line with general macroeconomic trends, long-term obligations to international institutions and suggestions of the Organization for Economic Co-operation and Development

on maintaining the debt level of about 40% of GDP. The development of government debt reflects a targeted fiscal policy of the Government towards the sustainability of public finances. The government debt projections are presented in Table 20.

On 1 January 2018, the total amount of loans of the SSIF budget taken up and not repaid of EUR 3 682.3 million that generated until 31 December 2017 and amount of EUR 3 million of calculated interest was transferred to the State Treasury. This takeover did not change the amount of consolidated government debt. At the end of 2018, the SSIF had no debt obligations. The debt of the local government sub-sector amounted for 3.2% of the total government debt.

Management of debt obligations assumed by the Government on behalf of the state and of the state's monetary resources risk covers management of exchange rate fluctuations, interest rate changes, credit, liquidity (refinancing) and operational risk. In 2018, the statutory borrowing and debt limits were observed. At the end of 2018, short-term obligations by residual maturity accounted for 5.8%, the average weighted residual maturity of the debt was 6.9 years, the average weighted residual maturity of the debt before changes in interest rates was 6.5 years. Debt for floating interest rates, after financial derivatives, accounted for 0% of the total debt. The central government debt, after financial derivatives, was 100% denominated in euros. The state-guaranteed debt amounted to 0.8% of GDP.

In 2018, the Government distributed on the market green bond issue that was listed on *Nasdaq* Baltic debt securities List. This is the first emission of the government securities in the Baltic States. The funds attracted by it will be used to implement green projects - to modernize apartment buildings and increase their energy efficiency. Annual interest of 1.2% will be paid for the Government bonds. The duration of the green bond issue is 10 years, the bonds will be redeemed on 3 May 2028. The nominal value per one bond – EUR 100.

Government Borrowing and Debt Management Guidelines for 2019-2022

Management of the Government 2019-2022 borrowing and debt is aimed at ensuring financing of state expenditure established by the laws of the Republic of Lithuania, and fulfilling the debt obligations assumed with borrowed funds by incurring as low costs as possible and at acceptable risk. In pursuing this objective, three key tasks of management of the Government 2019-2022 borrowing and debt, and the criteria for their implementation.

The first task is to increase the liquidity of the domestic government securities market as an important part of the Lithuanian financial market by promoting the attractiveness of domestic government securities to investors. The current ratio of domestic debt to total debt on behalf of the state is also seen as one of the factors of risk that is posed on debt stability. In implementing this task, it is planned to maintain a yield curve of government securities with the duration of at least up to 10 years, by focusing on the issue of bond issuance with a residual maturity of 2 to 3 years, 4 to 6 years and 7 to 10 years, by issuing new government domestic bond issuances, to create relatively liquid emissions of at least 250 million euros. Relations with partners and investors are also planned to be developed. The increased share of

domestic debt of the total debt on behalf of the state to 28% in the medium-term represents the task implementation criterion.

The second task – to attract to the State Treasury as much as possible of the monetary resources that are temporary not used by entities and which are classified as resources of general government. This task is aimed at improving the liquidity of the State Treasury financial assets and at more effective management of the state's monetary resources. Analysis and adoption of legislation that enables the liquidity of the State Treasury assets to be increased represent the criterion of implementing the task.

The third task involves managing interest rate fluctuations, refinancing, exchange rate changes and guaranteed debt risk. Risk management is an important factor in achieving the key debt objective, ensuring debt stability and the Government's ability to meet its obligations. Adherence to risk limits that are consistent with international practice represents the criterion of the task – the relative indicator of short-term debt on behalf of the state by the residual maturity and debt obligations of the total debt on behalf of the state will not exceed 25%; the average weighted residual maturity of the debt on behalf of the state will be longer than 4 years; the average weighted residual maturity of the debt on behalf of the state before changes in interest rates will be longer than 3,5 years; the ratio of the floating interest rate debt and the total debt on behalf of the state will not be greater than 10%; the debt in euros, having assessed the entered into transactions of financial derivatives, will make 100% of the total debt; the total level of the state obligations under guarantees will not exceed 3% of GDP.

The forecasted general government borrowing requirement, having assessed the applicable refinancing risk management measures for redemption of eurobond issuances, in 2019-2022 will on average account for 2.4 billion euros each year. Such borrowing requirement is determined by eurobond issuances that are redeemed in 2020, 2021 and 2022. Their total nominal amount after transactions of financial derivatives amounts to EUR 3.6 billion.

Credit rating

On 31 December 2018, credit ratings of Lithuania's long-term foreign currency borrowing established by international credit rating agencies *Moody's*, *Standard & Poor's* and *Fitch Ratings* were accordingly A3 / A / A- (fig. 15).

In March 2018, international credit rating agency *Standard & Poor's* positively evaluated fiscal policy implemented by Lithuania and economic growth prospects, and changed long-term and short-term borrowing ratings established for the country from A- and A-2 to A and A-.

In August 2018, international credit rating agency *Fitch Ratings* changed Lithuania's long-term credit rating outlook from stable to positive. The long-term and short-term credit ratings (A- and F1) established by the agency for the country remain unchanged.

Fig. 15. Development of credit ratings of Lithuania's long-term foreign currency borrowing
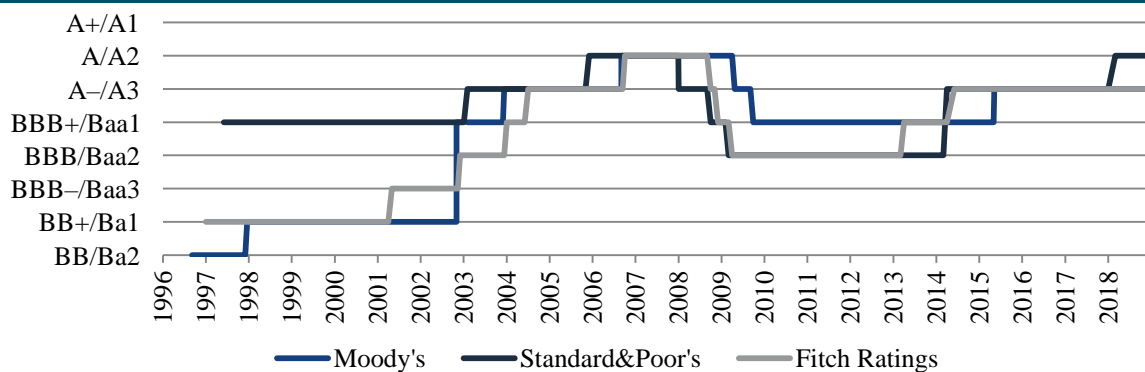
Source – Ministry of Finance.

PART IV
QUALITY OF PUBLIC FINANCES

Tax administration in 2018

In promoting voluntary tax payment and improving tax collection, and in implementing Recommendation for Lithuania to Improve the Implementation of Tax Obligations, in 2018 projects started in previous years were continued:

Fig. 16. The impact of measures to improve tax and social security contributions administration on revenue

Source – Ministry of Finance, STI.

• **Adaptation of analytical measures in implementing tax administration**. In 2018, the STI, by using analytical measures to improve the efficiency of tax administration and performing an automatic cross-checking of data of registers of VAT invoices submitted to i.SAF, had an opportunity to quickly detect discrepancies (buyers presented an invoice and the seller did not, and vice versa) and notify the taxpayer thereof, and after having determined transactions related to potential fraud, the institution could perform taxpayer control actions. Monitoring and control actions were organised. They were initiated on the basis of i.SAF and i.VAZ data analysis. The programme of inspection of groups of companies and large taxpayers was additionally initiated.

• **International cooperation.** In 2018, international cooperation between tax administrations continued to be strengthened – entities automatically exchanged between each other information on accounts opened with financial institutions and the funds held in them. Information from more than 60 countries and territories about accounts opened by Lithuanian citizens in other countries and the funds held in them became available. Exchange of

reciprocal information on binding decisions and pricing arrangements and international groups of companies was exercised.

- **Promoting voluntary tax payment and payers' awareness**. In 2018, in promoting voluntary tax payment and improving tax collection, the complex STI 2017-2021 strategy of

taxpayer education and awareness-raising and the plan of its implementing measures were consistently implemented; the game of a cash register receipts is organised thus promoting public involvement in the reduction of the shadow economy.

- **Fight against tax avoidance and evasion**. In 2018, in implementing the provisions of Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, and recommendations of the Organization for Economic Cooperation and Development, new measures to combat tax avoidance and evasion were set in the Law of the Republic of Lithuania on Corporate Income Tax, specifically a general anti-abuse rule and the rule limiting interest deduction, also the scope of application of the rules for taxation of foreign controlled taxable entities was extended.

Measures to improve the administration of tax and social security contributions that were implemented **in 2018 generated about EUR 171 million of revenue**.

Tax administration in 2019

In 2019, in order to further improve tax administration and reduce shadow economy, the simplification of tax procedures and the development of electronic services will be continued.

New measures will also be taken in the following areas:

- **Voluntary revelation**. In 2019, taxpayers are given a unique one-time opportunity to pay in January-June so called "forgotten" taxes fees with exemption from usual sanctions.

- **Encouragement to pay taxes in areas sensitive to shadow economy**. In 2019-2021, the residents acquiring officially accounted services in areas that are sensitive to shadow economy (building and structure finishing and repair, car repair, baby sitting services) are provided an opportunity to reduce taxable income, thus recovering part of the costs incurred.

- **Intolerance of tax offenders**. So called "white finances" are promoted by restricting the possibilities for unreliable taxpayers to participate in public procurement, to receive support, by making it more difficult to obtain bank financing and setting a longer limitation period. The application of the reverse charge mechanism for collecting VAT is being extended to areas where the most of cases of fraud were identified.

- **Fight against tax avoidance and evasion**. In further engagement in fight against tax avoidance and evasion, in implementing the provisions of Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, and of Council Directive (EU) 2017/952 of 29

May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries, and recommendations of the Organization for Economic Cooperation and Development, additional measures to combat tax avoidance and evasion, specifically rules for resettlement taxation and hybrid mismatches, will be enshrined in Law of the Republic of Lithuania on Corporate Income Tax.

Having assessed the said measures to improve tax administration, an amount of **EUR 220 million** was included in the revenue plans for the **2019** budgets to be received by improving the administration of tax and social security contributions.

Reform of the budget system

Since 2017, Lithuania has been reforming its budgeting and strategic planning system (hereinafter - reform of the budgetary system) with a view to establishing a reliable and efficient medium-term budgeting and program management system which will be clearly linked to the updated state strategic planning system.

Currently, reforming the budgetary system, changes in the structure of budget frameworks are under preparation, the procedure for programming is adjusted by linking it closely to the updated model of the state strategic planning documents, and also other improvements in the budgeting and strategic planning system are carried out. The fully updated system will be implemented at the time of forming the state budget for 2021–2023. Much attention is paid to better publicizing the budget-related information. At the time of preparing the state budget for 2020-2022, the publication "Budget at a glance 2020" will be prepared. It will disclose information about the budget in clear and publicly understandable format.

Increasing the efficiency of programme of public investment

To improve the efficiency of public investment, since 2018, the procedure for the preparation, assessment and selection of investment projects financed from the state budget has been changed - all new investment projects must be based on a cost-benefit analysis, the analysis of their alternatives is carried out, the approved selection criteria for investment projects in the relevant field and their implications are applied for the selection of investment projects, the procedures for the evaluation of investment projects and monitoring of investment projects were revised.

The entire procedure for the establishing the state budget frameworks, the procedures for justification of budget expenditures and their ex ante review are reviewed in parallel. These changes will be implemented in a complex manner, without separating investment planning from planning of other state budget funds, i.e. by linking the public investment planning to strategic planning processes. Project preparation and selection procedures for all types of investments that are financed from various possible sources of funding (including EU support) will be merged. The changes are expected to be fully included in the 2021-2023 budget formation process.

State real estate management reorganization

The state real estate management reform that was launched in 2015 is continued. In 2018, significant changes occurred in management of administrative state-owned real estate. According to the plan of the measures for implementing the Government's programme that was approved by the Resolution No 167 of the Government of the Republic of Lithuania of 13 March 2017 on the approval of the Plan of implementing the programme of the Government of the Republic of Lithuania, by the end of 2020, it is planned to hand over to be managed centrally 100% of the administrative state-owned real estate. At the end of 2018, nearly 48% of the administrative state-owned real estate were handed over to the CREM. It is planned for 2019 to hand over to be managed centrally a space of the administrative state-owned real estate with an area of about 200 thousand square meters, or 28%.

In 2018, the list of the state-owned real estate sold by the means of public auction was supplemented with nearly 890 objects of property for sale which were surrendered as unused state-owned real estate by the state enterprises or public bodies. Those objects were handed over to the CREM to be managed centrally. Revenue from the state-owned real estate that was sold in 2018 by means of auction amounted to EUR 3.84 million.

In this and the coming years the biggest focus will be on centralization of management of the administrative state-owned real estate. According to the data of January 2018, the total area of the administrative state-owned real estate was about 723 thousand square meters, and it was managed or used by more than 500 public bodies. According to independent expert assessment, a space of about 400 thousand square meters of this purpose real estate is required for exercising of state functions. For this reason, formal transfer of the administrative state-owned real estate to the CREM is not the ultimate goal of effective management. Strategic objective – after having taken over to be centrally managed the administrative state-owned real estate, to optimize its volumes, to transit to a new system of centralized management of the administrative state-owned real estate, in which the CREM would play a role of the manager of such property, rather of the provider of services of maintenance of the administrative state-owned real estate, that on the basis of lease agreements carries out maintenance of the administrative state-owned real estate. A new legal regulation is required to optimize volumes of the administrative state-owned real estate, and financial instruments should be provided which would grant additional powers to the CREM and rights to use the sales proceeds, borrowed funds of the company or rental income to renovate the administrative state-owned real estate that is needed for the public functions.

Another aim – to restrict as much as possible the possibilities to use free of charge (on the grounds of lending) the state-owned real estate. Legislative measures (the package of 13 laws was submitted to the Seimas for consideration in 2018) are purported to reduce a spectrum of lending entities established by the laws, to reduce volumes of real estate transferred on the grounds of lending, to review open-ended lending agreements.

The state-owned real estate reform will also cover the management of the state-owned real estate of other purposes that is used in such areas as education and sports, health care, culture, education, social security, internal affairs and justice. The majority of the state policy-making state institutions operating in the areas listed above are already carrying out optimization of the network of institutions, consolidation of services, without linking these changes to the need to properly assess the impact of changes on the state-owned real estate management or optimization of its volumes. It is therefore planned to prepare by 2021 the long-term guidelines for state-owned real estate management and general government policy, and the action plan for their implementation.

Ensuring financial stability

To consolidate and optimize supervisory processes for all financial market participants, in 2018, a package of draft amendments to the Law of the Republic of Lithuania on the Bank of Lithuania and related laws was adopted (a package of 27 laws). The laws adopted ensure a uniform position of financial market participants in the supervisory process, strengthen supervision effectiveness, consumer protection and contribute to strengthening of financial stability.

In December 2018, the package of EC legal proposals on banking prudential measures, consisting of amendments to the Bank Recovery and Resolution Directive[17], the Single Resolution Mechanism Regulation[18], the Capital Requirements Directive IV[19], and the Capital Requirements Regulation[20] (CRR IV), was adopted. The amendments will strengthen the risk management of banks and their readiness to better absorb losses through own funds and adequate obligations. Implementation of these legal acts will strengthen the stability of Lithuanian banking sector and will have a positive impact on the completion of EU banking union initiatives.

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[17] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council Text with EEA relevance (OJ 2014 L 173, p. 190), as last amended by Directive (EU) 2017/2399 of the European Parliament and of the Council of 12 December 2017 (OJ 2017 L. 345, p. 96).

[18] Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014, p. 1).

[19] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investments firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ 2013 L 176, p. 338).

[20] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ 2013 L 176, p. 1).

Macroprudential policy

Having assessed development in the credit and real estate market in recent years, and in order to increase resistance of the financial system, on 20 June 2018 the Bank of Lithuania decided to increase the quarterly reviewed countercyclical capital buffer rate from 0.5% to 1%. The increased countercyclical capital buffer rate will become effective from 30 June 2019. Before that date, the countercyclical capital buffer rate of 0.5% that became effective on 31 December 2018 will apply. The countercyclical capital buffer helps to strengthen the resilience of the financial system to potential shocks. Furthermore, in the event of slowdown in economic growth or should it experience shocks, this capital requirement may be reduced thus increasing the ability of credit institutions to maintain lending supply during the downturns.

In the context of the review in 2018, as in previous years, four systemically important institutions were identified in Lithuania and the other systemically important institutions buffer was adapted to them. The same 2% buffer rates were established for AB SEB bank, Luminor Bank AB, and Swedbank, AB. Due to the increased the systemic importance of Šiaulių bankas AB, a higher, i.e. 1% capital buffer, was established for the bank. The bank must build up the capital buffer by 31 December 2020 (before that date, the 0.5% capital buffer that was established earlier will apply to the bank). On 2 January 2019, the bank Luminor Bank, AB, that operated in Lithuania, has become the branch of Luminor Bank, AS, established in Estonia. Therefore, the other systemically important institutions buffer that was earlier imposed for the bank by the Bank of Lithuania no longer applies to it.

The Bank of Lithuania continues to actively operate under the available macroprudential policy mandate. In the light of developments in macroprudential policy, in 2018 the Macroprudential Policy Strategy was reviewed. The reciprocation of macroprudential policy measures of other EU Member States was defined in more detail in the strategy, and the list of macroprudential policy measures that can be applied was supplemented. The basic principles of lending to households and ratios that are established in the responsible lending regulations remained unchanged (the minimum down-payment is 15%; the maximum financial debt-service-to-income ratio – 40%, this ratio in applying the interest rate stress test – 50%; the maximum loan maturity – 30 years).

Reorganization of the credit union sector

The consolidation of tasks and objectives of the credit union reform was continued in the credit union sector. The amendments to the laws[21] implementing the credit union sector reform, that provide for the possibility for the central credit unions not only to provide financial services, but also their obligation to maintain liquidity of their member credit unions, to ensure their solvency, to monitor and verify the risk they assume, came into force

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[21] The Law No XII-2566 amending the Law of the Republic of Lithuania on Central Credit Union No VIII-1682; The Law No XII-2567 amending the Law of the Republic of Lithuania on Credit Union No XII-2567; The Law No XII-2568 amending Articles 2, 4, 9 and 40 of the Law of the Republic of Lithuania on Banks No IX-2085.

on1 January 2018. The central credit unions monitor and supervise the risk assumed by their members, they pool resources in stabilization funds to be used, when necessary, to restorate the solvency of credit unions. At least 1% of the assets of each central credit union must be pooled in the stabilization funds. Credit unions, which are the members of central credit unions, comply with the agreed rules, thereby limiting the risk borne by the entire credit union system. Furthermore, the model of supervision of credit union activities is strengthened because the Bank of Lithuania supervises both individual credit unions and groups of central credit unions at a consolidated level. The strengthened credit union sector, which started operating in 2018 under the new rules, worked profitably and strengthened capital base.

Execution of bank resolution functions

In performing the function of the resolution authority, the Bank of Lithuania helps to ensure that banks which are experiencing difficulties could be promptly resolved and to secure their uninterrupted activities without state aid. To this end, the Bank of Lithuania, together with the Single Resolution Board, the Swedish, Danish, Estonian and Latvian resolution authorities, prepares the bank resolution plans. In 2018, the Sweden's SEB and "Swedbank" banking groups' resolution plans, involving the subsidiaries operating in Lithuania, were updated. The plans establish the mandatory consolidated Minimum Requirement for own funds and Eligible Liabilities (MREL), i.e. an additional fiscal protection measure to ensure that banks which encounter operational difficulties would have sufficient resources to absorb losses and recapitalize. This measure would ensure their smooth resolution. The internal MREL which is assigned to subsidiary banks is planned to be established in the next few years. In 2018, the Bank of Lithuania prepared and approved the resolution plans of Šiaulių bankas AB and UAB Medicinos Bankas. The Latvia's "Citadele" and Denmark's "Danske" banking group's resolution plans were also updated.

In 2018, an amount of ex-ante contributions of EUR 6.6 million was collected from the banks operating in Lithuania and was transferred to the Single Resolution Fund (SRF), and the total of EUR 7.5 billion from the banks of all 19 euro area Member Stated. In 2018 the SRF reachedEUR 24.9 billion in total, and by 2024 it will have to reach the target level of least 1% of the covered deposits of the banking union, i.e. about EUR 60 billion. On 22-23 January 2019, the financial stability institutions of the Nordic and Baltic coutnriesorganized a joint financial crisis management exercise involving the representatives from 31 Danish, Estonian, Finish Icelandic, Latvian, Lithuanian, Norwegian, Swedish and other EU institutions. The ability of Nordic and Baltic financial authorities to manage the crisis and cooperate at regional level was tested during the exercise. Following the analysis of the exercise experience, the cooperation and decision-making processes will be improved.

Development of financial markets

Promotion of *Fintech* development remained the issued of priority in 2018. For this reason, in cooperation with state institutions and financial market participants, the Plan of the

measures to promote financial technology sector development in Lithuania[22], that was approved during the Government meeting of 9 January 2019, was prepared. The plan provides for further improvement of the legal environment, increasing demand for *Fintech* products and services, special attention to be paid to the management of the risks related to potential money laundering, terrorist financing, infringements relating to consumer protection. The plan also provides for the promotion of professional labour supply and the expansion of capital supply at every stage of the company's development. The plan for 2019 provides for the priorities related to improving customer identification capabilities, establishment of the international 16 + 1 *Fintech* coordination centre, preparation of the concept of ecosystem for non-cash payment in educational institutions, assessment of the possibilities for installing personal investment account of the resident. The plan for the first time includes an aim to promote exports of services and products of *Fintech* sector companies located in Lithuania to foreign markets.

Competition in the financial market is further promoted by improving the regulatory environment and administrative procedures. To make Lithuania attractive to foreign investors, a list of remote customer identification methods was supplemented. A category of the specialized bank license appeared, payment and e-money institutions were provided access to the central bank's retail payment system, the credit institution licensing fee was reduced ten times, etc.

In 2018, the *Fintech* sector in Lithuania expanded extremely fast: according to the data of the 2018 *Fintech* Market Review, in 2018, 170 *Fintech* companies operated in Lithuania (in 2017 – 117, the growth of 45%). The important fact is that the Bank of Lithuania has also granted licenses for operation to internationally renowned companies, whose attention to Lithuania later makes it easier to attract investments from other *Fintech* companies. In 2018, the Baltic Sandbox accelerator program for start-ups of *Fintech* area was launched, the SEB innovation centre was opened in Vilnius. Lithuania in this respect is becoming the leading EU country. High added value jobs are created, in the background of increasing competition opportunities are expanded for the residents and business to use more affordable and convenient financial services.

Technological innovations inevitably involve certain risks (money laundering, terrorist financing, cyber security, etc.). Steps have been taken to reduce these risks: competence and resources of the Supervisory Authority of the Bank of Lithuania are strengthened, close cooperation with law enforcement authorities in assessing the shareholders and managers of licensed companies is taking place, relations are being established with the foreign supervisory authorities.

To expeditiously anticipate and effectively manage potential risks in *Fintech* area, the Memorandum on cooperation and exchange of information aimed at overseeing and managing

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[22] Plan of measures to promote fintech sector development in Lithuania (http://lrv.lt/lt/posedziai/lietuvos-respublikos-vyriausybes-pasitarimas-32).

risks in the fintech sector (hereinafter – the Memorandum)[23] was signed on 18 March 2019. Signatories of the Memorandum will cooperate between each other, including exchange of information about illegal acts related to provision of financial services, *Fintech,* the noticed risk factors, trends, incidents and measures that were taken to manage risks. The Memorandum foresees that the institutions will strengthen the administrative capacity of their staff in the area of financial innovations and of monitoring and managing potential *Fintech* risks, will develop competence in this area and will organize joint specialized training in the areas of financial innovations and monitoring and managing potential risks of technologies. Close cooperation between institutions in the area of *Fintech* risk management will contribute to strengthening of financial stability.

Development of capital markets

To promote the development of Lithuanian capital markets and to create a more competitive legal environment that offers more opportunities both for companies looking for additional funds and for investors, in 2019 the draft Law of the Republic of Lithuania on Securisation and Covered Bonds will be prepared. In order to create a more favourable jurisdiction for the operation of investment funds in Lithuania and to create accordingly the preconditions for increasing the added value for the economy created by their activities, in December 2018, the laws relating to the activities of investment funds were adopted. After the European Bank for Reconstruction and Development has performed the study, in 2018, specific recommendations were made on developing possible new measures and a favourable environment for institutional investors were provided, and they are planned to be implemented by the end of 2020. The implementation of these measures will increase access to capital and will attract larger business investments.

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PART V
LONG-TERM SUSTAINABILITY OF GENERAL GOVERNMENT FINANCES

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Ensuring the long-term sustainability of public finances is a concern for all EU countries. It was exacerbated by the financial and debt crisis. In order to ensure the long-term sustainability of public finances, it is important to reduce government debt, to increase employment and to implement structural reforms that ensure sustainable long-term economic growth. Sustainability of the government finances in a long-term is determined by changes in the demographic structure of the population. The Programme presents a complex budget projection of the long-term government expenditure for Lithuania[24] (hereinafter – the long-

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[23] The Memorandum signed between the Ministry of Finance, the Ministry of the Interior, the Bank of Lithuania, the Financial Crime Investigation Service under the Ministry of the Interior, the Police Department under the Ministry of the Interior, the Special Investigation Service, the State Tax Inspectorate under the Ministry of Finance, the State Data Protection Inspectorate and the State Enterprise Deposit and Investment Insurance.

[24] The 2018 Ageing Report (angl. *The 2018 Ageing Report:Economic and Budgetary Projections for the EU Member states (2016–2070)*).

term projection) that was performed by the EC authorities in cooperation with the Working Group on Ageing, that allows determining the impact of demographic change on the sustainability of pension, health and education systems in the long-term, and foreseeing actions for ensuring their future stability. The long-term projection was carried out on the assumption that decisions taken in the medium-term in the areas of health care, pensions and education will continue in the long-term. It is therefore important to emphasize that the projection does not reflect the most likely future scenario. The long-term projection is aimed at determining challenges of public finances that are linked to demographic changes.

The long-term projection consists of the totality of long-term costs of five categories. The projections of the long-term government expenditure, including expenditure on health protection, long-term health care, education and unemployment were performed by the EC. The pension projection of the long-term expenditure was performed by the Ministry of Social Security and Labour. The macroeconomic assumptions agreed at EU level in the first half of 2017 and published in November of the same year, and the demographic projection of Lithuania performed by Eurostat in 2017, under which by 2060 the population of Lithuania will drop to 1.83 million, serve as the basis of the long-term projection. Between 2017 and 2060, the working-age population (15-64 years old) in Lithuania will drop from 65.6% to 51.4%, while the elderly population (65 years and older) will increase - from 19.5% to 32.9% of the total population. According to the methodology applied by Eurostat, migration will lead to a particularly rapid decline in the working age population between 2020 and 2030 - on average about 2.2% per year. And this will have a negative effect on the GDP. According to the new Eurostat demographic projections, between 2017 and 2060, the population of children in Lithuania will increase: 0-14 years old children – from 14.9% in 2017 to 15.7% in 2060; school-age children (7-16 years old) – from 9.4% to 10.6%; the population of 15-19 year olds will drop from 5.2% to 4.8% of the entire population.

The current actual demographic situation in the country is much better than the one provided for in Eurostat projections. According to the data that were published in March 2019 by the Department of Statistics of Lithuania, in 2018 the lowest international net migration rate since 1990 was recorded - 3.3 thousand more people emigrated from Lithuania than immigrated. In the Eurostat demographic projection for Lithuania that was performed in 2017, the net migration rate for 2018 was provided for about 7 times worse that the actual result.

The projections of the government long-term finance expenditure (pensions, health protection, education systems) until 2060, that are presented in Table **7** of the programme, show that overall aging-related expenditure will remain stable in the long-term. They are expected to increase from 16% of GDP in 2016 to 16.7% in 2030, and will be the highest in 2040 – 17.1%, and in 2060 they will drop again to 16.7%.

The fiscal sustainability has increased after the new pension indexation formula was introduced in 2018. Pension benefits and pension points collected are now indexed according to wage fund changes. From 2018 onwards, the minimum length of service for entitlement to pension is also increased every year by six months – until it will reach 35 years in 2027. Due to

the new indexation mechanism and higher seniority requirements for the entitlement to pension, pension expenditure in 2016-2060 is expected to decrease by 3.7% of GDP compared to the projections that are based on the earlier rules. Pensions make up about 40% of all aging-related expenditure. Hence, their indexation reduced the overall risk posed on Lithuanian public finances by demographic trends (the ageing of society).

Expenditure on health care and long-term care is expected to remain relatively low – it will respectively increase from 4.1% and 1% of GDP in 2016 to 4.6% and 2.2% of GDP in 2060, while expenditure on education will be relatively stable and in 2060 it will amount to 4.2% of GDP.

Based on the calculations presented in Table **7**, and according to the government debt sustainability analysis performed, the EC estimates that in the short-term, medium-term and long-term, Lithuania is at low risk with regard to the sustainability of government finances (*Fiscal sustainability report 2018*[25]).

Table 7. Projections of long-term government expenditure

Indicator	% of GDP						
	2007	2010	2020	2030	2040	2050	2060
Age-related expenditure	17,2	20,7	15,7	16,7	17,1	16,6	16,7
pensions:	6,6	8,6	7,0	7,1	7,0	6,5	6,0
social security pensions	6,6	8,6	7,0	7,1	7,0	6,5	6,0
old-age and early pensions	4,7	6,2	4,9	4,9	5,0	4,6	4,3
other pensions (disability, widows and survivors)	1,8	2,4	1,8	2,0	1,9	1,8	1,6
occupational pensions (in general government)	–	–	–	–	–	–	–
health care	4,8	4,8	4,2	4,4	4,6	4,7	4,6
long-term health care	0,6	1,1	1,0	1,3	1,7	2,0	2,2
education	5,2	6,2	4,0	4,1	3,7	3,5	4,2
other age-related expenditure (unemployment benefits)	0,1	0,4	0,1	0,2	0,2	0,2	0,2
Assumptions							
Increase in labour productivity (per hour)	7,2	6,1	2,3	2,5	2,1	1,9	1,7
Real GDP growth	11,1	1,6	1,7	0,5	1,0	0,9	1,0
Participation rate males (aged 20–64)	79,9	80,6	83,6	83,8	84,3	85,0	86,3
Participation rate females (aged 20–64)	72,2	76	78,5	82,1	82,6	83,0	84,9
Total participation rate (aged 20–64)	75,9	78,2	81,0	82,9	83,4	84	85,6
Unemployment rate (aged 20–74)	4,2	17,8	6,9	7,8	7,7	7,6	7,6
Population aged 65+ in total population (beginning of the year)	16,6	17,3	20,5	26,9	31,8	32,3	32,9

Source – Ageing report 2018 of the EC (https://ec.europa.eu/info/publications/economy-finance/2018-ageing-report-economic-and-budgetary-projections-eu-member-states-2016-2070_en).

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[25] https://ec.europa.eu/info/publications/economy-finance/fiscal-sustainability-report-2018_en.

PART VI
COMPARISON OF MACROECONOMIC AND FISCAL PROJECTIONS, RISK AND SENSITIVITY ANALYSIS

SECTION 1
COMPARISON OF PROJECTIONS

Comparison of indicators of economic development scenarios

Taking into account the actual data of 2018 published by Statistics Lithuania, current trends of economic development and changes in assumptions on foreign environment prospects, the Ministry of Finance has changed the GDP projections.

Table 8. GDP projections compared to the indicators provided for in the SP2018

Indicator	2018	2019	2020	2021	2022
Real GDP change (%):					
Projection of 21 March 2018	3,2	2,8	2,5	2,5	–
Projection of 21 March 2019	3,4	2,6	2,4	2,3	2,3
decrease (–) / increase (+)	0,2	–0,2	–0,1	–0,2	–

Source – Ministry of Finance.

There are no significant differences in EC's 2018 winter forecast and in the EDS of the Ministry of Finance as regards Lithuania's economic development scenario. The EDS of the Ministry of Finance was developed building on the prevailing economic trends and more detailed statistical data on national accounts for 2018 published on 1 March 2019.

Table 9. Comparison of Lithuania's GDP and inflation projections

Indicator	Year	Ministry of Finance, March 2018	EC, 2018 winter	Difference between the projection of the Ministry of Finance and the EC's forecast, in percentage points
GDP growth, %	2019	2,6	2,7	–0,1
	2020	2,4	2,4	0,0
HICP, %	2019	2,2	2,2	0,0
	2020	2,2	2,1	0,1

Source: Ministry of Finance, EC.

Comparison of government finance projections

The value of the general government balance indicator for 2018 that is presented in SP2017 and LBP2018[26] did not differ substantially. The government expenditure specified in LBP2018, compared to the corresponding indicators of SP2017, increased by EUR 665.8 million, and revenue – by EUR 665.9 million. The discretionary measures of expenditure provided for in LBP2018 accounted for 40% of the increased expenditure share. The rest of the expenditure consisted of increased pension expenditure due to indexation, municipal expenditure and expenditure of other government budgets. Accordingly, the discretionary

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[26] LBP2018 (http://finmin.lrv.lt/uploads/finmin/documents/files/2018%20metų%20Lietuvos%20biudžeto%20projektas.pdf).

measures of revenue provided for in LBP2018 accounted for 45% of the increased expenditure share, compared to SP2017 and LBP2018 revenue projections. The rest of the increased revenue consisted of revenue that increased due to the updated EDS.

Fig. 17. Changes in government balance projections and actual data*
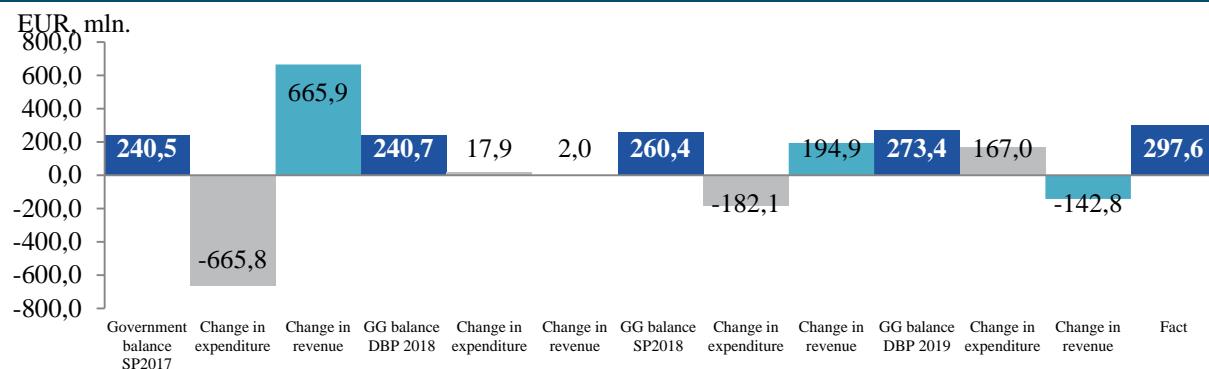
Source – Ministry of Finance.
* The change in expenditure and revenue with a negative sign worsens the balance, and with a positive sign – grades it up. The data are presented excluding EU and other international support funds that have no impact on the balance.

The general government surplus provided for in SP2018[27] compared to the indicator provided for in LBP2018, increased by EUR 19.7 million in 2018. In preparing SP2018, an increase in salaries for medical staff and savings in public budgets expenditure were taken into consideration. The projection of revenue has not changed substantially. The general government surplus of LBP2019 was increased to EUR 260.6 million, i.e. by EUR 13 million compared to the indicator provided for in SP2018. Expenditure increase of EUR 85 million was due to the updated projection of interest on government debt, and presentation of expenditure on military equipment as accruals. The general government expenditure increased by another EUR 43 million due to sickness and maternity social benefits that were higher than planned. The government revenue growth was mainly driven by EUR 130 million higher growth of revenue of the budgets of social security funds that was provided for in SP2018.

The comparison of the 2018 projection presented in LBP2019 with factual data revealed the government surplus that is EUR 24.2 million higher than planned. The actual expenditure was lower than planned, mainly due to presentation of expenditure on military equipment as accruals. Revenue was lower than planned mainly due to the social security subsector revenue that was EUR 67 million lower than provided for in LBP2019, and adjustment of corrections to the accumulation of VAT and excise duties according to the actual data.

The 2018 actual government balance is 0.1% of GDP better than the targeted balance approved by the Seimas that is provided for in LBP2018, and the balance provided for in SP2018. The 2019 general government surplus presented in the programme matches the indicator presented in LBP2019, but is 0.2% of GDP lower than provided for in SP2018.

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[27] SP2018
(http://finmin.lrv.lt/uploads/finmin/documents/files/Lietuvos%20stabilumo%202018%20metų%20programa(1).pdf).

Having assessed the need for public expenditure (especially in the social, productive investment areas), it is enough to form in 2019 the general government surplus of 0.4% of GDP in order for the fiscal discipline rule that is established in the Constitutional law to be met, - in order for the 2019 structural balance, compared to the 2018 structural balance, to improve.

The latest projections for 2020 and 2021, like SP2018, reflect a neutral fiscal policy.

Table 10. Comparison of general government balance projections with projections in SP2018

Indicator	ESA code	2018	2019	2020	2021	2022
Net lending (+) / borrowing (–) of general government:	B.9	GDP %				
projection of 30 April 2018		0,6	0,6	0,6	0,3	–
projection of 30 April 2019		0,7*	0,4	0,2	0,1	0,1
worsening (–) / improvement (+)		0,1	–0,2	–0,4	–0,2	–

Sources: Lithuanian Department of Statistics, Ministry of Finance.
* Actual value.

There are no fundamental differences between the balance projections provided for in the EC 2018 winter forecast and in the Programme (Table 11).

Table 11. Comparison of the government balance projections

Indicator	Year	Ministry of Finance (Programme indicators)	EC (2018 autumn forecast)	Difference between the projection of the Ministry of Finance and the EC's forecast, in percentage points
		GDP %		
Government balance	2018	0,7	0,6	0,1
	2019	0,4	0,4	0,0
Structural government balance	2018	–0,5	–0,6	0,1
	2019	–0,4	–0,5	0,1

Source: Ministry of Finance, EC.

Comparison of the government debt projections with previous projections

Refinancing risk management results, updated projections of GDP, revenue, and expenditure lead to differences in level of debt projections.

Table 12. Comparison of government debt projections with projections in SP2018 projections

Indicator	2018	2019	2020	2021	2022
Government debt:	GDP %				
Projection of 30 April 2018	35,8	38,1	36,6	35,3	–
Projection of 30 April 2019	34,2	37,0	36,2	35,4	32,9
decrease (–) / increase (+)	–1,6	–1,1	–0,4	0,1	–

Sources: Lithuanian Department of Statistics, Ministry of Finance.

SECTION 2
SENSITIVITY ANALYSIS

GDP sensitivity analysis

Lithuania's economy is small and open, with export accounting for more than 80% of the GDP (82.2% in 2018). Therefore, the economic situation and future prospects of trade partners have a significant influence on Lithuania's economic development. The medium term economic development, as compared to that envisaged in the EDS of the Ministry of Finance, published on 21 March 2019, could be either faster or slower. Due to continuing uncertainty about the future, there is both a positive and a negative risk of deviation from the EDC, which is mainly caused by external factors. Therefore, technical calculations were done and alternative scenarios developed assuming that GDP growth in the respective year in the medium-term will be by 1 percentage point lower than in the economic development scenario (pessimistic scenario) and assuming that GDP growth in the respective year in the medium-term will be by 1 percentage point faster than in the economic development scenario (optimistic scenario). In case of a decrease/increase in GDP growth by 1 percentage point, the general government revenue would decrease/increase, on average, by about 0.4% of the GDP.

Table 13. Alternative scenarios

Indicator	2018	2019	2020	2021	2022
EDS					
Change in GDP at constant prices, %	3,4	2,6	2,4	2,3	2,3
GDP at current prices, million EUR	45133,6	47369,1	49609,0	51843,4	54113,3
Change in GDP at current prices, %	7,0	5,0	4,7	4,5	4,4
Pessimistic scenario					
Change in GDP at constant prices, %	3,4	1,6	1,4	1,3	1,3
GDP at current prices, million EUR	45133,6	46900,6	49117,3	51329,0	53576,2
Change in GDP at current prices, %	7,0	3,9	3,7	3,5	3,3
Optimistic scenario					
Change in GDP at constant prices, %	3,4	3,6	3,4	3,3	3,3
GDP at current prices, million EUR	45133,6	47837,8	50100,8	52357,9	54650,6
Change in GDP at current prices, %	7,0	6,0	5,8	5,5	5,4

Sources: Ministry of Finance, Lithuanian Department of Statistics.

Sensitivity analysis of revenue and interest payable by the central government

In the event of 1 percentage point increase in floating and fixed interest rates on the market in the medium-term, the central government's interest due on new liabilities assumed would respectively increase by EUR 19 million, EUR 35 million, and EUR 50 million in 2020-2020, i.e. on average, 7 basic points of GDP per year.

Table 14. Sensitivity analysis for revenue and interest payable by the central government

Indicators	2019	2020	2021	2022
Change in revenue if the pesimistic* scenario is realized, million EUR	–184,0	–193,1	–202,0	–210,9
Change in revenue if the optimistic* scenario is realized, million EUR	184,1	193,1	202,0	211,0
Change in the general government balance due to revenue change under pessimistic* scenario, million EUR	–0,4	–0,4	–0,4	–0,4
Change in the general government balance due to revenue change under optimistic* scenario, million EUR	0,4	0,4	0,4	0,4
Change in the central government interest due, as a result of a 1 pp increase/decrease in floating and fixed interest rates	–	19 (–19)	35 (–35)	50 (–50)
Change in the general government balance after a respective increase/decrease in the central government interest due	–	0,0	–0,1 (0,1)	–0,1 (0,1)

Source – Ministry of Finance.
* Revenue sensitivity was assessed according to the scenarios designed in Table 13 of the Programme.

SECTION 3
RISK ASSESSMENT

Risks of fulfillment of economic development scenario

The world economy is facing challenges. Restrictions on international trade have already had a negative impact on the global economy - a slowdown in global trade and global GDP in 2018, and China's economy has been slowest since 1990. Geopolitical tension has persisted and can become more intense. A high level of debt in some countries and challenges related to its financing poses risk on sustainability of the global economy. Manifestations of political tensions in the EU and economic nationalism increase the vulnerability of the global, euro area and Lithuanian economies.

At the end of 2018, the USA and China agreed for a 90-day break in the introduction of the new duties. Manifestations of protectionism became less intense after both countries extended the break after 1 March 2019 "until further notice". However, uncertainty about political decisions in the area of international trade has remained together with the risk of developing protectionism in the future.

At the time of drawing up the EDS, the outcome of Brexit process was unknown. Uncertainty in EU-UK trade and other conditions has increased. This and persistent internal problems encountered by some major euro area economies may adversely affect the assumptions about the external environment that were applied at the time of drawing up the scenario.

Estimates of some of the indicators provided for in the scenario may also be altered by changes in the statistical projection base.

There is a positive risk that prudent monetary policy, economic policies implemented by the Government, and effectively used EU and other international financial support funds will increase domestic demand in Lithuania by more than expected in the scenario.

The positive consequences of Brexit are not ignored either – some people in Lithuania may abandon their plans to emigrate, while individuals already residing in the United Kingdom as emigrants could decide to return to Lithuania. This would, in the short-term, improve demographic trends and create conditions for a faster growth of employed population in Lithuania. Changes in the labour market would also have an impact on the wage and wage fund projections.

Brexit can also have a positive impact on investment development in Lithuania – Lithuania is an attractive location to establish a representative office, to obtain licenses for UK companies that wish to continue operating in the EU market after the Brexit will come true – this could accelerate investment development.

Uncertainty in the development of international oil prices, which have a significant impact on the prices of consumer products in Lithuania, remains the key risk associated with the inflation rates projected in the scenario.

Risk to the stability of the Lithuanian financial system

Imbalances in the Nordic countries and a sharp increase in risk premia, and its potential impact on parent banks continued to pose the biggest risk on Lithuanian finance system in 2018. Although the rapidly growing housing prices in Sweden and Norway have stabilized, uncertainty about their further development remains high, and their faster fall scenario should not be excluded. Given that household indebtedness in these countries is still high and continues to rise, the declining housing prices may lead to bank losses and the overall slowdown or even fall in economic growth in these countries. In addition, Nordic banks continue to finance a relatively large part of their activities with resources attracted in international financial markets. As the global economy is recovering, tightening monetary policy is already taking place in individual regions of the world. It is therefore expected that this may increase the cost of borrowing on the international market and increase the cost of borrowing by Nordic banks. Such the lasting situation could lead to the situation where the parent banking sector may begin to change its lending policy. For this reason, credit volume in Lithuania may decrease and loans may become more expensive.

The protracted rapid growth in housing loans and active real estate market also remain one of the most important risks. High mortgage and real estate market activity is intense for several years in a row. The portfolio of housing loans granted by credit institutions increased by 8.7% in 2018, and this is the fastest growth rate since the pre-crisis boom. The housing prices (6.6%) and the number of housing transactions (2%) continued to rise. Should such trend persist and economic grow become slower, the relative level of indebtedness may increase significantly, and may, in this way, increase the potential negative consequences in case of unfavourable shock. Expectations with regard to the country's economic development, including real estate market developments in the future, remain optimistic. For this reason, borrowing for housing purchase and real estate prices are likely to grow further. On the other

hand, this risk is mitigated by the still large supply of housing, sustainable financial situation of households and the macro-prudential measures applied by the Bank of Lithuania.

State guarantees

At the end of 2018, the government-guaranteed loan portfolio accounted for 0.8% of the 2018 GDP. Taking into account the guarantees for debt obligations assumed by the guarantee institutions, loans granted to students, loans granted to finance state investment projects and / or used for supplementing the working capital of the enterprises specified in the Law of the Republic of Lithuania on the Protection of Objects of Importance to Ensuring National Security, that are planned to be provided in 2019, it is forecasted that the sovereign debt may rise to 1.1% of the GDP.

Table 15. State guarantees

Indicator	% of GDP	
	2018	2019
State guarantees	0,8	1,1
of which – linked to the financial sector	0	–

Source – Ministry of Finance.

Other risks

Table 16. Risks that can affect general government finances

Risks	Risk source	Risk level	Risk likelihood
Operations of State-owned enterprises	Performance improvement or worsening may increase or decrease the amounts of dividends paid to the state budget	medium	medium
Deposit and Investment Insurance	In the event of the bankruptcy of credit institutions, central government expenditure related to the execution of obligations to depositors would increase	low	low
Increase in contributions to the EU budget	National contributions to the EU budget may increase due to the acceleration of the implementation of the EU Multiannual Financial Framework 2014-2020, and due to disorderly withdrawal of the UK from the EU. Increase in national contributions payable to the EU budget is also expected under another EU (2021-2027) Multiannual Financial Framework due to the withdrawal of the UK from the EU and the country's economic growth (the major part of the contribution is based on the country's gross national income)	medium	high
Statistical corrections to defence spending data	Significant differences between the estimates and actual data for expenditure on military equipment, arms and inventories, reported in general government financial statistics on accrual basis (under ESA) may either increase or decrease the general government expenditure.	high	high
Costs of implementing structural changes	Changing (compared to forecasted) economic environment influences the estimation of the costs of structural changes - costs may either increase or decrease	medium	high
Political cycle	Increased pressure to assume the long-term commitments that is experienced before and during the election year may increase expenditure	high	high

Risks	Risk source	Risk level	Risk likelihood
Conditions on the global financial markets	Changes on the global financial markets may augment the Government's borrowing expenses	medium	low
Changes in EU funds	Lithuania's funding from the EU budget under the EU Multiannual Financial Framework for 2021-2027 may decrease	high	high
Natural disasters	Heavy rains, fires and disease epidemics may increase general government expenditure.	medium	medium
Risk due to the greater than expected withdrawal of individuals from the second pension pillar pension funds, and transfer of the funds accumulated to the SSIF budget	Pension obligations will increase in the long-term	medium	medium
Demographic changes	The changing age structure of the society, better or worse than expected migration balance can affect the general government balance either positively or negatively.	medium	medium

Source – Ministry of Finance

PART VII
STATISTICAL INFORMATION

Table 17. General government indicators, 2018–2022*

Indicator	ESA code	2018		2019	2020	2021	2022
		million EUR	GDP %	GDP %	GDP %	GDP %	GDP %
Net lending (+) / net borrowing (–) (B.9) by subsector							
1. General government	S.13	297,6	0,7	0,4	0,2	0,1	0,1
2. Central government	S.1311	–3783,7	–8,4	–0,9	–0,7	–0,7	–0,6
3. State government	S.1312	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
4. Local government	S.1313	87,7	0,2	0,2	0,1	0,1	0,1
5. Social security funds	S.1314	3993,6	8,8	1,1	0,7	0,6	0,6
General government (S13)							
6. Total revenue	TR	15640,4	34,7	36,0	36,0	35,9	35,6
7. Total expenditure	TE	15342,8	34,0	35,5	35,9	35,9	35,5
8. Net lending / borrowing	B.9	297,6	0,7	0,4	0,2	0,1	0,1
9. Interest expenditure	D.41	399,3	0,9	0,9	0,7	0,5	0,3
10. Primary balance		696,9	1,5	1,3	0,8	0,6	0,3
11. One-off and other temporary measures		–7,0	0,0	0,1	0,0	0,0	0,0
Items of revenue							
12. Total taxes (12 = 12a + 12b + 12c)		7788,0	17,3	20,4	20,7	21,0	21,2
12a. Revenues from indirect taxes	D.2	5219,5	11,6	11,8	12,0	12,3	12,4
12b. Revenues from direct taxes	D.5	2566,7	5,7	8,5	8,6	8,6	8,9
12c. Property taxes	D.91	1,8	0,0	0,0	0,0	0,0	0,0
13. Social contributions	D.61	5891,9	13,1	10,4	10,6	10,6	10,6
14. Property income	D.4	243,8	0,5	0,6	0,5	0,5	0,5
15. Other		1716,7	3,8	4,6	4,2	3,9	3,3
16 = 6. Total revenue	TR	15640,4	34,7	36,0	36,0	35,9	35,6
Revenues from taxes and		13670,9	30,3	30,8	31,2	31,5	31,8

Indicator	ESA code	2018		2019	2020	2021	2022
		million EUR	GDP %	GDP %	GDP %	GDP %	GDP %
contributions (D.2 + D.5 + D.61 + D.91 – D.995)							
Items of expenditure							
17. Compensation of employees + intermediate consumption	D.1 + P.2	6380,3	14,1	14,6	14,5	14,2	14,1
17a. Compensation of employees	D.1	4411,4	9,8	9,6	9,6	9,6	9,6
17b. Intermediate consumption	P.2	1968,9	4,4	5,0	4,8	4,6	4,5
18. Social payments (18 = 18a + 18b)	D.6M	6112,7	13,5	14,1	14,7	15,1	15,4
of which, unemployment benefits	D.6M	167,7	0,4	0,4	0,4	0,4	0,4
18a. Social transfers in kind	D.632	755,2	1,7	1,6	1,6	1,6	1,6
18b. Social transfers other than in kind	D.62	5357,5	11,9	12,5	13,1	13,5	13,8
19 = 9. Interest expenditure	D.41	399,3	0,9	0,9	0,7	0,5	0,3
20. Subsidies	D.3	187,1	0,4	0,3	0,3	0,3	0,2
21. Gross fixed capital formation	P.51G	1448,4	3,2	3,7	3,7	3,7	3,2
22. Capital transfers	D.9	166,0	0,4	0,2	0,2	0,2	0,2
23. Other		649,0	1,4	1,8	1,8	1,9	2,1
24 = 7. Total expenditure	OTE1	15342,8	34,0	35,5	35,9	35,9	35,5

Sources: Lithuanian Department of Statistics, Ministry of Finance.
* Due to the rounding, the amount of revenue and expenditure components may differ against those specified under "Total revenue" and "Total expenditure".

Table 18. Structural general government balance

Indicator	2017	2018	2019	2020	2021	2022
	GDP % *					
Structural general government balance	–0,6	–0,5	–0,4	–0,3	0,0	0,1
Change in structural general government balance	–0,2	0,1	0,1	0,2	0,2	0,1
The option of flexibility offered by the EC taking into account the ongoing structural reforms in Lithuania	0,5	0,5	0,5	–	–	–
Structural general government balance taking into account the option of flexibility offered due to the ongoing structural reforms	–0,1	0,0	0,1	–0,3	0,0	0,1
Change in the structural general government balance taking into account the option of flexibility	0,2	0,1	0,1	–	–	–

Source – Ministry of Finance.
* For some years, due to the rounding, the sum specified may not coincide with the values of calculated indicators.

Table 19. Revenue and expenditure of the general government under the no-policy change scenario

Indicator	2018, million EUR	GDP %				
		2018	2019	2020	2021	2022
1. Total revenue at unchanged policy scenario	15640,4	34,7	35,8	35,6	35,9	35,6
2. Total expenditure at unchanged policy scenario	15342,8	34,0	34,6	35,1	35,4	35,5

Sources: Lithuanian Department of Statistics, Ministry of Finance.

Table 20. General government debt developments

Indicator	GDP %				
	2018	2019	2020	2021	2022
1. Statistical debt including accumulation of funds for managing refinancing risk	34,2	37,0	36,2	35,4	32,9
1.a. General government debt at the end of year excluding the funds accumulated for managing the refinancing risk	34,2	34,2	34,0	33,2	32,9
2. Change of gross debt	–5,2	2,9	–0,8	–0,8	–2,5
Contributions to changes in gross debt					
3. Primary balance	1,5	1,3	0,8	0,6	0,3
4. Interest expenditure	0,9	0,9	0,6	0,5	0,3
5. Stock-flow adjustment	–2,2	4,9	1,0	0,8	–1,0
of which:					
difference between cash and accruals	–	–	–	–	–
net accumulation of financial assets of which: privatization proceeds	–	–	–	–	–
implicit interest rate on government debt	2,6	2,3	1,7	1,3	0,8
Other relevant variables leading to government debt	–	–	–	–	–
6. Liquid financial assets	–	–	–	–	–
7. Net financial debt (7 = 1 – 6)	–	–	–	–	–
8. Debt amortization since end of previous year	–	–	–	–	–
9. Percentage of debt denominated in foreign currency	–	–	–	–	–
10. Average debt maturity	–	–	–	–	–

Sources: Ministry of Finance, Lithuanian Department of Statistics

Table 21. Expenditure taken into account when assessing the compliance of the general government expenditure with the SGP expenditure limitation rule (Expenditure benchmark)

Indicator	2018, million EUR	GDP %				
		2018	2019	2020	2021	2022
1. Expenditure on the EU programmes fully matched by the EU funds revenue	557,67	1,2	1,7	1,8	1,5	0,9
2. Cyclical unemployment benefit expenditure	–42,3	–0,09	–0,06	–0,00	0,03	0,03
3. Effect of discretionary revenue measures*	281,4	0,6	0,1	0,4	0,0	0,0
4. Revenue increase mandated by law	0	0	0	0	0	0

Sources: Lithuanian Department of Statistics, Ministry of Finance.

* The Programme, compared to LBP2019, includes several new tax measures related to PIT (tax reform adjustments), corporate income tax (withdrawal of tax advantages and expansion or prolongation), VAT (establishment of tax advantages), and changes in excise duties (increasing the tariff for ethyl alcohol). Their total impact – EUR 1.6 million in 2019.

PART VIII
THE INSTITUTIONAL SET-UP OF GENERAL GOVERNMENT FINANCES

Implementation of the requirements of Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States (hereinafter – the Directive)

On 28 June 2018, the Seimas adopted the Law No XIII-1328 Amending Articles 5, 17, 19, 37, 38 and 39 of the Law of the Republic of Lithuania on the Budget Structure No I-430 (hereinafter – the Law[28]). The provisions of the law reflect the opinion of the EC officially presented to Lithuania on the need to supplement the national legislation with provisions that would complete transposition of the provisions of the Directive to the national law. The EC was notified on the adoption of the Law. The provisions of the Law and implementation thereof contribute to ensuring a transparent process of implementing fiscal discipline in Lithuania. the Law imposes:

• an obligation in the Explanatory Note of the Draft Law of the Republic of Lithuania on Approval of Financial Indicators of State Budget and Municipal Budgets for a certain year to provide a comparison of the latest macroeconomic and fiscal projections prepared by the Ministry of Finance with the corresponding EC forecasts, also assessment of the impact of EDS and interest rate changes on fiscal projections;

• an obligation to assess the bias of the budget expenditure plans and to make this assessment publicly available;

• an obligation to provide the Seimas with information on compliance or non-compliance with the general government expenditure limitation rule established by the Constitutional Law, and actions of the Government of the Republic of Lithuania if the rule is not observed.

National and EU fiscal discipline regulations

With a view to increasing confidence in the long-term sustainability of public finances and the long-term rules of fiscal discipline ensuring economic development, on 6 November 2017, the Seimas adopted the Constitutional Law and the Law Amending Articles 2, 4, 6, 9 and 23 of the Law I-907 of the Republic of Lithuania on the State Control, which came into effect on 1 January 2015. In accordance with the requirements of the reformed EU economic governance, the State Control was assigned to perform the functions of budget policy monitoring authority as of 1 January 2015.

These laws provide the stengthening Lithuania's capacity to pursue a responsible fiscal policy aiming to achieve a sustainable economic growth and stable public finances as well as to ensure protection against debt crisis. The general government surplus rule laid

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[28] https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/5d8098b07add11e89188e16a6495e98c?positionInSearchResults=1&searchModelUUID=4b541358-8754-4f6d-b33d-89ff842dc9f9.
Law compatibility table https://e-seimas.lrs.lt/portal/legalAct/lt/TAK/51c8e251413211e89517ff5ccea63d58?jfwid=-lqwel7uvg.

down in the Constitutional Law sets out the principles for managing the structural general government balance indicator. According to that rule, the structural general government balance indicator must improve with every year where economic growth exceeds potential growth, until structural surplus is attained. Where the GDP is below the potential, the structural balance indicator cannot be below the medium-term objective, set by the Seimas for a maximum period of three years. The Law set out procedures applicable in the event of deviation from the medium-term objective and the circumstances in which the structural adjustment target has to be set, the value of the target and actions to be taken in case of failure to meet it. A temporary deviation from this rule is allowed only under exceptional circumstances and it has to be adjusted within the prescribed period.

It also provides for the rule limiting government expenditure: if the arithmetic average of general government balance over the 5 recently completed years is negative, the growth of the budget allocations (excluding EU and other international financial support funds) shall not exceed 0.5 of the potential multiannual average growth of the GDP at current prices. The rule does not impose limits on all general government appropriations, but only on the totality of those budgets attributable to the general government whose individual appropriations exceed 3% of the GDP at current prices. At present, that totality consists of the appropriations of the state budget, the SSIF and the CHIF. The Constitutional Law provides a final list of specific conditions when this rule does not apply.

The Constitutional Law lays down the rules applicable to the budgets attributable to the general government: each budget attributable to the general government, with the exception of the SSIF budget, state budget and budgets smaller than 0.3% of the GDP in terms of the structural balance indicator, must either have a surplus or be balanced. The structural deficit of the SSIF budget may grow only if there is a negative output gap. Budgets smaller than 0.3% of the GDP must be balanced in terms of the nominal balance indicator. The rule applicable to small municipal budgets and the SSIF budget entered into force on 1 January 2016. The rule applicable to big municipality budget and the CHIF budget entered into force on 1 January 2018.

For the purpose of the implementation of the EU requirements for budget control and fiscal policy strengthening, the Constitutional Law provides for the functions of an independent budget monitoring authority: the effective and timely monitoring of compliance with the general government surplus rule, based on reliable and independent analysis, and early detection of deviations from budget targets as well as advice on preventive, remedial and enforcement actions. In order to ensure the independence of the EDS, which serves as the basis for the budget, this authority is tasked with drawing up of an opinion on the approval of the EDS developed by the Ministry of Finance.

The Constitutional Law provides for an automatic adjustment mechanism that is activated in case of deviations from the structural adjustment target: the Government submits a report to the Seimas and the budget policy monitoring authority regarding the reasons for failing to achieve the structural adjustment target as well as measures to attain the structural

adjustment target in the coming year. This information is also be communicated to the Seimas orally. The budget policy monitoring authority submits to the Seimas an opinion regarding the justification of the reasons provided by the Government for failing to achieve the structural adjustment target as well as the suitability of the measures to achieve the structural adjustment target. Having taken this opinion into account, the Government submits a final statement to the Seimas about the reasons for failing to achieve the structural adjustment target as well as measures to achieve the structural adjustment target for the coming year. the measures listed in the statement must be taken into account by the Government when drafting a budget proposal for the coming year.

The SGP sets limits on the general government expenditure growth as well as the structural balance requirements. Growth in the adjusted general government expenditure should not exceed the estimated expenditure growth limit, established based on potential GDP growth and the difference between the structural balance and medium-term objectives. The rule covers all general government expenditures which are adjusted based on the SGP by the interest payable by the general government, the net effect of discretionary revenue measures, one-off expenditure, the resources of EU and other international financial assistance to the general government, and the costs of investment.

The requirement applicable to structural balance under the SGP is not to deviate from the medium-term objective or to approach it at the prescribed pace where the country has not yet achieved the medium-term objective. Also, when calculating the structural balance indicator, a flexibility may be provided if the country is implementing structural reforms and the EC views them as significant structural reforms, contributing to the economic growth potential and strengthening the country's long-term financial sustainability.

The Draft Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets for 2020 will be drafted in accordance with the Plan for Drafting Financial Indicators of the State Budget of 2020 of the Republic of Lithuania and Municipal Budgets, approved by the Government Resolution No 163 of 20 February 2019 on the approval of the Plan for Drafting Financial Indicators of the State Budget of 2020 of the Republic of Lithuania and Municipal Budgets. Medium-term government finances are planned in accordance with the legal acts specified in Table 22.

Table 22. Medium-term government sector regulation

Numerical fiscal rules	
1. General government structural balance rule	Article 3 of the Constitutional Law
2. Rule limiting growth in general government expenditure	Article 3 of the Constitutional Law
3. Small municipality budget balance indicator rule	Article 4(4) of the Constitutional Law
4. Big municipality CHIF budget balance indicator rule	Article 4(2) of the Constitutional Law
5. SSIF budget balance indicator	Article 4(3) of the Constitutional Law
Medium term tasks	
1. Setting the medium-term target	Approved by a legal act of the Seimas for a maximum period of three years
2. The structural adjustment target for the coming year	Approved by a legal act of the Seimas if the need for

Numerical fiscal rules	
and the structural adjustment guidelines for the remaining years of the medium-term	structural adjustment is established
3. The overall indicators of State budget and local government budget revenues and spending over the three-year period	The three-year indicators set out in the Lithuanian Stability Programme are approved by a Government resolution; approved by a resolution of the Seimas when drafting the budget for a particular year.
4. Next-year plans of the SSIF and CHIF budgets and forecasts for the remaining years in the medium-term.	The law approving the SSIF indicators for a particular year; the law approving the CHIF budget indicator for a particular year.

Source – Ministry of Finance.

Table 23. Key medium-term indicators of the State budget, municipal budgets

Indicator	million EUR			
	2019, approved	2020	2021	2022
Revenues				
The totality of State and municipal budgets consolidated without the EU and other international financial assistance, *cash flow*	10 693,7	11 154,3	11 775,7	12401,9
including:				
State budget	8 668,1	9 190,0	9 752,6	10 256,7
Expenditure				
The totality of State and municipal budgets consolidated without the EU and other international financial assistance, *cash flow*	11 298,3	11 692,8	12 181,2	12938,2
including:				
State budget	9 463,2	9 798,5	10 218,0	10 842,9

Sources – Ministry of Finance.