



GOVERNMENT OF THE REPUBLIC OF LITHUANIA

RESOLUTION NO 346

ON

THE CONVERGENCE PROGRAMME OF LITHUANIA FOR 2014

16 April 2014

Vilnius

Acting pursuant to Article 7 of 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 2004, Special Edition, Chapter 10, Volume 1, p. 84), as last amended by Council Regulation (EC) No 1175/2011 of 16 November 2011 (OJ 2011 L, 306, p. 12), which lays down a multilateral surveillance procedure of the European Union Member States carried out in the form of stability and convergence programmes, the Government of the Republic of Lithuania has resolved:

1. To approve the Convergence Programme of Lithuania for 2014 (as appended);
2. To delegate to the Ministry of Finance the task of submitting the Convergence Programme of Lithuania for 2014 to the European Commission.

Prime Minister

Algirdas Butkevičius

Minister of Finance

Rimantas Šadžius

APPROVED BY
Resolution No 346 of 16 April 2014
of the Government of the Republic of Lithuania

CONVERGENCE PROGRAMME OF LITHUANIA FOR 2014

CHAPTER I FINANCIAL POLICY OVERVIEW

1. The Convergence Programme of Lithuania for 2014 (hereinafter referred to as “the Programme”) reflects the economic policy outlined in the Programme of the Sixteenth Government of the Republic of Lithuania for 2012–2016 approved by Resolution No XII-51 of the Seimas of the Republic of Lithuania of 13 December 2012 (hereinafter referred to as “the Programme of the Government”) as well as in the Law of the Republic of Lithuania on the Approval of Financial Indicators of the State Budget and Municipal Budgets of 2014. The Programme has been coordinated with the Seimas of the Republic of Lithuania (hereinafter referred to as “the Seimas”).

2. The Programme is oriented towards the development of implementing measures for the specific short-term (nearest term) and medium-term objectives, namely:

2.1. to implement a budgetary policy ensuring economic growth, higher employment, and reduction of unemployment, poverty and social exclusion, thereby enabling the growth of real wages in the country; to swiftly improve conditions for business and investment;

2.2. to ensure financial sustainability of the national economy and consistently raise public funds’ revenues, to curb smuggling and shadow economy, and to strengthen the fight against corruption;

2.3. to efficiently and rationally make use of structural funds of the European Union (hereinafter referred to as “the EU”) in order to enhance the country’s competitiveness and raise the living standards;

2.4. to cut the debt of the State Social Insurance Fund and, with economic recovery, to raise pensions and other social benefits in a consistent fashion;

2.5. to address energy problems;

2.6. to improve the science and education policy;

2.7. to continue the implementation of the economic policy commitments of the exchange rate mechanism II (hereinafter referred to as “the ERM II”), to achieve sustainable compliance to the convergence criteria laid down in the Treaty on the Functioning of the European Union (OJ 2010 C 83, p. 1), and to prepare for the adoption of the euro as the currency of Lithuania.

3. The Programme gives an overview of recent economic developments in Lithuania, a projection of a medium-term budgetary policy, an assessment of factors of economic development and fiscal risk, the quality of general government finances, and a description of Lithuania’s readiness to overcome the effects of the ageing population. The guidelines for Lithuania’s structural reforms have been laid down in the Programme of the Government, while the progress of implementing the structural reform measures has been presented in the National Reform

Programme 2014. When implementing the structural reforms envisaged in the Programme of the Government, priority will be given to measures that would enable effective reduction of dependence of the Lithuanian economy on imports of energy resources from third countries without losing productivity, which will reduce the risk of the structural current account deficit (hereinafter referred to as “CAD”) and preserve for Lithuania’s residents the potential of national revenues to promote domestic consumption and to provide credits for investment.

4. The Programme examines and assesses conditions for the achievement of the economic policy goals. The Programme has been based on assumptions concerning the euro exchange rate and the prices of oil and other raw materials, which were used by the European Commission when preparing the winter forecast 2014.

5. After 2014, in compliance with the Law of the Republic of Lithuania on Fiscal Discipline (hereinafter referred to as “the Law on Fiscal Discipline”), the general government balance indicator will be further improved by approximately one percentage point of the GDP on an annual basis. A medium term objective to keep structural deficit within 1% of the GDP has been set. It is planned to achieve this objective in 2015. In case the output gap exceeds the potential, it will be ensured, in accordance with the Law on Fiscal Discipline, that the general government surplus gained and the medium term objective are satisfied without a risk of violation thereof. The pursuit of the general government surplus, which has been laid down in the legal acts regulating Lithuania’s budgetary policy, will allow reducing the state debt and sustainably getting ready to overcome the challenges raised for the general government finances due to the ageing population.

CHAPTER II ECONOMIC OUTLOOK

SECTION I ASSUMPTIONS FOR THE PROJECTIONS

6. The key assumptions for the external economic environment, while implementing the EU fiscal surveillance procedure and seeking to ensure comparability of economic forecasts of the EU member states, correspond to the assumptions on the euro exchange rate and prices of oil and other raw materials, which were used by the European Commission when updating the winter forecast 2014.

Table 1. Key assumptions

Indicator	2013	2014	2015	2016	2017
Short-term interest rates (annual average)	0.4	0.5	0.5	0.7	1.3
Long-term interest rates (annual average)	3.9	3.5	3.8	4.1	4.3
USD/EUR exchange rate (euro area and ERM II countries)	1.33	1.36	1.36	1.36	1.36
Nominal effective exchange rate	2.6	0	0	0	0
Exchange rate vis-à-vis the euro (annual average) (for countries not in euro area or ERM II)	N.A.	N.A.	N.A.	N.A.	N.A.

Indicator	2013	2014	2015	2016	2017
World GDP growth (excl. EU), %	3.6	4.1	4.4	4.4	4.4
EU GDP growth, %	0.1	1.6	2.0	2.0	2.0
Growth of relevant foreign markets, %	0.1	1.6	2.0	2.0	2.0
World import growth (excl. EU). %	3.5	5.4	6.1	6.1	6.1
Oil prices (Brent, USD/barrel)	108.8	104.1	99.6	99.6	99.6

Sources: Ministry of Finance of the Republic of Lithuania (hereinafter referred to as "the Ministry of Finance", Bank of Lithuania, European Commission (2014 winter forecast)

Lithuania's prospects for export markets in the EU represent the key assumption of the economic development scenario. It was also assumed that in 2014–2017 the Eurozone's fiscal stability risk will be brought under control.

The economic development scenario providing for a sustainable potential growth of the economy also depends on the speed of implementation of structural reforms, stability of the low interest rates, and the growth of investments up to the multi-annual average.

SECTION II THE MONETARY AND EXCHANGE RATE POLICY

7. Lithuania develops its monetary policy under the conditions of a fixed exchange rate. Such an exchange rate regime increases confidence in Lithuania's economic policy and, alongside a competitive economic environment, allows pursuing relative price stability over the long-term. Openness of the economy, relative flexibility of prices and wages, and the importance of the exchange rate for the price stability are those features of Lithuania's economy that contribute to the successful application of the fixed exchange rate strategy.

Upon becoming an EU member state, Lithuania undertook to replace the litas with the euro in the future. Lithuania has been successfully participating in the ERM II since 28 June 2004, by implementing a unilateral commitment to maintain a fixed exchange rate regime and a fixed national currency exchange rate vis-à-vis the euro.

Lithuania's monetary and exchange rate policy goals remain unchanged as compared to the previous year. Lithuania has been participating in the ERM II by maintaining a strictly fixed litas exchange rate vis-à-vis the euro in accordance with the previously established exchange rate, and intends to join the euro area as soon as the convergence criteria are met. The Bank of Lithuania maintains the level of institutional preparation, which, under favourable macroeconomic conditions, will ensure a smooth and rapid currency changeover. Bearing in mind the urgent priority of the Government of the Republic of Lithuania (hereinafter referred to as "the Government") set by the Programme of the Government, namely the country's preparedness for the introduction of the European common currency and full membership of the Eurozone as soon as that becomes possible based on the established convergence criteria, and in order to improve the coordination of preparation for the adoption of the euro in Lithuania, Government Resolution No 1171 of 4 December 2013 on amendments to Government Resolution No 178 of 27 February 2013 on coordination of actions for the preparation of euro introduction in the Republic of Lithuania was

adopted. Government Resolution No 1171 of 4 December 2013 on approval of action plan for implementation of the national changeover plan has approved the Action Plan for Implementation of the National Changeover Plan, which lays down measures for the implementation thereof, designates coordinators responsible for the implementation of measures, and sets the deadlines for the implementation of measures. Furthermore, Government Resolution No 1172 of 4 December 2013 on amendments to Government Resolution No 604 of 26 June 2013 on the approval of the National Changeover Plan and the Strategy for Raising Public Awareness of Euro Introduction in Lithuania and for Communication was adopted; it has amended the National Changeover Plan and the Strategy for Raising Public Awareness of Euro Introduction in Lithuania and for Communication.

To harmonize the national law with the EU law, the following laws were adopted on 23 January 2014: the Law of the Republic of Lithuania on amendments to the Law on State Control, laws on amendments to the Law on the Bank of Lithuania, and the Law of the Republic of Lithuania on amendments to the Law of the Republic of Lithuania on the ratification of the amendment of Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro adopted by the European Council decision 2011/199/EU of 25 March 2011.

A draft Law of the Republic of Lithuania on the adoption of the euro in the Republic of Lithuania was approved by Government Resolution No 30 of 15 January 2014 on submission of the draft law of the Republic of Lithuania on the adoption of the euro in the Republic of Lithuania and other related draft laws to the Seimas of the Republic of Lithuania; and the draft Law was submitted to the Seimas. It is planned that the draft Law will be read and adopted by the Seimas during its spring session. The objective of the Law is to set the procedure for preparation of the euro adoption, changeover from the litas to the euro, recalculation of the value that has been expressed in the litas into that of the euro, and withdrawal of the litas from circulation following the adoption of the euro in the Republic of Lithuania. To regulate accounting matters related to the introduction of the euro, the Public Sector Accounting and Financial Accountability Standard No 28 "Euro Adoption", for public sector entities, was approved by Order No 1K-033 of 6 February 2014 of the Minister of Finance on the approval of the Public Sector Accounting and Financial Accountability Standard No 28, and the Business Accounting Standard No 40 "Euro Adoption", for profit-seeking entities, was approved by Order No VAS-22 of 28 March 2014 of the Director of the Authority of Audit and Accounting on the approval of the Business Accounting Standard No 40 "Euro Adoption".

SECTION III OVERVIEW OF ERM II IMPLEMENTATION

8. The Government must pursue an economic policy in line with the commitments made on 28 June 2004, when it joined ERM II: to unilaterally maintain the fixed currency regime and the stable litas exchange rate against the main currency, the euro; to pursue a steady fiscal policy required to maintain macroeconomic stability and to ensure sustainability of the convergence

process; to aim to maintain a balanced budget over the medium term and a balanced domestic credit growth, to strengthen efficient financial supervision with an objective to ensure sustainability of the current account, to implement structural reforms, thereby ensuring further economic flexibility and adaptability, while seeking to strengthen the internal adjustment mechanism and to maintain the general economic competitiveness. With the aim to ensure a balanced growth in loans in the country, the Bank of Lithuania undertook several measures. First of all, the Responsible Lending Regulations, approved by Resolution No 03-144 of the Board of the Bank of Lithuania of 1 September 2011, laying down the principles for the assessment of risks in order to limit the assumed risks by banks, came into force in 2011. When the Seimas adopts laws amending the Law of the Republic of Lithuania on the Bank of Lithuania in its spring session of 2014, the Bank of Lithuania will become an authority responsible for the execution of macroprudential policy in Lithuania. Having this empowerment, and based on the Capital Requirements Directive and Regulation (CRDIV/CRR), the Bank of Lithuania will be entitled to apply macroprudential measures on the scale of the Republic of Lithuania; for example, to set the conservation and counter-cyclical capital buffers.

The current economic environment is different from the one that prevailed at the time of joining ERM II, which makes the obligations as regards speedier implementation of structural reforms a priority. Reforms that are related to the long-term public finance sustainability will be pursued further in the fields of pensions, education, and health care systems. Other implementing measures for structural reform have been specified in the National Reform Programme 2014. By adhering to the strict fiscal discipline Lithuania aims to be ready to use the euro as its currency as of the start of 2015. For information on the public finance policy, please see Chapters III–VI of the Programme.

SECTION IV ECONOMIC CYCLE AND MEDIUM-TERM ECONOMIC DEVELOPMENT SCENARIO

The real sector

9. In 2013 Lithuania's economy proved resistant to negative external factors and remained one of the fastest-growing economies across the EU. During the first six months the economic growth was determined by rapid export development, while later on domestic consumption and investment became the major engine of growth. In 2013 a positive impact of the domestic demand became stronger: household consumption expenditure was marked by an ever increasing rise, and, starting from the second quarter, domestic investment saw a rapid growth.

In 2013, growth in gross value added was the most remarkable in the sectors of construction (10.7%), manufacturing (4.9%), trade, transport, accommodation and catering services (3.7%), and financial intermediation (3.3%). While in 2012 sectors of agriculture, forestry, and fisheries grew by 11.8% due to the record-high cereal harvest, in 2013 this sector experienced a setback, with 2% less of the gross value added as against the previous year during the same period. The value added

that was generated in Lithuania's economy in 2013 in comparable prices exceeded the level seen before the economic crisis in 2007 by 1.1%.

In 2013 investments into the gross fixed capital grew by 12.8% (this indicator saw the highest growth in the 3rd quarter, 16.9%). Investments grew both due to the one-off actions, and changed economic circumstances. The emission standard "Euro 6" for new vehicles, which came into force as of 2014, should be mentioned as the key one-off factor that has prompted enterprises to acquire vehicles before the entry into force of the standard. This emission standard had an impact on a particularly rapid growth of investment into vehicles. Investment into the production means has also grown quite significantly. It is considered that a relatively high level of the use of productive capacities, alongside positive prospects for the global economic development, were among the major factors that encouraged enterprises to invest into the modernisation and enhancement of productive capacities. The general government has contributed to the development of investment as well. Following a pause in 2012, in 2013 investment into infrastructure, especially roads, streets, and railways, were increased again. It is expected that in 2014–2017, the recovering external economic and business environment, favourable borrowing conditions, economic prospects that are healthier as compared to the other EU member states, business-friendly environment, and projects that are initiated by the Government (such as the new model for multi-apartment housing renovation) will encourage Lithuania's entrepreneurs to expand their production capacities (at present, 75% of all the production capacities are used) and to boost investment.

In 2013, with a more rapid growth in real household incomes, household consumption expenditure grew ever more rapidly. Real household incomes grew due to favourable employment trends and wages dynamics as well as the falling inflation. Other factors that had a significant impact on household consumption were better household climate (consumer confidence indicator was probably the highest since the start of collection of this data) and slower reduction of financial obligations to credit institutions. Over the medium term, growing income and private deposits will enable moderate growth of private consumption: inflation recently has been higher than the interest rates on deposits, which serves as a stimulus for consumption and not for saving for the future.

Despite one-off expenses of the general government, which are related to the fulfilment of commitments in compliance with the rulings of the Constitutional Court of the Republic of Lithuania, public sector consumption will remain moderate over the medium term due to the need to further consolidate public finances.

The economic government policy followed by the European Central Bank and the EU member states promises that the period of 2014–2017 will see continued formation of favourable conditions for the growth of Lithuania's economy.

Table 2. Macroeconomic indicators

Indicator	ESA* code	Indicator value in 2013 million LTL	Change, %				
			2013	2014	2015	2016	2017
Real GDP	B1*g	86 606,3	3.3	3.4	4.3	4.0	4.3
Nominal GDP	B1*g	119 469.0	5.0	5.4	7.0	7.2	7.6
Components of real GDP							
Private consumption expenditure + NPISHs	P.3	54 001.7	4.8	5.0	5.8	5.1	5.6
Government consumption expenditure	P.3	13 689.7	1.8	0.3	0.2	0.6	0.6
Gross fixed capital formation	P.51	18 464.6	12.8	9.1	9.4	4.8	7.7
Changes in inventories and net acquisition of valuables (% of GDP)	P.52+P.53	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Exports of goods and services	P.6	76 728.9	9.5	6.1	6.7	5.6	9.3
Imports of goods and services	P.7	72 662.3	9.8	7.9	8.2	6.0	10.2
Contributions to real GDP growth, %							
Final domestic demand		–	3.4	4.9	5.7	4.5	5.4
Changes in inventories and net acquisition of valuables	P.52+P.53	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Balance of goods and services	B.11	–	-0.2	-1.5	-1.4	-0.5	-1.1

Sources: Statistics Lithuania, Ministry of Finance

* European System of Accounts

Inflation

10. Average annual inflation, calculated in accordance with the Harmonised Index of Consumer Prices amounted to 1.2% in 2013, which is two percentage points lower than in 2012, when it amounted to 3.2%, and much lower than the average long-term inflation rate (3.4%). Compared to 2012, the average annual inflation decline was largely due to the trends in prices related to external factors, i.e. administered (regulated by the state) prices, as well as fuel and food prices.

The administered prices and the prices of fuels are related to the global trends in prices of energy resources; the trends of 2013 were different from those in 2012: *Brent* oil price in Litas shrank (it had risen by nearly a tenth in 2012), the price of natural gas imported from Russia, which had been rising previously, was also reduced. The growth of administered prices was mostly slowed down by heat, the component with the biggest weight in this group: its price went up by more than one tenth in 2012, then went down by 8 per cent in 2013 because of the decreased prices of fuels (natural gas in particular) used in its production. Electricity prices went up and stopped the slowdown of the administered prices' growth: in the beginning of 2013 electricity prices for household consumers jumped by nearly one tenth because of the new biofuel power stations, the electricity of which is bought for a higher price, and the increased support for combined-cycle power plants.

In 2013, food prices (including beverages and tobacco) rose less than in 2012. The slowdown in the rise of food prices was a less significant factor in the inflation decline compared to the change in prices related to energy commodities. According to the data from the Food and Agriculture Organisation of the United Nations, in 2013 global food raw material prices were lower than a year ago, though they did not fall as quickly as in 2012.

Prices, related to the domestic market, that are taken when calculating the core inflation rate and include prices of industrial goods and services, modestly affected the decline in inflation: even though in 2013 the prices in the services market grew markedly less than in 2012, the prices of industrial goods increased more than in 2012 (due to the solid fuel prices).

The trends in indicators related to consumer prices in 2013 were favourable for low inflation. Producer prices in the domestic market and import prices in 2013 were lower than in 2012. Even though in the beginning of 2013 the minimum monthly wage was increased by 18 percent (to LTL 1000), the growth of unit labour costs, calculated as the difference between the wage growth and the labour productivity growth, was modest.

In 2013 inflation was also affected by tax decisions. In the beginning of the year some new value-added tax (VAT) reliefs (for passenger carriage, press, etc.) came into force, while certain excise duties were increased (as of January – for gasoline due to the end of Lithuania's transitional period, as of March – for cigarettes in order to gradually reach the EU excise rate by the beginning of 2018).

It is expected that in the medium-term, while consumption remains moderate and the effect caused by the prices of external factors (food raw materials and energy) stays low, the average annual inflation will reach 1–2.9%. The deceleration process of the annual inflation rate that began in the middle of 2011 will end in the first half of 2014. A moderate inflation increase is envisaged for 2014–2017; it will be accompanied by increasing labour force demand and admissible wage growth trends. Nevertheless, a small risk remains that due to various unforeseen factors (such as possible disruptions of international oil supply or geopolitical conflicts) the price of oil will grow more rapidly than predicted in the European Commission's assumptions, which would have a negative impact on the prices of various goods and services in Lithuania. Moreover, due to the constant growth in the global demand for food, the prices of food commodities and products could decline only in the case of favourable natural conditions for harvests. Therefore, rising food commodity prices are also associated with the risk of higher inflation in the medium term. The impact of the prices of food commodities and energy on inflation would be stronger in Lithuania, compared to developed countries, due to a bigger share in the consumer's basket related to these prices.

As labour productivity will keep increasing in the country, the demand for labour force will continue growing, unemployment levels will keep decreasing and the supply of labour force will slightly diminish, the wages will grow faster than in 2013. Wages are expected to increase by 5.8–6.9% in the 2014–2017 period.

Table 3. Price indicators

Indicator	ESA code	Indicator value in 2013	Change, %				
			2013	2014	2015	2016	2017
1. GDP deflator		137.9	1.7	1.9	2.5	3.1	3.1
2. Private consumption deflator		139.7	1.1	1.1	2.0	2.7	3.1
3. HICP* (average annual)		101.2	1.2	1.0	2.0	2.5	2.9
4. Public consumption deflator		148.6	0.2	4.8	5.6	3.8	2.7
5. Investment deflator		115.6	2.6	3.3	2.7	2.7	2.7
6. Export price deflator (goods and services)		134.4	-1.4	-0.6	0.9	2.0	2.0
7. Import price deflator (goods and services)		140.9	-1.4	-0.5	1.0	1.7	1.7

Sources: Statistics Lithuania, Ministry of Finance

*HICP – Harmonised Index of Consumer Prices.

Labour Market

11. The unemployment rate, having dropped by 2.4 percentage points (to 15.4%) in 2011 and 2 percentage points (to 13.4%) in 2012, kept rapidly declining in 2013 and averaged 11.8%; it was close to the Non-Accelerating Wage Rate of Unemployment (NAWRU), calculated by the European Commission, that amounted to 11.6%. In 2013, Lithuania ranked second among EU Member States according to the pace of unemployment rate reduction with 1.6 percentage points. This resulted from a 1.3% rise in the number of employed persons and a 0.5% decline in labour force.

In 2013, the rate of employment for residents in the age group 15–64 amounted to 63.7% and increased by 1.7 percentage points as against the previous year. The average rate of employment for persons in the age group 15–74 amounted to 57%, which is 1.4% higher than in the previous year. In 2013, the employment levels of both male and female persons were the highest in the last 5 years. One of the reasons for the rise in employment was the rising number of job vacancies, which averaged 10.7 thousand in 2013, a 2.1% improvement year on year. Same as in 2012, the most sizeable growth in employment was recorded in the manufacturing, wholesale and retail trade, public administration, defence and compulsory social security activities. Companies with 10 and more employees experienced an increase of 12.9% in job vacancies, while very small companies (with less than 10 employees) witnessed a decrease in job vacancies by nearly a half (41.6%).

In 2013, an average of 1292.8 thousand persons aged 15 and higher were employed, which is 17.1 thousand or 1.3% more than in 2012. In the private sector the number of employed persons increased by 16.9 thousand or 1.9%; in the public sector the numbers remained nearly the same (increased by 0.2 thousand or 0.1%). The major increase in the number of employed persons was

traced in the construction (9.8 thousand or 10.9%), public administration, defence and compulsory social security (6.6 thousand or 9%), wholesale and retail trade (4.2 thousand or by 1.9%) activities, while the number of employed persons decreased the most in the activities of education (8.8 thousand or 6.5%), information and communication (3.5 thousand or 12.4%), agriculture, forestry and fishing (3.3 thousand or 2.9%).

The improvement of the results obtained by surveys on business concerning the projected number of employees for the next 2–3 months, the increasingly favourable consumer opinions on the anticipated changes in the number of unemployed people over the next 12 months, as demonstrated by consumer surveys, the number of the long-term unemployed persons that have been declining for nearly three years in a row (the results of labour force surveys show that in quarter 4 of 2013 the number of persons that were not employed for a year or longer totalled 69.2 thousand, i.e. was 21.6% smaller than the year before) and the rapid (as against the first half-year) annual growth rate of the employed, recorded in the second half-year of 2013, allows to expect that the positive employment and unemployment trends will not change in 2014.

Table 4. Labour market indicators

Indicator	ESA code	Indicator value in 2013	Change, %				
			2013	2014	2015	2016	2017
1. Employment, persons (thou)		1 292.8	1.3	1.5	1.3	0.8	0.6
2. Employment, hours worked		2 378 689	0.5	–	–	–	–
3. Unemployment rate (%)*		11.8	–	10.5	9.0	7.8	6.5
4. Labour productivity (real GDP per employed person), thou LTL		83.5	1.9	1.9	3.0	3.2	3.6
5. Labour productivity, hours worked (real added value per actual hour worked), LTL		45.3	2.8	-	–	–	–
6. Compensations of employees, million LTL	D.1	47 444.3	6.5	7.4	8.1	7.3	7.6
7. Compensation per employee, LTL		36 698.8	5.0	5.8	6.7	6.4	6.9

Sources: Statistics Lithuania, Ministry of Finance

* Indicator value is given.

Despite the economic recovery and the relatively fast decline in unemployment, it will remain substantial in the medium term. The unemployment rate is expected to decline to 10.5% in 2014 and should amount to 9.0%, 7.8% and 6.5% in 2015–2017, respectively.

After attaining the goals of the Employment Enhancement Program 2014–2020, approved by the Government Resolution No 878 of 25 September 2013 On the Approval of the Employment Enhancement Program 2014–2020, and implementing the measures indicated in the Inter-institutional action plan approved by Government Resolution No 204 of 26 February 2014 On the Approval of the Inter-institutional Action Plan for the Implementation of the Employment

Enhancement Program 2014–2020, the amount of labour force, the numbers of employed persons and employees in full-time units in the medium-term will grow on average 2.1–2.4 percentage points faster during the year. To secure such rapid increase in the number of the employed, GDP would have to grow 5 percentage points faster during the year in the medium-term than provided in the economic development scenario. With respect to the provisions about the economic development scenario, used to form the budgetary policy, and that it should be cautious, the ambitious aims to increase employment are viewed as a positive risk to exceed the rates provided in the economic development scenario.

SECTION V BALANCE OF PAYMENTS OF LITHUANIA

12. In 2013, the current account surplus amounted to LTL 1.8 billion or 1.5% GDP. Yet, the released data on quarters show the current account balance fluctuation. A current account deficit accumulated in quarter 1 (-1.7 per cent of the GDP); it was mostly due to the greater demand for energy products in the cold season and gradually decreasing agricultural surplus as well as dividends paid by foreign capital companies. A current account deficit also accumulated in quarter 2 (4.8 per cent of the GDP); this was determined by larger than previously transfers from the EU funds and rapidly growing service account surplus (due to the beginning of the tourist season). In quarter 3, the current account was broadly balanced (0.0 per cent of the GDP). The surplus balances of services and current transfers together with foreign trade and revenue balance deficits that have been declining determined that in 2013 the current account balance surplus in quarter 4 made up LTL 732.1 billion or 2.4 per cent of the GDP. The year 2010-2012 saw an intense development of the nominal export of goods, which slowed down in 2013 (annual change stood at 7.2 per cent). In quarter 1 (partly in quarter 2 as well), export development was strongly affected by one-off factors: notably large export of grain crops harvest, high prices of grain in the global market as well as intensive export of petroleum products. In the first half-year of 2013 export of grain and petroleum products accounted for more than a half of the development of export of goods. After the effect of the above mentioned factors vanished, export development started being influenced by foreign demand, which was weak, both in Western and Eastern markets; therefore, exports consistently slowed down in the second half-year. The situation in the global fertilizer market had a negative influence over exports – because of the lower production prices and expensive raw materials part of the producers reduced production. Due to these reasons, the nominal export of fertilizers in the second half-year of 2013 was more than 40% lower than in the same period of 2012. The development of export was influenced even more by the oil refinery margin that decreased in Europe in the second half-year (especially quarter 4); consequently, in the second half-year export of the production of the company ORLEN Lietuva was nearly one fifth lower than in the previous year. The development of the nominal import and export of goods in 2013 was alike (both increased by 6.5%). A slightly slower import development than in the previous year was due to the lesser demand of the oil refining companies for raw materials. Same as in 2013, the current account balance experienced a positive impact by current transfers – mostly

from the EU Structural Assistance and emigrants transferring money to Lithuania. In 2013, the transfers from the EU funds to Lithuania shrank by 4.5% (as against 2012), while transfers from private persons increased by 33.8%.

The overall current account balance surplus increased by LTL 1.7 million (1.5 times).

The surplus of the services balance increased by 28.7% in 2013, primarily due to the increasing transportation (road transportation in particular) service export and travel service balance, which reflects the growth of the incoming tourism in Lithuania.

In 2013, the overall income balance deficit decreased by 2 per cent compared to 2012. In the same period the investment income balance deficit declined by LTL 27.9 million (0.6 per cent) due to the decreasing deficit portfolio investment and other investment income balances, but the labour income balance surplus increased by LTL 65.1 million (48.7 per cent). The accumulated current account surplus enabled Lithuania to increase its foreign investments and decrease external liabilities. The Government borrowed especially actively in the domestic market, i.e. the reduction of external liabilities, envisaged in the Government borrowing programme of 2013, increased negative portfolio investment flow. The net direct investment flow was positive (LTL 1.1 million) and emerged because of reinvestments accumulated in Lithuania by foreign capital companies and decreased foreign investments of Lithuanian companies. Foreign liabilities of banks decreased similarly to the previous year, but not as rapidly as in 2009–2010. A share of the negative financial account flows was covered by positive capital flows and net flows that originated because of the changes in official reserves (LTL 2.2 million and LTL 1.4 million respectively). The capital flows were largely formed by capital transfers, while the official international reserves mostly decreased due to the changes in the government deposit kept in the Bank of Lithuania.

In 2013, the overall foreign debt reached nearly LTL 5.4 million, which is 6.4 per cent smaller than in 2012. The ratio of overall foreign debt to GDP was 67.2 per cent, which is smaller than in 2012. The government debt shrank from 47.1 per cent of overall foreign debt of the country at the end of 2012 to 45 per cent in the end of 2013. With the overall debt declining, the amount of interest paid for the government debt was also slightly smaller. In 2013, the amount of interest for external debt was 13 per cent smaller than in 2012.

It is likely that the importance of domestic demand (investments in particular) to the development of the country's economy will increase, while imports will grow more rapidly than exports; therefore, in the medium-term the current account balance surplus should disappear.

Table 5. Sectoral balances

Indicator	ESA code	Percentage of GDP				
		2013	2014	2015	2016	2017
1. Net lending/borrowing vis-à-vis the rest of the world	B.9N	3.8	0.6	-1.1	-1.2	-1.9
of which:						
balance of goods and services		1.1	-0.9	-2.3	-2.4	-3.1
balance of income and transfers*		0.4	-0.3	-0.7	-0.7	-0.7

Indicator	ESA code	Percentage of GDP				
		2013	2014	2015	2016	2017
capital account*		2.3	1.8	1.9	1.9	1.9
2. Surplus (+)/deficit (-) of the private		5.9	2.5	-0.2	-1.3	-3.0
3. Surplus (+)/deficit (-) of the general government	B.9N	-2.1	-1.9	-0.9	0.1	1.1
4. Statistical discrepancy		0	0	0	0	0

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

SECTION VI RISK-RELATED ASPECTS OF ECONOMIC DEVELOPMENT

13. The prospect of Lithuanian export markets in the EU continues to represent the main risk factor in terms of changes in the economic development scenario. Whether the economic development scenario introduced in the Programme will come true also depends on the following assumptions: the use of EU support in 2014 will grow as expected; long-term interest rates on loans in the national currency will remain sustainable at a level acceptable to investors investing in industrial capacities as well as consumers; measures to neutralise the risk of structural current account deficit will be timely implemented.

A faster-than-expected growth in oil prices may also have a negative impact on economic development. The abovementioned risks should be mitigated by giving priority to measures that allow effective reduction of dependency of Lithuania's economy on energy resources imported from third countries and retreat of exporters from high political risk involving countries when implementing structural reforms foreseen in the Programme of the Government.

Divergence from the plans for the use of EU support funds would correct the growth of the GDP. The evaluation of the impact of such divergence on GDP is based on the assumption that the GDP correction would amount to the half of the EU support funds that were used or not used when diverging from the plan.

During the past 20 years the economic ties between Lithuania and Russia have weakened tremendously, Lithuania's export became more diversified; in 2013 goods of Lithuanian origin exported to Russia accounted for only 4.8 per cent of all the goods of Lithuanian origin exported or 2.1 per cent of GDP. Re-export to Russia made up 12 per cent of GDP.

Unclear geopolitical situation poses negative risk to the prospective economic development scenario. However, data available at the time of preparation of the Programme does not suggest the likelihood of having such a pessimistic risk related situation. Information on the abovementioned risk is constantly monitored and evaluated.

The experience of previous crises in Russia suggests that Lithuanian businesses succeeded to find new export markets within 15-18 months, thus they would experience a short-term impact of the loss of the Russian market.

There is still positive risk as well that allows to hope that the pace of economy development will be more rapid than foreseen in the economy development scenario if business confidence in

EU will increase more rapidly than suggested in the European Commission winter forecast 2014. The current account deficit worsening risk may be mitigated by a more rapid export growth than that stipulated in the economic development scenario.

CHAPTER III PUBLIC FINANCES

SECTION I STRATEGY FOR FINANCIAL POLICY

14. The main aim of 2012–2016 activities of the Government is Lithuania's economic growth. This aim can be reached by conducting active investment and taxation policy geared towards job creation and, therefore, also towards reduction of emigration. A tool of such policy is economic-priority-based investment strategy. Investment first of all should be focused at the increase and development of efficiency of industry as the economy's driving force. Small and medium-sized business should recover.

Having reduced in 2013 the general government deficit to 2.1 per cent of the GDP, which is higher by 0.4 per cent than the one indicated in the 2013 Lithuanian convergence programme, the general government finances will be consolidated further seeking to achieve a Medium Term Objective. The Medium Term Objective is established, namely, to achieve that the structural deficit is not higher than 1 per cent of the GDP. This objective is to be achieved in 2015. Conditions will be created for the general government balance indicator to improve in 2015–2017 by a percentage point of the GDP each year, reaching in 2017 a surplus of 1.1 per cent of the GDP as provided for in the Law on Fiscal Discipline of the Republic of Lithuania.

15. Bearing in mind that the country's macroeconomic stability is a safeguard for the growth of the living standard, the budgetary policy will be cautious and will ensure strict control of the public finance system and long-term sustainability of general government finances. Aiming to further consolidate public finances the following priorities of the medium-term macroeconomic policy are established:

15.1. to align the current fiscal policy with the priorities of social policy;

15.2. to encourage the continuation of the launched energy reforms;

15.3. in order to ensure long-term sustainability of general government finances, to continue implementing the reforms of the pension system and the health system as well as other structural reforms provided for in the Government programme;

15.4. to create favourable conditions for the improvement of labour efficiency, improve competitiveness of the economy, attract more foreign direct investment, and successfully implement EU cohesion policies;

15.5. to boost confidence in the long-term sustainability of general government finances and fiscal discipline norms that ensure long-term economic development; follow the rule that under suitable economic conditions a stabilisation reserve would be regularly accumulated using a part of

state property privatisation funds, taxation and other revenue; establish the procedure for the use of the stabilisation reserve funds considering the phase of the economic cycle;

15.6. to upgrade the medium-term planning framework of the State Budget of the Republic of Lithuania (hereinafter referred to as “the State Budget”); manage state finances in a more efficient manner, use the accounting data of public sector finances based on the accrual principle;

15.7. to base saving of the State Budget expenditure on particular priorities; in certain areas (for example, investments, R&D) the State Budget expenditure should not be reduced (State Budget expenditure on national defence should be gradually increased aiming to ensure the allocation of 2 per cent of the GDP in 2020), however, funds should be used more efficiently; having restored sustainable economic growth and taking account of certain priorities to increase financing for sectors that ensure the provision of lacking services for the population and which create new jobs;

15.8. to continue integrated revisions of the taxation system focusing in particular on taxation of labour income and reduced VAT rates; possible changes should be planned in such a manner as to ensure that they do not slow the decrease of the general government deficit;

15.9. to curb shadow business, strengthen the fight against corruption; focus on the fight against smuggling, for that purpose, review the legislation, as appropriate, reform relevant state institutions, and create an effective incentives system for officers, increase the State Budget revenue by applying strict measures for the reduction of shadow economy, ensure that control institutions implement legal and practical measures to this end.

16. With a view to maintain confidence of markets in the successful development of its economy, Lithuania will, in the area of fiscal policy, continue to provide favourable conditions for improving labour efficiency, encourage investment, create a favourable business environment, and ensure effective use of public funds allocated for investment. Any additional general government revenue or unspent planned expenditure will be used for the achievement of the general government budgetary targets and for measures aimed at ensuring long-term sustainability of general government finances.

Measures planned for 2015–2017 to achieve the structural general government budgetary target

17. With a view to ensure structural developments during 2015–2017 plans are under way to apply additional structural measures allocating for the purpose not less than 0.5 per cent of the GDP giving priority to the economic growth and ensuring favourable fiscal consolidation. Priority will be given to curbing shadow economy. This goal will be achieved by taking three steps: by improving the administration of excise duties and VAT as well as reducing the amount of revenue, that has not been registered in official accounting (including wages that have not been registered in official accounting). For this purpose draft amendments to the Law on Tax Administration of the Republic of Lithuania, Law on Value Added Tax of the Republic of Lithuania and legislation that regulates guarantee system have been prepared.

18. In case of lack of priority measures for the achievement of the 2015–2017 structural general government budgetary targets as indicated in line 10 of Table 9, they may be supplemented by the following measures:

18.1. to continue the reduction of share of GDP that constitutes public expenditure and/or change the applicable taxes when that is necessary to compensate for the loss of revenue or to maintain the deficit reduction trends if the expenditure grows more rapidly than the economic potential;

18.2. to continue the implementation of the EU acquis in the field of excise duties;

18.3. to review excise duty tariffs for alcohol aiming to achieve a more balanced taxation of individual groups of alcoholic beverages;

18.4. to review the base for property taxes, i.e. increase the share of tax yield from property taxes with a view to avoid property bubbles and apply the principle of progressive taxation;

18.5. to review the base for environment taxes, i.e. increase the share of tax yield from such taxes with a view to fulfilling environmental objectives.

SECTION II

STATE BUDGET IMPACT ON MEDIUM-TERM GENERAL GOVERNMENT BUDGETARY TARGETS

19. The general government finance structure in 2014–2017, compared to 2013, will undergo major changes due to restricted expenditure for social benefits: expenditure will grow slower than the nominal GDP. Currently no data is available on the new multi-annual financial perspective and its implementation plans; thus, based on the assumption, it is likely that in 2014–2020 the multi-annual financial perspective will repeat the multi-annual trends, and the GDP part comprised of the gross capital in 2014–2017 will be approximately 1.5 percentage point of the GDP lower than in 2013. As wages and other taxable bases will rise faster as from 2014, the necessary conditions for an increase in compensations for employees and intermediate consumption in the general government will emerge: the rise of this kind of expenditure will ensure stable share of GDP.

In the Programme, the general government finance projections essentially change due to the application of rules governing the expenditure growth restrictions as set forth in the Law of the Republic of Lithuania on Fiscal Discipline, 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 01, 2004, p. 84) and 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 01, 2004, p. 89).

Table 6. General government indicators (S13), 2013–2017*

Indicator	ESA code	Value of indicator in 2013 (LTL million)	Percentage of GDP				
			2013	2014	2015	2016	2017
Net lending/borrowing of the general government							
1. General government	S.13	-2 536.2	-2.1	-1.9	-0.9	0.1	1.1
2. Central government	S.1311	-979.2	-0.8	-0.8	-0.3	0.3	0.8
3. State government	S.1312	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
4. Local government	S.1313	-330.2	-0.3	-0.1	-0.2	-0.2	-0.2
5. Social security funds	S.1314	-1 226.8	-1.0	-1.0	-0.4	0.1	0.5
General government (S13)							
6. Total revenue	TR	38 541.4	32.3	32.3	32.0	31.2	31.2
7. Total expenditure	TE	41 077.6	34.4	34.2	32.9	31.1	30.1
8. Net lending/borrowing	EDP B.9	-2 536.2	-2.1	-1.9	-0.9	0.1	1.1
9. Interest expenditure	EDP	1 996.8	1.7	1.8	1.6	1.5	1.4
10. Primary balance		-539.4	-0.5	-0.1	0.7	1.6	2.5
11. One-off and other temporary measures			0.27	-0.09	-0.08	-0.08	0.00
Revenue							
12. Total taxes (12=12a+12b+12c)		19 155.7	16.0	16.1	16.0	15.9	15.8
12a. Taxes on production and imports	D.2	13 133.5	11.0	11.1	11.0	10.9	10.8
12b. Current taxes on income, wealth, etc.	D.5	6 017.7	5.0	5.0	5.1	5.1	5.1
12c. Capital taxes	D.91	4.4	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	13 424.0	11.2	11.4	11.6	11.6	11.6
14. Property income	D.4	398.4	0.3	0.3	0.3	0.3	0.3
15. Other		5 563.3	4.7	4.4	4.1	3.4	3.4
16=6. Total revenue	TR	38 541.4	32.3	32.3	32.0	31.2	31.2
Tax burden (D.2+D.5+D.61+D.91-D.995)		32 519.6	27.2	27.6	27.6	27.5	27.4
Expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	17 119.2	14.3	14.3	14.3	14.3	14.1
17a. Compensation of employees	D.1	11 453.8	9.6	9.6	9.5	9.6	9.4
17b. Intermediate consumption	P.2	5 665.4	4.7	4.7	4.7	4.7	4.7
18. Social payments (18=18a+18b)		15 563.9	13.0	12.9	12.4	11.9	11.1
of which unemployment social insurance benefits	D.621+D.624	248.2	0.2	0.1	0.1	0.1	0.1

Indicator	ESA code	Value of indicator in 2013 (LTL million)	Percentage of GDP				
			2013	2014	2015	2016	2017
18a. Social transfers in kind	D.6311, D.63121, D.63131	2 041.5	1.7	1.7	1.6	1.6	1.5
18b. Social transfers other than in kind	D.62	13 522.4	11.3	11.2	10.7	10.3	9.7
19=9. Interest expenditure	EDP D.41	1 996.8	1.7	1.8	1.6	1.5	1.4
20. Subsidies	D.3	399.3	0.3	0.3	0.3	0.3	0.3
21. Gross fixed capital formation	P.51	4 092.7	3.4	3.5	3.1	1.9	1.9
22. Other		1 905.9	1.6	1.5	1.3	1.3	1.2
23=7. Total expenditure	TE	41 077.6	34.4	34.2	32.9	31.1	30.1
Government consumption (nominal)	P.3	20 182.0	16.9	16.6	16.4	16.2	15.8

Sources: Lithuanian Department of Statistics, Ministry of Finance

* Due to rounding, the sum of revenue and expenditure components may be different from the amounts given under "Total revenue" and "Total expenditure".

Table 7. General government revenue, 2013–2017

Indicator	Value of indicator in 2013 (LTL million)	Percentage of GDP				
		2013	2014	2015	2016	2017
1. Total revenue at unchanged policies	38 541.4	32.3	32.3	32.0	31.2	31.2
2. Total expenditure at unchanged policies	41 077.6	34.4	34.2	32.9	31.1	30.1

Sources: Lithuanian Department of Statistics, Ministry of Finance

Table 8. Amounts to be excluded from the expenditure benchmark

	Value of indicator in 2013 (LTL million)	Percentage of GDP				
		2013	2014	2015	2016	2017
1. Expenditure on EU programmes fully matched by EU funds revenue	5 166.1	4.3	4.6	4.2	2.9	3.1
2. Cyclical unemployment benefit expenditure	57.9	0.05	0.03	0.01	0.00	-0.01
3. Effect of discretionary revenue measures	-35	-0.03	-0.13	0.08	0.02	0.02
4. Revenue increases mandated by law	0	0	0	0	0	0

Sources: Lithuanian Department of Statistics, Ministry of Finance

In 2013, the non-discretionary changes in unemployment benefit expenditure accounted for LTL 57.9 million or 0.05 per cent of the GDP. Unemployment benefits will stabilise in the medium term as a result of a more favourable situation in the labour market. The evaluation of cyclical unemployment benefit expenditure was based on the assumptions concerning the structural unemployment level in Lithuania that corresponds to the output gap described in point 22 of the Programme. When comparing the structural unemployment level of 2013–2017 with the unemployment level projected for 2013–2016, a cyclical unemployment benefit constituent was taken into consideration. In terms of the classification of state functions (code CG1005), unemployment benefit projections for 2013–2017 were calculated according to the multiannual average ratio between unemployment benefits and the GDP.

In the medium term, the general government revenue (as a percentage of the GDP) will be subject to decline due to the declining absorption of the EU structural funds support: in 2016 and 2017 the revenue will be the lowest, accounting for 31.2 per cent of the GDP. In 2014–2017 the GDP share of revenue from indirect taxes will gradually decline from 11.1 to 10.8 per cent of the GDP because revenue from excise duties will grow slower than the nominal GDP. Revenue from direct taxes in 2014–2017 will stand at about 5–5.1 per cent of the GDP.

The pension accumulation system reform implemented in 2013 will allow preparations to reduce the general government debt envisaged for 2060. The reform is elaborated in paragraph 44 of the Programme.

The share of tax revenues allocated in 2013 for the implementation of the pension reform and transferred to private pension funds approximately accounted for 0.4% of the GDP.

Interest expenditure as a share of the GDP stood at 1.7 per cent of the GDP in 2013. In 2017, the interest expenditure will drop to 1.5 per cent of the GDP.

Gross fixed capital formation will slow down owing to the expiring Financial Framework 2007–2013 and subsequently, due to prevailing multiannual trends of Multiannual Financial Framework funds absorption.

Balance of general government subsectors

20. In 2013, the balance of social insurance funds subsector improved by LTL 756.7 million, the deficit accounted for 1 per cent of the GDP.

The local government subsector deficit in 2013 accounted for 0.3 per cent of the GDP.

In 2013, the deficit of social insurance funds subsector accounted for 48.4 per cent of the deficit of general government subsector. A declining deficit of the central government and social insurance funds subsector in 2014–2017 will have to result in the change of the total general government deficit into surplus in the medium term.

The data provided in Table 9 show that, as a result of applied rule of restricted increases in the expenditure, set forth in the Law on Fiscal Discipline of the Republic of Lithuania, in 2014–2017 the average annual structural government deficit will shrink by around 0.7 per cent of the GDP.

SECTION III STRUCTURAL GENERAL GOVERNMENT DEFICIT AND CONTINUITY OF FISCAL POLICY

21. In 2013, the structural general government deficit declined by 1.1 percentage point of the GDP, standing at 1.7 per cent of the GDP. Due to the application of the rule of restricted increases in the expenditure, set forth in the Law on Fiscal Discipline of the Republic of Lithuania as well as the measures increasing structural revenues, the structural government balance indicator will improve in 2017, standing at 0.9 per cent of the GDP surplus. The implementation of these plans requires continued decisive efforts to speed up structural reforms and implement expenditure and revenue related structural measures.

Structural balance indicator of the general government was calculated taking into account the following three one-off and temporary measures: temporary corporation tax relief, one-off expenditure related to the Lithuanian presidency of the Council of the EU and temporary reduction of the rate of pension contribution to pension funds.

The State Budget temporary loses around LTL 110 million of annual revenue due to the application of the corporation tax relief that allows temporary reduction of taxable profit by means of expenditures dedicated for eligible investments. The above mentioned relief is applied as from 2009 and will continue to be applied until 2018. Due to the one-off expenditure related to the Lithuanian presidency of the Council of the EU the expenditure of the general government in 2013 increased by LTL 171 million, in 2012 – by LTL 34 million, in 2014 – by LTL 10 million. Due to the temporary reduction of the rate of pension contribution to pension funds in 2009 the amount of additional revenues of the general government during 2009–2013 ranged from LTL 557 to 604 million.

When implementing the provisions of the Stability and Growth Pact the changes in the structural balance indicator of the general government will make up 0.5 per cent of the GDP in 2014, 0.6 per cent of the GDP in 2015, 0.8 per cent of the GDP in 2016. Such a scheme of structural changes will be good enough to ensure the achievement in 2015, as scheduled, of a medium-term objective.

Evaluation of the output gap

22. The GDP cycle was estimated by applying the Hodrick-Prescott (HP) filter approach. The estimated projections indicate that in the period 2014–2016 output gap will be negative. The output gap will be -2.3 per cent in 2014, -1.1 per cent in 2015, -0.3 per cent in 2016, and 0.8 per cent in 2017.

However, owing to short time-series and structural shocks under the HP filter approach or under the production function approach (based on the NAWRU conception), the estimate of Lithuania's output gap is not absolutely accurate. Conclusions obtained under the production function approach (based on the NAWRU conception) are, for the time being, not acceptable owing to short time-series, a lack of reliable data and a multitude of structural breaks. The NAWRU approach ignores "structural shocks". First, the rapid growth of construction during

2006–2007 significantly contributed to the cyclical reduction of unemployment, which, under the NAWRU approach, might be treated as a long-term. Second, the European single labour market will make impact on cyclical fluctuations of employment: integration will reduce cyclical unemployment as a part of the unemployed are likely to emigrate. Cyclical unemployment might develop into permanent reduction of labour force, however currently there is no reliable method for its estimation. On the other hand, the average increase of salary that exceeded productivity growth indicators in the second half of 2013 suggests that in 2014 the economy will acquire features characteristic to ‘good times’, thus from 2015 the structural balance indicator of the general government should be increased by more than 0.5 per cent of the GDP.

Table 9. Cyclical developments

Indicator	ESA code	Percentage of GDP				
		2013	2014	2015	2016	2017
1. GDP growth/chain linked volume growth		3.3	3.4	4.3	4.0	4.3
2. Net lending (+)/borrowing (-) of general government	EDP B.9	-2.1	-1.9	-0.9	0.1	1.1
3. Interest expenditure	EDP D.41	1.7	1.8	1.6	1.5	1.4
4. One-off and other temporary measures		0.27	-0.09	-0.08	-0.08	0.00
5. Potential GDP growth, %		2.8	2.9	3.0	3.2	3.2
contributions:						
- labour		N.A.	N.A.	N.A.	N.A.	N.A.
- capital		N.A.	N.A.	N.A.	N.A.	N.A.
- technological progress		N.A.	N.A.	N.A.	N.A.	N.A.
6. Output gap		-2.8	-2.3	-1.1	-0.3	0.8
7. Cyclical budgetary component		-0.7	-0.6	-0.3	-0.1	0.2
8. Cyclically-adjusted balance (2–7)		-1.4	-1.3	-0.6	0.2	0.9
9. Cyclically-adjusted primary balance (8+3)		0.3	0.5	0.9	1.6	2.4
10. Structural balance (8–4)		-1.7	-1.2	-0.6	0.2	0.9

Sources: Department of Statistics, Ministry of Finance

SECTION IV GENERAL GOVERNMENT DEBT LEVELS AND DEVELOPMENTS

23. Taking into account the derivative financial instruments used, the general government debt at the end of 2013 was 39.4 per cent of the GDP (40.5 per cent of the GDP in 2012). The central government debt structure poses no threat to public finances. At the end of 2013, short-term

liabilities (by residual maturity) accounted for 11 per cent of the total debt and the average residual maturity of the debt was 4.9 years. The floating interest rate debt, including the impact of financial derivatives, accounted for 0.9 per cent of the total debt. Taking into account financial derivatives, the central government debt is 100 per cent denominated in the litas and the euro.

Table 10. General government debt projections

Indicator	Percentage of GDP				
	2013	2014	2015	2016	2017
1. Gross debt as of year-end	39.4	41.6*	40.7*	35.3	34.8*
2. Change of gross debt ratio	1.0	2.1	-0.9	-5.4	-0.6
Factors determining changes in gross debt					
3. Primary balance	-0.5	-0.1	0.7	1.6	2.5
4. Interest expenditure	1.7	1.8	1.6	1.5	1.4
5. Stock flow adjustment	1.9	2.2	1.0	-2.6	3.0
of which:					
difference between cash and accruals	–	–	–	–	–
net accumulation of financial assets of which: privatization revenues	0	0	0	0	0
implicit interest rate on debt (%)	4.5	4.7	4.0	3.9	4.4
Other relevant variables contributing to gross debt	–	–	–	–	–
6. Liquid financial assets	–	–	–	–	–
7. Net debt (7=1–6)	–	–	–	–	–
8. Debt amortization since end of previous year	–	–	–	–	–
9. Percentage of foreign currency denominated debt	–	–	–	–	–
10. Average debt maturity	–	–	–	–	–

Sources: Ministry of Finance

* If we disregarded the possible accumulation of funds aimed at the management of the refinancing risk of the Eurobond redemptions, at the end of 2014 the general government debt would stand at 38.8 per cent of the GDP, at the end of 2015 – 38.1 per cent of the GDP, at the end of 2017 – 31.7 per cent of the GDP.

24. In the medium term, the tasks of the Government regarding borrowing and debt management are as follows:

24.1. to seek acceptable risk levels of interest rate, refinancing and exchange rate changes by adhering to established risk limits that are in line with the international practice;

24.2. to implement measures to control the refinancing risk related to redemption of large amount Eurobond issues (equivalent to EUR 1 billion and more), such as buy-back of Government securities (hereinafter referred to as GS), exchange of GS, advance accumulation of financial resources or a combination of the said measures;

24.3. to increase domestic debt share in the total debt in the name of the state and increase the maturity of domestic debt;

24.4. to develop and maintain an efficient and liquid domestic GS market;

24.5. to implement liquid GS emissions by borrowing in foreign capital markets.

CHAPTER IV SENSITIVITY ANALYSIS OF BUDGET INDICATORS AND COMPARISON WITH PREVIOUS PLANS

SECTION I ECONOMIC DEVELOPMENT RISKS AND THEIR IMPLICATIONS FOR GENERAL GOVERNMENT FINANCES

25. A medium-term growth of floating and fixed market interest rates by 1 percentage point would suggest an increase of the interest expenditure of central government borrowing of LTL 22 million, LTL 105 million, LTL 146 million and LTL 181 million respectively in the period 2014–2017 or about 0.1% of GDP on average.

Taking into account financial derivatives, the central government debt (including interest payments) is 100% denominated in the litas and the euro, therefore, exchange rate changes have no effect on central government interest payments.

The economic development scenario, predicting a success in maintaining economic growth, depends on the speed of structural reform implementation. The key precondition for the economic development scenario is structural reforms, which reduce energy dependence on mineral fuel. If this precondition fails to hold true, this will create a risk of an increase in import volumes in response to recovery of consumer and business confidence, resulting in a further increase in the CAD by several percentage points of GDP and thus raising the risk premiums and suppressing the growth of GDP potential. In such a case, general government consolidation would have to rely on smaller private sector resources.

However, there is a positive risk of a several-percentage-points faster growth. After achieving the goals of the Programme for Increasing Employment for 2014–2020, approved by Resolution No 878 of the Government of the Republic of Lithuania of 25 September 2013, and after implementing the measures envisaged in the Inter-institutional Action Plan for the Implementation of the Programme for Increasing Employment for 2014–2020, approved by Government Resolution No 204 of 26 February 2014, annual GDP growth in the medium-term would be, on average, by 5 percentage points faster than foreseen in the economic development scenario.

The 2014 negative and positive risks of possible deviations from the economic development scenario are balanced.

SECTION II FISCAL RISK

26. The major projected sources of fiscal risk include: deposit insurance, state guarantees and securing of financial stability of the banking system. Implementation of the rulings and decisions of the Constitutional Court of the Republic of Lithuania should also be considered as a non-structural source of fiscal risk.

Deposit insurance

27. The Lithuanian deposit insurance system is in compliance with the requirements of the relevant EU *acquis*. The total amount of insured deposits on 31 December 2013 was LTL 41 775.3 million, while the total amount of potential insurance compensations before the said date stood at LTL 31 367.6 million.

On 24 January 2013, the Bank of Lithuania recognized the National Credit Union and the credit union *Švyturio taupomoji kasa* as insolvent. The total amount of insurance compensations paid to the depositors of these credit institutions made LTL 139 million. On 18 February 2013, the Board of the Bank of Lithuania recognized the AB Ūkio bankas as insolvent and, assuming that the transfer of the bank's assets, rights, transactions and liabilities to another bank rather than liquidation of the AB Ūkio bankas due to bankruptcy should better help preserve clients' trust in the stability and reliability of the banking system and otherwise protect the public interests, approved the transfer of the bank's assets, rights, transactions and liabilities to another bank. Resolution of the Government No 153 of 20 February 2013 "On Participation of the State Company "Deposit and Investment Insurance" in the Financing of the Transfer of the Assets, Rights, Transactions and Liabilities of the AB Ūkio bankas" approved the participation of the state-owned company "Deposit and Investment Insurance" in the financing of the transfer of the assets, rights, transactions and liabilities of the AB Ūkio bankas in the manner established in Article 12¹(2)(2) of the Law of the Republic of Lithuania on Insurance of Deposits and Liabilities to Investors, and for this purpose the company was granted a loan from the funds borrowed on behalf of the state, worth up to LTL 800 million; subsequently, an additional LTL 128.5 million was transferred from the Deposit Insurance Fund to finance this transaction.

On 9 May 2013, the Bank of Lithuania revoked the licence of the credit union *Laikinosios sostinės kreditas*, insurance payments to its members totalled LTL 23.3 million.

On 17 January 2014, the Board of the Bank of Lithuania declared the credit union *Vilniaus taupomoji kasa*, the largest by total assets, insolvent and permanently revoked its licence. The amount of deposit insurance required to be paid by the state-owned company "Deposit and Investment Insurance" to the members of this credit union was LTL 235 million.

Currently, creditor claims of the state-owned company "Deposit and Investment Insurance" are being paid under the court-approved plans of settlement between bankrupt financial institutions and creditors. By the end of February 2014, LTL 760 million was recovered from the AB Bankas Snoras and a further LTL 23.6 million – from the credit unions. A further plan of repayment to the insurance company is being agreed on with the AB Bankas Snoras Bankruptcy Administrator. Over a month's period, the state-owned company "Deposit and Investment Insurance" collects nearly LTL 14 million in deposit insurance payments and the continued increase in the balances of insured deposits makes it possible to predict that the company's income from deposit insurance payments will be stable. As at 28 February 2014, the debt of the state-owned company "Deposit and Investment Insurance" to the Ministry of Finance was LTL 2 509 million. Funds earned by the company are

regularly transferred to the Ministry of Finance to repay the loans, thus, the remaining loan balance as on 4 April 2014 decreased to LTL 2 378 million.

Government guarantees

28. The Government-guaranteed loan portfolio at the end of 2013 accounted for about 0.8% of GDP. Taking into account the guarantees planned to be provided in 2014, including the guarantees in respect to the state-supported loans specified in the Law of the Republic of Lithuania on Science and Studies and, also, the Liquefied Natural Gas Terminal Project, the Government-guaranteed loan is projected to increase to 1.2% of GDP.

Table 11. Contingent liabilities

Indicator	% of GDP	
	2013	2014
Government guarantees	0.8	1.2
of which linked to the financial sector	0	–

Source: Ministry of Finance

Securing financial stability

29. With a view to strengthening financial stability, amendments will be made in 2014 to the Law on the Bank of Lithuania, empowering the Bank of Lithuania to shape and conduct Lithuania's macro-prudential policy. The aim of macro-prudential policy is to contribute to the protection of the stability of the financial system, including enhancement of the resilience of the financial system and reduction of the build-up of systemic risk, thus ensuring sustainable contribution of the financial sector to economic growth. In designing and conducting the macro-prudential policy, the Bank of Lithuania, will apply policy measures prescribed by legislation which are necessary to achieve the aim of macro-prudential policy, shaped and implemented by the Bank of Lithuania, and which set requirements applicable to the financial system or individual financial institutions, so as to prevent or reduce the threat to the country's financial system.

In order to ensure the stability of credit institutions, enhance the resilience of the credit institutions sector and to provide a further financing to the economy, reconsideration of the requirements for banking operations, including risk management, capital adequacy and disclosure of information, is planned for 2014.

In order to increase financial stability, amendments are planned to be introduced to the Law of the Republic of Lithuania on Credit Unions in 2014, helping to ensure a safe and reliable operation of credit unions, i.e. establish a proper balance between the development of credit unions and the capability to amortize losses due to risk exposure (assumption of risk). The new provisions of the law regarding strengthening of the capital of credit unions, prudential requirements, strengthening of management and supervision, reduction of administrative burden on credit unions, possibility for credit unions to provide a wider variety of financial services to a larger number of individuals will allow for a significant change in the regulation of the operation of credit unions.

With a view to encouraging the development of financial markets and increasing their stability, improvements in sector-specific legislation will be made, taking into account the provisions of EU regulations. The aim will be to ensure better protection of deposits – to improve deposit guarantee schemes. Improvements will be introduced in the legal framework relating to the prevention of financial crises, early intervention, reorganization and liquidation of credit institutions. With a view to contributing to a greater financial stability, ensuring a higher level of confidence in financial statements submitted by credit institutions and other public interest entities, a reform of the oversight of auditors performing audits of public interest entities and audit companies will be launched – the mandate to perform the said oversight will be given to an institution which is independent from audit profession.

As from 1 August 2013, new EU State aid rules came into force, limiting the risk of irresponsible behaviour of banks and strengthening market discipline by imposing binding conditions on bank shareholders and creditors to share the burden of measures to strengthen financial stability. Under these rules, a permission of the European Commission is required for the provision of State aid. If the application of measures to strengthen financial stability is necessary, the European Commission will be notified of each planned application of the measures and provided with a restructuring plan. Measures to strengthen financial stability will be applied only upon obtaining the permission of the European Commission.

Implementation of rulings and decisions of the Constitutional Court of the Republic of Lithuania

30. The Decision of the Constitutional Court of the Republic of Lithuania of 20 April 2010 “On Interpretation of the Provisions of the Rulings of the Constitutional Court of the Republic of Lithuania of 25 November 2002, 3 December 2003, 16 January 2006, 26 September 2007, 22 October 2007, 22 November 2007, 24 December 2008 and the Decision of 15 January 2009“ states, concerning reduction of pensions during the period of economic hardship, that: “the legislative body has a duty to provide for the mechanism of compensation of the incurred losses to the persons who had been assigned and paid an old-age or disability pension, under which the state, once the extraordinary situation is over, would undertake to pay, within a reasonable time period, fair compensations to make up for the losses of the said persons due to old-age or disability pension cuts“. The Decision (No KT8-S5/2014) of the Constitutional Court of the Republic of Lithuania of 7 March 2014 “On Interpretation of Certain Provisions of the Ruling of the Constitutional Court of the Republic of Lithuania of 6 February 2012” states that: „<...> the provision “for payment, within a reasonable time period, of fair compensations the legislative body must, without undue delay, determine, pursuant to the law, the key elements of compensation for reduced pensions (justification, amounts and etc.)” *inter alia* means that the legislative body must determine the mechanism for compensation for reduced (*inter alia* by legal provisions recognized as contrary to the Constitution) old-age pensions, *inter alia* the beginning of payment of compensations and the reasonable time period, during which the losses due to such pensions cut will be reimbursed, taking into account the consequences of the extraordinary situation and the capabilities of the state, *inter*

alia the various obligations undertaken by the state, *inter alia* relating to fiscal discipline and, therefore, to the imperative of balancing state revenues and expenditures”. Fiscal risk on account of these decisions may lead to an increase in the year-on-year expenditure commitments of the general government by 0.4–0.7% of GDP.

31. The Ruling of the Constitutional Court of the Republic of Lithuania of 1 July 2013 “On Compliance of the Legal Provisions of the Republic of Lithuania, Laying down Reduced Salaries of Civil Servants and Judges owing to Especially Difficult Economic and Financial Situation in the State, to the Constitution of the Republic of Lithuania“ imposes an obligation on the legislative body to establish a mechanism of compensation of losses incurred by persons who are paid salaries from the State Budget and municipal budgets, specifically, the procedure pursuant to which the state, within a reasonable time period (*inter alia* considering the economic, financial situation of the state, assessing the possibilities to accumulate (obtain) funds required for such compensation), will pay fair compensations, to the extent that the losses incurred were disproportionate. Fiscal risk arising from the above Ruling would worsen the annual general government balance indicator by 0.2–0.4% of GDP.

32. Concerning the implementation of the decisions of the Constitutional Court of the Republic of Lithuania related to unpaid salaries and pensions, it should be noted that, based on available information, no amounts may be recorded as government expenditure in 2013. Only the commitment to compensate for the losses incurred by an identified group of persons, established in a legislative act (determining or allowing to determine, with sufficient reliability, the amount of losses subject to compensation), and the mechanism of compensation are the basis for recording the amount of all losses subject to compensation as government expenditure for the year, in which such legislative act is adopted. The Lithuanian Department of Statistics in cooperation with the EU’s Statistical Office (hereinafter – Eurostat) will evaluate draft legislative acts, already adopted legislative acts and decide as to when the expenditure commitments to compensate for salary and pension cuts should be included in the accounts. However, losses due to pension cuts will be given priority of reimbursement over the losses due to reduced salaries.

SECTION III COMPARISON WITH PREVIOUS PLANS

33. GDP projections have been revised to reflect the actual figures of 2013 announced by the Lithuanian Department of Statistics and the emerging trends in economic development.

General government deficit and debt projections have been made according to ESA’95. The 2014–2016 objectives of the general government balance indicator have been revised to mitigate the pro-cyclical consolidation effects in the period of economic growth, during which the output gap will remain negative, while interest rates will stay low.

Table 12. Change in GDP, general government deficit and general government debt projections compared to the Convergence Programme of Lithuania of 2013

Indicator	ESA code	% of GDP				
		2013	2014	2015	2016	2017

Indicator	ESA code	% of GDP				
		2013	2014	2015	2016	2017
1. GDP growth:						
Previous update		3.0	3.4	4.3	4.0	N.A.
Current update		3.3	3.4	4.3	4.0	4.3
Decrease (-) / Increase (+)		0.3	0	0	0	N.A.
2. General government net lending(+)/borrowing(-):						
Previous update	EDP B.9	-2.5	-1.5	-0.5	0.5	N.A.
Current update		-2.1	-1.9	-0.9	0.1	1.1
Worsening (-) / Improvement (+)		0.4	-0.4	-0.4	-0.4	N.A.
3. General government gross debt:						
Previous update		39.7	41.2*	39.6*	34.5*	N.A.
Current update		39.4	41.6*	40.7*	35.3	34.8*
Decrease (-) / Increase (+)		-0.3	0.4	1.1	0.8	N.A.

Sources: Lithuanian Department of Statistics, Ministry of Finance.

*Excluding the possible accumulation of funds aimed at reducing the refinancing risk by Eurobond redemption the general government debt at the end of 2014 is forecast at 38.8% of GDP, at the end of 2015 – 38.1% of GDP and at the end of 2017 – 31.7% of GDP.

CHAPTER V QUALITY OF GENERAL GOVERNMENT FINANCES

34. In order to introduce the elements of performance-driven and evidence-based management in the public sector, a project “Improvement of Performance Based Management“ has been implemented following successful international practice, resulting in the development and introduction of the key performance-oriented and evidence-based management tools, such as performance results monitoring system, programme evaluation and functional review tools and the system of impact assessment. These initiatives are aimed at enhancing the quality of performance and increasing accountability for results of the Government and its subordinate institutions. New IT solutions for performance management and monitoring have been developed, along with relevant methodological instruments.

The Ministry of Finance introduced the Monitoring Information System, aimed at helping to ensure a regular performance monitoring of Government-accountable institutions, enabling automatic delivery of performance data, cross-section analysis, and at any time viewing institutional performance results via a single access point. Since 2012, the Government-accountable institutions report performance information on a quarterly basis to the system, which allows the analysts from the Prime Minister's Office and other institutions to obtain quick access to performance information and subsequently report to their superiors and the Government.

In order to improve public policy making and decision making, to provide public decision making institutions and bodies with possible alternative solutions and their implementation impact, to enable opting for the best solution, it has been established that the impact assessment of draft priority decisions should also include the cost-benefit or cost effectiveness analysis, enabling the identification of optimal implementation costs.

To ensure the publicity and transparency of budgeting, the information related to the 2014 State Budget is published annually on the website of the Ministry of Finance.

35. Optimization of the management of funds of the State Social Insurance Fund has been carried out. At the end of 2013, amendments were adapted to the laws regulating state social insurance, specifying that, as from 1 January 2015, the maintenance costs of the Lithuanian Labour Exchange and its subdivisions shall be included in the State Budget. The amendments provide that although health insurance continues to be one of the forms of social insurance, it is implemented in accordance with the procedure established in the Law of the Republic of Lithuania on Health Insurance and, as from 1 January 2013, shall not be included in the calculation of the budget of the State Social Insurance Fund. Moreover, according to the amendments, state social insurance contributions and spending across different types of state social insurance, excluding the operational costs of the State Social Insurance Fund and the non-recoverable amounts as well as the amounts of doubtful recoverability, will be annually included in the supplementary tables together with the Compendium of Reports on Implementation of the Budget of the State Social Insurance Fund; in order to meet the obligations to the insured, interest on loans taken after 1 January 2014, will be covered from the State Budget.

36. The reform of the system of financial social assistance launched in 2012, with a view to providing a more focused financial social assistance, ensuring social justice, efficient and responsible use of State Budget funds, gave positive results. In the five pilot municipalities (Akmenė, Panevėžys, Radviliškis, Raseiniai and Šilalė), in 2013 as compared to 2012, the number of people on social benefits decreased by 18.7%, social benefit spending contracted by 26.8%, compensation spending – by 19%, while the number of compensation beneficiaries dropped by 8.4%.

Taking into account the good practice of the pilot municipalities, since 1 January 2014, provision of social security benefits, as an independent function of municipalities, has been transferred also to the other 55 municipalities.

37. As a result of fiscal consolidation, a share of public administration expenditure in Lithuania (% of GDP) remains low in comparison with that of the other EU Member States. According to the data provided by the Lithuanian Department of Statistics, public administration expenditure in 2012 decreased to 36.1% of GDP in 2012 (compared to 38.7% of GDP in 2011). As a result of implementation of the provisions of the Law of the Republic of Lithuania on Fiscal Discipline concerning expenditure restraint, general government expenditure is expected to continue to decline to multiannual levels close to 30.1% of GDP by 2017.

Table 13. General government expenditure by function

Indicator	COFOG Code	% of GDP	
		2012	2017
1. General public services	01	4.3	
2. Defence	02	1.0	
3. Public order and safety	03	1.8	
4. Economic affairs	04	3.3	

Indicator	COFOG Code	% of GDP	
		2012	2017
5. Environmental protection	05	0.9	
6. Housing and community amenities	06	0.2	
7. Health care	07	5.9	
8. Recreation, culture and religion	08	0.8	
9. Education	09	5.6	
10. Social protection	10	12.1	
11. Total expenditure		36.1	30.1

Sources: Lithuanian Department of Statistics, Ministry of Finance.

SECTION I GENERAL GOVERNMENT EXPENDITURE

38. State Budget expenditure targets and priorities are defined in a number of strategic papers that are interrelated and form a single integrated set. The key national budget expenditure targets and priorities have been set by the Programme of the Government of the Republic of Lithuania. Each year, before drawing up the State Budget, the Government of the Republic of Lithuania also drafts a plan of the Government's priority activities for the respective year. According to these priorities, funds are allocated to areas of responsibility of relevant ministers for the implementation of programmes of the institutions and bodies under their charge.

The draft Law of the Republic of Lithuania on Approval of Financial Indicators of the State Budget and Municipal Budgets of 2014 was prepared following the Law on Fiscal Discipline and with a view to ensuring that the planned State Budget allocations and revenues would provide for the improvement of the general government balance indicator of at least 1% of GDP.

With a view to containing the general government deficit within 1.9 % of GDP in 2014, the State Budget allocations, excluding EU and other international financial support, increased by LTL 711 million, as compared to 2013, (of which, as part of implementation of the Decision of the Constitutional Court of the Republic of Lithuania of 1 July 2013, LTL 235.6 million was allocated for the share of restoration of salaries, related contributions and other payments; LTL 136.7 million – for the restoration of state pensions, social assistance benefits and other social assistance payments; LTL 90 million was given for incentive payments into pension accumulation funds. The EU and other international financial support decreased by LTL 113.9 million.

Pursuant to the Resolution No 482 of the Government of the Republic of Lithuania of 31 May 2013 “On the Main Preliminary Indicators of the Consolidated State and Municipal Budgets of the Republic of Lithuania of 2014–2016“, the Ministry of Finance when notifying the State Budget appropriation managers of the budgetary ceilings allowable for 2014–2016, calculated the 2014 maximum limits of the State Budget allocations (for expenditure and asset acquisition) by not exceeding the allocations approved for the 2013 State Budget (apart from EU and other international financial support, contributions from the revenues of budgetary institutions to the State Budget as well as part of tax revenues and other funds envisaged by laws and other legislative acts for programme funding), minus appropriations for the programmes to be discontinued and/or

programme measures, which will be completed in 2013 and which do not require allocations from the 2014 budget, and considering the agreements on the allocation of the maximum limits of State Budget appropriations in the period 2014–2016 to the areas governed by relevant ministers, negotiated during discussions between the Prime Minister of the Republic of Lithuania, Minister of Finance and relevant government ministers on the results planned to be achieved and State Budget appropriations, arranged by the Office of the Government.

The approved Law on Approval of Financial Indicators of the State Budget of the Republic of Lithuania and Municipal Budgets of 2014 restricts the rights of the Ministry of Environment to undertake financial obligations – according to the law, the Ministry of Environment may use up for payments from the Special Climate Change Programme no more than LTL 85 million of the amount of funds actually paid in 2014 and no more than LTL 120 million of the amount paid in the previous year.

SECTION II GENERAL GOVERNMENT REVENUE

39. Changes in direct taxes:

39.1. The adopted amendments to the Law on Personal Income Tax, introduced, as from 2014, a more progressive income tax by increasing the maximum non-taxable allowance and reduced the tax burden on lower income earners, as well as on persons raising children. The amendments also provide for a reduction in the income tax rate applied to dividends (from 20 to 15%) designed to stimulate investment. For the purpose of ensuring a more even distribution of the tax burden between labour income and capital profits, the amendments limit the application of income tax exemptions on capital income (interest from deposits or non-equity securities and capital gains from the disposal of securities).

39.2. After adoption of the amendments to the Law of the Republic of Lithuania on Corporate Income Tax aimed at promoting business competitiveness, from 2014 onward, the period of profit tax relief granted for the entities carrying out investment projects and investing in major technological upgrading has been extended, and a unified deadline for filing profit tax returns and paying tax has been set. To ensure the balancing of the flows of budget revenue from profit tax, enterprises are allowed to offset no more than 70% of the taxable profit of the tax period by tax losses from previous periods and also allowed to continue not to impose any time limit on using up the carryforward tax losses. Moreover, the profit tax base has been expanded to include also the non-life insurance investment income of insurance companies.

39.3. With a view to encouraging the introduction of new waste management technologies (sorting, utilization, recycling), reducing the amount of waste disposed of in landfills, collecting funds for the establishment and development of the waste management system, a draft Law on Amending the Law of the Republic of Lithuania on Environmental Pollution Tax has been prepared, proposing to impose, as from 2016, an environmental pollution tax on the disposal of waste to landfill (landfill tax).

40. Changes in indirect taxes:

40.1. As a result of the amendments to the Law of the Republic of Lithuania on Excise Duties, as from 1 March 2014, excise duties on tobacco products have been increased, and as from 1 April 2014 – excise rates on ethyl alcohol and alcoholic beverages.

40.2. Following the adoption of the amendments to Article 19 of the Law of the Republic of Lithuania on the Value Added Tax, the application of a reduced VAT rate of 9% on heating, supplied to heat residential houses (including heat supplied through hot water supply system), hot water for residential houses or cold water used for preparation of hot water, and heat used for heating of water has been extended to 31 December 2014. Also, application of a reduced VAT rate of 5% on medicines and medical aid devices when their acquisition costs are fully or partly compensated in accordance with the procedure established by the Law of the Republic of Lithuania on Health Insurance has been extended (without fixing a validity period).

41. Changes in tax administration:

41.1. Increasing the efficiency of tax administration and the fight against shadow economy continue to remain priority areas. To this end, a few legislative initiatives are underway. In 2013, draft laws were prepared and submitted to the Seimas in order to limit the scope of settlements as well as other payments under transactions and/or related transactions in cash between persons (no more than LTL 10 000 per transaction or its equivalent in foreign currency). This would be one of the conditions for reducing the scale of shadow economy. The laws are planned for adoption in the first half of 2014.

41.2. Regulation of third party obligations in the area of information provision will be improved, conditions will be created for reducing the risk of unaccountable income, steps will be taken towards ensuring an efficient performance of the tax administrator functions, a more effective fight against unlawful evasion of the VAT and excise duty payment, as well as ensuring a better collection of these taxes for the budget. For this purpose, draft laws amending the Law of the Republic of Lithuania on Tax Administration and the Law of the Republic of Lithuania on the Value Added Tax have been prepared, and also the system for guaranties and warranties against tax liabilities is being re-considered.

41.3. The supervisory institutions pay more attention to the fight against illegal trade in excise goods, disclosure and prevention of cases of illicit use of 0% of VAT rate, hiding of income, including unaccounted wages and wealth earned by unlawful means.

CHAPTER VI SUSTAINABILITY OF GENERAL GOVERNMENT FINANCES

42. Long-term sustainability of public finances represents a problem for all EU countries, aggravated by financial and debt crisis. Due to the economic crisis, the gap between the general government balance indicator and sustainability indicators deepened in many countries, including Lithuania. To achieve long-term sustainability of public finances, it is extremely important to reduce the general government deficit and debt, to increase employment and to carry out a reform in social security.

SECTION I SOCIAL SECURITY REFORM

43. The existing social security scheme in Lithuania is affected not only by the long-term effects of the economic crisis (insufficient contributions to match the benefits, rising unemployment, excessive previous commitments), but also by long-term structural problems (ageing society), therefore, on 8 June 2011, the Government of the Republic of Lithuania adopted Resolution No 684 “On Approval of the Action Plan for Implementation of the Guidelines of Reform of the State Social Insurance and Pension System”. The reform is aimed at developing a more effectively and transparently administered financially sustainable social insurance system, and creating closer relation between social benefits and national economic capacities.

44. Pension-related challenges identified in the draft concept of the reform of the state social insurance and pension system will be addressed through gradual implementation of the following measures:

44.1. since 2012, to start to increase the retirement age by 4 months every year for women and by 2 months for men until 2026, when the retirement age for both genders reaches 65;

44.2. to change the procedure for the calculation of social insurance pensions, i.e. by gradually moving towards a new basic pension or national pension to be financed from the general taxes;

44.3. to lay down a procedure for determining the amount of pension and pension indexation;

44.4. to include supplemental income (earnings) when calculating pension insurance contributions;

44.5. to encourage participation in pension pillar schemes II and III.

45. The Guidelines for Reforming State Social Insurance and Pension Scheme (hereinafter referred to as the Guidelines) adopted by Resolution No XI-1410 of the Seimas of the Republic of Lithuania of 24 May 2011 provide for the long-term goal of social insurance and pension scheme reform, which is to create a more sustainable, secure, transparent, proportionate scheme, ensuring adequate benefits, at the same time transforming the current model of the State social insurance and pension system and ensuring proper rewarding for the lifetime work. To implement the Guidelines,

the Government of the Republic of Lithuania adopted Resolution No 684 of 8 June 2011 approving the Action Plan for the Implementation of the Guidelines for Reforming State Social Insurance and Pension Scheme. One of the measures under this Plan has been implemented through the Law of the Seimas of the Republic of Lithuania Amending Articles 21, 25, 33, 56, 57 and 67 of the Law on State Social Insurance Pensions of 9 June 2011, thus providing for a gradual extension of the retirement age for men and women, starting from 2012 (as specified in Paragraph 44.1 of the Programme).

Following the principle, established in the Guidelines, of raising the efficiency of pillar II private pension scheme, and seeking to establish optimal rates of State social insurance pension contribution for social insurance and pension savings, the Seimas of the Republic of Lithuania adopted the Law Amending Articles 1, 2, 3, 4, 7 and 8 of the Law on Reform of the Pension Scheme, on 14 November 2012.

According to the Law, as of 1 January 2014, the rate of pension accumulation contribution is 2 per cent of the participant's income from which state social insurance contributions are calculated (these contributions are transferred from participant's state social insurance contributions), an additional 1 per cent of participant's income from which state social insurance contributions are calculated is paid from the participant's income to the pension fund, and an additional 1 per cent of contribution, calculated from the country's average monthly gross wage of the four quarters of the year before the preceding year that is published by the *Statistics Lithuania*, is paid from the state budget. Since 2016 the rate of social insurance contributions transferred to pension accumulation funds will not change (2 per cent of the participant's income, from which state social insurance contributions are calculated), also additional 2 per cent contribution from the participant's income, from which state social insurance contributions are calculated, , and an additional contribution from the state budget will be set at 2 per cent of the country's average monthly gross wage of the four quarters of the year before the preceding year that is published by the *Statistics Lithuania*. As of 1 January 2020, the rate of pension accumulation contribution from social insurance contributions has been set at 3.5 per cent of participant's income, the rate of additional contribution to be paid from the participant's income – at 2 per cent of the participant's income, from which state social insurance contributions are calculated, while the rate of additional contribution paid for the participant from the state budget – at 2 per cent of the country's average monthly gross wage of the four quarters of the year before the previous year that is published by the *Statistics Lithuania*. Since 1 January 2014, one of the parents raising a child under three years of age and receiving maternity (paternity) social insurance benefit or covered by state social pension insurance will receive contributions to their pension fund equal to 2 per cent of the country's average monthly gross wage of the four quarters of the year before the preceding year that is published by the *Statistics Lithuania*, from the state budget. If these parents raise more than one child under 3 years of age, a fixed payment to the parent's account is credited for each child.

Pension accumulation agreements signed post-1 January 2013 shall be subject only to new pension accumulation scheme terms, i.e. by becoming a participant of the pension accumulation scheme, an individual shall have to follow the three-part-contribution model. During the transition

period from 1 April 2013 to 30 November 2013, pension scheme participants, having joined the scheme by 31 December 2012, were able to decide about their further participation in the pension accumulation scheme, i. e. either unilaterally terminate participation in the scheme, continue under the previous terms or sign an agreement for participation in pension scheme on new terms (involving additional contribution on personal funds and an additional contribution for a participant from the state budget).

According to the 30 December 2013 data pension accumulation system had 1 million 117 thousand participants. In 2013, 36.7 per cent of all pension scheme participants opted for additional pension contributions (409 thousand individuals). Termination of further contributions to private pension funds was chosen by 24 thousand or 2.1 per cent of all those involved in pension accumulation scheme, 684 thousand pension scheme participants (that is, 61.2 per cent of all the participants) continued to participate in the pension accumulation scheme with contributions only from state social insurance contributions, i.e. without paying additional contributions and without receiving encouraging contribution from the state budget. The above measures will help to reduce the planned general government debt in 2060 and encourage private individuals to save additional funds for old-age pensions thus increasing their future pension.

The pension system is inseparable from the transformation of labour relations; therefore, a project for the overall reformation of labour relations, social security and pension scheme has been launched. This project, which aims to create a new legal-administrative model, is to be implemented in the first half of 2015. The model is developed in the framework of objective VP1-4.3-VRM-02-V Promotion of Public Policy Reforms of Priority 4 Strengthening Administrative Capacities and Increasing Efficiency of Public Administration of the Human Resources Development Operational Programme (HRDOP) for 2007-2013.

SECTION II HEALTH CARE REFORM

46. National health care is greatly impacted by economic, social and demographic changes in the country. The population is declining in number, and it is becoming older. Due to decreasing number of working age population, the need for social care services is greater, resulting in higher spending on health care. As the working-age population is declining, it is essential to improve their health, cutting down on days lost due to disease, prolonging working life, providing for more possibilities to remain active in social life and the labour market. Good health and active involvement in social life means higher productivity and reduced social exclusion and poverty.

The Programme for Stage Three of Restructuring of Health Care Institutions and Services) was carried out in 2009-2012 with a view to provision of safe, reliable and accessible health care services, and to an efficient use of health care allocations. In 2010-2011, with a view to creating a more efficient network of medical institutions, reducing administrative and maintenance costs, eliminating funding for irrelevant projects and using investment funds more efficiently, the number of institutions providing health care services was reduced by 20 – they were merged into larger legal entities in accordance with criteria set out in the Programme. A plan for the next stage in

development of health system and consolidation of the network of hospitals has been foreseen for 2014.

47. Cardiovascular and oncological diseases, injuries and accidents are the main working-age population mortality reasons. In order to reduce the negative impact of ill health on society's working capacity, the following programmes are underway until the end of 2015: an annual programme for the reduction of morbidity and mortality of non-communicable diseases for 2007-2013, and the programme for the continuity of health care reform and streamlining of health care infrastructure. Medical infrastructure has been upgraded, modern technologies introduced to ensure quality and accessibility of complex services in prevention, diagnosis and treatment.

In 2013, an integrated system of health care or functional clusters (oncology, cardiology, stroke diagnosis and treatment, reduction of mortality due to external causes, perinatology and paediatric diseases and intensive care) was started, with a view to embarking as early as possible on quality treatment of patients with severe diseases, managing more effectively their flows and improving hospital operation.

48. With a view to improving the mechanism for the compensation of health care services, as of 1 January 2012, the diagnosis related groups (DRG)-based health care payment compensation system for in-patient services has been introduced nationwide. It continued to be applied throughout 2013. It aims to achieve a more precise calculation of the compensation of costs related to health service provision in medical establishments, while encouraging them to pursue better performance. The assessment under the DRG method of actual costs incurred by medical establishments resulted in readjustment of actual treatment prices applicable as of 1 June 2013. A price list has been drawn up for the prices of medical aids, chemotherapy medicines and blood components, affecting the determination of the actual price of an active treatment case. Hospital performance analysis has showed the main trends of inpatient services in various Lithuanian inpatient medical facilities. In order to accurately compensate for the costs of active treatment services, attributable to the DRG, it has been planned to recalculate, in 2014-2016, standard duration of treatments, the price factors of active treatment cases following the DRG and the base of the price of an active treatment case. In 2014-2016, efforts will be made to ensure that all the inpatient medical facilities would attribute inpatient treatment services costs to the respective groups under DRG method, in a uniform manner. Medical facilities are expected in 2014 to start introduction of a selected detailed cost accounting method (procurement of technical support services).

With a view to narrowing the public health care funding gap between Lithuania and the EU average (EU average – 2.9 per cent of GDP, in Lithuania – 0.8 per cent of GDP, which is 3.6 times less), changes have occurred in funding principles of public health functions (public health care – health care offered to pupils of municipal pre-school education, general education and vocational training institutions, following the pre-primary, primary and secondary education programmes, as well as public health promotion, public health monitoring). Before 1 January 2014, these functions were funded by the Compulsory Health Insurance Fund, local budgets, state budget earmarked allocations, while since 1 January 2014 they have been funded from a single source –state budget

special purpose grants allocated to local government budgets. This will ensure that all Lithuanian citizens are fairly and efficiently provided with public health services.

49. The development of e-health system included e-projects as “Development of e-health services and cooperation infrastructure”, “Development of e-service “e-prescription” and “Development of national information system for medical image archiving and exchange, and the related e-services”, which have been allocated necessary funding; project funding and administration agreements were signed. Operational models of the projects “Development of infrastructure for e-health services and cooperation”, “Development of e-service “e-prescription” and “Development of national information system for medical image archiving and exchange, and the related e-services” have been developed; they include the descriptions and funding models of the information system for electronic health services and collaboration infrastructure (hereinafter referred to as the ESPBI IS) and its subsystem, the specification of health care information systems and ESPBI IS interface (data exchange and integration components), electronic documents and forms, etc. On the basis of these outcomes, ESPBI introduction was started in the fourth quarter of 2013. The introduction of the IS ESPBI from 2015 will enable more efficient, higher quality, safer health services and a more secure data exchange between medical facilities.

50. The court decision of 16 May 2013 (case No. 47/2009-131/2010) of the Lithuanian Constitutional Court has obliged the Government to submit draft laws governing emergency medical assistance and its funding by 1 July 2014 (amendments should be made to the Republic of Lithuania Law on Health Insurance and the Republic of Lithuania Law on Health Care).

51. The priority measures for the implementation of the Programme of the Government for 2012-2016, approved by Resolution No 228 of the Government of the Republic of Lithuania of 13 March 2013 on the approval of priority measures for the implementation of the Programme of the Government of the Republic of Lithuania for 2012-2016 provide for efforts towards achieving the 4.2 per cent of the GDP for the Compulsory Health Insurance Fund budget for 2016.

SECTION III EDUCATION AND SCIENCE REFORM

52. In 2012-2013, Lithuania approved two key strategic documents; their implementation will receive major national allocations, including EU’s structural support. They are: the National Education Strategy for 2013-2022 and the National Programme for the Development of Studies, Research and Experimental (social, cultural) Development for 2013-2020. For the purpose of the implementation of these documents, numerous detailed action plans have been worked out (4 of them approved by 2013, others – in 2014).

53. The quality of education. It should be noted that the 50 per cent target in reading achievements set in Lithuania’s Progress Strategy 2020 has already been achieved, and 55 per cent target in natural science literacy is achievable by 2030. This has resulted from the actions aimed to improve Lituanistic education and strengthen ethnic identity. The curriculum has been overhauled, and the data base of carefully selected learning resources of the Lithuanian language, literature,

Lithuania's history was compiled: www.saltiniai.info, teachers (820 in total) have been provided access to on-line consultations in a virtual learning environment *Modular Object Oriented Dynamic Learning Environment* (MOODLE). In schools, where education is effected in a minority language, the primary classes have been equipped with Lithuanian language learning tools.

The general measures promoting quality education have continued throughout 2013. 36.6 per cent of schools in Lithuania (35 per cent planned) have undergone an external evaluation, 83.5 per cent of schools used online self-assessment platform (planned 15 per cent) in the first year of launching it. A number of applicants to school principal position, having done competence self-assessment, has reached 20 per cent (7 per cent in 2012) compared to the current number of the existing principles. The Education Management Information System has been updated; it provides data at 3 levels – national, municipal and school.

54. Bringing education closer to home. In 2013, the Rules for Building a Network of Schools Providing Formal Education have been updated, just like a calculation and disbursement method for Pupil's Basket. 28 municipalities are organising 62 new pre-school groups (with more than 950 children), and 55 pre-primary school groups (with more than 1 070 children). The Statistics Lithuania has shown the recent rise in the number of pre-school, pre-primary and primary education pupils, while that of secondary and higher education has been falling (possibly due to migration), but for 3 consecutive years Lithuania has been leading the EU in terms of the level of education of the working-age population.

55. Quality improvement in vocational training. 79 vocational training institutions have introduced an internal quality management system; vocational trainers have had a possibility of developing their technological competencies in enterprises. 100 technological competence programmes with training materials have been drafted, 386 vocational trainers completed internship in enterprises under these programmes, and another 200 trainers have started the programme. A new form of vocational training – apprenticeship – has been put to practice.

56. Higher education policy transformation. For the purpose of improving access to studies, in 2013, 15064 students received social grants for the semester (instead of planned 13 000), thus making 100 per cent compensation of the tuition fee. The hard efforts over the years have resulted in Lithuania reaching, for the first time, the second place in the EU by the number of people with tertiary education. A comprehensive revision of the number, the structure and quality of study programmes has been carried out with a view to financial efficiency: last year alone, 209 study programmes (17 college, 31 bachelor, 160 master and one integrated programmes of study) have been withdrawn. It has also resulted in 3.03 doctoral graduates (projected – 1.05) per 25-34 thousand population, which shows the growing scientific potential of the country.

To achieve a better match between education and labour market demand, a specialist qualifications map has been compiled: in 2013, indicators were set, the Education Management Information System (EMIS) software programme was developed for their calculation, an anonymised data supply agreements were concluded with the State Social Insurance Fund Board of the Ministry of Social Security and Labour, and employee data was started to be transferred through SoDra information system.

57. Science and Technology. The Government approved six priority guidelines in research and development (R&D) and innovation development (smart specialization): energy and environmental sustainability, inclusive and creative society, agro-innovations and food technology, new technological processes, materials and technology, health technology and biotechnology, transport, logistics, information and communication technologies. This will enable us achieve a closer interaction between science and business.

58. Lifelong Learning. In 2013, the rate of lifelong learning in 25-64 aged population showed a little rise against 2012: in 2013 the rate was 5.7 per cent, and in 2012 – 5.2 per cent.

The further developments in the lifelong learning will be affected largely by the National Education Strategy for 2013-2022, designed to implement paragraph 183 of the Programme of the Sixteenth Government of the Republic of Lithuania for 2012-2016, obliging for efforts in achieving openness at all levels of education and training, as well as their responsiveness to the needs of the labour market and society. The stated Strategy was adopted by the Seimas only in the end of 2013; therefore, related action plans will be worked out in 2014. An action plan for the development of non-formal adult education for 2014-2016 was the first to be drafted.

SECTION IV

IMPACT OF AGING POPULATION ON GENERAL GOVERNMENT FINANCES

59. Long-term sustainability of general government finances is determined by changes in the demographic structure of the population. The Programme includes an integrated budgetary projection of sustainability of general government finances (hereinafter referred to as the Projection) that makes it possible to assess the impact of demographic developments on the long-term sustainability of the pension system, health system, and education system, and to provide for appropriate actions securing stability of these systems in the future.

The Projection is based on the demographic projection for Lithuania until 2060, done by Eurostat in 2010. According to this Projection, Lithuania's population is to shrink to 2.7 million (from 2.9 million in 2013) or by 6.9% in the period from 2010 to 2060. Moreover, the same period will see a marked decline in the number of children: the number of those aged between 0 and 14 will drop from 14.7 per cent in 2013 to 13.8 per cent in 2060, those of school age (aged 7–16 years) will drop from 10.6 to 9.8 per cent, and the number of those aged between 15 and 19 – from 6.3 to 4.4 per cent of the total population. The number of the working age population (15–64) will decrease from 68.5 per cent to 55 per cent, whereas the number of elderly people (65+) will almost double – from 16.4 per cent to 31.2 per cent of the total population.

60. Table 14 below gives projections on long-term expenditure of public finances (pensions, health care and education systems) for the period until 2060. The projections have been made under the assumption of non-changing policy post-2017 and on the basis of medium-term economic and employment projections by the Ministry of Finance, done in spring 2014, as well as economic and employment assumptions for 2018-2060 agreed by the Economic Policy Committee in autumn 2011. The projections have been built on the basis of the existing Lithuanian national social security legislation.

Table 14. Long-term sustainability of general government finances

Indicator	% of GDP						
	2007	2010	2020	2030	2040	2050	2060
1. Total expenditure	34.6	42.2	30.9	31.7	32.1	33.2	34.7
of which: age-related expenditure	17.3	21.1	18.0	18.8	19.3	20.3	21.8
pension expenditure*	6.6	8.6	6.4	7.1	8.0	8.7	9.6
social security pensions	6.6	8.6	6.4	7.1	8.0	8.7	9.6
old-age and early pensions	4.8	6.2	4.5	5.3	6.1	6.8	7.8
other pensions (disability, survivors')	1.8	2.4	1.8	1.9	1.8	1.9	1.8
occupational pensions (in general government)	–	–	–	–	–	–	–
health care	4.8	4.8	5.2	5.4	5.4	5.3	5.3
long-term health care	0.6	1.1	1.1	1.2	1.4	1.7	2.0
education expenditure**	5.2	6.2	4.8	4.8	4.3	4.3	4.8
other age-related expenditure***	0.1	0.4	0.5	0.2	0.2	0.2	0.2
interest expenditure	0.7	1.8	1.3	1.6	2.1	2.7	3.9
2. Total revenue	33.6	35.0	31.2	31.2	31.2	31.2	31.2
of which: property income	0.6	0.6	0.3	0.3	0.3	0.3	0.3
of which: pensions contributions (or relevant social insurance contributions)****	6.5	6.9	6.4	6.3	6.3	6.3	6.3
Pension reserve fund assets	2.9	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
of which: consolidated public pension fund assets*****	1.7	4.1	11.1	23.4	37.2	52.0	65.2
Systemic pension reforms							
Social insurance contributions diverted to the mandatory private scheme	0.9	0.3	0.7	0.8	0.8	0.8	0.8
Pension expenditure paid by the mandatory private scheme	0	0	0	0.2	0.4	0.8	1.5
Assumptions							
Labour productivity growth	5.7	5.8	1.5	2.2	2.2	1.9	1.5
Actual GDP growth	9.8	1.6	1.5	1.7	1.7	0.7	0.8
Participation rate males (20–64)	79.9	80.6	81.9	81.4	81.1	80.6	81.4
Participation rate females (20–64)	72.2	76	76.6	78.2	77.8	77.2	78.3
Total participation rate (20–64)	75.9	78.2	79.2	79.8	79.5	78.9	79.9
Unemployment rate	4.2	17.8	16.7	8.6	7.6	7.4	7.3
Population aged 65+ of the total population (beginning of the year)	17.3	16.6	17.7	22.3	25.6	27.8	31.2

Sources: Statistics Lithuania, Ministry of Finance, Ministry of Social Security and Labour, Ministry of Education and Science, Ministry of Health, and Economic Policy Committee

* Pension expenditure has been calculated following the methodology of the European Commission presented in the document "Pension projection exercise: Revised framework and guidelines" (Brussels, 17 June 2011).

** Excluding spending on payments to households and private entities and direct capital spending on education establishments.

*** Unemployment benefits.

**** Contributions for social security pensions, from 2004 and onwards – excluding transfers to private pension funds.

***** Financial assets of the Pension Scheme (Pillar II) accumulated in individual accounts of pension accumulation participants and the annuity funding reserve.

61. Table 14 demonstrates the revenue from social insurance contributions (excluding private pension funds run by pension accumulation companies) and the expenditure pertinent to actual social security pension schemes, i.e. the social insurance pension scheme and the state pension scheme (including social benefits). State pensions (including social benefits) are funded directly from the state budget. As compared to the pension spending projection provided in Lithuania's Convergence Programme 2013, approved by Resolution No 343 of the Government of the Republic of Lithuania of 23 April 2013, table 14 shows that it has not changed for 2060.

62. Growing elderly population and declining number of schoolchildren, as well as shrinking working-age population will result in increased government spending (GDP share) on pensions and long-term health care, and decreased spending on education: from 2010 to 2060, pension spending will grow by 1% of the GDP, long-term health care spending by 1.3% of the GDP, while education spending will come down by 1.3% of the GDP. In general, age-related spending is projected to grow by 0.7% of the GDP.

63. Pension spending is likely to grow the fastest, though it will be mitigated by the pension reform launched in 2004, which created the sub-scheme of voluntary pension accumulation (Pillar II of the state social insurance pension scheme) which is financed with a part of mandatory state social insurance contributions that is shifted to private pension funds. Growing spending for pensions will be tamed by an increased rate of contributions to Pillar II pension funds, making 3.5% as of 2020. Tax revenues intended for the implementation of the pension reform in 2013-2016, and transferred to private pension funds, will amount on average to 0.4 per cent of GDP. To ensure that there are sufficient funds for all the commitments of the State Social Insurance Fund, in 2012, the pension accumulation tariff was reduced to 1.5 per cent, and in order to compensate for this reduction, it was increased by 2.5 per cent in 2013. It is assumed in the pension spending projection that in 2014-2015 the accumulation scheme participants, which have opted for extra contributions in 2013, or have concluded new pension accrual agreements, will pay 1 per cent extra contribution of their salary, and pension account will also be contributed with 1 per cent of the average salary of the penultimate year from the state budget. Since 2016, both individual and the state budget pension contribution rates will increase to 2 per cent. In the long term, the contributions credited to private pension funds (including contributions transferred from the state social security funds, extra contributions by individuals and the state budget) will annually make about 1.37 per cent of GDP and will be 0.17 per cent GDP above the projected value specified in the convergence programme of Lithuania in 2013 due to the following reasons:

63.1. the projection provided in the Programme was made following the model, which is based on an improved methodology for income and pension forecasting;

63.2. transfers to pension funds were projected in accordance with the actual choices of pension participants in 2013 regarding the pension accumulation type;

63.3. projected transfers to pension funds for one of the parents raising a child under 3 years of age and receiving maternity (paternity) social insurance benefit or covered by state social pension insurance from public funds;

63.4. an average of 0.18 percentage points lower GDP growth assumptions in 2014-2017, and an average of 1.03 percentage points higher average salary growth assumptions in 2014-2017 .

64. Pension fund assets in 2060 will reach 65.2 per cent of GDP. Benefits paid from private pension funds will amount to 1.5 per cent of GDP in 2060 and will remain the same as provided in the Convergence Programme of the Republic of Lithuania for 2013.

65. Due to the current demographic developments, shrinking population and falling number of schoolchildren, the years between 2010 and 2060 will see a decrease in children aged between 0 and 14 by 130 596, or 26.3 per cent, and in teenagers aged 15 to 19 – by 98 982, or 42.3 per cent; thus the education spending is projected to come down by 1.3 percentage points of GDP – from 6.2 per cent of the GDP in 2010 to 4.8 per cent of the GDP in 2060.

66. In 2010-2060, the total general government spending will decrease by 7.5 percentage points of the GDP, from 42.2% of the GDP in 2010 to 34.7% of the GDP in 2060, including non-age-related spending, which was fixed and held constant from 2017, will come down by 8.2 percentage points of the GDP. Public revenues will decrease by 3.9 percentage points of the GDP: from 35% of the GDP in 2010 to 31.2% of the GDP in 2060

CHAPTER VII INSTITUTIONAL FEATURES FOR THE IMPROVEMENT OF GOVERNMENT FINANCES

67. It has been planned to:

67.1. reform the system of state budget planning and execution with a view to managing political cycles of the economy.

67.2. adopt the Republic of Lithuania constitutional law on the implementation of Fiscal Compact, providing for general government surplus rule, and assigning the task of independent budget supervision to the National Audit Office of Lithuania. The constitutional law would be aimed to reduce structural gap between spending and revenues with regard to the economic cycle.

67.3. make use of the outcomes of the reforming public sector accounting – the data of the financial statements drawn following the principal of accrual, should be used for analysis of the developments in state assets, liabilities, funding received and its use, public revenues and costs, in order to more effectively manage public finances and property, and for the compilation of statistical information.

67.4. develop general government statistics, and provide the taxpayers with a possibility of judging the efficiency of the management of public finances.

CHAPTER VIII
ASSESSMENT OF CONSISTENCY OF LITHUANIA'S CONVERGENCE PROGRAMME
2013 WITH THE NATIONAL REFORMS PROGRAMME

68. The direct impact of the measures of the draft National Reforms Programme on the budget balance has been fully taken into account in calculating general government financial indicators covered in the Programme. The impact of the structural reforms on the budget is illustrated by Table 15, which shows the data related to the 2013 reform allocations and year-on-year developments as of 2014.

Table 15. Direct impact of major structural reforms on general government finances
(increased spending or decreased revenues (+); decreased spending or increased revenues (-))

No	Major measures of structural reforms ¹	Spending/revenue category (according to ESA'95)	2013		2014		2015		2016		2017	
			LTL million	GDP %	LTL million	GDP %	(LTL million	GDP %	LTL million	GDP %	LTL million*	GDP %
1.	Education reform ²	IC and GFCF	2 152.1	1.80	220.4	0.18	-212.5	-0.16	-1 958.0	-1.36	252.0	0.16
2.	Measures encouraging entrepreneurship, implementation of the Republic of Lithuania Law on Energy from Renewable Sources; national climate change management, youth employment policies, programmes of integrated studies, science and business centres in the area of agriculture,	IC and GFCF	328.2	0.27	-31.5	-0.03	-4.3	0.00	13.1	0.01	3.2	0.00
3.	Increasing renewable energy consumption, increasing end-use energy efficiency; implementation of EU Council recommendations to promote competition by improving the energy networks of electricity and gas interconnections with the EU Member States	IC and GFCF	0.0	0.00	0.0	0.00	50.0	0.04	350.0	0.24	100.0	0.06
4.	Health reform ³	IC and GFCF	137.5	0.12	24.9	0.02	-134.8	-0.10	-27.5	-0.02	0.0	0.00
5.	Taxation reform ⁴	RDT	27.0	0.02	215.0	0.17	-70.0	-0.05	0.0	0.00	0.0	0.00
		RIT	8.0	0.01	-55.0	-0.04	-34.0	-0.03	-36.0	-0.02	-36.0	-0.02
6.	Environment (modernisation of apartment houses); water supply, renovation of waste water management systems, their development,	IC	382.5	0.32	54.6	0.04	629.6	0.47	-553.7	-0.38	125.0	0.08

No	Major measures of structural reforms ¹	Spending/revenue category (according to ESA'95)	2013		2014		2015		2016		2017	
			LTL million	GDP %	LTL million	GDP %	(LTL million	GDP %	LTL million	GDP %	LTL million*	GDP %
	building of waste management system											
7.	Lithuanian innovation development long-term programme, the Energy Independence Strategy (draft), Economic Growth Action Plan, Cohesion Promotion Programme	IC and GFCF	517.5	0.43	-52.9	-0.04	-56.3	-0.04	-396.9	-0.27	-11.3	-0.01
8.	Upgrading or building new transport and communications network ⁵	GFCF	1 442.8	1.21	234.8	0.19	147.6	0.11	-637.1	-0.44	62.45	0.04
9.	Active labour market policy measures	IC	171.1	0.14	4.8	0.00	38.2	0.03	0.0	0.00	0.0	0.00
Overall direct impact on the state budget				4.32	615.1	0.49	353.4	0.26	-3 246.0	-2.25	495.3	0.32
10.	Total spending on pension accrual reform		513.5	0.43	54.5	0.04	58.0	0.04	169.7	0.12	81.4	0.05

Sources: Ministry of Finance, Ministry of Education and Science, Ministry of Health, Ministry of Economy, Ministry of the Environment, Ministry of Transport and Communications, Ministry of Agriculture, Ministry of Energy, Ministry of Social Security and Labour

IC – intermediate consumption, GFCF – gross fixed capital formation, RDT revenue from direct taxes, RIT – revenue from indirect taxes.

* Difference in allocations against previous year. National or EU funding, or national and EU funding (in case of co-financing).

¹ Measures under the National Reforms Programme.

² Lithuania's Innovation Strategy for 2010-2020; Pre-school the Pre-primary Education Development Programme for 2011-2013, Action Plan for the National Education Strategy (2013-2022); National Programme for Vocational Guidance in Education (2007-2015); National Programme for Higher Education (2007-2013), Strategy for Ensuring Life-long Learning (2008-2016), Information society development programme for 2011-2019, Programme for the Promotion of the International Dimension in Higher Education (2011-2016), Programme for the Development of the Resources of Practical Vocational Training (2007-2015); Joint National Framework Programme (2007-2015); Joint National Research and Education and Business Cooperation Programme (2007-2015); Action plan for improvement of funding for non-formal child education 2014-2016; Children and youth socialization programme (2010-2014); National Programme for higher education, research and experimental (social, cultural) development 2013-2020.

³ Programme for Reducing Morbidity and Mortality from major non-communicable Diseases, Programme for Streamlining Medical Infrastructure and Health Reform Continuity.

⁴ Amendments to Republic of Lithuania laws relating to the taxation changes, according to the latest information provided by the Programme.

⁵ Structural facilitation for economic growth: business environment improvement and infrastructure development; Lithuania's Long-term (until 2025) Transport Strategy, Lithuania's Programme for the Development of the Information Society in 2011-2019.