APPROVED BY
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of the Government of the Republic of Lithuania

STABILITY PROGRAMME OF LITHUANIA FOR 2017

CHAPTER I
OVERVIEW

1. In 2016, Lithuania's general government balance indicator was the best over its monitoring period since the restoration of independence of the Republic of Lithuania in 1990, namely, general government surplus of 0.3 per cent of the gross domestic product (hereinafter referred to as GDP). For the third successive year, no deviations from the medium term objective[1] have occurred in 2016, where the structural general government deficit stood at 0.1 per cent of GDP and corresponded with the provisions of the Stability and Growth Pact on structural balance indicator. Tax revenue to GDP ratio (or reallocated share of GDP) has increased by 1 percentage point and amounted to 30.1 per cent of GDP (29.1 per cent of GDP in 2015[2]). The increase has resulted from the fast growth of GDP components (wage income, consumption expenditure) that are key for tax collection, as well as from measures applied for better tax administration.

2. At the end of 2016, the general government debt comprised 40.2 percent of GDP, and decreased by 2.5 percentage points compared with the one at the end of 2015, when it amounted to 42.7 percent of GDP. The indicator had a positive impact from EUR 1 billion funds accumulated at the end of 2015 and designated for the Eurobond redemption at the beginning of 2016. Under the favourable situation that had developed in the financial market, an advance repayment of the share of USD 200 million of the Eurobond emission of USD 2 billion maturing in 2020, and the share of USD 50 million of the Eurobond emission of USD 750 million maturing in 2017 was made in 2016. Redemption of commitments has been partly financed having issued a 19-year maturity EUR 450 million Eurobond emission at a lower annual interest rate, 2.125 per cent.

3. GDP will grow faster in 2017 than in 2016, and will amount to 2.7 per cent (GDP grew 2.3 per cent in 2016). In 2018-2020, GDP will grow approximately 2.5 per cent a year on average. In 2016, GDP growth was driven, to a major extent, by household consumption as well as exports of goods and services. As of 2017, Lithuania will see a more balanced economic growth: GDP growth will be driven by domestic demand (consumption and investment) and external demand (exports). The potential GDP will be slightly lower than the real GDP over the medium term. Worsening demographic trends have a negative impact on the labour factor potential; therefore, the growth of economic potential is slowing down, while the output gap is widening. The negative impact that demographic trends exert on the economic potential is partly compensated by the level of labour force participation, which has been growing rapidly over the recent years.

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[1] Medium term objective – general government structural balance deficit below 1 per cent of GDP.
[2] Revenue from taxes excluding the European Union institution taxes. Including the European Union institution taxes, indicators are higher by approximately 0.3 per cent of GDP.

4. The following major objectives of the public finances policy for 2017-2020 have been planned:

4.1. To pursue fiscal policy taking into account the state of the economic cycle: in 2018-2020, with economic growth exceeding the potential, and part of the general government revenue being of a temporary nature, to improve sustainability of the general government debt: to seek the general government surplus of at least 0.3 per cent of GDP, and to implement a fiscal policy of growing surpluses, which reduces the aggregate demand pressure on prices and creates a wider fiscal space to stimulate economy in times of austerity in accordance with the fiscal policy rules. It is estimated that due to implementation of the social model[3] reform, the general government balance indicator will be at a deficit, and amount to 0.4 per cent of GDP in 2017.

4.2. To increase the share of GDP to be redistributed to 32 per cent of the GDP level.

4.3. To implement structural reforms aimed to increase the economic growth potential and stability of public finances. First of all, to continue the social model reform, to draft and implement the education reform, to reduce social exclusion by increasing non-taxable income, to create incentives to families with children, to focus on results-oriented budget, to develop capital market and alternative sources of funding, to improve conditions to develop financial technologies (hereinafter, FinTech), and to increase defence funding in compliance with the NATO commitments[4].

4.4. To more rapidly accumulate general government fiscal reserves in consideration of the external risk and internal challenges with regard to the ageing society and unfavourable phenomena of migration.

4.5. To reduce the general government debt level to below 40 per cent of GDP.

4.6. To form and approve public budgets on the basis of cautious assumptions under high external uncertainty, and to ensure compliance of the financial indicators of the general government to fiscal discipline rules stipulated in the national and the European Union (hereinafter, the EU) legal acts.

5. In order to achieve objectives of the public fiscal policy, the following financial sources have been planned:

5.1. More revenue will be collected through improvement of the tax authority performance efficiency, application of the state-of-the-art technologies, reconsideration of tax exemptions, and taxation provisions that would not be harmful to the economic growth.

5.2. Improvement of performance of the state-owned enterprises will increase the return on capital thereof.

5.3. While focusing on results-oriented budget, and implementing public expenditure review, quality indicators of public expenditure will be taken into account, public asset management will be evaluated, new priorities of the Government of the Republic of Lithuania (hereinafter, the Government) will be financed through redistribution of priorities for public expenditure and

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[3] A legal-administrative model of labour relations and the State social insurance of Lithuania. For more information, please see Section "Information on Compliance of the Structural Reform (Social Model) to the Exemption Provided by the Stability and Growth Pact" of this Programme.

[4] Additional information on the social security, education system, and other reforms is presented in the National Reforms Agenda.

increase of expenditure in insufficiently efficient areas of performance will be restricted through more efficient management of the State assets. The Stability Programme of Lithuania for 2017 (hereinafter, the Programme) largely focuses on efficiency indicators of public expenditure and asset management:

5.3.1. The share of GDP that constitutes Lithuania's general government sector expenditure is still among the smallest in the EU; yet, in terms of structure of expenditure, according to the Eurostat data and the international comparison, expenditure efficiency indicators differ:

5.3.1.1. Education. In Lithuania, the ratio between the total expenditure on education and the GDP exceeds that of the EU average (although expenditure per pupil, as against the GDP per capita, is among the lowest). In Lithuania, the share of people with secondary and/or higher education is among the largest in the EU; however, quality indicators have not reached a reasonable level in the field of education compared to other EU member states; there is a lack of quality at the secondary education level, and fund management should be more efficient in the field of higher education. Quality indicators in education system could be improved, and salaries of employees in education system could be increased through a structural reform of education system, i.e. by more efficient use of the internal resources of the system, reorganisation of the network of higher education establishments and financing thereof, and quality assurance systems. To tackle higher education problems, the Action Plan for the Government Programme, approved by Resolution No 167 of 13 March 2017 of the Government of the Republic of Lithuania plans that a sustainable network of vocational training, science and study institutions will be created by the middle of 2019.

5.3.1.2. Health care. Expenditure on health care (share of GDP) in Lithuania is lower than the EU average; however, it is close to the EU average while taking into account private spending and country development level. Quality indicators have been improving compared to other EU member states; however, some of them do not reach the average level of indicators of the EU member states. To improve quality of health care system, and to enhance efficiency of the use of funds, development of health care system and the network of hospitals are being consolidated, it is planned that the number of active treatment hospital beds will be reduced, while the number of nursing care beds will be increased, much attention is given to disease prevention, child and youth health promotion, and corruption prevention.

5.3.1.3. Social security. The general government expenditure (share of GDP) on social security in Lithuania remains lower than the EU average, while qualitative and quantitative indicators are poorer than in the majority of other EU member states. However, the social security system has changed as of 2017: in compliance with the social model reform, pensions shall be indexed by correlating them to the multiannual increase in wage and salaries bill, the scope and adequacy of the unemployment insurance shall be widened, the long-term employment allowances fund will be in operation, and the scope of the insured will be broadened. In addition, in 2017, non-taxable income will be increased for the lowest-income earners, persons bringing up children, and employees with disabilities, and child benefits will be increased. Social welfare system has become more efficient after the social benefit allocation model has been changed (the benefit allocation function has been transferred to municipalities); it is planned that the financial social assistance system will be improved over the medium term as well, while moving over from passive to active forms of assistance aimed at stimulating employment.

5.3.1.4. Culture. In Lithuania, the general government expenditure (share of GDP) on culture is almost twice as high as the EU average. In Lithuania less citizens use cultural services, especially those provided by libraries, than in the EU. In order to use the general government expenditure efficiently, and to enhance the quality of services, it is important to reconsider funding for the maintenance of cultural objects in consideration of the numbers of visitors.

5.3.1.5. Agriculture, forestry, fisheries, and hunting. In Lithuania, the general government expenditure (share of GDP) on agriculture, forestry, fisheries, and hunting is several times higher (share of GDP) than the average of the EU member states; however, efficiency of this field lags behind that of the other comparative countries. Lower values of the qualitative and quantitative indicators, as compared to other comparative countries, show that it is necessary to reconsider the general government expenditure on this field.

5.3.1.6. The general government expenditure on justice, transport, and environmental protection is lower than the average of the EU member states; however, quality results of these sectors are considered to be good.

5.3.2. Results of the analysis of the assets and expenditure of the appropriation managers (ministries mostly), which was carried out based on the new data on Lithuania's public financial accountability reports, and followed a method of inter-institutional comparison, showed that intensity of the use of assets in certain categories was uneven, and that levels of expenditure diverged. To reduce these disparities, review of expenditure will consider the assets and expenditure indicators of the following categories (not limited to these indicators):

transport vehicles;

software;

simple repairs and maintenance costs.

6. The medium-term objective is set in accordance with the 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, p. 84), as last amended by Regulation (EC) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 (OJ 2011 L 306, p. 12) (hereinafter, Regulation (EC) No 1466/97), as well as the Constitutional Law of the Republic of Lithuania on the Implementation of the Fiscal Compact (hereinafter, the Constitutional Law). The last time the medium-term objective of Lithuania was set by Resolution No XII-2147 of 8 December 2015 'On a Medium-Term Objective' of the Seimas of the Republic of Lithuania (hereinafter, the Seimas), which provided for up to 1 per cent structural government deficit as of GDP at current prices.

7. In compliance with Article 4.1 of Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (OJ 2013 L 140, p.11), Member States in the euro area shall make public their national medium-term fiscal plans in accordance with their medium-term budgetary framework. The Programme provides all this information. The Programme is in full compliance with the provisions on information to be provided in stability programmes, as laid down in Article 3 of Council

Regulation (EC) No 1466/97[5], as well as requirements on the format and content of the Stability Programme. The Programme is presented to the Seimas Committee on European Affairs.

On 13 May 2016, the European Commission (hereinafter, the Commission) issued a recommendation on Lithuania's National Reform Programme for 2016, alongside the Council Opinion on the Stability Programme of Lithuania for 2016. The recommendation was discussed at the Seimas Committee on European Affairs and the Seimas Committee on Social Affairs and Labour.

On the basis of the recommendation, Action Plan for Implementation of Council Recommendations on Lithuania of 2016-2017 was drafted and submitted to the Government and the Seimas Committees in September 2016. The Plan was submitted to the Commission as an integral part of the draft budgetary plan of Lithuania for 2017.

8. Following the entry into force of the Constitutional Law as of 1 January 2015, a conclusion on the economic development scenario shall be made by an independent monitoring budget policy institution. Under the rules of the reformed EU economic governance, the National Audit Office of the Republic of Lithuania (hereinafter, the National Audit Office) has been entrusted as of 1 January 2015 with the function of monitoring budget policy. On 29 March 2017, the National Audit Office submitted Conclusion No BP-1 "On the Approval of the Economic Development Scenario", stating that "the scenario drafted by the Ministry of Finance of the Republic of Lithuania is based on the selected and identified assumptions, supported by the existing statistics, and in line with economic regularities. The fiscal institution approves the economic development scenario for 2017-2020, published on the website of the Ministry of Finance of the Republic of Lithuania on 20 March 2017".

9. In the Programme, Lithuania provides comprehensive information on the social model, and asks for the Commission to evaluate the compliance of the structural reform (social model) to the provisions of the Stability and Growth Pact, which provide for the possibility for the Member States implementing major structural reforms aimed to improve long-term financial stability and enhance potential economic growth to make use of the flexibility of the Stability and Growth Pact.

[5] Information about the medium-term objective, budgetary or other economic policy measures that are applied and/or proposed to be applied in order to implement the Programme objectives, is presented in Chapter "Fiscal System" of the Programme; major economic indicators that are planned to achieve economic development and the Programme objectives are presented in Chapter "Economic Outlook"; assessment of the impact of possible changes in major economic assumptions on the budget and the debt situation is presented in Chapter "Sensitivity Analysis of Budget Indicators and Comparison with Previous Plans"; information on planned commitments related to the ageing society, and contingent liabilities, such as Government guarantees, which can make large impact on the national budget, is provided in Chapter "Sustainability of General Government Finance"; and information on consistency of Lithuania's Stability Programme with the general economic policy guidelines and the National Reform Programme is presented in Chapter "Assessment of Consistency of the Programme with the National Reform Programme".

CHAPTER II
ECONOMIC OUTLOOK

SECTION ONE
ASSUMPTIONS FOR ECONOMIC DEVELOPMENT SCENARIO

10. The key assumptions for the external economic environment (trading partner development, oil prices, the euro-dollar exchange rate) correspond to the Commission's 2017 Winter Forecast.

Table 1. Key assumptions

Indicator	2016	2017	2018	2019	2020
Short-term interest rates (annual average)	0.1	–0.1	0.0	0.4	0.7
Long-term interest rates (annual average)	0.9	1.4	1.6	1.9	2.1
USD/EUR exchange rate (annual average)	1.11	1.07	1.07	1.07	1.07
Nominal effective exchange rate	2.3	1.2	0	0	0
Exchange rate vis-à-vis the euro (annual average) (for countries not in euro area or ERM II)*	–	–	–	–	–
World GDP growth (excl. EU), %	3.2	3.7	3.9	3.9	3.9
EU GDP growth, %	1.9	1.8	1.8	1.8	1.8
Growth of relevant foreign markets, %	1.4	1.7	1.8	1.8	1.8
World import growth (excl. EU), %	0.8	3.0	3.7	3.7	3.7
Oil prices (Brent, USD/barrel)	44.8	56.4	56.9	56.9	56.9

Sources: Ministry of Finance of the Republic of Lithuania, European Commission (2017 Winter Forecast)
*Exchange Rate Mechanism II.

Lithuania's prospects for key export markets represent the key assumption of the economic development scenario.

SECTION TWO
MEDIUM-TERM ECONOMIC DEVELOPMENT SCENARIO

11. The economic development scenario for 2017-2020, as drawn up by the Ministry of Finance (hereinafter, the economic development scenario), plans that over the medium term, economy will continue to be driven by strong household consumption as well as exports of goods and services, while the investment process, which revived after a year's break (in 2016, gross fixed capital formation slightly suppressed the GDP growth, by 0.1 percentage point), will again contribute to the economic growth. It is foreseen that Lithuania's economy will grow by 2.5 per cent a year on average over the medium term, and, with the increased labour productivity in 2017 and 2018, GDP may grow even faster: by 2.7 and 2.6 per cent, respectively.

In 2016, rapid growth of household consumption expenditure (there was the fastest growth over the recent 9 years) and increased exports of goods and services determined the 2.3 per cent growth of Lithuania's GDP.

Over the medium term, with the further rapid growth of wages and decrease in unemployment, it is expected that household consumption will be active (approximately 3.6 per cent per year on average); however, consumption expenditure will grow slower than in 2016 due to the faster-rising prices.

It is estimated that as of 2017, the growth of investments will be stimulated by more active implementation of the EU-funded projects. Continuity of the investment process will be further sustained by favourable credit terms offered by banks. Over the medium-term, gross fixed capital formation expenditure could grow approximately 5 per cent per year.

Over the medium-term, Lithuania's exporters will have to continue to adapt to the changing economic circumstances, further invest seeking to boost competitiveness and manage currency risk, and take decisions cutting production costs and boosting performance efficiency and production capacity. Highly diversified exports of goods continue to give grounds for optimism about export prospects. Export of services, which has seen stable growth since 2010, and investments in tangible fixed assets into manufacturing, which grew in the second half of 2016, create conditions to further develop exports over the medium term.

It is estimated that real exports of goods and services are expected to grow 3.8 per cent in 2017, 3.9 per cent, in 2018, 4 per cent, in 2019, and 4 per cent, in 2020.

Table 2. Macroeconomic indicators

Indicator	ESA* code	Indicator value in 2016, million EUR	Change %				
			2016	2017	2018	2019	2020
GDP, chain-linked volume	B1g	34 415.1	2.3	2.7	2.6	2.5	2.4
GDP, at current prices	B1g	38 631.0	3.5	5.1	4.4	4.2	4.0
Components of GDP (chained volume statistics)							
Household consumption expenditure + NPI serving households	P.3	23 154.1	5.6	3.9	3.6	3.5	3.5
Government final consumption expenditure	P.3	5 795.0	1.3	1.5	1.2	1.0	1.0
Gross fixed capital formation	P.51	6 529.5	–0.5	5.9	5.4	4.4	4.3
Changes in stocks and acquisitions less disposals of valuables (% of GDP)	P.52+P.53	–	–	–	–	–	–
Exports of goods and services	P.6	27 446.5	2.9	3.8	3.9	4.0	4.0
Imports of goods and services	P.7	28 207.4	2.6	4.6	4.8	4.2	4.1
Contributions to real GDP growth, percentage points							
Final domestic demand		35 477.4	3.7	4.0	3.7	3.4	3.4
Changes in stocks and acquisitions less disposals of valuables	P.52+P.53	–	–	–	–	–	–
External balance of goods and services	B.11	–760.9	0.2	–0.5	–0.7	–0.1	–0.1

Sources: Statistics Lithuania, Ministry of Finance of the Republic of Lithuania
* European System of Accounts.

12. The comparison of the economic development scenario with the Commission's 2017 winter forecast shows the Commission projects 0.2 percentage points faster economic growth in

2017-2018 than the Ministry of Finance of the Republic of Lithuania: in 2017 – 2.9 per cent, and in 2018 – 2.8 per cent GDP growth in Lithuania. The external environment assumptions in the economic development scenario and in the Commission's 2017 winter forecast coincide. In projecting the inflation estimate, the Ministry of Finance of the Republic of Lithuania took into account an increase of the excise duty rates on the ethyl alcohol by nearly a quarter since 1 March 2017 and the doubled excise duty rate on alcoholic beverages, as well as one tenth increase on tobacco products (with the exception of the smoking tobacco), and faster growth in food prices.

Table 3. Comparison of the projections of Lithuania's GDP and inflation:

Indicator	Year	Ministry of Finance, March 2017	Commission winter 2017 forecast	Difference between the projection of the Ministry of Finance of the Republic of Lithuania and the Commission's forecast, in percentage points
GDP change %	2017	2.7	2.9	–0.2
	2018	2.6	2.8	–0.2
Harmonised index of consumer prices, change %	2017	3.4	2.1	1.3
	2018	2.7	1.9	0.8

Sources: Ministry of Finance of the Republic of Lithuania, EC

13. With the rapidly rising wages, businesses have been increasingly shifting the share of the growing labour costs to the price of goods and services. In 2016, service prices went up by 3.2 per cent, and food products – by 1.3 per cent. This, combined with the rising global oil and food commodity prices, have been, since the second half of 2016, increasingly driving the inflation. The average annual core inflation, calculated on the basis of the Consumer Price Index methodologically harmonised with the other EU Member States (hereinafter – the HICP), excluding energy goods and unprocessed food, accelerated in 2016 to 1.9 per cent (from 1.2 per cent in 2015), thus signalling the growing pressure of the internal factors on prices, particularly because of the upsurge in labour costs.

The HICP annual inflation stood at 1.1 per cent in November 2016, rising to 2 per cent in December, and picking up to 2.5 per cent in January. The higher annual inflation was due to the rising transport fuel and food prices. In January 2017, Brent crude/barrel (in euros) changed about 80 percent (YOY), mainly due to the statistical base effect (i.e. due to the lower price at the same period of the previous year). According to the EC winter 2017 forecast, in 2017, the Brent crude/barrel (in euros) should rise by 30.7 per cent. Thus, the annual increase in fuel prices will continue the trend this year until the middle of the year, when it will start slowing down. The oil price should stabilise in 2018.

An increase of the excise duty rates on the ethyl alcohol by nearly a quarter since 1 March 2017 and the doubled excise duty rate on alcoholic beverages, as well as one tenth increase on tobacco products will drive inflation in 2017 by 0.7 percentage points (compared to the inflation projection in the September 2016 economic development scenario).

The one-off factors increase the projection of the average annual inflation to 3.4 per cent in 2017, and to 2.7 per cent in 2018. The average annual inflation in 2019 and 2020 is expected to be close to a multi-annual average core inflation of 2.5 per cent.

Table 4. Price indicators

Indicator	ESA code	Indicator value in 2016	Change %				
			2016	2017	2018	2019	2020
1. GDP deflator		112.3	1.2	2.3	1.8	1.7	1.6
2. Household consumption expenditure deflator		108.6	0.9	3.4	2.7	2.5	2.5
3. HICP (average annual)		100.7	0.7	3.4	2.7	2.5	2.5
4. General government consumption expenditure deflator		118.0	2.9	3.7	3.7	3.7	3.7
5. Gross fixed capital formation deflator		110.2	0.5	2.0	2.0	2.0	2.0
6. Exports of goods and services deflator		104.1	–1.9	4.4	1.7	1.7	1.7
7. Imports of goods and services deflator		99.4	–4.3	5.2	2.0	2.0	2.0

Sources: Statistics Lithuania, Ministry of Finance of the Republic of Lithuania

14. Although labour participation has been lately growing, businesses will increasingly face difficulties in filling up new vacancies spurred by favourable economic conditions that will continue over the medium-term. The labour supply will decrease due to the negative demographic trends and the lack of adequate labour skills. Thus in the medium term, with no changes in the migration trends, the possibilities of increasing the number of employed persons are limited. In 2017, the number of employed persons is expected to increase by 0.8 per cent, in 2018 – 0.3 per cent, in 2019 – 0.2 per cent, in 2020 – 0.1 per cent. The unemployment rate will continue to decline, and in 2017 it will account for 7 per cent, in 2018 – 6.4 per cent, in 2019 – 5.9 per cent, and in 2020 – 5.4 per cent.

The labour market will benefit from positive changes over the medium term due to the enactment of the amendments to the Labour Code of the Republic of Lithuania (hereinafter – the Labour Code) aimed to facilitate the entry into the labour market for new players, such as young students or parents raising small children. The attractiveness of the Lithuanian labour market will increase. This will positively influence both the labour force participation and the employment. Failure to adopt the amendments to the Labour Code would result, over the medium term, in the downward trend in the employment of the persons.

Over the immediate term, similarly to 2016, the negative impact of the emigration on the labour force will be temporarily offset by the high labour force participation geared by the rapid increase in wage growth and the increasing retirement age.

In 2016, the wage growth was prompted by the employees-friendly market situation: the labour demand exceeding the supply, the falling unemployment and the increasing bargaining power of the employees, and a substantially increased minimum monthly wages (hereinafter – the MMW).

The falling unemployment and the growing prices will step up the pressure to increase wages over the medium term. The wage growth will be also geared in 2017 by the Law of the Republic of Lithuania on payment for state and municipal employees working under contracts enacted on 1 February 2017, which provides for the wage increase for the lowest paid staff. In 2017, the average monthly gross wage should increase by 6.7 per cent. In 2018-2020, the change in the average monthly gross wage will depend on the economic factors such as developments in labour supply and demand, labour productivity, inflation, corporate profitability. On the one hand, the decreasing unemployment will accelerate wage growth, on the other – the wage growth possibilities will be restricted by the slower nominal GDP. With the medium annual wage growth rate of close to 6 per cent in 2018-2020, in 2020, the compensation of employees should make 47 per cent of GDP, which has never been witnessed before in Lithuania. The fastest growth in wages will be observed in the private sector, i.e. in those economic activities where the demand of labour force is the largest and wages are the lowest. The projections show that the average monthly gross wages in 2018 will increase by 6.1 per cent, in 2019 – 6.2 per cent, and in 2020 – 6.3 per cent. Wages outpacing labour productivity reflect the increasing bargaining power of employees and the closing gap with the EU labour market average.

Table 5. Labour market indicators

Indicator	ESA code	Indicator value in 2016	Change in %				
			2016	2017	2018	2019	2020
1. Employment, persons, thou		1 361.4*	2.0	0.8	0.3	0.2	0.1
2. Employment, hours worked, thou		2 565 893	3.4	–	–	–	–
3. Unemployment rate (%)**		7.9	7.9	7.0	6.4	5.9	5.4
4. Labour productivity, persons (gross value added at constant prices per person employed), thou EUR		25.5	0.3	1.9	2.3	2.3	2.3
5. Labour productivity, hours worked (gross value added at constant prices per hour worked), EUR		13.5	–1.1	–	–	–	–
6. Compensation of employees, million EUR	D.1	16 670.3	7.0	7.5	6.4	6.4	6.4
7. Compensation per employee, EUR		13 971.1	5.0	6.7	6.1	6.2	6.3

Sources: Statistics Lithuania, Ministry of Finance of the Republic of Lithuania
*Labour force survey.
** Value of the indicator.

SECTION THREE
LITHUANIA'S BALANCE OF PAYMENTS

15. The current account deficit came down from 2.3 per cent of GDP in 2015 to 0.9 per cent of GDP in 2016: the surplus of the service balance went up, while the deficit of the balance of goods and primary income declined. In the future, the current account deficit is foreseen due to growing deficit of the goods balance.

The surplus of the service balance grew due to exports outpacing imports of services. Most groups of services showed improvement in their trade balance (declining deficits, increasing surplus), particularly transport services. This sector offered the most extensive employment for immigrants from non-EU countries, thus its further development is highly dependent on Lithuania's immigration policy. Provided there is no slow-down in the immigration of the sector-relevant labour force, the sector should continue to grow. Other services are also expected to improve their trade balance indicators.

The deficit of the goods balance shrunk because of the exports, which (excluding mineral products) grew faster than the imports (excluding mineral products). Moreover, the export growth was to a large extent due to the goods of Lithuanian origin. Most groups of goods demonstrated improvement in their trade balance, with the exception of transport vehicles required for the development of Lithuanian carriers' industry, and textiles and clothing. At the end of the year, the surplus of the agricultural and food trade balance decreased due to the poor harvest in 2016. In the future, the deficit of the goods balance is expected to grow due to the increased import of machinery and equipment needed for investment, and higher oil prices.

In 2016, there was a decline in the deficit of the balance of primary income because of the lower growth rates of business profitability, which had negative implications on the non-resident income. Besides, Lithuania's general government deficit has been lately declining and the increasing share of the debt has been financed by the residents, so the public debt-related non-resident income has been decreasing in Lithuania.

The decline in the surplus of the balance of the secondary income was due to the slow acceleration in the use of the EU funds in the new financial perspective, as well as the shrinking transfers by non-residents to Lithuania. In the short run, the surplus of the balance should remain more or less the same, as the use of EU funds should gain momentum, and thus have a positive impact on this balance, but it is likely that it will continue to be dampened by the non-resident personal transfers to Lithuania, as their recovery is not likely so far.

The capital account surplus, which is mainly caused by capital transfers from EU funds, was about half less in 2016 compared to 2015 due to the insufficient acceleration in the use of the EU funds in the new financial period. The capital account surplus is expected to markedly grow in the years to come.

The financial account structure is mostly affected by the Eurosystem Quantitative Easing Programme[6]. The Programme is expected to continue at least until December 2017.

Table 6. Sectoral balances

Indicator	ESA code	GDP %				
		2016	2017	2018	2019	2020
1. Net lending/borrowing	B.9N	1.2	1.5	1.1	0.7	0.4
from which:						
balance of goods and services		1.4	0.2	–0.6	–1.0	–1.3
balance of primary and secondary income*		–1.6	–1.0	–0.9	–0.9	–0.9
capital account*		1.4	2.3	2.6	2.6	2.6
2. Surplus (+)/deficit (-) of the private sector		0.9	1.9	0.7	0.4	–0.9
3. Surplus (+)/deficit (-) of the general government	B.9N	0.3	–0.4	0.4	0.3	1.3
4. Statistical discrepancy		0	0	0	0	0

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

[6] See for more infromation on the Eurosystem Quantitative Easing Programme: http://www.ecb.europa.eu/press/pressconf/2017/html/is170309.en.html.

CHAPTER III
FISCAL SYSTEM

SECTION ONE
FINANCIAL POLICY GUIDELINES

16. For the implementation of the 2017-2020 public finances policy, it has been foreseen to:

16.1. implement fiscal policy considering the economic cycle – where economic growth exceeds the potential in 2018-2020, and part of government revenues are temporary, to improve public debt sustainability – to aspire for an annual general government surplus of at least 0.3 per cent of GDP, to implement fiscal policy of increasing surpluses that reduces the pressure of aggregate demand on prices and creates a larger fiscal space to stimulate the economy in the times of crisis, following the rules of fiscal discipline. The implementation of the social model [7] reform is expected to result in the general government deficit of 0.4 per cent of GDP in 2017.

16.2. increase the redistributable share of GDP to 32 per cent of GDP.

16.3. implement structural reforms aimed to increase the economic growth potential and stability of public finances. First of all, to continue the social model reform, to draft and implement the education reform, to reduce social exclusion by increasing non-taxable allowance, to create incentives to families with children, to focus on results-oriented budget, to develop capital market and alternative sources of funding, to improve conditions to develop FinTech, and to increase defence funding in compliance with the NATO commitments [8].

16.4. make a faster accumulation of government fiscal reserves, considering the external risk and internal challenges related to an aging population and the adverse effects of migration. By the end of 2017, the Reserve (Stabilization) Fund is expected to accumulate 0.5 per cent of GDP in financial assets. The implementation of the social model reform is accompanied by the accumulation of financial reserves for future pensions as of 2017. It is expected that in 2020, the Reserve (Stabilization) Fund and the Pension Reserve will have accumulated more than 2.6 per cent of GDP in financial assets. Other options are also considered as regards faster medium term formation of fiscal reserves attributable to the general government.

16.5. reduce the level of the general government debt to below 40 per cent of GDP.

16.6. make and approve public budgets on the basis of cautious assumptions under the conditions of high external uncertainty and to ensure the compliance of general government financial indicators with fiscal discipline requirements laid down in the national and EU legislation.

SECTION TWO
GENERAL GOVERNMENT REVENUE

17. Redistribution through budgets attributable to general government (tax revenue share of GDP) in the medium term would increase to close to 32 per cent of GDP. This indicator in 2016

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[7] Lithuania’s legal-administrative model for labour relations and social security. See for more information in the “Information on the compliance of the structural reform (social model) with the Stability and Growth Pact exception” of the Programme.

[8] Additional information on social security, education and other reforms is available in the National Reform Agenda.

was 30.1 per cent of GDP, in 2015 – 29.1 per cent of GDP (0.3 per cent of GDP more with EU institutions' taxes included).

Tax administration

18. Tax administration improvement in Lithuania is one of the most effective means to increase public financial resources without entailing risk to economic growth (compared to the enlargement of public resources through higher tax rates or new taxes). The newly launched smart tax administration system (hereinafter – i.MAS) and other administrative measures can markedly improve the revenue from the collection of the value added tax (hereinafter – VAT) over the medium term. This is expected to increase the proceeds by 0.4 per cent of GDP in 2017.

Introduced in 2016, the tax administration improvement measures have acquired new features in 2017:

18.1. To achieve better efficiency in the tax administration system through the latest technological solutions, efforts have been taken to formalise the introduction of the i.MAS in the State Tax Inspectorate under the Ministry of Finance of the Republic of Lithuania (hereinafter – the State Tax Inspectorate) by adopting the Law Amending Articles 40 and 75 and Supplementing Articles 42^2 and 42^3 to Law of the Republic of Lithuania on Tax Administration No IX-2112, the Law Amending Articles 78, 79 and 89 and Repealing Article 88^2 to the Law of the Republic of Lithuania on Value Added Tax No IX-751, and Law Repealing Articles 29 and 38 of the Road Transport Code of the Republic of Lithuania No I-1628. Following the enactment of these laws on 1 October 2016, the State Tax Inspectorate has introduced the subsystems of electronic invoicing (i.SAF) and electronic consignment (i.VAZ). The i.MAS is intended to reduce the impact of tax administration risks on the national budget revenues and administrative burden on taxpayers, to increase good faith business, to improve the performance of the tax administrator through smart online services and taking online the collection, processing and submission of tax payers' data, as well as to provide electronic services to taxpayers.

18.2. With a view to introducing in Lithuania, for taxation purposes, an automatic exchange of information about individual financial accounts under the global standard approved by the Organisation for Economic Cooperation and Development (hereinafter – OECD) and the latest EU initiatives for automatic tax information exchange, in 2016, an automatic exchange of information about individual financial accounts for taxation purposes was completed, following the assessment of the administrative capacities of the cooperation partners as regards the legal framework and data protection; and everything made ready to commence the actual exchange with more than 40 countries (the actual exchange of data is scheduled to begin in autumn 2017). Besides, the process of signing bilateral agreements with jurisdictions that are not part of the multilateral legal instruments (Singapore and the Bahamas) has started.

19. A comprehensive description of tax administration measures applicable in 2017 is available in 2017 Lithuania's Draft Budgetary Plan submitted to the European Commission in December 2016[9].

[9] https://ec.europa.eu/info/sites/info/files/2016-12-29_lt_dbp_revised_lt.pdf

Changes in taxation

20. The taxation changes in 2017:

20.1. In order to further increase the progressivity of taxation by reducing the tax burden on low-income earners, as well as shift the tax burden to the taxes more friendly to economic growth, the Law Amending Articles 20 and 38 of Law No IX-1007 of the Republic of Lithuania on Personal Income Tax, Law Amending Articles 30 and 31 of Law No IX-569 of the Republic of Lithuania on Excise Duties, and the Law Amending Articles 1, 2, 3, 4 and 7 of Law No XII-2145 Amending Articles 23, 24, 25, 26, 30 and 31 of Law No IX-569 of the Republic of Lithuania on Excise Duties were adopted.

Following the amendments to the Law on Personal Income Tax, the maximum monthly non-taxable allowance (hereinafter – the NTA) has been increased, as of 1 January 2017, from 200 to 310 euros; and the additional monthly non-taxable allowance (hereinafter – the ANTA) applicable for each child has been increased from 120 to 200 euros.

Individual NTAs have been raised for persons with disabilities: from 210 to 320 euros for those with minor disabilities; and from 270 to 380 euros for those with more serious disabilities.

The decisions on an increase in the basic and additional NTA have resulted in the maximum extra take-home amount of 37 euros per month in 2017, depending on the size of the salary, marital status and number of children raised.

The adoption of the amendments to the Law of the Republic of Lithuania on Excise Duties has resulted in an increase, as of 1 March 2017, of excise rates for all types of alcoholic beverages and ethyl alcohol: about 112 per cent for beer, 92-111 per cent for wine and other fermented beverages and intermediate products, and about 23 per cent for ethyl alcohol.

Furthermore, to ensure the compliance of cigarette excise rates with the EU statutory minimum (90 euros for 1 000 cigarettes), excise duties for cigarettes have been raised as of 1 March 2017, as well as for cigars and cigarillos, with a view to avoiding a substitution effect.

20.2. In order to encourage foreign residents to invest in the economy of the Republic of Lithuania as well as to prevent tax avoidance, a double taxation avoidance agreement was initialled with Japan in December 2016. Lithuania is currently party to 53 double taxation avoidance agreements.

20.3. For the purpose of the implementation of Priority IV "Sustainable development and competitive economy" of the Action Plan Implementing the Programme of the Government of the Republic of Lithuania, approved by Resolution No 167 of the Government of the Republic of Lithuania of 13 March 2017, efforts will be taken to bring down the shadow economy and increase the efficiency in the area of taxation and social security systems. In order to change the taxation system, the tax structure is being improved to facilitate economic growth, and the tax base is being optimised, voluntary tax compliance is encouraged, along with more efficient tax collection.

20.4. To improve the tax structure and optimise the tax base, the plans are:

20.4.1. to reduce the tax burden on low-income earners, i.e. to consolidate and transfer to the employee social security contributions of the employer and the employee, to combine the social security contribution ensuring basic pension with the personal income tax and to make relevant reduction of the rate of the social security contribution. These changes would provide for opportunities to increase the NTA and further reduce the tax burden on low-income earners and other socially vulnerable groups (persons raising children, persons with disabilities). Non-taxable allowance will be gradually increased after 2017 in accordance with other indicators of public finances.

20.4.2. to shift the tax burden to taxes less harmful for economic growth, i.e. by changing excise duty rates and application, to review the environmental taxes, to abandon tax incentives that did not achieve the main aims, have been inefficient and socially unjust, in consideration of the impact on public finances, the economy and revenue collection.

20.4.3. to contribute more to the growth of productive investment through taxation measures by eliminating alternative capital market development obstacles in the field of taxation, with a view to improving access to funding for starting and growing business, at the same time expanding the base for incentives applicable for investment in technological renewal, and encouraging through taxation measures research and development.

20.5. To encourage voluntary payment of taxes and improving tax collection, the plans are:

20.5.1. to focus on taxpayer education (introducing an integrated taxpayer education strategy) and taxation facilitation (in 2017, services will be provided as regards the formation of VAT and advance income tax preliminary declarations and data verification, as well as for tax calculation for small business, i.e. providing for semi-automatic processing of income and expenditure accounts).

20.5.2. to create automated processes for an efficient use of taxation-relevant information received from foreign and national sources (to implement the OECD automatic tax information exchange initiatives and use the information received through the automatic exchange), and electronically generated detailed data of monthly received taxpayers’ VAT invoices and bills of lading, which started to come in October 2016.

20.5.3. to evaluate the proportionality of the sanctions for violations of tax laws in order to ensure the inevitability of liability and deterrence against violations.

SECTION THREE
GENERAL GOVERNMENT EXPENDITURE

21. The share of general government expenditure to GDP is among the smallest in the EU. General government expenditure in 2015 amounted to 35.1 percent of GDP in Lithuania, the EU average being 47.2 per cent of GDP. General government expenditure in 2016 Lithuania has dropped to 34.2 per cent of GDP – mainly due to the temporary reduction in EU investments. The expenditure was planned to meet the Stability and Growth Pact rule limiting expenditure growth, taking into account increase in tax expenditures due to the higher NTA and ANTA. Improving tax administration and tax revenue-to-GDP ratio, ensures better conditions for the financing of public expenditure in compliance with the fiscal discipline. In the medium term, especially in 2017-2018, defence spending will increase, to reach 2 per cent of GDP in 2018. Further capital investment growth will be ensured through national, EU and other international assistance. Lithuania spends much less on social protection in comparison with the relevant average EU indicators. Efforts will be taken to reduce social exclusion. Under the social model provisions that enter into force from 2017, pensions will be indexed and their calculation changed, which will result in increased

expenditure on social protection and more adequate unemployment benefits. Tax expenditure will increase: non-taxable allowance will be increased for minimum wage earners, for persons raising children, and for people with disabilities. Child allowances will go up. The funding of these and other priority objectives of the Government will be financed from the share of the rising income and from the internal public financial resources generated through a more efficient management of public resources.

SECTION FOUR
MEDIUM-TERM PROJECTIONS FOR GENERAL GOVERNMENT FINANCES

22. General government finance projections have been made taking into account the economic development scenario, legal obligations of the State, fiscal discipline rules stipulated in the Constitutional Law, the Law of the Republic of Lithuania on Fiscal Discipline, the Law of the Republic of Lithuania on Budget Structure, the Law on Approval of Financial Indicators of the State Budget of the Republic of Lithuania and Municipal Budgets of 2017 and EU legislation[10].

23. In 2016, the general government surplus accounted for 0.3 per cent of GDP. Based on the data available during the preparation of the Programme, and taking into account the costs for the introduction of the social model, the general government deficit should be 0.4 per cent of GDP in 2017, and later in the medium-term (2018-2020) the projections reveal the general government surplus of 0.3-1.3 per cent of GDP, considering the need to implement fiscal policy with regard to the phase of an economic cycle and ensuring the public finances' compliance with EU and national fiscal discipline rules. The surplus in general government will create favourable conditions for increasing reserves and carrying out growth-oriented fiscal policy in the times of recession, with a view to minimizing negative migration and maintaining higher potential GDP growth (multi-annual). The property revenues are projected to increase in 2020 through the transformation of the state-owned enterprises and thus their increased performance. Social insurance funds balance will show relative deterioration due to the pension reform, i.e. higher deductions to the second pillar pension funds.

Table 7. General government indicators (S13), 2016-2020*

Indicator	ESA 2010 code	2016		2017	2018	2019	2020
		EUR million	GDP %	GDP %	GDP %	GDP %	GDP %
Net borrowing (+)/net lending (–) (B.9) by subsector							
1. General government	S.13	100.8	0.3	–0.4	0.4	0.3	1.3
2. Central government	S.1311	–106.8	–0.3	–0.6	0.2	0.1	1.3
3. State government	S.1312	–	–	–	–	–	–
4. Local government	S.1313	191.8	0.5	0.1	0.1	0.0	0.0
5. Social security funds	S.1314	15.8	0.0	0.2	0.1	0.2	0.0
General government (S13)							

[10] In 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 Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 (OJ 2011 L 306, p. 12), in Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ 2004 Special Edition, Chapter 10, Volume 1, p. 89) as last amended by Regulation (EU) No 1177/2011 of the Council of 8 November 2011 (OJ 2011 L306, p. 33).

Indicator	ESA 2010 code	2016		2017	2018	2019	2020
		EUR million	GDP %	GDP %	GDP %	GDP %	GDP %
6. Total revenue	OTR	13 314.6	34.5	36.0	36.4	36.3	36.7
7. Total expenditure	OTE	13 213.9	34.2	36.3	36.0	36.0	35.4
8. Net lending/borrowing	B.9	100.8	0.3	–0.4	0.4	0.4	1.3
9. Interest expenditure	D.41	522.7	1.4	1.3	1.0	1.0	0.7
10. Primary balance		623.5	1.6	0.9	1.4	1.3	2.0
11. One-off and other temporary measures		33.4	0.1	–0.1	0.2	0.0	0.0
Items of revenue							
12. Total taxes (12=12a+12b+12c)		6 790.3	17.6	17.9	18.1	18.4	18.5
12a. Taxes on production and imports	D.2	4 586.6	11.9	12.4	12.5	12.6	12.7
12b. Current taxes on income, wealth, etc.	D.5	2 202.3	5.7	5.6	5.5	5.8	5.8
12c. Capital taxes	D.91	1.5	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	4 844.1	12.5	12.8	12.9	13.2	13.2
14. Property income	D.4	196.4	0.5	0.5	0.4	0.4	0.6
15. Other		1 483.9	3.8	4.8	5.0	4.4	4.4
16=6. Total revenue	OTR	13 314.6	34.5	36.0	36.4	36.3	36.7
Tax burden (D.2+D.5+D.61+D.91-D.995)		11 620.2	30.1	30.7	30.9	31.5	31.6
Items of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	5 661.7	14.7	15.2	15.0	14,7	14,6
17a. Compensation of employees	D.1	3 802.3	9.8	9.7	9.5	9.4	9.3
17b. Intermediate consumption	P.2	1 859.4	4.8	5.5	5.5	5.3	5.3
18. Social payments (18=18a+18b)	D.6M	4 902.9	12.7	13.3	13.7	13.8	14.1
of which, unemployment benefits	D.6M	77.5	0.2	0.2	0.2	0.2	0.2
18a. Social transfers in kind	D.632	758.3	2.0	1.8	1.9	1.9	1.9
18b. Social transfers other than in kind	D.62	4 144.6	10.7	11.4	11.8	11.9	12.1
19=9. Interest expenditure	D.41	522.7	1.4	1.3	1.0	1.0	0.7
20. Subsidies	D.3	162.4	0.4	0.3	0.3	0.3	0.3
21. Gross fixed capital formation	P.51G	1 123.9	2.9	3.6	3.8	4.2	4.1
22. Capital transfers	D.9	183.9	0.5	0.4	0.2	0.2	0.1
23. Other		656.4	1.7	2.3	2.0	1.8	1.5
24=7. Total expenditure	OTE1	13 213.9	34.2	36.3	36.0	36.0	35.4

Sources: Statistics Lithuania, Ministry of Finance of the Republic of Lithuania

* Due to the rounding, the amount of revenue and expenditure components may differ against those specified under "Total revenue" and "Total expenditure".

** Revenues from taxes and contributions, excluding payments to EU institutions. With payments to EU institutions included, the indicator would increase by about 0.3 per cent of GDP, accounting for 31.9 per cent of GDP in 2020.

Since the general government finance projections are based on the considerations of the unchanged policy, the projections in Table 7 and Table 8 coincide.

Table 8. General government revenue, 2016-2020

Indicator	2016, million EUR	GDP %				
		2016	2017	2018	2019	2020
1. Total revenue at unchanged policy scenario	13 314.6	34.5	36.0	36.4	36.3	36.7
2. Total expenditure at unchanged policy scenario	13 213.9	34.2	36.3	36.0	36.0	35.4

Sources: Statistics Lithuania, Ministry of Finance of the Republic of Lithuania

Table 9. General government expenditure to be excluded from the expenditure benchmark

Indicator	2016, million EUR	GDP %				
		2016	2017	2018	2019	2020
1. Expenditure on EU programmes fully matched by EU funds revenue	423.1	1.1	2.3	2.4	2.1	2.0
2. Cyclical unemployment benefit expenditure	–31.3	–0.08	–0.06	–0.04	–0.01	0.01
3. Effect of discretionary revenue measures	141.5	0.4	0.3	–0.1	0.0	0.0
4. Revenue increase mandated by law	0	0	0	0	0	0

Sources: Statistics Lithuania, Ministry of Finance of the Republic of Lithuania

According to the projection of cyclical unemployment benefit expenditure for 2016, presented in Table 9, cyclical unemployment benefit expenditure amounted to –31.3 million euros. The cyclical unemployment benefit expenditure was considered against the estimates of the non-accelerating wage rate of unemployment (NAWRU) obtained by using the calculator developed by the EC. In 2017-2019, a negative cyclical unemployment benefit constituent is anticipated due to the unemployment level below the NAWRU estimates. In terms of the classification of state functions (code 10.5), unemployment benefit projections for medium term were calculated having regard to the amount of unemployment benefits per unemployed person in 2015.

Medium-term revenues and expenditure indicators of the budgets attributable to the general government, and guidelines for expenditure review

24. The key medium-term indicators of the revenues and expenditure of the state budget of the Republic of Lithuania (hereinafter – the state budget) and municipal budgets have been projected on the basis of the Government priorities, the data of the economic development scenario, the statutory EU and national provisions for fiscal discipline, and following the medium-term budgetary framework in Lithuania, established in accordance with Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States (OJ L 306, 2011, p. 41).

Table 10. The key medium-term indicators of the revenues and expenditure of the state budget, municipal budgets, the State Social Insurance Fund and the Compulsory Health Insurance Fund

Indicator	million EUR			
	2017, approved	2018	2019	2020
Revenues				
1. The totality of state and municipal budgets consolidated with the EU funds and other international assistance, *cash flows*	10 010.1	10 846.5	11 083.3	11 692.0
including:				

Indicator	million EUR			
	2017, approved	2018	2019	2020
State budget	6 386.0	6 639.3	6 965.9	7 445.9
EU funds and other international assistance *	2 101.3	2 561.9	2 351.6	2 351.6
2. State Social Insurance Fund	3 571.2	3 819.7	4 053.7	4 136.7
3. Compulsory Health Insurance Fund, *cash flows*	1 574.5	1 692.5	1 817.4	1 956.4
Expenditure				
1. The totality of state and municipal budgets consolidated with the EU funds and other international assistance, *cash flows*	10 568.6	11 151.6	11 006.0	11 134.5
Including:				
State budget	6 944.4	6 944.4	6 888.5	6 888.5
EU funds and other international assistance *	2 101.3	2 561.9	2 351.6	2 351.6
2. State Social Insurance Fund	3 491.1	3 773.4	3 966.0	4 167.0
3. Compulsory Health Insurance Fund, *cash flows*	1 578.0	1 692.5	1 797.4	1 926.4

Source- Ministry of Finance of the Republic of Lithuania , State Social Insurance Fund, Ministry of Health of the Republic of Lithuania
* EU funds and other international assistance for Lithuania (for private and public sectors).

When planning the 2018 budget, the review of the public expenditure will be made in 2017 – the revision of the state budget appropriations approved for the year 2017 will take place. The 2018 state budget appropriations (excluding EU funds and other international financial assistance) are planned so that they would not exceed the ones approved by the Law on Approval of Financial Indicators of the State Budget of the Republic of Lithuania and Municipal Budgets of 2017. Institutional performance will be increased and resources will be reallocated to finance public policy reformation measures.

General government subsector balances

25. In 2016, the general government balance indicator improved by 0.5 per cent of GDP, if to compare it with the one in 2015, and resulted in 0.3 per cent of GDP surplus. The central government subsector deficit for 2016 was smaller compared to 2015 and accounted for 0.3 per cent of GDP (0.5 of GDP in 2015). The decline in central government subsector deficit was driven by faster than expected growing income, somewhat underperformed expenditure plan and methodological changes in representation of defence expenditure in statistics. State-owned company “Deposit and Investment Insurance” is attributed to central government subsector, and its surplus in 2016 amounted to 0.25 per cent of GDP.

The surplus of 0.5 percent of GDP of the local government sub-sector in 2016 was mainly driven by higher than expected revenues and lower estimated expenditure. The sub-sector of social security funds continued the trend of 2015; it remained balanced and the result was improved better than expected through faster than expected growth in revenues.

SECTION FIVE
STRUCTURAL GENERAL GOVERNMENT BALANCE INDICATOR

26. In 2016, the structural general government deficit declined by 0.5 percentage points of GDP and accounted for 0.1 per cent of GDP – the general government came close to structural balance. The structural general government deficit in 2017 will increase due to the new social

model implementation costs, nevertheless it will not breach medium-term objective, and will account for 0.8 per cent of GDP. The structural general government deficit is set to decrease over the medium-term until the structural surplus in 2020 will be reached.

The structural general government balance indicator for 2016-2020 was calculated by subtracting from the general government balance indicator the cyclical component obtained by multiplying the output gap for the respective year by the elasticity of the general government balance indicator. The value of the elasticity of the general government balance indicator equals 0.413 and corresponds to the European Commission estimate known at the time of preparation of the Programme. The calculation of the structural general government balance indicator takes into account the following one-off measures: the revenue and expenditure of the SE “Deposit and Investment Insurance“ related to insured events, the net of revenue and expenditure of the Climate Change Programme (Emissions trading scheme). No other than specified measures have been foreseen.

SECTION SIX
ALTERNATIVE MEASURES TO ACHIEVE THE STRUCTURAL GENERAL GOVERNMENT BALANCE TARGETS

27. Should there be a shortage of instruments to achieve the values of the indicator of the structural general government balance over the period of 2017-2020, the following additional measures may be activated:

27.1. refusal of a larger part of the existing tax exemptions (current impact on the budget is about 2.5 per cent of GDP);

27.2. reduced GDP share of government expenditure;

27.3. revision of the property tax base, taking into account the share of taxation revenues comprised of property taxes, with a view to prevent real estate bubbles and apply the progressivity of taxation;

27.4. revision of the environmental tax base by increasing taxation revenues share consisting of these taxes, for environmental purposes.

SECTION SEVEN
ASSESSMENT OF ECONOMIC CYCLE

28. For the assessment of the economic cycle, the Ministry of Finance of the Republic of Lithuania calculated the estimates for the potential GDP and the output gap. The concept of potential GDP refers to a theoretical economic output level attainable which would be attained if the output factors, i.e. labour and capital, were utilised to their full potential, without pressure on prices or wages. The output gap measures the difference between the actual output of an economy and its potential output. Since the potential GDP and the output gap are unobservable indicators, statistical as well as econometrical methods are used for their assessment. Application of different methods may yield different estimates for these indicators.

The potential GDP and output gap were estimated in accordance with the Procedure for the Estimation of the Level of the Chained Volume of Potential Gross Domestic Product and the Output Gap, approved by Order No 1K-315 of the Minister of Finance of 19 October 2015 “On Approval of the Procedure for the Estimation of the Level of the Chained Volume of Potential Gross Domestic Product and the Output Gap". Pursuant to the Procedure, the output gap estimates are calculated using the potential GDP figures estimated by the following methods: the method approved by the EU Economic and Financial Affairs Council and developed by the EC, which is based on the Cobb-Douglas production function; the Hodrick Prescot filter approach.

The findings show that the output gap will be positive in 2017, accounting for 1 per cent of the potential GDP. From 2017 [11], the output gap will continue to grow, but not more than 1.5 per cent.

The worsening demographic trends negatively affect the potential of the labour factor, so the potential for economic growth has been slowing down, while the positive output gap going up. The negative demographic implications for the economic potential are in part offset by the recent fast growth in the participation of the labour force.

Table 11. Economic cycles

Indicator	ESA code	% of GDP*				
		2016	2017	2018	2019	2020
1 GDP growth / chain linked volume growth		2.3	2.7	2.6	2.5	2.4
2. Net lending (+)/borrowing (-) of general government	PDP B.9	0.3	–0.4	0.4	0.3	1.3
3. Interest expenditure	PDP D.41	1.4	1.3	1.0	1.0	0.7
4. One-off and other temporary measures		0.1	–0.1	0.2	0.0	0.0
including:						
one-off measures – general government revenues		0.3	0.2	0.3	0.1	0.1
one-off measures – general government expenditure		–0.2	–0.3	–0.1	–0.1	–0.1
5. Potential GDP growth, %		2,0	2.3	2.5	2.4	2.2
including:						
labour		0.9	0.8	0.7	0.4	0.0
capital		1.0	1.1	1.2	1.2	1.2
total factor productivity		0.1	0.4	0.6	0.8	1.0
6. Output gap		0.6	1.0	1.1	1.2	1.4
7. Cyclical budgetary component		0.3	0.4	0.4	0.5	0.6
8. Cyclically-adjusted balance (2–7)		0.0	–0.8	–0.1	–0.1	0.7
9. Cyclically-adjusted primary balance (8+3)		1.4	0.5	1.0	0.8	1.5
10. Structural balance (8-4)		–0.1	–0.7	–0.3	–0.2	0.7

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

[11] Pursuant to the provisions of the Procedure for the Estimation of the Level of the Chained Volume of Potential Gross Domestic Product and the Output Gap, approved by Order No 1K-315 of the Minister of Finance of 19 October 2015 „Approving Procedure for the Estimation of the Level of the Chained Volume of Potential Gross Domestic Product and the Output Gap", the Countercyclical State Fiscal Policy Commission was approached for a decision on the sign of the output gap for the years 2017 and 2018, and the Commission in its conclusion, presented to the Fiscal Policy Department of the Ministry of Finance, has confirmed the positive sign of the output gap for the years 2017 and 2018 This corresponds to the sign of the output gap calculated by the Ministry of Finance of the Republic of Lithuania using the potential GDP estimate, obtained according to the Cobb-Douglas production function.

SECTION EIGHT
GENERAL GOVERNMENT DEBT LEVELS AND DEVELOPMENTS

29. Taking into account the financial derivatives that were developed, the general government debt at the end of 2016 was 40.2% of GDP (42.7% of GDP in 2015). The central government debt structure poses no threat to public finances. At the end of 2016, short-term liabilities (by residual maturity) accounted for 8.4 per cent of the total debt, the average residual maturity of the debt was 6.2 years, and the average residual maturity of the debt prior to the changes in interest rates was 5.4 years. The floating interest rate debt, including the impact of financial derivatives, accounted for 0.1 per cent of the total debt. Taking into account financial derivatives, the central government debt was 100 per cent denominated in the euro.

Table 12. General government debt projections

Indicator	% of GDP				
	2016	2017	2018	2019	2020
1. Statistical debt including accumulation of funds for managing refinancing risk	40.2	42.4	38.4	39.1	33.8
1.a. General government debt at the end of year excluding the funds accumulated for managing the refinancing risk	40.2	39.1	38.4	36.0	33.8
2. Change of gross debt	-2.5	2.2	-4.0	0.7	-5.3
Contributions to changes in gross debt					
3. Primary balance	1.6	0.9	1.4	1.3	2.0
4. Interest	1.4	1.3	1.0	1.0	0.7
5. Debt change adjustment	-0.8	3.8	-1.8	2.6	-2.4
of which:					
difference between cash and accruals	–	–	–	–	–
net accumulation of financial assets of which: privatization revenues	–	–	–	–	–
implicit interest rate on government debt (%)	3.4	3.0	2.7	2.5	2.1
Other relevant variables	–	–	–	–	–
6. Liquid financial assets	–	–	–	–	–
7. Net financial 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 of the Republic of Lithuania, Statistics Lithuania

30. The borrowing and debt management guidelines of the Government of the Republic of Lithuania for 2015-2017 approved by Government Resolution No 1437 of 15 December 2014 ‘On the Approval of the Borrowing and Debt Management Guidelines of the Government of the Republic of Lithuania for 2015-2017’ set out the following medium-term targets:

30.1. to borrow at the lowest possible risk premiums, thus ensuring the achievement of other borrowing and debt management targets;

30.2. to seek an acceptable risk level for interest rate changes, re-financing and currency exchange rate changes, while complying with the established risk limits in line with the international practice, and to ensure credit, operational and liquidity risk management;

30.3. to apply the re-financing risk management instruments by redeeming major (equivalent to EUR 1 billion and above) Eurobond issues in 2015, 2016 and 2018, such as Eurobond buy-back, exchange of Government securities (hereinafter GS), advance accumulation of financial resources, signature of agreements on credit lines with financial institutions having a minimum credit rating of AA-/Aa3 assigned by at least two credit rating agencies (the rating requirement does not apply in the case of a credit line agreement with international institutions) or a combination of the said measures;

30.4. to improve the liquidity of the financial assets of the State Treasury;

30.4.1. to develop relations with investors;

30.4.2. to evaluate the possible demand for alternative borrowing instruments;

30.4.3. to attract to the State Treasury the largest possible share of temporary idle monetary resources of entities attributed to the general government (or controlled by entities of general government);

30.5. to develop and promote an efficient and liquid internal GS market;

30.6. to increase the domestic debt share in the total debt on behalf of the State and increase the maturity of domestic debt;

30.7. to issue liquid GS when borrowing in foreign capital markets.

CHAPTER IV
INFORMATION ON COMPLIANCE OF THE STRUCTURAL REFORM (THE SOCIAL MODEL) WITH THE EXEMPTION OF THE STABILITY AND GROWTH PACT

31. **Scope and objectives of the social model[12].** The structural reform (the social model) is focused on more flexible labour relations, higher employment, more sustainable social insurance and reduction of poverty. The purpose of the new social model is to ensure the necessary guarantees as well as a better match between work and family commitments for employees, while for employers it offers creating a more favourable environment for the recruitment and retention of workforce. The increased flexibility of labour relations aims to attract more investment, create additional workplaces and provide conditions for ensuring financial sustainability of the pension system as well as adequacy of pension benefits.

32. **The relationship of the social model with country-specific recommendations of the Council of Europe for Lithuania.** The reform, i.e. the social model, implements the European Council's Recommendation 2015 for Lithuania: 'Adopt a comprehensive reform of the pension system that also addresses the challenge of achieving pension adequacy. Improve the coverage and adequacy of unemployment benefits and cash social assistance and improve the employability of those looking for work' and part of the European Council Recommendation 2016 for Lithuania: 'to improve the coverage and adequacy of unemployment benefits and social assistance'.

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[12] A detailed description of the new social model, information about the drafters, related research, cost and benefit analysis as well as other information is provided on a special website at: http://www.socmodelis.lt/.

33. **Drafters and independent assessors of the social model.** In the framework of the Human Resources Development Operational Programme for 2007-2013, Priority 4 ‘Strengthening of Administrative Capacities and Increasing Efficiency of Public Administration’, implementation measure VP1-4.3-VRM-02-V ‘Promotion of Public Policy Reforms’, approved by Resolution No 789 of the Government of the Republic of Lithuania of 23 July 2008 ‘On approval of the Human Resources Development Operational Programme’, Vilnius university, in co-operation with partners from the Social Research Centre, Mykolas Romeris University and other independent experts, drafted a new legal-administrative model of the Lithuanian labour relations and state social insurance, proposing a comprehensive structural labour market and social reforms.

34. **Legal status and main legislation of the social model.** Part of the social model related to the regulation of the social sphere was put into effect from 1 January 2017, while the other part concerning labour market regulation will become applicable after the entry into force of the Labour Code and its implementing legislation (the planned date of entry into force is 1 July 2017). It was decided to postpone the entry into force of this part in order to further reinforce the protection of persons who lost their jobs, namely:

34.1. to further increase the list of persons entitled to the unemployment social insurance benefit and extend the duration of the payment of the benefit, to establish that the required 12 month state social unemployment insurance period entitling to unemployment insurance benefit is acquired within 30, rather than 24 months;

34.2. to establish that the unemployment insurance benefits are paid for 9 months to all persons who are entitled to the said benefit, regardless of the unemployment insurance period acquired. The amendments to the Law of the Republic of Lithuania on Unemployment Social Insurance providing for the regulation specified in subparagraph 34.1 and this subparagraph on 24 April 2017 were registered in the Seimas;

34.3. to establish that the employer has the duty to submit the information on wages, fixed-term employment contracts, remote working, part-time work and temporary workers to the works council or, in its absence, to the trade union only upon their request. However, an employer must keep records of the working hours of all employees, excluding only the employees who will be working on a schedule of fixed working hours (shift) and working days per week;

34.4. to improve the introduction of cumulative recording of working time − cumulative recording of working time is introduced as the need arises, following the procedure of information and consultation with the works council and having taken into account the opinion of the trade union operating on the employer’s level.

The social model is regulated by the following most relevant legislation: the Law on the Approval, Entry into Force and Implementation of the Labour Code of the Republic of Lithuania, the Republic of Lithuania Law on Employment, the Law Amending the Law No I-1336 of the Republic of Lithuania on State Social Insurance, Law Amending the Law No I-549 of the Republic of Lithuania on State Social Insurance Pensions and the Law Amending Law No IX-1904 of the Republic of Lithuania on Unemployment Social Insurance. The list of legal acts:

34.4.1. The Law No XII-2603 of the Republic of Lithuania on the Approval, Entry into Force and Implementation of the Labour Code.

34.4.2. The Law No XII-2463 Amending Article 19 of the Law No IX-216 of the Republic of Lithuania on Bankruptcy of Enterprises.

34.4.3. The Law No XII-2465 Amending Article 10 of the Law No I-722 of the Republic of Lithuania on State and Municipal Enterprises.

34.4.4. The Law No XII-2466 Amending Articles 19 and 70 of the Law No VIII-1012 of the Republic of Lithuania on the Diplomatic Service.

34.4.5. The Law No XII-2467 Amending Article 14 of the Law No IX-2251 of the Republic of Lithuania on Social Enterprises.

34.4.6. The Law No XII-2468 Amending Article 15^1 of the Law No I-1367 of the Republic of Lithuania on Health Care Institutions .

34.4.7. The Law No XII-2606 Amending Articles 1, 6, 8 , 9, Section $Four^1$ and the Annex and Repealing Article 13^1 of the Law No IX-1768 of the Republic of Lithuania on the State Labour Inspectorate.

34.4.8. The Law No XII-2470 of the Republic of Lithuania on the Insurance of Deposits.

34.4.9. The Law Amending the Law No IX-1904 of the Republic of Lithuania on Unemployment Social Insurance (new version).

34.4.10. The Law No XII-2472 Amending the Law No VIII-1509 of the Republic of Lithuania on Social Insurance of Occupational Accidents and Occupational Diseases (new version).

34.4.11. The Law No XII-2604 of the Republic of Lithuania on the Guarantees to Employers in the Event of Employer's Insolvency and Long-Term Employment Benefits.

34.4.12. The Law No XII-2508 Amending the Law No I-1336 of the Republic of Lithuania on State Social Insurance (new version).

34.4.13. The Law No XII-2511 Amending Articles 2, 4, 5, 6, 11 and 14 of the Law No IX-547 of the Republic of Lithuania on the Structure of the Budget of the State Social Insurance Fund

34.4.14. The Law No XII-2500 Amending Articles 1, 3, 12, 13 and Title of Section Four of the Law No I-621 of the Republic of Lithuania on Benefits for Children and Supplementing thereof with Articles 10^1 and 10^2.

34.4.15. The Law Amending Article 57 of the Law No XII-2509 of the Republic of Lithuania on the Statute of Internal Service.

34.4.16. The Law No XII-2510 Amending Articles 65, 66, 67, 68, 70 and 72 of the Law No VIII-723 of the Republic of Lithuania on the Organization of the National Defence System and Military Service

34.4.17. The Law No XII-2501 Amending the Law No IX-110 of the Republic of Lithuania on Sickness and Maternity Social Insurance.

34.4.18. The Law Amending Articles 17 and 38 of the Law No IX-1007 of the Republic of Lithuania on Personal Income Tax.

34.4.19. The Law No XII-2607 Amending Articles 1, 2, 3, 9, 10, 12, 13, 16, 21, 22, 25, 26, 27, 29, 31, 33, 34, 35, 44, Section V and the Annex of the Law No IX-1672 of the Republic of Lithuania on Safety and Health at Work and Supplementing thereof with Section V^1.

34.4.20. The Law No XII-2512 Amending the Law No I-549 of the Republic of Lithuania on State Social Insurance Pensions.

34.4.21. The Law No XII-2513 Amending Articles 3,4,5 and 6 of the Law No IX-1215 of the Republic of Lithuania on Reform of the Pension System

34.4.22. The Law No XII-2514 Amending Articles 3, 4, 5, 9, 10, 14, 15 and 16 of the Law No I-730 of the Republic of Lithuania on State Pensions.

34.4.23. The Law No XII-2515 Repealing the Law No IX-1828 of the Republic of Lithuania on Advance Payment of State Social Insurance Old-Age Pensions.

34.4.24. The Law No XII-2516 Amending Article 2 of the Law No X-1710 of the Republic of Lithuania on Establishment of Reference Values and Basic Rate of Fines and Penalties of Social Security Benefits.

34.4.25. The Law No XII-2517 Amending Article 3 of the Provisional Law No I-732 of the Republic of Lithuania on the State Pensions of Scientists.

34.4.26. The Law No XII-2505 Amending Articles 3, 4, 10, 17, 23, 25, 15 and 27 of the Law No IX-1691 of the Republic of Lithuania on Accumulation of Pensions .

34.4.27. The Law No XII-2506 Amending the Law No I-675 of the Republic of Lithuania on State Social Assistance Benefits.

34.4.28. The Law No XII-2507 of the Republic of Lithuania on Target Compensations.

34.4.29. The Law No XII-2518 of the Republic of Lithuania Amending Articles 737, 738 and 739 of the Code of Civil Procedure.

34.4.30. The Law No XII-2519 Amending Articles 8, 10 and 17 of the Law No IX-1675 of the Republic of Lithuania on Monetary Social Assistance for Low Income Residents.

34.4.31. The Law No XII-2520 Amending Articles 29 and 30 of the Law No X-493 of the Republic of Lithuania on Social Services.

35. **Measures of the social model.** The new Labour Code aims to eliminate the deficiencies of regulation of employment relations, reduce undeclared employment and encourage different labour contract forms, balance employment guarantees and combine flexibility with employment security. The provisions of the new Labour Code will make it easier for employees to combine work with responsibilities towards family or science, while encouraging employers to create legal jobs and not rush with employee dismissal at the onset of crisis. The prominent novelties of the Labour Code are as follows:

35.1. New types of employment contracts (project-based employment contract, job sharing employment contract, employee sharing contract, apprenticeship employment contract). Introduction of new types of employment contracts will allow employers to choose a more acceptable method of formalization of labour relations and will encourage them to define working relations in the areas, where at present they are not formalized or where civil relations are defined.

35.2. Shorter periods of notice and lower severance allowances for dismissed employees. Currently, long notice periods and large severance allowances (up to 6 monthly average wages) discourage the employers from creating new jobs, as they fear that in case of a business failure, they will not be able to pay large severance allowances.

35.3. More flexible regulation of the working-hours (abandonment of strict regulation of working day hours, greater annual limit for overtime work) will encourage employers to create new jobs more easily.

35.4. The reduction of administrative burden will enable creation of jobs with an added value. A provision is made that the written submission of documents and information where data are transmitted by means of information technologies (such as by post, mobile devices and other) shall also be considered as cases of written submissions, provided that it is possible to identify the content of the information, its provider as well as the fact and time of submission; also, a requirement is established to calculate the length of the working day and the number of working days per week for all workers, excluding those working on a fixed working hours (shift) schedule; exceptions are allowed to be made in relation to the obligations of employers who employ less than 10 workers; full material responsibility agreements are to be abandoned; no disciplinary liability shall be imposed.

The draft Law of the Republic of Lithuania on Employment expands the scope of application of the current support of employment by providing a classification of forms of employment; legalizes a new more efficient model of application of active labour market policy measures, which could help address employment challenges of persons on social assistance and reduce long-term unemployment risk; provides extensive opportunities for the unemployed for learning and on-the job practice in order to achieve maximum efficiency in the integration of the unemployed into the labour market; reduces the risk of illegal employment, i.e. provides for a liability for illegal and undeclared work or undeclared independent activity as well as violations of the procedure for the employment of foreigners; encourages a more sustainable creation of jobs, alignment with workforce demand, more flexible labour relations and social security tailored to the population needs.

The Law Amending the Law of the Republic of Lithuania on Unemployment Social Insurance No IX-1904 provides for an increase in the number of the insured persons who are entitled to the unemployment social insurance benefit; ensures adequate unemployment social insurance benefits, while taking into account the change of the status of an unemployed person; specifies the grounds for suspension and termination of benefit payments.

The above-mentioned laws also provide for the reduction of the pension social insurance contribution rate to be paid by employers and financing of the basic pension with the State budget resources. This will be done gradually and in compliance with fiscal discipline.

36. The draft Law Amending the Law No I-549 of the Republic of Lithuania on State Social Insurance Pensions proposes a reform of the system of state social insurance pensions, i.e. moving towards a clearer and more transparent calculation of pensions, while making pension levels more dependable on pension insurance contributions and creation of conditions for ensuring the financial sustainability of the pension system as well as adequacy of pension benefits. The Law provides for:

36.1. considering the component of the pension that depends on the state social insurance contributions as an individual pension component (it is proposed to introduce a system of units of account) and to finance it from the State Social Insurance budget, while considering the pension component that depends on the length of service, but is not directly related to the size of contributions paid, as the general pension component and gradually transfer its payment to the State budget;

36.2. establishing a pension indexation procedure based on clear criteria that allow the assessment of both the economic conditions and demographic indicators (pensions would be indexed according to the average change of the wages fund for 3 past years, current year and 3 forecast years);

36.3. a gradual increase of the required length of pensionable service from 30 to 35 years;

36.4. to change the procedure for the calculation of lost working capacity pensions, i.e. to relate the sizes of lost working capacity pensions to the determined level of capacity for work in per cent.

37. Expected positive impact of implementation of the social model on economic growth potential, assessment method and assumptions. Implementation of the legislative acts under the framework of the social model will allow for improving labour market operation, making the labour market more dynamic and labour relations more flexible; workers will be offered guarantees of staying in the labour market, the coverage and adequacy of the unemployment social insurance benefits will improve.

As a result of the reform the average annual number of the employed in the medium term will increase up to 10%, while the average annual number of the employees (in full-time units) – up to 7%. Employment growth has been calculated after conducting a survey of employers designed to find out what provisions would encourage them to create new jobs.

37.1. Factors contributing to the increase in employment:

37.1.1. Provisions of the Labour Code that will enable employers to create new jobs.

37.1.2. Other provisions:

37.1.2.1. the change in the unemployment social insurance benefit conditions and an increase in contribution rates for this type of insurance will ensure high-quality protection for persons who lost their jobs as a result of more flexible employment conditions;

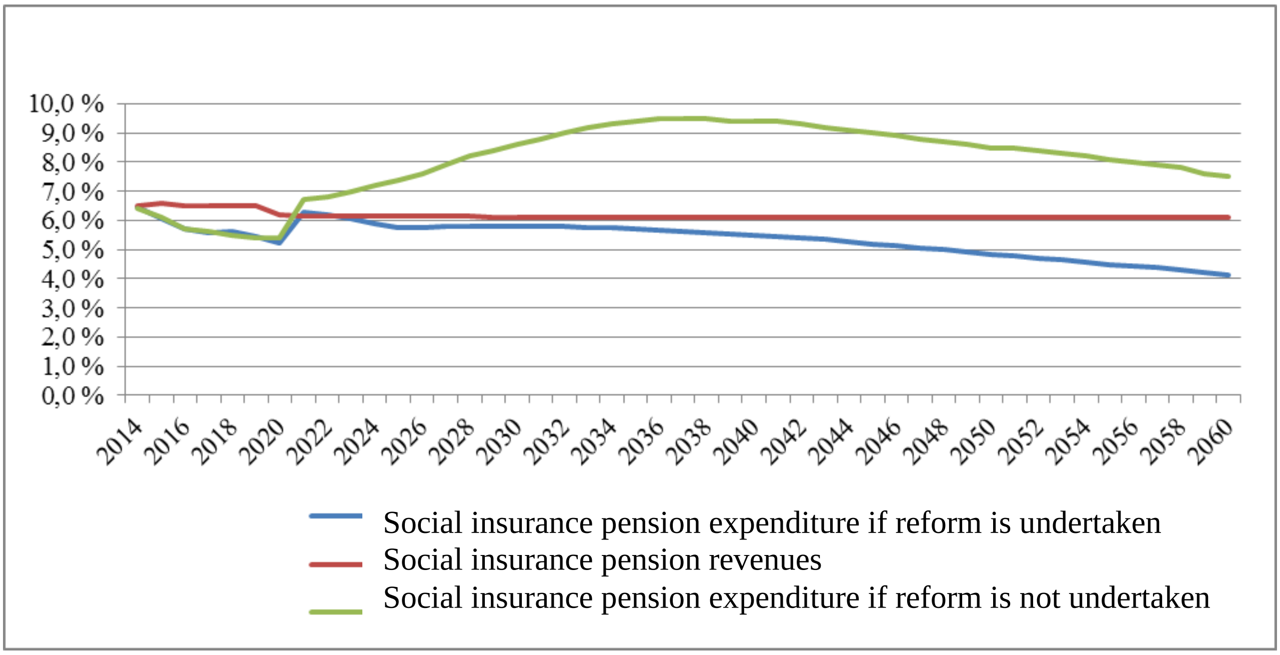
37.1.2.2. widening of the social insurance base will ensure higher-quality of social security for persons engaged in individual activities;

37.1.2.3. the reduction of the pension social insurance contribution rate to be paid by employers.

38. Expected positive impact of implementation of the social model on the sustainability of general government finances, assessment method and assumptions. In order to make a comprehensive long-term assessment of the impact of the proposals for the pension system reform on the budget of the State Social Insurance Fund, in 2016, a cost assessment of the pension system reform was performed in accordance with the Law Amending the Law No I-549 of the Republic of Lithuania on State Social Insurance Pensions by using the cohort pension system model. The pension expenditure projection provided in the Stability Programme for 2016 was used for the baseline option in accordance with the then existing laws and macroeconomic assumptions. In calculating the impact of the reform, only the pension reform measures were introduced without changing other conditions, i.e. the indexation rate was changed by introducing the 7-year average wage fund index instead of the wage growth index and a new rule of the required period of pensionable service was applied to new retired persons. The assessment of the impact also took into account the economic and employment assumptions for 2020-2060 agreed by the Economic Policy Committee (EPC).

Given that the adopted pension indexation allows for the estimation of the worsening ratio between contribution payers and beneficiaries and that the increase in the required period of pensionable service allows for non-assuming of greater obligations in terms of higher life expectancy, in the future the proposals for the pension reform in the longer term would enable annual average pension expenditure savings of 3.7% of GDP as compared to the scenario, if no changes are made.

Chart 1. Impact of indexation and other measures on the budget of the State Social Insurance Fund (% of GDP)



Source: Ministry of Social Protection and Labour of the Republic of Lithuania

Table 13. Economic and finance impact of the social model

Description of the reform (1)	Methodological elements		Quantitative elements							Anticipated implementation	
			Main outcome of macroeconomic modelling (4)						Other impacts/indicators (7)	Deadline for approval and implementation of measures (8)	Institutional process of adoption of measures (9)
	Main characteristics of the model used/calculation method (2)	Main macroeconomic assumptions/modelling assumptions (3)	Description (5)	Annual and general impact on GDP and other key macroeconomic variables(6)							
				X + 5 years	X + 10 years	X + 15 years	X + 20 years	X + 25 years			
The purpose of the reform is to attract investment to the Lithuanian economy and create new jobs. To implement this purpose, a new Labour Code has been developed and adopted. Along with the new Labour Code, the Law Amending the Law on Unemployment Social Insurance, Law Amending the Law on Social Insurance of Occupational Accidents and Occupational Diseases, Law Amending the Law on State Social Insurance and the Law Amending the Law on Sickness and Maternity Social Insurance were adopted.	Employment growth was calculated after conducting a survey of employers designed to find out what provisions of the draft Labour Code and what other provisions would encourage them to create new jobs.	The provisions of the Labour Code that will enable employers to create new jobs: 1. New types of employment contracts (project-based employment contract, job sharing employment contract, employee sharing contract, apprenticeship employment contract). Introduction of new types of employment contracts will allow employers to choose a more acceptable method of formalization of labour relations and will encourage them to define working relations in the areas, where at present they are not formalized or where civil relations are defined. 2. Shorter periods of notice and lower severance allowances for dismissed employees. Shorter periods of notice and lower severance allowances for dismissed employees; Currently, long notice periods and large severance allowances (up to 6 monthly average wages) discourage the employers from creating new jobs, as they fear that in case of a business failure, they will not be able to pay large severance allowances. 3. More flexible regulation of the working-hours (abandonment of strict regulation of working day hours, greater annual limit for overtime work) will encourage employers to create new jobs more easily.	Employment	As a result of the reform the average annual number of the employed in the medium term would increase up to 10 per cent, while the average number of employees (in full-time units) – up to 7 per cent.						01/07/2017	Legal acts adopted

Description of the reform (1)	Methodological elements		Quantitative elements							Anticipated implementation	
			Main outcome of macroeconomic modelling (4)						Other impacts/indicators (7)	Deadline for approval and implementation of measures (8)	Institutional process of adoption of measures (9)
	Main characteristics of the model used/calculation method (2)	Main macroeconomic assumptions/modelling assumptions (3)	Description (5)	Annual and general impact on GDP and other key macroeconomic variables(6)							
				X + 5 years	X + 10 years	X + 15 years	X + 20 years	X + 25 years			
		4. Reduction of administrative burden will enable creation of jobs that generate an added value. Other provisions: 1. Change in the unemployment social insurance benefit conditions and an increase in contribution rates for this type of insurance will ensure high-quality protection for persons who lost their jobs as a result of more flexible employment conditions; 2. Widening of the social insurance base will ensure higher-quality of social security for persons engaged in individual activities. 3. Reduction of the pension social insurance contribution rate to be paid by employers.									
Reform of social insurance pensions: indexation of pensions based on the growth rates of the wages fund (according to the average change of the wages fund for 3 past years, current year and 3 forecast years) and increase of the required length of pensionable service from 30 to 35 years by half year	In order to make a comprehensive long-term assessment of the impact of the proposals for the pension system reform on the budget of the State Social Insurance Fund, the cost assessment of the pension system reform was performed in accordance with the Law Amending the Law No I-549 of the Republic of Lithuania on State Social Insurance Pensions by using the cohort pension system model. With a view to assessing the impact of the model,	The pension expenditure projection provided in the Stability Programme for 2016 was used for the baseline option in accordance with the then existing laws and macroeconomic assumptions. In calculating the impact of the reform, only the pension reform measures were introduced without changing other conditions, i.e. the indexation rate was changed by introducing the 7-year average wage fund index instead of the wage growth index and a new rule of the required period of pensionable service was applied to new retired persons. The assessment of the impact also took into account the economic and employment assumptions for 2020-2060 agreed by	Direct fiscal impact on primary balance (reduction of pension expenditure), % BVP (in % of GDP)	0.8 per cent	2.1 per cent	3.1 per cent	3.7 per cent	3.8 per cent		Indexation of pensions will start from 1 January 2017, while the required length of pensionable service will be gradually increased from 30 to 35 years by half a year annually from 2018 to 2027.	Legal acts adopted

Description of the reform (1)	Methodological elements		Quantitative elements							Anticipated implementation	
			Main outcome of macroeconomic modelling (4)						Other impacts/indicators (7)	Deadline for approval and implementation of measures (8)	Institutional process of adoption of measures (9)
	Main characteristics of the model used/calculation method (2)	Main macroeconomic assumptions/modelling assumptions (3)	Description (5)	Annual and general impact on GDP and other key macroeconomic variables(6)							
				X + 5 years	X + 10 years	X + 15 years	X + 20 years	X + 25 years			
annually from 2018 to 2027	two scenarios were defined. They were compared with each other in order to evaluate the impact of the model being designed on Lithuania's social insurance system, i.e. the budget of the State Social Insurance Fund and the labour market.	the Economic Policy Committee (EPC)									

Source: Ministry of Social Protection and Labour of the Republic of Lithuania

Labour market reform measures (the new Labour Code and other measures) will result in a greater number of the employed in the medium term, thus contributing to higher budgetary revenues as well as more favourable pension indexation opportunities given sustainable public finances.

Social model costs in 2017

Table 14. Impact of the social model on general government finances in 2017

Indicator	2017, million EUR
I. Revenue	5
A 1 percentage point reduction of social insurance contribution rate	-59
Increase in the unemployment contribution rate by 0.5 percentage point	28
Widening of the social insurance contributions base for persons engaged in individual activities	7
Taxation of bonuses by social insurance contributions	6
Employer insurance contribution to the new Long-Term Work Benefit Fund at the rate of 0.5%	23
II Expenditure	225
Increase in the State budget expenditure due to a 0.5 percentage point increase in the unemployment contribution rate (expenditure increase)	6
Extension of the cases in which sickness allowance is to be paid (expenditure increase)	5
Reduction of the State budget expenditure due to a 1 percentage point reduction of social insurance contributions rate (expenditure reduction)	-11.5
Increase in the budgets' expenditure due to indexation of pension expenditure	167
Insurance of mothers and caregivers from state funds by paying an additional amount up to the minimum monthly wage	16
Increase in the budgets' expenditure due to indexation of pension expenditure	24
Employee benefits from the Long-Term Work Benefit Fund	18.5
Balance/net costs (I–II)	-220
Balance, % BVP	-0.5

Source: Ministry of Social Protection and Labour of the Republic of Lithuania

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

SECTION ONE
RISKS RELATED TO THE FULFILMENT OF THE ECONOMIC DEVELOPMENT SCENARIO

39. The medium-term outlook for economic development will depend on global demand, especially in the main Lithuanian export markets. The geopolitical tension has not receded yet, the world economy's growth is slow, the reciprocal Russia and EU sanctions, extended to 2017, may not be lifted for a longer period. The problems that stifle the EU, i.e. debts of some EU Member States, the refugees that flooded Europe, tensions in EU banking sector and terrorism threat have not diminished. There is a risk of political tension in the EU and manifestations of economic nationalism. All this contributes to increasing vulnerability of

the global, eurozone as well as Lithuanian economies. The unknown outcomes of the Brexit negotiations as well as the elections to be held this year in several EU Member States create an economic and political uncertainty, which may cause changes in the currently existing trends of the Lithuanian economy and the perspectives of the key macroeconomic indicators envisaged in the economic development scenario as provided in the Programme.

The rapid growth of wages in the recent years has increased the risk that, if no measures to increase labour productivity are taken and if, in the context of increasing productivity, the gap between wage growth and productivity growth is not managed, a sudden slowdown in the growth of employees' wages might occur. There is yet another risk that without increasing labour productivity (without investment in more productive work equipment and in the professional development of employees) the rising labour cost will be passed on the prices of goods and services, thus winding the spiral of wages and prices. In this case, inflation and wages would rise more than was predicted in the economic development scenario. If the assumption of the economic development scenario regarding oil price developments is not fulfilled, i.e. if oil prices are lower than those predicted at the time of drafting of the economic development scenario, a lower inflation might be expected.

There are stronger indications than before that, in the medium term, Lithuania risks falling into a slow growth trap: given the lack of investment and shrinking population, the country's potential GDP growth is currently nearly twice as slow as in the period before the economic crisis; the GDP per capita (according to purchasing power standard) level has not been increasing for several consecutive years (settling to 75 per cent of EU level in 2014–2015); wage growth surpasses productivity growth; there is a high income inequality in the country and across its counties.

The growing uncertainty about the future, which will be influenced by external factors, may encourage business to postpone investment projects, and households – to save larger share of income and refuse to purchase non-primary goods.

After the entry into force of the provisions of the new Labour Code, investment growth in the medium term could be faster than predicted in the economic development scenario. This would create more jobs in the country and contribute to a more robust GDP growth. GDP growth could also be faster, if economic growth in Lithuania's main export markets or labour productivity growth would accelerate faster than foreseen during the preparation of the economic development scenario.

Positive Brexit consequences should not be rejected either. At the end of medium term, some people in Lithuania may abandon plans for emigration because of Brexit, while those who have already emigrated to the United Kingdom, may decide to come back to Lithuania, which will contribute to improving demographic trends and facilitate faster growth of employed population.

Flexible Lithuanian economy and well-qualified, relatively cheap labour force could be regarded as attractive factors for transferring services provided in the UK to Lithuania.

Therefore, already now it is very important for state institutions and the Lithuanian business to identify the areas of new possibilities and take focused actions.

SECTION TWO
FISCAL RISK

40. The major projected sources of fiscal risk are deposit insurance, state guarantees, economic development and interest rates.

Deposit insurance

41. The Lithuanian deposit insurance system is in compliance with the requirements of the EU acquis in this field. The amount of core insured deposits, from which insurance premiums are to be calculated, was EUR 11 819 million as at 31 December 2016, i.e. has increased by 7.61 per cent over the year. Over the year 2016, the credit institutions paid EUR 32.47 million to the Deposit Insurance Fund, which is by 30.44 per cent less than over the year 2015. This can be explained by the reduction, pursuant to EU legislation, of the base of deposits on which insurance premiums are paid (insurance premiums are paid only on deposits of up to EUR 100 000 that are eligible for coverage) and the change of the procedure for calculating insurance premiums.

On 20 September 2016, the Bank of Lithuania recognized the credit union 'Amber' as insolvent and its depositors were paid EUR 19.97 million of insurance compensations. The creditor claim of the SC Deposit and Investment Insurance in the bankruptcy proceedings against the credit union 'Amber' was filed in the first Quarter of 2017. Creditor claims of the SC Deposit and Investment Insurance are being paid under the court-approved plans of settlement between bankrupt financial institutions and creditors. By 31 December 2016, the total amount of funds recovered in 2011-2014 from credit institutions that went bankrupt was EUR 898.70 million: EUR 808.72 million was recovered from the insolvent AB Bankas Snoras, EUR 45.11 million – from the failing AB Ūkio bankas and another EUR 44.87 million – from the credit unions. As at 31 December 2016, the residual debt of the SC Deposit and Investment Insurance to the Ministry of Finance of the Republic of Lithuania was EUR 62.26 million and has decreased by 24.8 per cent as against the same period in 2015. The main part of the funds paid to the SC Deposit and Investment Insurance was used for payment of insurance compensations to depositors and for repayment of loan to the Ministry of Finance of the Republic of Lithuania.

As at 31 December 2016, the Deposit Insurance Fund accumulated a reserve amount of EUR 85.74 million to finance the deposit insurance compensations. The amount of financial resources of the Deposit Insurance Fund after evaluating the debentures of the Fund amounted, as at 31 December 2016, to about 0.2 per cent of the total amount of the core insured deposits of all participants of deposit insurance system. By 3 July 2024, the amount accumulated in the Deposit Insurance Fund after evaluating the debentures of the Fund has to reach 0.8 per cent of the total core insured deposits.

Government guarantees

42. The Government-guaranteed loan portfolio at the end of 2016 accounted for about 0.8 per cent of the GDP of 2016. Taking into account the guarantees planned to be provided in 2017, 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, in respect of the ongoing state investment projects, the Government-guaranteed loan is projected to increase to 1.4 per cent of GDP.

Table 15. Contingent liabilities

Indicator	% of GDP	
	2016	2017
Government guarantees	0.8	1.4
of which linked to the financial sector	0	–

Source: Ministry of Finance

SECTION THREE
SENSITIVITY ANALYSIS

43. Lithuania's economy is small and open, with export accounting for more than 70 per cent of GDP (in 2016 – 74 per cent of GDP), therefore, the economic situation and future prospects of trade partners have a significant influence on Lithuania's economic development. The medium term economic development, as compared to that envisaged in the economic development scenario of the Ministry of Finance of the Republic of Lithuania, published on 20 March 2017, could be faster or slower. In the recent atmosphere of uncertainty about the future, there is both positive and negative risk of deviation from the economic development scenario, which is mainly caused by external factors. Therefore, technical calculations were done and alternative scenarios developed assuming that GDP growth in the respective year in the medium term will be by 1 percentage point lower than in the economic development scenario (pessimistic scenario) and assuming that GDP growth in the respective year in the medium term will be by 1 percentage point faster than in the economic development scenario (optimistic scenario). As a result of the decrease/increase in GDP growth by 1 percentage point, the general government revenue would decrease/increase, on average, by about 0.4 percent of GDP.

Table 16. Alternative scenarios

Indicator	2016	2017	2018	2019	2020
Economic development scenario					
Change in GDP at constant prices, in percent	2.3	2.7	2.6	2.5	2.4
GDP at current prices, million EUR	38631.0.	40 584.5	42 367.4	44 162.4	45 924.9
Change in GDP at constant prices, in percent	3.5	5.1	4.4	4.2	4.0

Indicator	2016	2017	2018	2019	2020
Pessimistic scenario					
Change in GDP at constant prices, in percent	2.3	1.7	1.6	1.5	1.4
GDP at current prices, million EUR	38 631.0	40 183.3	41 948.0	43 725.0	45 469.5
Change in GDP at constant prices, in percent	3.5	4.0	3.4	3.2	3.0
Optimistic scenario					
Change in GDP at constant prices, in percent	2.3	3.7	3.6	3.5	3.4
GDP at current prices, million EUR	38 631.0	40 985.9	42 786.9	44 600.0	46 380.4
Change in GDP at constant prices, in percent	3.5	6.1	5.4	5.3	5.0

Sources: Sources: Ministry of Finance of the Republic of Lithuania, Statistics Lithuania

Table 17. Sensitivity analysis of revenues

Indicator	2016	2017	2018	2019	2020
Change of revenues if the pessimistic* scenario is realized, million EUR	-160.2	-168.6	-176.9	-185.3	-172.7
Change of revenues if the optimistic* scenario is realized, million EUR	160.5	168.9	177.2	185.6	173.1

*Income sensitivity was assessed according to the scenarios designed in Table 16 of the Programme
Source: Ministry of Finance

A medium-term growth of floating and fixed market interest rates by 1 percentage point would contribute to an increase of the interest payable on the newly-assumed central government obligations of EUR 21 million, EUR 34 million and EUR 53 million respectively in the period 2018-2020 or about 8 basis points of GDP annually on average.

Taking into account the fact that, including financial derivatives, the central government debt (including interest payments) is 100% denominated in the euro, the changes in exchange rate do not affect central government interest payments.

SECTION FOUR
COMPARISON WITH PREVIOUS PLANS

44. Taking into account the actual figures for 2016 provided by the Statistics Lithuania along with the current trends in economic development and increased uncertainty of external environment perspectives, the Ministry of Finance of the Republic of Lithuania has lowered GDP projections. General government deficit and debt estimates have been made according to the accounting standards of the European System of Accounts (ESA2010) considering the GDP projections.

The 2017-2020 general government balance indicators have worsened as a result of the costs of the structural reform, i.e. the social model launched on 1 January 2017. Taking into account the refinancing risk management, the updated GDP projections, and also the projections of revenue and expenditure balance, the projected level of government debt will be 0.9 percentage points lower in 2017, 0.3 percentage points higher in 2018 and 0.1 percentage points higher in 2019 as compared to the previous forecasts contained in the Stability Programme for Lithuania for 2016 approved by Resolution No 417 of the

Government of the Republic of Lithuania of 27 April 2016 ‘On the Stability Programme for Lithuania for 2016’.

Table 18. GDP, general government deficit/surplus and general government debt estimates compared to the Stability Programme for Lithuania for 2016

Indicator	ESA2010 Code	2016	2017	2018	2019	2020
1. Real GDP change (%):						
Previous update		2.5	3.2	3.1	3.1	–
Current update		2.3	2.7	2.6	2.5	2.4
Decrease (-)/Increase (+)		-0.2	-0.5	-0.5	-0.6	–
2. Net lending (+)/borrowing (-) of general government (% of GDP)	PDP B.9					
Previous update		-0.8	0.0	0.8	0.9	–
Current update		0.3	-0.4	0.4	0.3	1.3
Worsening (-)/Improvement (+)		1.0	-0.4	-0.4	-0.6	–
3. Ratio of General Government Debt (% of GDP)						
Previous update		41.1	43.3	38.1	39.0	–
Current update		40.2	42.4	38.4	39.1	33.8
Decrease (-)/Increase (+)		-0.9	-0.9	0.3	0.1	–

Sources: Statistics Lithuania, Ministry of Finance.

CHAPTER VI
QUALITY OF GENERAL GOVERNMENT FINANCES

SECTION I
SECTORAL ANALYSIS

Education system

45. According to Eurostat data for 2014, the EU general government expenditure on education on average amounted to 5 per cent of GDP, compared to 5.4 per cent of GDP in Lithuania. In 2015 in Lithuania the general government expenditure on education in relation to GDP remained on the same level while the EU average went down to 4.9 per cent of GDP. According to another methodology used by Eurostat which does not cover indicators related to early childhood education and which is based on the latest data, the government expenditure on education in EU amounted to 5.34 per cent of GDP (in 2013), compared to 4.38 per cent of GDP in Lithuania (in 2014). In 2013 the funding per pupil in Lithuania amounted to 20.1 per cent of GDP per capita, compared to EU average amounting to 28.4 per cent. In 2015 the Trends in International Mathematics and Science Study (TIMSS) was conducted in Lithuania with the aim to assess the performance of pupils of fourth and eighth school grades in mathematics and natural science, its development as well as social, economic and cultural factors that influence such performance. The study revealed that average test results of Lithuania’s pupils of fourth and eighth school grades in mathematics and natural science were higher than average test results of pupils in the European countries. In 2015 the Lithuanian results of the international assessment of performance of 15-year-olds (Programme for International Student Assessment, PISA) in mathematics, reading and natural science were below the results of the year 2012 and still below the EU average. When compared to

previous studies, the results showed a downward trend not only in Lithuania but in EU as well. The OECD review of school resources in Lithuania of 2016[13] based on data of 2012 revealed that the difference in average test results in the cities compared with rural areas totalled 57 points against the EU average of 31. In 2014–2015 OECD conducted a study under the Programme for the International Assessment of Adult Competencies (PIAAC) that assessed the level of ability of persons aged 16–65 to write, count, read and solve problems by means of technologies. The results of this study showed variations depending on a field. Results of reading and writing tests in Lithuania in all age groups were close to the OECD average. In Lithuania test results of counting ability of persons aged 16-24 and of persons aged 25-34 appeared to be higher than the OECD average, however the results of other age groups were close to the OECD average. Poor ability to solve problems by means of technologies remains a problem in Lithuania. Results of tests performed to assess this ability are significantly worse in all age groups than the OECD average. Test results of persons aged 16-24 in Lithuania are 1.4 times lower than the OECD average while in other age groups the difference increases and test results of persons aged 55-65 in Lithuania are more than 3.5 times lower than the OECD average.

According to Eurostat data for 2013, Lithuania’s general government expenditure on primary and lower secondary education amounted to 1.89 per cent of GDP against the EU average of 2.24 per cent of GDP in the same year. In 2013 Lithuania spent a smaller share of total funding for education to finance upper secondary education and vocational training, compared to the EU average (0.79 per cent of GDP in Lithuania against the EU average of 1.17 per cent of GDP). However, Lithuania spent a larger share to finance higher education (1.34 per cent of GDP in Lithuania against the EU average of 1.29 per cent of GDP). The share spent to finance vocational training (when separated from general secondary education) is also comparatively large. In the view of International Monetary Fund (IMF), there are too many establishments in Lithuania that provide higher education, i.e. the number is disproportionate to the national population.

According to Eurostat data for 2015 the rate of employment of recent graduates from upper secondary to tertiary education who are no longer in education (82.4 per cent) is above the EU average (78.5 per cent) and is above the benchmark under the Strategic Programme for Education and Training for 2020 (82 per cent). In this area, Lithuania has shown the greatest progress among EU states since 2011, raising this indicator to 80.8 per cent in 2014, against the EU average of 77.7 per cent. Although in 2016 Lithuania led the entire EU based on the share of people with higher education, 58.3 per cent, among those aged 30–34, the International Monetary Fund (IMF) noted in the 2015 study on public expenditure efficiency in Lithuania[14] that the majority of students still opted for social sciences, business and law, instead of physics or other sciences. This trend in choice of a study field does not match the

[13] Link:http://www.oecd.org/countries/lithuania/oecd-reviews-of-school-resources-lithuania-2016-9789264252547-en.htm.

[14] Link:https://www.imf.org/external/pubs/cat/longres.aspx?sk=43496.0.

needs of the labour market and results in situation where a sizable portion of residents aged 30–34 in Lithuania hold a job that does not match their completed field of study.

The Lithuanian structure of expenditure on education differs from the EU average. Although intermediate consumption (which accounted for 16 per cent of the entire education expenditure in 2015) is equal to the EU average of 16 per cent, the share of expenditure on wages of education system workers (63.3 per cent of total education expenditure in 2014) is roughly 3.5 percentage points above the EU average of 59.9 per cent. The IMF determined in 2015 that the education expenditure in Lithuania was high due to the payment of wages to a large number of workers, including social and health care workers working in schools, in the education system. Wages remain low, especially for young people. The share of education expenditure for gross fixed capital formation (15.7 per cent of total general government expenditure on education in 2015) is more than double the EU average (7.8 per cent).

As reported by Statistics Lithuania, the number of pupils and students from the 2013/14 school year to the 2015/16 school year has declined by 36 000. According to UNESCO data for 2014, the pupil–teacher ratio at Lithuanian secondary schools remained the same as previous years and stood at 8.1, which was below the European average that reached 11.1 in 2014. Based on Eurostat data for 2012, the average class size in Lithuania at lower secondary level was also below the EU average. The OECD report of 2016 on the Lithuanian education system indicates that the indicator of an average class size at lower secondary level of education is low in Lithuania due to the fact that this indicator in rural areas is just above half that in the cities: 20.6 in Lithuanian cities, compared to only 11.4 in rural areas in 2015. As reported by Statistics Lithuania, the pupil/student–teacher ratio remained nearly the same between school years 2013/14 and 2015/16.

In 2016 91.8 per cent of Lithuanian children aged 4 to 6 were participating in education. In recent years this indicator developed positively due to the introduction of new pre-school and preparatory education groups (their number increased by 437 in cities and by 84 in rural areas during the period of two years). As from September 2016 preparatory education became obligatory in Lithuania. According to data of Statistics Lithuania and Education Management Information System, in 2016 only about half (52.4 per cent) of children aged 4-6 who live in rural areas were participating in education in rural areas, while certain proportion of children living in rural areas attended educational institutions in the cities. In 2016 89.4 per cent of children aged 5 and 85.3 per cent of children aged 4 regularly attended educational institutions. According to Eurostat data, in more than half of EU Member States (including Latvia and Estonia) the number of children aged 4 attending educational institutions was higher than that in Lithuania. After preparatory education became obligatory in Lithuania, all children turning 6 attend educational institutions. In order to ensure a more active involvement of children in early education, plans are underway to increase the accessibility of younger children, in particular those living in rural areas, to quality early years education. The level of participation in life-long learning among Lithuanian residents aged 25–64 is low when compared to other European countries (in 2016 the level of participation in life-long learning among Lithuanian residents was 6 per cent compared to the EU average of 10.8 per cent). The level of participation in life-long learning among Lithuanian residents showed no change over the past 6 years (in 2011 and in 2016 it was 6 per cent). The level of participation in life-long learning is particularly low among residents of rural areas (in 2016 the level of participation among people living in rural areas amounted to 3.7 per cent compared to 7 per cent of people living in cities). Poor participation of adults in informal adult education becomes a barrier to success of such persons when competing in the labour market and participating in social life.

Failure to include the informal adult education in Lithuania's strategic documents for a long time, lack of in-depth studies by 2014 that would reveal the actual situation as well as poor financing and investments into adult education (informal adult education programmes started to receive annual funding from the State budget only in 2014) led to low level of participation in life-long learning among Lithuanian residents. Aiming to solve the problems related to higher education plans are underway to draft in 2017 an optimisation plan of network of education and training institutions in consultation with socioeconomic partners which would include the reform of the network of higher education institutions, its funding and quality assurance systems. In line with the decree of Prime Minister No 46 of 6 March 2017 on the setting up of an expert working group that would submit proposals on the optimisation of network of state higher education institutions, an expert working group was set up to assess the potential of the network of higher education institutions on the basis of demographic situation, financial resources, scientific potential and effectiveness of management, prepare and submit to the Government by 28 April 2017 proposals on the optimisation of network of higher education institutions.

To ensure the follow-up of measures aimed to increase the accessibility to pre-school and preparatory education, measure 'Increased Accessibility to Pre-school and Preparatory Education' under the EU investments related Action Programme for 2014-2020 will be implemented by 2020. The implementation of this measure will result in modernisation of 20 pre-schools that provide pre-school and preparatory education (refurbished education premises of institutions, facilities to house 2 000 additional children, etc.) and introduction of innovative models for organisation of pre-school education.

Aiming to ensure increased participation in adult education, the European Economic Area grant scheme 'Implementation of Norwegian experience in adult education in Lithuania' was implemented in Lithuania, services in the field of informal adult education were expanded and, in line with the results of the study under Programme for the International Assessment of Adult Competencies (PIAAC) in 2016, the following training measures were presented: 'Methodological guidance in relation to basic abilities' and 'Basic adult abilities. Results of PIAAC study. Handbook of best practices.'

Health care

46. According to Eurostat data for 2015, the average EU general government expenditure on health care amounted to 7.2 per cent of GDP, compared to 5.8 per cent of GDP in Lithuania. This indicator has increased in Lithuania in 2015 if compared to 5.5 per cent of GDP in 2014. The average EU general government expenditure remained the same in 2014 and 2015. Two things are significant in the assessment of general government expenditure on health care: what is the household out-of-pocket expenditure on health care (according to Eurostat data for 2014, these contributions averaged 1.5 per cent of GDP in the EU and 1.9 per cent of GDP in Lithuania); the development level of the country (more developed countries, with a higher GDP per capita, tend to spend more on health care compared to less developed countries). As reported by Eurostat, GDP per capita in Lithuania amounted to 75 per cent of the EU average in 2014 and 2015.

One of the indicators reflecting the quality of a health care system is average life expectancy. According to Eurostat, average life expectancy in Lithuania came to 74.7 years in 2014, trailing the EU average of 80.9. Over the 2013–2014 period, life expectancy in Lithuania grew faster than the EU average (by 0.6 years in Lithuania, compared to 0.4 years in the EU). According to OECD[15], one of the possible reasons behind the rather short average life expectancy is an unhealthy lifestyle. Based on Eurostat data for 2015, the mortality rate per 100 000 residents was nearly 1.4 times higher than the EU average. In 2015 this indicator in Lithuania was 1 430.1 compared to EU average of 1 026.6.

Eurostat reports that the structure of the Lithuanian general government expenditure on health care differs from the EU average. Lithuania's intermediate consumption in 2015 accounted for 16.8 per cent of total expenditure and 1 per cent of GDP, which was below the respective EU averages of 18 and 1.3 per cent. Expenditure on wages for health care system workers in Lithuania (35.9 per cent of the total 2015 expenditure on health care) were more than 9 percentage points above the EU average of 26.6 per cent, while its ratio to GDP (2 per cent) came very close, but just above the EU average of 1.9 per cent. Capital formation expenditure in Lithuania accounted for a similar share in total expenditure as in the EU in relation to GDP, however, according to Eurostat data for 2015, capital formation expenditure in Lithuania accounted for a larger share of all general government expenditure on health care in 2015. In Lithuania it accounted for 5.8 per cent of all general government expenditure on health care compared to the EU average of 3.5 per cent.

Based on Eurostat data for 2014, Lithuania had 43.1 practising physicians per 10 000 residents, compared to the estimated EU average of 34.8. According to Statistics Lithuania, this indicator went up slightly in Lithuania in 2015. Based on Eurostat data the ratio of practising physicians and practising nurses in 2014 stood at 1.6 in Lithuania, below the EU

[15] Link to OECD report http://www.oecd.org/countries/lithuania/oecd-economic-surveys-lithuania-2016-eco-surveys-ltu-2016-en.htm.

average estimate of 2.7. IMF regards an indicator value of 4 as an economical level for a country.

According to Eurostat data for 2014, Lithuania had 722.1 hospital beds (excluding nursing beds) per 100 000 residents, which is a slightly smaller number than in 2013 but is 200 beds above the EU average of 521 bed. This indicator declined by 24 beds per 100 000 residents in Lithuania in 2015, according to the Statistics Lithuania data for 2015. The OECD informed that Lithuania's indicator is too high and that merger of hospitals and improvement of their administration could contribute to the efficiency of the health care system.

The plan for stage four of health care system development and hospital network consolidation was approved by Government Resolution No 1290 of 9 December 2015 "Approving the Plan for Stage Four of Health Care System Development and Hospital Network Consolidation”. This plan is intended to improve the quality and accessibility of health care services, to optimise the scope and structure of provided services, to rationalise the use of the financial and infrastructural resources of the health care system, to stabilise the financial state of health care institutions and to provide the possibilities for higher wages of health care system employees. An objective for 2016 was to develop a model for a more efficient and accurate monitoring of health inequality indicators in the course of the project "Development of a Model for the Strengthening of the Capacities to Identify and Reduce Health Inequalities", jointly implemented by the Lithuanian University of Health Sciences, the Institute of Hygiene, Vilnius University and Klaipėda University. To enable a more objective assessment of the health system activities, a model for the evaluation of health condition outcomes was developed in 2016, which describes the processes required to improve the quality of cause of death coding and to improve the accuracy of disease registration in order to reduce the likelihood of systemic errors. To reduce the level of corruption at health care institutions, there are plans to develop measures for reducing and eliminating the practices of unofficial payments in the health care sector and to introduce a single system for monitoring and assessment of corrupt practices in the health system. The anti-corruption initiative "Clean Hands" is already being implemented at the institutions of the national health system. These measures were approved by Order No V-1565 of the Minister of Health of the Republic of Lithuania of 30 December 2015 "Approving the Strategic Activity Plan of the Minister of Health of the Republic of Lithuania for 2016–2018".

In 2017 efforts will be made to ensure efficient functioning of national health care institutions by reducing the number of beds for active treatment and increasing the number of nursing beds. In addition actions will be taken to improve the performance of the public health care system by ensuring high-quality and modern vocational training of health care professionals, more efficient training of the public aimed at developing healthy lifestyle and by improving services related to preservation and improvement of public health and disease prevention.

Social security

47. According to Eurostat data for 2015, the Lithuanian general government spending on social security declined by 0.3 percentage points of GDP to 11.1 per cent of GDP and further departed from the EU average of 19.2 per cent of GDP in 2015.

The Gini coefficient is one of the qualitative indicators in the field of social security, reflecting the scale of social inequality. The higher the coefficient, the more severe social inequality is. Eurostat reported in 2015 that Lithuania's and EU average index (37.9 and 31) increased in comparison with the index in 2014 (35 and 30.9).

According to Eurostat data for 2015, the share of people who experience the risk of poverty has increased from 27.3 per cent of the Lithuanian population in 2014 to 29.3 per cent of the Lithuanian population in 2015. This indicator shows a negative development when compared to other EU Member States. The EU average declined from 24.4 per cent of the total population to 23.7 per cent during the same period.

Based on Eurostat data for 2014 and 2015, birth rate per 1 000 residents in Lithuania amounted to 10.4 and 10.8, surpassing the EU averages of 10.1 and 10. The fertility rate in Lithuania has also increased and was slightly higher than the EU average. In 2015, this rate stood at 1.7 in Lithuania, i.e. 0.12 above the EU average although in 2014 the difference of this average indicator in Lithuania and EU was only 0.05.

As reported by Eurostat for 2015, the ratio of pension income of residents aged 65-74 to the average income from employment of residents aged 50-59 in Lithuania increased to 0.46 from 0.45 in 2014, however, it falls further behind the EU average of 0.57 for the year 2015.

In Lithuania, the general government expenditure on pensions in 2013 accounted for 7.2 per cent of GDP, compared to the EU average of 13 per cent of GDP. In 2014 and 2015 this indicator decreased in Lithuania and, according to preliminary data of Statistics Lithuania, amounted to 6.9 per cent of GDP in 2015. Expenditure on ill and disabled people in 2013 accounted for 2.8 per cent of GDP, which was equal to the EU average for the same year. In 2014 and 2015, in Lithuania expenditure on ill and disabled people (per cent of GDP) stayed nearly on the same level as the EU average. As highlighted in the IMF study of 2015, although reforms have tried to address high disability spending through tightening the certification system, the number of disabled beneficiaries has continued to increase in recent years, preventing any reduction in expenditure in this area. Expenditure on families and children in 2014 and 2015 were 0.7 percentage points below the EU average of 1.7 per cent of GDP. As reported by Eurostat, general government expenditure on the unemployed increased from 2013 to 2015 and amounted to 0.6 per cent of GDP in 2015. This indicator is 0.8 percentage points below the EU average of 2014.

Statistics Lithuania reports that the total number of pension recipients went down from 926 600 in 2013 to 912 300 in 2015. According to Eurostat data, the change in population (measured in units per 1 000 residents) due to birth and mortality rates deteriorated, remained negative in 2015, totalling -3.5 while the EU average deteriorated to -0.2 when compared to

0.3 in 2014. The change in population (in units per 1 000 residents) in Lithuania due to immigration deteriorated, remained negative in 2015, totalling -7.7 (-4.2 in 2014) against the EU average of 3.7 (2.2 in 2014).

According to IMF, low spending on social security may have contributed to poor social outcomes, e.g., high income inequality level and a high at-risk-of-poverty rate. The IMF indicates that reforms in this area might help increase the efficiency of social security and address the growing spending pressures.

In 2017 structural reform, so called social model has been launched. The aim of the social model reform is to ensure that pensions are indexed according to the multi-annual gain of the wages fund, the coverage and adequacy of the unemployment social insurance payments is improved, long-term employee benefit fund is functioning and the number of those attributed to the insured is increased. Moreover, in 2017 the maximum non-taxable allowance on lowest income earners, persons raising children and disabled workers as well as child benefits are increased.

At present Lithuania's municipalities apply a uniform monetary social assistance model according to which the function of providing monetary social assistance to low-income residents in the form of compensations for home heating costs as well as hot and drinking water costs is an independent function of municipalities funded from the municipal budgets.

Effective provision of monetary social assistance, improving economic situation in Lithuania, along with positive changes in the labour market have contributed to the decrease in the number of assistance beneficiaries as well as lower assistance expenditure. In every month of 2016, social benefits were received by an average of 88 000 persons (3.1 per cent of the Lithuanian population). This represents a 20.5 per cent decrease compared to the year 2015 (from 110 700 down to 88 000 persons). As a result social benefits spending shrank by 21.4 per cent (from EUR 77.3 million to EUR 60.75 million). The ongoing monitoring of the monetary social assistance scheme has shown that the majority of social assistance beneficiaries exiting the scheme succeed in finding a job (47 per cent in 2014, 45.2 per cent in 2015 and 43 per cent in 2016).

Changes in beneficiaries and number of beneficiaries revealed that assistance is effective and monetary social assistance scheme is compatible with its key purpose that is to help people when they are in most need of assistance, encourages persons who receive assistance to join in the labour market and reduces long-term reliance on social assistance scheme.

In implementing the EU Council Recommendation of 18 May 2016 on the 2016 National Reform Programme of Lithuania and delivering a Council opinion on the 2016 Stability Programme of Lithuania, bearing in mind the results of the monitoring of the implementation of legal regulation of monetary social assistance, striving to improve access to social assistance for low-income residents, improve the adequacy of assistance and to encourage working-age employable persons to join in the labour market on 20 September 2016 amendments to Articles 1, 2, 8, 10, 12, 17, 20, 23, 25 and Annex of the Law of the

Republic of Lithuania on Monetary Social Assistance for Low-income Residents have been adopted. They stipulate that proportional reduction of social benefits is applied to persons who are able to work and are of working age but are not employed (including those who are not self-employed), supplement the list of cases when the scheme of proportional reduction of social benefits is not applied, ensure more favourable conditions to receive part of additional social assistance after entry into employment, etc. Plans are underway to improve the compatibility of monetary social assistance, social services and active labour market policy measures by moving gradually away from passive forms of assistance towards active forms of assistance that stimulate employment in integrating the unemployed into the labour market. In recent years the level of activity of residents was raised by the Employment Enhancement Programme 2014–2020 that has been successfully implemented by the Government. The Programme was approved by Government Resolution No 878 of 25 September 2013 "Approving the Employment Enhancement Programme 2014–2020" (hereinafter referred to as "the Employment Enhancement Programme") and is aimed at maximising resident employment, so that every resident could find a job matching his or her qualifications and ensuring a decent standard of living. To implement the Employment Enhancement Programme, the objectives set out in the Interinstitutional Action Plan for 2016–2018 were pursued, the tasks and measures to create jobs and stimulate labour demand as well as to deal with the mismatch between the workforce skills and labour market needs were carried out and the integration of unengaged workforce into the labour market was supported.

Culture

48. According to Eurostat data for 2015, the Lithuanian general government spending on culture experienced annual growth in the order of 0.1 percentage point of GDP during the period 2011-2015 and amounted to 1.8 per cent of GDP in 2015. The average EU general government spending on culture remained the same and amounted to 1 per cent of GDP during the same period.

According to Eurostat data, in 2011 57.3 per cent of people of the 25-64 age group were in a concert or theatre at least once a year, which is more than EU average (43.5 per cent). Statistics Lithuania reports that in 2011 the number of spectators in theatres and events held by state concert organisations was the lowest over the last 10 years. Since then until 2015 the number of spectators has increased by more than 1.6 times, however owing to the lack of data, it is not possible to evaluate changes in attendance in cultural events in other EU countries. According to Eurostat data, in 2011 34.5 per cent of Lithuania’s people of the 25-64 age group went to museum, gallery or other culture related place, which is less than the EU average (45.5 per cent). However, Statistics Lithuania reports that the total number of people visiting museums increased by 1.5 time from 2011 to 2015. According to Eurostat data of 2011, 54.7 per cent of Lithuania’s people read at least one book during the last 12 months which is less than the EU average (60 per cent). According to Statistics Lithuania, the number of library visitors has declined by 10 per cent during 2011-2015.

Agriculture, forestry, fishery and hunting

49. According to Eurostat data of 2015, the Lithuanian general government spending on agriculture, forestry, fishery and hunting amount to 1 per cent of GDP, which is more than the EU average (0.2 per cent of GDP). The Lithuanian general government spending on this sector in relation to GDP is higher than in any other country of Central and Eastern Europe, except Bulgaria.

Agriculture. According to Eurostat data of 2013, the value of agricultural production produced in Lithuania per one hectare of land used (EUR 670.8 per hectare) was among the lowest in the countries of Central and Eastern Europe and overtook only Latvia (EUR 527.2 per hectare). The value of production of Poland in 2013 was twice as high as Lithuania's value and amounted to EUR 1 512.7 per hectare. According to Eurostat data of 2013, the number of farms in Lithuania compared to the number of farms in the countries of Central and Eastern Europe was much lower than in Romania, Poland, Hungary and Bulgaria, but higher than in Latvia, Estonia, Czech Republic, Slovenia and Slovakia. The number of people employed in Lithuania's farms is relatively low when compared to other countries of Central and Eastern Europe. The ratio of number of people directly employed in agricultural sector to the number of farms in Lithuania in 2013 was among the lowest among the countries of Central and Eastern Europe and amounted to 0.84. In 2013 only the ratio in Romania (0.43) was lower than the ratio in Lithuania; the ratio in all other countries of Central and Eastern Europe, except Hungary, amounted to at least 1 (the ratio in Czech Republic was 4).

Justice and law enforcement

50. According to Eurostat data of 2015, the Lithuanian general government spending on public order and security declined by 0.1 percentage point as from 2014 and amounted to 1.6 per cent of GDP. For the fifth consecutive year the EU average remained stable and amounted to 1.8 per cent of GDP.

According to Eurostat data the number of victims of intentional homocides per 100 000 population in Lithuania in 2014 amounted to 5.4 and was 5 times higher than the EU average (1.1). The number of such victims in other Baltic states is also much higher than the EU average (in Latvia - 3.2, in Estonia - 3.12). According to Eurostat data of 2014, the number of victims of sexual violence per 100 000 population in Lithuania was much lower than the EU average: in Lithuania this indicator amounted to 4.25 compared to EU average of 15.16.

The number of policemen per 100 000 population in Lithuania was close to the EU average. According to Eurostat data of 2014, the number of policemen per 100 000 population in Lithuania was 322.2 compared to EU average of 333.6. The number of policemen per 100 000 population in Latvia in 2014 was 440.3 while the number of policemen in Estonia amounted to 310.8.

The 2016 EU Justice Scoreboard of European Commission provides estimates concerning average time necessary to solve cases in courts of first instance in EU Member States. According to data of 2014, although the average time necessary to solve cases in courts of first instance in Lithuania has increased over the past few years, this indicator is still among the best in the EU Member States. Lithuania is surpassed only by Denmark, Estonia, Austria, Poland and Hungary. However, according to Eurostat data, the number of professional judiciary per 100 000 population in Lithuania in 2014 amounted to 25.7 compared to EU average 17.1.

The number of people employed in adult prisons per 100 000 population in the Baltic states is the highest in the EU. According to Eurostat data of 2014, the number of people employed in adult prisons per 100 000 population in Lithuania is 100.4, in Latvia - 127.2, in Estonia - 120 compared to EU average of 59.4 (in 2014) which is almost two times lower than that in Lithuania. However, according to Eurostat data, the number of imprisoned persons per 100 000 population in Lithuania in 2014 was the highest in EU. This indicator in Lithuania amounted to 293.4, in Latvia - 237.1, in Estonia - 230.6 compared to the EU average of 115.8.

Transport

51. According to Eurostat data, Lithuania's general government expenditure on transport in 2015 increased by 0.2 percentage point and amounted to 1.4 per cent of GDP. The average general government spending on transport of EU countries in relation to GDP in 2015 remained stable, was higher than that in Lithuania and amounted to 2 per cent of GDP.

The number of fatalities per 100 000 population in Lithuania is among the highest in the EU, although it significantly declined during the past ten years (by 3 times). According to Eurostat data, in 2015 in Lithuania this indicator amounted to 8.3 and surpassed the EU average (5.2). In 2014 Latvia, Romania and Bulgaria surpassed Lithuania according to the number of fatalities per 100 000 population.

According to Eurostat data of 2014, freight (tons of freight per one kilometre) ratio to GDP in Lithuania was among the highest in EU. In Lithuania this indicator amounted to 119.9 compared to EU average of 90.6. According to Eurostat data of 2014, number of kilometres travelled ratio to GDP in Lithuania was 57.1, although in 2013 this indicator amounted to 77.8. In 2013 and in 2014 the EU average amounted to 97.9.

Environmental protection

52. In 2015 Lithuania's general government expenditure on environmental protection declined by 0.1 percentage point and its ratio to GDP was lower than the EU average. According to Eurostat data of 2015, Lithuania's general government expenditure on environmental protection amounted to 0.5 per cent of GDP compared to the EU average of 0.8 per cent of GDP.

According to Eurostat data, in 2014 level of greenhouse gas emissions (CO_2) indexed in 1990 amounted to 40.7 per cent which is the lowest among the EU countries (EU average in 2014 amounted to 77.1 per cent).

Although from 2012 to 2014 the amount of waste in Lithuania's landfills declined by 10 percentage points, according to Eurostat data, in 2014 this indicator amounted to 48 per cent (the EU average amounts to 25 per cent and is nearly two times lower). The amount of municipal waste processed in Lithuania is lower than the EU average. According to Eurostat data, in 2015 municipal waste processed in Lithuania amounted to 33.1 per cent (EU average amounted to 45 per cent).

Aiming to reduce the dependency on imported fuel, in 2016 harmonious development of renewable energy sources was ensured in Lithuania. Strategic goals defined in relation to renewable energy sources contributed to rapid development of local energy production capacities and renewable energies.

In line with the Programme on the modernisation of blocks of flats approved by Resolution No 1213 of 23 September 2004 of the Government of the Republic of Lithuania "On the Approval of the Programme on the Modernisation of Blocks of Flats" 784 blocks of flats were modernised in 2016. On the initiative of residents 1 280 measures aimed at improving energy efficiency were applied in blocks of flats. As from 2005 thermal costs calculated in blocks of flats that were built in line with construction standards applicable up to 1993 were reduced by 14.4 per cent (plans are underway to reduce such costs by at least 20 per cent by 2020). In 2017 plans are underway to modernise at least 500 blocks of flats, thus thermal costs calculated in blocks of flats should continue to decline.

SECTION II
ANALYSIS OF ASSETS AND EXPENDITURE

53. With the aim to define assets and expenditure related fields of appropriations managers, that could be made more effective, analysis[16] of data related to assets and expenditure in 2014–2015 of appropriations managers (17 appropriations managers including ministries, Office of the Seimas, Office of the Government, Office of the President of the Republic of Lithuania) and subordinate institutions[17] was performed.

The comparison of assets and expenditure related fields of appropriations managers revealed that expenditure incurred or assets of certain appropriations managers are much higher (lower) than those of other appropriations managers. Greatest imbalances were noticed in the fields of vehicles and software as well as in expenditure on general repair and

[16] Assets and expenditure ratio to expenditure on wages and social insurance (indicator) forms the basis of the analysis. Expenditure on wages and social insurance serves as a denominator because it indicates the size of appropriations managers. Due to considerable differences between certain indicators they are not taken into account when calculating average values and standard deviation values in order to avoid distortion of analytical results.

[17] During the period in question the Ministry of Energy of the Republic of Lithuania, Office of the Seimas and Office of the President of the Republic of Lithuania had no subordinate institutions, thus analysis covered only assets and expenditure related data of those institutions.

exploitation. The average value of coefficient of variation[18] in 2014 amounted to 1.13, in 2015 it improved and amounted to 1.04, however in 2014 and 2015 this value did not show much change and was similar in certain fields. When comparing the indicators of appropriations managers attention should be paid to the disproportion between expenditure incurred and assets and efforts should be made to ensure a more effective use of expenditure and management of assets.

Table 19. Results of analysis of expenditure and assets

Indicator	Coefficient of variation		Sum of expenditure and assets analysed, % of GDP	
	2014	2015	2014	2015
Business trips and training related expenditure	0.77	0.71	0.12	0.11
Expenditure on leasing*	0.91	1.06	0.05	0.06
Expenditure on general repair and exploitation**	0.85	1.12	0.36	0.41
Expenditure on utility services and communications	0.37	0.38	0.31	0.29
Expenditure on transport***	0.90	0.64	0.15	0.13
Assets consisting of software tools and their licences	1.56	1.05	0.11	0.20
Expenditure on other services purchased****	1.02	0.99	0.77	0.71
Assets consisting of furniture and office equipment	0.58	0.57	0.23	0.29
Assets consisting of vehicles***	1.96	1.56	0.34	0.60
Assets consisting of machinery and other equipment***	0.99	1.13	1.16	1.36

Source: Ministry of Finance of the Republic of Lithuania
Calculations of arithmetic average and standard deviation exclude: *Ministry of Foreign Affairs of the Republic of Lithuania **Ministry of Transport of the Republic of Lithuania, ***Ministry of Defence of the Republic of Lithuania, ****Ministry of Energy of the Republic of Lithuania.

Table 20. General government expenditure by function

Indicator	COFOG Code	% of GDP, ESA' 2010				Additional information on the increase of certified expenditure from the State and municipal budgets in 2017 when compared to the plan of 2016 and cash flows, EUR million
		2014	2015	2016*: *preliminary data*	2020	
1. General public services	01	4.6	4.4	3.9	–	*-26.6*
2. Defence	02	1.1	1.3	1.5	–	*+157*
3. Public order and safety	03	1.7	1.6	1.5	–	*+74.8*
4. Economic affairs	04	3.2	3.6	3.1	–	*-91.6*
5. Environmental protection	05	0.6	0.5	0.6	–	*+59.6*

[18] The coefficient of variation means the ratio between standard deviation in a field and arithmetic average. The closer the value of the coefficient of variation to the zero, the weaker the dissemination of data.

Indicator	COFOG Code	% of GDP, ESA' 2010				Additional information on the increase of certified expenditure from the State and municipal budgets in 2017 when compared to the plan of 2016 and cash flows, EUR million
		2014	2015	2016*: *preliminary data*	2020	
6. Housing and community amenities	06	0.3	0.3	0.4	–	*-21.2*
7. Health care	07	5.5	5.8	5.9	–	*+28.5*
8. Recreation, culture and religion	08	0.9	0.9	1.0	–	*+27.3*
9. Education	09	5.4	5.4	5.0	–	*+164.2*
10. Social security	10	11.4	11.1	11.3	–	*+120.3*
11. Total expenditure		34.7	35.1	34.2	35.4	

Sources: Statistics Lithuania, Ministry of Finance of the Republic of Lithuania
* General government expenditure decreased due to temporary decline in EU funds and other international financial support in 2016 when compared to expenditure in 2015.

CHAPTER VII
SUSTAINABILITY OF GENERAL GOVERNMENT FINANCES

54. Long-term sustainability of public finances represents a problem for all EU countries, aggravated by financial and debt crisis. To achieve long-term sustainability of public finances, it is extremely important to reduce the general government debt, to increase employment and to carry out structural reforms.

55. In the long term, sustainability of public finances will be determined by changes in the demographic structure of 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 was made based on the assumption that the decisions taken in the medium-term in the areas of health, pension and education will continue to be implemented in the long-term, and therefore, it is important to emphasize that the Projection does not reflect the most likely future scenario. The aim of the Projection is to identify the challenges of public finances that are associated with demographic changes.

The Projection is based on the demographic projection for Lithuania until 2060, done by Eurostat in 2013. According to this Projection, Lithuania's population is to shrink to 1.8 million (from 2.89 million in 2016) from 2016 to 2060. Compared with the Eurostat demographic projections made in 2011, the number of the population in 2060 will have decreased by 311 thousand, or 9.5 per cent of the population, having taken into account the results of the 2011 census, and by 836 thousand of the population due to the expected negative net migration. From 2016 to 2060, the number of the working age population (15-64) will decrease from 65.6 per cent to 56.1 per cent, whereas the number of elderly people (65+) will increase from 19 to 25.8 per cent of the total population. Based on the new methodology used by Eurostat, owing to migration the number of the working-age population will be shrinking at a particularly rapid pace between 2020 and 2030 – at about 3 per cent per year, which will have a negative impact on GDP. According to Eurostat's new demographic projections for the growing birth rates from 2016 to 2060, the number of children will increase in Lithuania: children aged between 0-14 – from 14.7 per cent in 2016 to 17.8 per cent in 2060, school age children (7-16) – from 9.5 per cent to 12.4 per cent, while 15-19 year olds – from 5.6 per cent to 6.2 per cent of the total population.

Table 21. Long-term sustainability of general government finances

Indicator	% of GDP						
	2007	2010	2020	2030	2040	2050	2060
1. Total expenditure	35.3	42.3	35.4	34.8	34.5	34.4	34.1
of which: age-related expenditure	17.2	20.7	16.3	15.7	15.4	15.3	15.0
pension expenditure*	6.6	8.6	6.7	6.0	5.6	4.9	4.3
social security pension	6.6	8.6	6.7	6.0	5.6	4.9	4.3
old-age and early pensions	4.7	6.2	5.1	4.6	4.5	3.9	3.2
other pensions (disability, widows' and survivors')	1.8	2.4	1.7	1.3	1.1	1.1	1.0
occupational pensions (general government sector)	–	–	–	–	–	–	–
health care	4.8	4.8	4.4	4.3	4.4	4.3	4.1
long-term health care	0.6	1.1	1.0	1.2	1.4	1.6	1.6
education expenditure**	5.2	6.2	4.0	3.9	3.9	4.2	4.9
other age-related expenditure***	0.1	0.4	0.1	0.3	0.2	0.2	0.2
interest expenditure	0.7	1.8	0.7	0.7	0.5	0.3	0.3
2. Total revenue	34.3	35.4	36.7	36.7	36.7	36.7	36.7
of which: property income	0.6	0.7	0.6	0.6	0.6	0.6	0.6
of which: from pensions contributions (or relevant social insurance contributions)****	6.4	6.8	7.5	6.0	5.9	5.9	5.9
Pension reserve fund assets	2.9	–	–	–	–	–	–
of which: consolidated public pension fund assets*****	1.7	4.1	10.2	24.1	37.8	48.3	56.1
Systemic pension reforms							
Social insurance contributions diverted to mandatory private scheme	0.9	0.3	0.8	0.7	0.7	0.7	0.7
Pension expenditure paid by mandatory private scheme	0.0	0.0	0.0	0.2	0.5	0.8	1.3
Assumptions							
Labour productivity growth	7.2	6.1	3.9	2.4	1.7	1.7	1.5
Real GDP growth	11.1	1.6	2.4	-0.1	1.2	1.2	1.7

Indicator	% of GDP						
	2007	2010	2020	2030	2040	2050	2060
Participation rate males (aged 20-64)	79.9	80.6	81.1	80.6	81.2	82.0	82.5
Participation rate females (aged 20-64)	72.2	76.0	75.7	76.6	76.0	76.9	78.1
Total participation rate (aged 20-64)	75.9	78.2	78.3	78.5	78.6	79.5	80.3
Unemployment rate (aged 20-64)	4.2	17.8	5.6	9.5	7.4	7.4	7.4
Population aged 65+ over total population (beginning of the year)	16.6	17.3	20.7	27.7	30.8	28.3	25.8

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

* Pension expenditure has been calculated following the methodology of the Commission presented in the document "Pension projection exercise 2015: Revised framework – 1 amendment" (Brussels, 21 November 2013).

** 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.

56. Table 21 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-2020, the economic scenario drafted by the Ministry of Finance of the Republic of Lithuania in spring 2017, as well as economic and employment assumptions for 2021-2060 agreed by the Economic Policy Committee (EPC) in autumn 2014. The projections have been built on the basis of the existing Lithuanian national legislation on social security, health care and education.

57. Table 21 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 assistance benefits). State pensions (including social assistance benefits) are funded directly from the State budget. As compared to the pension spending projection provided in Lithuania's Stability Programme for 2016, the pension spending will decline significantly in 2060 due to the ongoing social insurance pension reform (the difference is 3.1 percent of GDP).

The comparison of the reformed and unreformed social insurance pension system during the entire period of 2016-2060 predicts that the most of the decline will occur in 2041 – to 3.7 per cent of GDP. The reduction in spending is mostly influenced by the new pension indexation procedure, which sustains pension spending increase at a steady rate, matching the pace of wages fund and GDP growth. According to the latest social security expenditure projections of pension spending, the pension expenditure in percentage of GDP will decline from 6.8 per cent in 2016 to 6 per cent in 2026 due to the increases in both the retirement age and the required length of pensionable service. Later on the said expenditure will remain constant until 2035. From 2035, with the decreasing trend in the elderly population (as an effect of formerly massive emigration) and growing trend in children and working-age population, pension spending will gradually come down, accounting for 1.6 per cent decrease of GDP in 2060 as compared to 2035. Another important reason for this decline is that the major part of the retired population is already receiving reduced social insurance contributions due to the Pillar II pension scheme reform. Between the projection years 2016 to 2060, social security pension spending will decrease by 2.6 per cent of GDP.

58. The reduction of social insurance pension spending was greatly influenced 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. At the end of 2016, there were 1. 256 million people who accumulated assets in private pension funds, of whom 66 per cent paid contributions. At the end of 2016, the participants who contribute to the pension scheme were distributed as follows: those who pay an additional 2 per cent from their salary and receive a contribution from the State budget of 2 per cent of the size of the average wage of the year before last (52 per cent), and those who have chosen to accumulate only a part (2 percentage points) of the social pension insurance contribution rate (48 per cent). The tax revenues for implementation of the pension reform that are transferred to private pension funds will be growing from 0.6 to 0.68 per cent of GDP in 2016-2019 to reach 1.05 per cent of GDP in 2020. Contributions transferred from the State budget make up 0.2 per cent of GDP. In 2016-2019, the contribution tariff of pension accumulation from state social insurance will stand at 2 per cent, and as of 2020 – at 3.5 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 on average make about 1.3 per cent of GDP and will be 0.1 per cent of GDP above the projected value specified in the Stability Programme of Lithuania for 2016 due to the modified medium-term macroeconomic assumptions.

59. Pension fund assets in 2060 are projected to reach 56.1 per cent of GDP and benefits paid from private pension funds will amount to 1.3 per cent of GDP. Expenditure of social insurance pensions and pension expenditure of pension funds will together reach 5.5 per cent of GDP in 2060.

60. The growing number of the elderly population will call for larger spending on long term health care (share of GDP): in 2016-2060 it will increase by 0.6 per cent of GDP.

61. According to the demographic projections of Eurostat in 2013, the estimated education spending in 2016-2060 will increase by 0.3 of GDP.

CHAPTER VIII
ASSESSMENT OF CONSISTENCY OF THE PROGRAMME WITH THE NATIONAL REFORM AGENDA

62. The direct impact of reforms specified in the National Reform Agenda, as well as other structural reforms-related measures, on the government sector balance has been taken into account in calculating general government financial indicators covered in the Programme. Table 22 illustrates the impact of the structural reforms on the budget. It shows the data related to reform allocations and year-on-year changes as of 2016.

Table 22. 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	Spending/ revenue category (according to ESA'2010)	2016		2017		2018		2019		2020	
			EUR million	% of GDP	change, m. euros	% of GDP	change, m. euros	% of GDP	change, m. euros	% of GDP	change, m. euros	% of GDP
1.	Education and science reform [1]	IC and GFCF	158.7	0.4	73.8	0.2	259.8	0.6	94.9	0.2	51.5	0.1
2.	Agriculture reforms[2]	IC and GFCF	95.5	0.2	60.1	0.1	9.5	0.0	-32.7	-0.1	-12.5	0.0
3.	Healthcare reform[3]	IC and GFCF	0.2	0.0	1.5	0.0	-1.7	0.0	0.0	0.0	0.0	0.0
4.	Taxation reform [4]	RDT	-14.3	0.0	-111.1	-0.3	-100.0	-0.2	0.0	0.0	0.0	0.0
		RIT	100.4	0.3	208.0	0.5	61.0	0.1	5.0	0.0	2.0	0.0
		Social contributions	55.4	0.1	18.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
5.	Environment protection policy[5]	IC	154.5	0.4	29.1	0.1	57.9	0.1	-26.8	-0.1	-69.9	-0.2
6.	Competitiveness policy[6]	IC and GFCF	50.1	0.1	28.0	0.1	100.8	0.2	17.2	0.0	-6.2	0.0
7.	Upgrading/building new transport and communications network [7]	GFCF	202.8	0.5	126.4	0.3	95.8	0.2	-147.7	-0.3	-116.4	-0.3
8.	Implementation of the social model		0.0	0.0	220.0	0.5	286.0	0.7	191.0	0.4	194.0	0.4
Overall direct impact on the budget			803.3	2.1	654.5	1.6	769.0	1.8	101.0	0.2	42.4	0.1
9.	Total spending on pension accumulation reform		232.8	0.6	22.7	0.1	23.2	0.1	24.3	0.1	183.5	0.4

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

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

* National funding, EU funding, or national and EU funding (in case of co-financing).

[1] The National Education Strategy for 2013-2022 Resolution No XII-745 of the Seimas of 23 December 2013); Action Plan for 2016-2018 of the National Programme for the Development of Studies, Scientific Research and Experimental (Social and Cultural) Development for 2013-2020 (Order No V-204 of the

No	Major measures of structural reforms	Spending/ revenue category (according to ESA'2010)	2016		2017		2018		2019		2020	
			EUR million	% of GDP	change, m. euros	% of GDP	change, m. euros	% of GDP	change, m. euros	% of GDP	change, m. euros	% of GDP

Minister of Education and Science of 17 March 2016).

[2] Entrepreneurship incentives; implementation of the Law of the Republic of Lithuania on Renewable Energy Sources; national climate change management, youth employment policy measures; promotion of innovation-related activities.

[3] The fourth stage of health system expansion and hospital network consolidation (Resolution No 1290 of the Government of the Republic of Lithuania of 9 December 2015).

[4] Amendments to the laws of the Republic of Lithuania related to taxation system changes: in accordance with the up-to-date information, as provided in the Programme.

[5] The Programme for the Renovation (Modernization) of Apartment Blocks (Resolution No 1213 of the Government of the Republic of Lithuania of 23 September 2004); energy consumption and higher production efficiency projects; projects encouraging the use of renewable energy sources and the introduction of environmentally friendly technologies; renovation and development of water supply and waste water treatment systems (Order No D1-717 of the Minister of Environment of 7 October 2015); establishment of the waste management system (Order No D1-248 of the Minister of Environment of 29 March 2010).

Promotion of innovations; encouragement of exports; industrial development; investment promotion; entrepreneurship promotion; improving the business environment; human resource development.

[7] National Programme for the Development of Transport and Communications for 2014–2022 (Resolution No 1253 of the Government of the Republic of Lithuania of 18 December 2013); Information Society Development Programme for 2014-2020: 'Digital Agenda of the Republic of Lithuania' (Resolution No 244 of the Government of the Republic of Lithuania of 12 March 2014).

Securing financial stability

63. On 23 November 2016, the Commission published legislative proposals on risk reduction measures that comprise amendments to the Regulation (EU) No 575/2013 of the European Parliament of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 2013, p. 1) (hereinafter CRR), the Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OL L 176, 2013, p. 338) (hereinafter CRD IV), the Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OL L 173, 2014, p. 190) (hereinafter BRRD) and the Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OL L 225, 2014, p. 1) (hereinafter

Single Resolution Mechanism Regulation), aimed at completing the post-crisis banking regulatory reform and strengthening the stability and resilience of EU banking system. The key elements of the banking regulatory reform are based on the internationally adopted standards of the Financial Stability Board and the Basel Committee on Banking Supervision (Basel III). The adoption and national transposition of the amendments of above-mentioned legislation will further enhance the resilience of the Lithuanian banking system against potential financial challenges.

64. In order to reduce the possible impact of systemic risks on the Lithuanian financial system, the Bank of Lithuania, in exercising its macroprudential policy mandate, continued in 2016 to implement the Macro-Prudential Policy Strategy approved by Resolution No 03-31 of the Board of the Bank of Lithuania of 12 March 2015 On the Approval of the Macro-Prudential Policy Strategy and was implementing macroprudential instruments. In implementing the first interim goal of that Strategy – to limit excessive credit growth and financial leverage and seek to avoid them – the Bank of Lithuania since mid-2015, each quarter, decides on the rate of the countercyclical capital buffer. The required capital buffer rate is established upon a comprehensive assessment of the situation in the credit and real estate markets. The Bank of Lithuania in its Resolution No 03-210 of the Board of the Bank of Lithuania of 22 December 2016 On the Application of the Countercyclical Capital Buffer made a decision to maintain the countercyclical capital buffer rate at 0 per cent (similar decision was taken in the previous quarters). A higher than 0 per cent countercyclical capital buffer rate would be set, if credit institutions required additional protection from excessive credit growth during the financial cycle upturn.

65. The Responsible Lending Regulations approved by Resolution No 03-144 of the Board of the Bank of Lithuania of 1 September 2011 on the responsible lending regulations ensure responsible lending in the environment of low interest rates and safeguard the financial system from the formation of imbalances. The loan-to-value ratio (LTV) may not exceed 85 per cent. Moreover, credit institutions are imposed with an obligation to ensure that the debt service-to-income ratio (DSTI) should not exceed 40 per cent and further to ensure that the ratio does not surpass 50 per cent, using a 5 per cent annual interest rate as a basis for calculations. The aim of this additional requirement is to safeguard households from the risk of encountering difficulties due to the increased loan repayments in case interest rates rise in the future. Besides, in order to prevent households from excessive indebtedness arising from long-term credits, the maximum loan term was limited to 30 years.

66. During the evaluation conducted in 2016, a decision was made to retain unchanged the list of institutions of national systemic importance, the capital buffer rate of other systemically relevant institutions that was assigned to the said institutions and the date from which that capital buffer is to be accumulated. The additional capital buffer requirement came into effect for systemically important institutions on 31 December 2016 pursuant to Resolution No 03-192 of the Board of the Bank of Lithuania of 15 December 2015 On the Setting of Capital Buffers for Other Systemically Important Institutions. The capital buffer

rate of other systemically important institutions is set at the end of each year with an aim to enhance the resilience of systemically important institutions against possible losses, and reduce their incentives for excessive risk-taking. 4 systemically important institutions were identified in Lithuania. A 2 per cent capital buffer rate, applied to other systemically important institutions, was set for AB SEB bankas, Swedbank, AB, and AB DNB bankas, and 0.5 per cent capital buffer rate was set for AB Šiaulių bankas.

67. On 19 November 2015, the Law Amending the Law No XI-393 of the Republic of Lithuania on Financial Sustainability and amendments to other related legislation were adopted, which transpose into the Lithuanian law BRRD provisions.

68. In 2016, the Bank of Lithuania started carrying out the functions of the national resolution authority, in accordance with the above-mentioned Law Amending the Law on Financial Sustainability and the amendments, effective from December 2015, of other related legislation transposing into the Lithuanian law BRRD provisions.

Having become the national resolution authority, the Bank of Lithuania began to participate in the Single Resolution Mechanism and in the activities of the EU level resolution body, the Single Resolution Board. The Single Resolution Board acts in close coordination with the supervisory authority, the European Central Bank, for the establishment of an effective banking resolution regime of the eurozone Member States, in which bail-in tool is an essential element. The Single Resolution Board is the central coordinating body of the Single Resolution Mechanism with the mission to restructure failing banks in such a way as to ensure a minimal impact on the real economy and public finances. The Board conducts the mission jointly with the national resolution authorities, including the Bank of Lithuania. The Board is determined to develop, in advance, the resolution plans for banks and remove the obstacles to bank resolution, and where there is a real probability of failure, to apply, together with the national resolution bodies, an efficient group resolution scheme.

In 2016, the Bank of Lithuania joined the work of the resolution colleges of Swedish, Danish and Latvian banking groups where the drafting of the first resolution projects of AB SEB bankas as well as bank groups, including Swedbank, AB, Danske Bank, Nordea Bank and Citadele Banka, was launched. At this stage, a choice was made of the resolution strategy and the scale of the critical functions, failure of which would have a negative effect on the real economy and financial stability. The Bank of Lithuania started the preparation of the resolution plan of the AB Šiaulių bankas. In terms of the size of the banking sector assets, drafting of the resolution plans in 2016 covered 80 per cent of the market. The bank of Lithuania for the first time performed the provisional calculation of the minimum requirement for own funds and eligible liabilities (hereinafter MREL). The MREL is an additional financial backstop tool, which, together with supervisory capital requirements, must ensure the orderly resolution of the banks experiencing difficulties in their functioning, i.e. ensure that they have sufficient resources to write down losses and convert them into capital.

69. After the implementation of the BRRD, in 2015 the national resolution fund started to accumulate contributions to be paid by banks and major investment firms. The

national resolution fund will be used to resolve problematic financial institutions so that their own funds, and not those by the taxpayers are used to cover the costs. In January 2016, the Single Resolution Fund began its formal operation for the gradual pooling of the contributions paid nationally by Banking Union Member States. The target level of the Fund aimed at 1 per cent of the covered deposits of the Banking Union's banks (about EUR 55 billion) should be accumulated by 2024. The individual *ex-ante* payments of banks to the Fund depend on their size and risk profile, which is assessed on the basis of uniform calculation of risk indicators. In the middle of 2016, the amount of *ex-ante* contributions collected by the Fund was EUR 64 billion. In 2016, the banks operating in Lithuania paid to the Fund EUR 7.4 million, and a further amount of EUR 10.1 million that had been collected in 2015 as contributions was transferred to the Fund.

On 10 February 2016, the Ministry of Finance of the Republic of Lithuania signed a loan facility agreement with the Single Resolution Board. Under this agreement, if in case of necessity to resolve a bank licensed in the Republic of Lithuania the resources available in the Single Resolution Fund are insufficient for financing the resolution, the Ministry of Finance of the Republic of Lithuania would lend to the Board the remaining amount (however not more than EUR 33 million). The loan should ensure that the resolution runs smoothly and help avoid the possible contagion within the financial sector. The loan would be paid off within 2 years from its granting, after the Single Resolution Board collects the respective contributions from the Lithuanian banks. Similar loan facility agreements have to be signed by all members of the Board. The loan facility agreement is applicable until 2024, unless it is agreed earlier, at a European level, on the single final stability tool, which (at the latest in 2024) will replace the national loan facility agreements concluded with the Single Resolution Board.

70. Experience of the recent years shows that sustainability of the credit union sector performance faces a number of challenges: 6 credit unions went bankrupt in Lithuania in 2013-2016, while as many as 25 credit unions worked at a loss in 2016. In order to stabilize and strengthen the Lithuanian credit union sector performance and implement the legal conditions of the Concept of Sustainable Credit Union Activity, approved by Decision No 109-S-1 of the Budget and Finance Committee of the Seimas of 18 March 2015 'On the Implementation of the Concept of Sustainable Credit Union Activity and the Drafting of the Amended Legislation of the Republic of Lithuania provided therein', the Seimas, on 30 June 2016, adopted the Law Amending the Law No VIII-1682 of the Republic of Lithuania on the Central Credit Union and the Law Amending the Law No I-796 of the Republic of Lithuania on Credit Unions, requisite for the implementation of the envisaged systemic reform of the credit union sector. The adopted laws will help to reform Lithuania's credit union system so that it is safe, reliable, transparent, and competitive, hence ensuring appropriate contribution of this sector into the national economic and social prosperity. In order to enable a successful strengthening of the sector's integration and the creation of an efficient self-regulation system, the laws require all credit unions to belong to organizations that unite them and to allow the

establishment of new central credit unions[19] that satisfy the capital requirements according to CRD IV and CRR on a consolidated basis.

Development of financial markets

71. With a view to encouraging the development of financial markets and enhancing their stability, improvements in sector-specific legislation will be made, taking into account the priority measures of the Government's Programme and the provisions of EU regulations.

To ensure a high level of protection of the rights and interests of consumers of payment services in the use of the said services and encourage the competition among payment service providers, the regulatory framework of payments, payment institutions, electronic money and electronic monetary institutions will be reviewed.

The reform of the credit union sector and strengthening of the credit union system's stability will aim to achieve, as from 1 January 2018, the compliance by central credit unions with the capital requirements according to CRD IV and CRR on a consolidated basis.

In order to increase financial stability and transparency of securities trading, mandatory transparency and reporting requirements for securities financing transactions will be set up.

To encourage the development of Lithuania's capital markets, the legislation on securitization, covered bonds, collective investment undertakings and risk capital will be reviewed. This will create a more competitive legal environment that will provide more possibilities for both enterprises seeking additional resources and investors alike. The regulation of financial markets will be improved to ensure a more efficient and safe operation of markets in financial instruments, to enhance the protection of non-professional investors and guarantee that all organized trade in financial instruments is conducted on regulated trading venues.

The Law of the Republic of Lithuania on Insurance will be revised to better protect the consumers of insurance services, i.e. uniform requirements will be set for all sellers of insurance products (insurance undertakings, insurance broking enterprises and insurance agents companies) as to how to provide to customers the information about the marketed products, personal recommendations, how to reveal the status of an intermediary and the type of remuneration received and other requirements. With the aim to ensure an equal position and a better legal certainty for financial market participants in the supervisory process, horizontal review of the regulation of financial services will be undertaken, including consolidation of the rights and obligations in respect of all supervised subjects of the Bank of Lithuania and unification of the supervisory procedures. Protection of non-professional investors who invest in packaged retail investment products and insurance-based investment products will be strengthened and the mechanism of the out-of-court settlement of financial services consumer disputes will be developed to include, besides the Bank of Lithuania, also

[19] The current Law of the Republic of Lithuania on the Central Credit Union establishes that only one central credit union may function in Lithuania.

other parties concerned. Drafting of the legal framework for the development of the Lithuanian *Fintech* sector and creation of an economic system favourable to that sector as well as new information technologies and products applicable to financial markets will be continued.

In order to ensure a transparent and efficient data accounting and operation control of gaming machines, more efficient prevention of money laundering and reinforce the accounting and control of the cash, paid in at gaming tables as well as gaming chips, to reduce the administrative burden for gaming operators, the Republic of Lithuania Gaming Law will be revised so that gaming operators will be obligated to integrate all slot machines into an electronic slot machine data management system, to film the inventory-taking of the amounts and gaming chips paid in at gaming tables and submit, on a regular basis, inventory reports to the Gaming Control Authority under the Ministry of Finance of the Republic of Lithuania.

With the aim to enhance the protection of gaming and lottery players, amendments will be prepared to the Republic of Lithuania Gaming Law and the Republic of Lithuania Law on Lotteries, laying down stricter requirements for the advertising of gaming and lotteries, people's access to gaming venues, age of lottery players and lottery tickets.

CHAPTER IX
INSTITUTIONAL FEATURES FOR THE IMPROVEMENT OF GOVERNMENT FINANCES

72. With a view to increasing confidence in the long-term sustainability of public finances and the long-term rules of fiscal discipline ensuring economic development, on 6 November 2014, the Seimas adopted the Constitutional Law, the Law Amending Articles 2 and 3 and the Annex of the Law No X-1316 of the Republic of Lithuania on Fiscal Discipline and the Law Amending Articles 2, 4, 6, 9 and 23 of the Law I-907 of the Republic of Lithuania on the State Control, which came into effect on 1 January 2015. In accordance with the requirements of the reformed EU economic governance, the State Control was assigned to perform the functions of budget policy monitoring authority as of 1 January 2015.

These laws provide for strengthening Lithuania's capacity to pursue a responsible fiscal policy aiming to achieve a sustainable economic growth and stable public finances as well as to ensure protection against debt crisis. The Constitutional Law introduces a general government surplus rule (in terms of structural general government balance indicator), and provides for procedures as regards failure to achieve a structural adjustment target. A temporary deviation from this rule is allowed only under exceptional circumstances and it has to be adjusted within the prescribed period.

It also provides for the rule limiting government expenditure: if the arithmetic average of general government balance over the 5 recently completed years is negative, the growth of these budget allocations (excluding EU funds) shall not exceed 0.5 of the potential multiannual average growth of GDP at current prices. The Constitutional Law and the Law of the Republic of Lithuania on Fiscal Discipline provide for clearly defined exemptions from the rule.

The rules applicable to the budgets attributable to the general government were laid down as follows: any budget attributable to the general government, with the exception of the State Social Insurance Fund, the State budget and the budgets under 0.3 per cent of GDP, shall be balanced or be in surplus in terms of structural balance; The structural budget deficit of the State Social Insurance Fund could rise only when there is a negative output gap.

The Law of the Republic of Lithuania on Fiscal Discipline provides for revenue rules, one of which establishes that extra revenues for the current year shall be used for the coverage of State budget deficit, and the other that if the statistical indicator of general government balance for the last completed calendar year is negative, it must be ensured that as a result of a new tax imposed, new tax rate, tax relief, sanctions for infringement of tax law or a fundamental change of the procedure of the imposition of a certain tax or legal regulation and application of taxation, the general government revenue would not decrease, except in the cases when decrease of revenues is off-set according to the amounts laid down in Council Regulation (EC) No 1466/97 through reduction of government expenditure indicators, increasing rates of other taxes or widening the tax base by removing tax reliefs.

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

The Constitutional law provides for an automatic correction mechanism that is activated in case of deviations from the structural adjustment target. The Government shall submit a report to the Seimas and the budget policy monitoring authority regarding the reasons for failing to achieve the structural adjustment target as well as measures to attain the structural adjustment target in the coming year. This information shall also be communicated to the Seimas orally. The budget policy monitoring authority shall submit to the Seimas an opinion regarding the justification of the reasons provided by the Government for failing to achieve the structural adjustment target as well as the suitability of the measures to achieve the structural adjustment target. Having taken regard of this opinion, the Government submits a final statement to the Seimas about the reasons for failing to achieve the structural adjustment target as well as measures to achieve the structural adjustment target for the coming year. The measures listed in the statement shall be taken into account by the Government when drafting a budget proposal for the coming year.

73. The Law Amending Articles 1, 9, 11 of the Law No I-712 of the Republic of Lithuania on State Treasury and Supplementing it with Section Four[1] , and Resolution No XII-2020 of the Seimas of the Republic of Lithuania of 17 November 2015 on Amendment of Resolution No IX-912 of the Seimas of the Republic of Lithuania of 30 May of 2002 ‘On the Regulations of the Reserve (Stabilisation) Fund’, which took effect on 1 January 2016, facilitate accelerated accumulation of financial resources in the Reserve (Stabilisation) Fund.

The resources from the Reserve (Stabilisation) Fund may be used to finance the State budget expenditure in the case referred to in the Constitutional law – in exceptional circumstances. Another possibility of usage of fund resources (reimbursable) is cases when the resources on the *ad hoc* basis would be needed for the implementation of the EU policies and/or related contracts or agreements, for example, to ensure the granting of credit lines to the Single Resolution Fund managed by the Single Resolution Board under Regulation on Single Resolution Mechanism and the Intergovernmental agreement on transfer and consolidation of funds to the Single Resolution Fund. Each year 50 per cent of funds received to the State budget are transferred to the Reserve (Stabilisation) fund: after the privatisation of state-owned shareholding in accordance with the procedures of national law, dividends paid by the state-owned companies, after the sale by auction of state-owned real estate and other immovable assets, and after the sale of state-owned agricultural land. Additional resources of the Reserve (Stabilisation) fund: transfer of the surplus budget allocations to the Fund under the Law of the Republic of Lithuania on the Approval of Financial Indicators of the State Budget and Municipal Budgets for the Year Concerned, and transfer of the allocations to the Fund provided for by this Law. This ensures regular cash flow to the Reserve (Stabilisation) fund and allows to accumulate fiscal reserve.

74. The Draft Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets for 2018 will be drafted in accordance with Resolution No 249 of the Government of the Republic of Lithuania of 5 April 2017 ‘On the Approval of the Plan for Drafting Financial Indicators of the State Budget of 2018 of the Republic of Lithuania and Municipal Budgets’.

75. Medium-term government finances are planned in accordance with the legal acts specified in Table 23.

Table 23. Medium-term government sector regulation

Numerical fiscal rules	
1. Borrowing limits	Budget Law[1]
2. Municipal debt limits	Budget Law[1]
3. Rule of municipal balance indicator*	Law on the Budget Structure[2]
4. General government surplus rule	Article 3 of the Constitutional Law
5. Rule limiting growth in general government expenditure	Article 3 of the Constitutional Law, Article 3 of the Law on Fiscal Discipline[3]
6. Rules for budgets attributable to general government	Article 4 of the Constitutional Law
7. Medium-term oriented structural adjustment	Article 6 of the Constitutional Law
The medium-term tasks	
1. Medium-term objective	Approved by parliamentary legislation
2. The structural adjustment target for the coming year and the structural adjustment guidelines for the	Annually approved by parliamentary legislation

Numerical fiscal rules	
remaining years of the medium-term	
3. The overall indicators of State budget and local government budget revenues and spending over the three-year period	The three-year targets annually approved by parliamentary resolution[4]
4. Plans for the coming year and forecasts for the remaining years of the medium-term of sub-sector budgets of the State Social Insurance Fund	Law on the Approval of Financial Indicators of the Budget of the State Social Insurance Fund, Law on the Approval of Financial Indicators of the Budget of the Compulsory Health Insurance Fund

Source: Ministry of Finance of the Republic of Lithuania

[1]The Law of the Republic of Lithuania on the Approval of Financial Indicators of the State Budget and Municipal Budgets for the Year Concerned.

[2]The Republic of Lithuania Law on the Budget Structure.

[3]The Republic of Lithuania Law on Fiscal Discipline.

[4]Article 17(3) of the Law of the Republic of Lithuania on the Budget Structure provides for the following: ‘State budget and municipal budget proposals may deviate from Seimas-approved consolidated whole of planned indicators of three consecutive fiscal years only when the Government provides a written reasoning to the Seimas as regards the relation of the modifications vis-à-vis the new economic policy priorities’.