

*Official translation*  
26 July 2018



Lietuvos Respublikos  
**FINANSŲ MINISTERIJA**

## STABILITY PROGRAMME OF LITHUANIA FOR 2018



25 April 2018

## CONTENTS

CHAPTER I INTRODUCTION .....	4
CHAPTER II OVERVIEW .....	6
CHAPTER III ECONOMIC OUTLOOK .....	7
SECTION ONE ASSUMPTIONS FOR ECONOMIC DEVELOPMENT SCENARIO.....	8
SECTION TWO MEDIUM-TERM ECONOMIC DEVELOPMENT SCENARIO .....	8
SECTION THREE LITHUANIA’S BALANCE OF PAYMENTS .....	13
CHAPTER IV THE CURRENT STATUS AND FUTURE PROSPECTS OF GENERAL GOVERNMENT FINANCE.....	14
SECTION ONE FISCAL POLICY GUIDELINES .....	14
SECTION TWO GENERAL GOVERNMENT FINANCES IN 2017.....	15
SECTION THREE GENERAL GOVERNMENT FINANCES IN 2018.....	19
SECTION FOUR 2019–2021 GENERAL GOVERNMENT FISCAL PROJECTIONS ....	21
SECTION FIVE ASSESSMENT OF THE ECONOMIC CYCLE AND GOALS FORESEEN IN RELATION TO THE STRUCTURAL BALANCE INDICATOR...27	27
SECTION SIX STRUCTURAL GENERAL GOVERNMENT BALANCE INDICATOR	29
SECTION SEVEN GENERAL GOVERNMENT DEBT AND ITS PROJECTIONS .....	30
CHAPTER V QUALITY OF PUBLIC FINANCES .....	33
CHAPTER VI STRUCTURAL REFORMS AND OTHER STRUCTURAL INSTRUMENTS 44	
CHAPTER VII RISK AND SENSITIVITY ANALYSIS .....	50
SECTION ONE RISK OF FULLFLIMENT OF THE ECONOMIC DEVELOPMENT SCENARIO .....	50
SECTION TWO FISCAL RISK .....	52
SECTION THREE SENSITIVITY ANALYSIS .....	54
CHAPTER VIII SUSTAINABILITY OF GENERAL GOVERNMENT FINANCES.....	55
CHAPTER IX EVALUATION OF COMPATIBILITY BETWEEN THE PROGRAMME AND NRA.....	59
CHAPTER X THE INSTITUTIONAL SET-UP OF GENERAL GOVERNMENT FINANCES .....	62
CHAPTER XI SETTING MEDIUM-TERM INDICATORS FOR THE EXPENDITURE OF BUDGETS ATTRIBUTABLE TO THE GENERAL GOVERNMENT.....	65

## LIST OF TABLES

Table 1 (8). Key assumptions .....	8
Table 2 (1a). Macroeconomic indicators .....	9
Table 3 (1b). Price indicators .....	10
Table 4 (1c). Labour market indicators .....	12
Table 5 (6.1). GDP projections compared to the indicators provided for in the SP2017.....	12
Table 6. Comparison of Lithuania's GDP and inflation projections.....	12
Table 7 (1d). Sectoral balances.....	14
Table 8. 2017 balance indicator projections.....	16
Table 9. 2017 general government expenditure and revenues projections*.....	16
Table 10. General government balance by subsector* .....	16
Table 11 (2a). General government indicators (S13), 2017-2021* .....	21
Table 12 (2b). Revenue and expenditure of the general government under the no-policy change scenario.....	22
Table 13. Key medium-term indicators of revenues and expenditure of the State budget, municipal budgets, the State Social Insurance Fund and the Compulsory Health Insurance Fund.....	24
Table 14 (6.2). Comparison of indicator's projections of the general government balance with the SP2017.....	27
Table 15. Comparison of the general government fiscal projections .....	27
Table 16 (5). Economic cycles .....	28
Table 17. Structural general government balance .....	29
Table 18 (2c). Expenditure taken into account when assessing the compliance of the general government expenditure with the SGP expenditure limitation rule (Expenditure benchmark). .....	30
Table 19 (4). General government debt developments.....	31
Table 20 (6.3). General government debt projections compared to the indicators in the Stability Programme for Lithuania for 2017 .....	33
Table 21(7a). State guarantees.....	53
Table 22. Risks that can affect general government finances .....	53
Table 23. Alternative scenarios .....	54
Table 24. Sensitivity analysis for revenues and interest payable by central government .....	55
Table 25 (7). Long-term sustainability of general government finances .....	56
Table 26. The impact of structural reforms on general government finances (increased spending or decreased revenues (+); decreased spending or increased revenues (-)*.....	60
Table 27. Medium-term government sector regulation.....	64
Table 28. Determination of the maximum general government expenditure (excluding EU and other international financial assistance) .....	66
Table 29. Amounts of the revenues of the general government and non-consolidated budgets attributable to it.....	67
Table 30. Determining the general government expenditure .....	67
Table 31. The total expenditure of the CHIF, SSIF and municipal budgets and the expenditures of other budgets attributable to the general government.....	68
Table 32. Setting the State budget expenditure limit .....	68

## **CHAPTER I INTRODUCTION**

The Stability Programme of Lithuania for 2018 has been drawn up following the multilateral surveillance procedure applicable for Member States set forth in Article 3 of Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (OJ *special edition*, 2004, chapter 10, volume 1, p. 84), as last amended by Regulation (EC) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 (OJ 2011 L 306, p. 12).

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. All this information has been provided in the Stability Programme of Lithuania for 2018. The Stability Programme of Lithuania for 2018 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 466/97, as well as requirements on the format and content of the stability programme. The Stability Programme of Lithuania for 2018 has been approved by Resolution No 387 of the Government of the Republic of Lithuania of 25 April 2018. The Stability Programme of Lithuania for 2018 has been presented to the Committee on European Affairs and the Committee on Audit of the Seimas of the Republic of Lithuania.

In Chapter IV ‘The Current Status and Future Prospects of General Government Finance’, the Stability Programme of Lithuania for 2018 provides 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 objectives of the Stability Programme of Lithuania for 2018; in Chapter III ‘Economic Outlook’ - it provides information on major economic indicators planned to achieve economic development and the objectives of the Stability Programme of Lithuania for 2018; in Chapter VII ‘Risk and Sensitivity Analysis’ - the assessment of the impact of possible changes in major economic assumptions on the budget and debt situation; in Chapter VIII ‘Sustainability of General Government Finance’ - 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; and in Chapter IX ‘Assessment of Consistency of the Programme with the NRA’ - information on

the consistency of the Stability Programme of Lithuania for 2018 with the general economic policy guidelines and the National Reform Agenda.

Abbreviations used for the purpose of the Stability Programme of Lithuania for 2018:

<b>CCB</b>	countercyclical capital buffer
<b>RLR</b>	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
<b>GDP</b>	gross domestic product
<b>Labour code</b>	Labour code of the Republic Of Lithuania
<b>OECD</b>	Organisation for the Economic Co-operation and Development
<b>EC</b>	European Commission
<b>EU</b>	European Union
<b>ESA</b>	2010 European System of Accounts
<b>Ministry of Finance</b>	Ministry of Finance of the Republic of Lithuania
<i>Fintech</i>	financial technologies
<b>PIT</b>	personal income tax
<b>i.MAS</b>	Smart tax administration information system
<b>i.SAF</b>	Subsystem of electronic invoicing of the Smart tax administration information system
<b>DIF</b>	Deposit Insurance Fund
<b>Constitutional Law</b>	Constitutional Law of the Republic of Lithuania on the Implementation of the Fiscal Compact
<b>DBP</b>	Lithuanian Draft Budgetary Plan
<b>MMW</b>	minimum monthly wage
<b>R&amp;D</b>	research and development
<b>NTI</b>	non-taxable income
<b>NRA</b>	National Reform Agenda
<b>Programme</b>	Stability Programme of Lithuania for 2018
<b>CHIF</b>	Compulsory Health Insurance Fund
<b>VAT</b>	value added tax
<b>Recommendation for Lithuania</b>	EU Council Recommendation No 2017/C 261/14 of 22 May 2017 on the 2017 National Reform Agenda of Lithuania and delivering a Council opinion on the 2017 Stability Programme of Lithuania
<b>SGP</b>	Stability and Growth Pact
<b>Seimas</b>	Seimas of the Republic of Lithuania
<b>SP2017</b>	The Stability Programme of Lithuania for 2017 approved by Resolution No 315 of the Government of the Republic of Lithuania of 26 April 2017 on The Stability Programme of Lithuania for 2017.
<b>HICP</b>	harmonised index of consumer prices
<b>National Audit Office</b>	National Audit Office of the Republic of Lithuania
<b>SOE DII</b>	State-owned enterprise ‘Deposit and Investment Insurance’
<b>Government</b>	Government of the Republic of Lithuania



**STI**  
**SSIF**  
**GS**

State Tax Inspectorate  
 State Social Insurance Fund  
 government securities

## **CHAPTER II** **OVERVIEW**

Following the exceptionally successful year for the economy of Lithuania in 2017, when the GDP grew by 3.8 %, the trend continues into 2018 at a projected fast pace of 3.2 % of GDP. In 2019-2021, the GDP will grow at an annual rate of about 2.6 %. In 2018-2021, as in 2017, the GDP growth will be driven by domestic demand (consumption and investment) and external demand (exports). The output gap is projected to continue positive over the entire medium term.

In 2017, Lithuania's general government balance indicator was the best over its monitoring period since the restoration of independence of the Republic of Lithuania back in 1990, namely, general government surplus of 0.5 % of GDP. For the 4th successive year, no deviations from the medium term objective have occurred in 2017, where the structural general government deficit stood at 0.4 % of GDP and corresponded with the provisions of the SGP<sup>1</sup> on the structural balance indicator.

At the end of 2017, the general government debt comprised 39.7 % of GDP, and it decreased by 0.4 percentage points as compared to the previous year, when it amounted to 40.1 % of GDP. It is projected that the downward trend of the general government debt will continue and the general government debt at the end of 2021 will make up 35.3 % of GDP.

In the medium term, efforts will be taken to pursue fiscal policy taking into account the state of the economic cycle, the ageing-related challenges, Council recommendation of 22 November 2017 on the economic policy of the euro area<sup>2</sup> and the Recommendation for Lithuania<sup>3</sup>. In the medium term when output gap forecasted to be positive, the plans are to pursue general government surplus which would ensure that the general government comes close to structural balance.

The medium-term objective is set in accordance with the SGP and the Constitutional Law. The last time the medium-term objective of Lithuania was set by the Seimas Resolution No XIII-1058 of 22 March 2018 'On a Medium Term Objective', which provided for up to 1 % structural government deficit as of GDP at current prices for 2019-2021. The year 2018

<sup>1</sup> 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 L 306, p. 33).

<sup>2</sup> Council's recommendation: <https://ec.europa.eu/info/sites/info/files/economy-finance/com-2017-770-en.pdf>

<sup>3</sup> EU Council Recommendation No 2017/C 261/14 of 22 May 2017 on the 2017 National Reform Agenda of Lithuania and delivering a Council opinion on the 2017 Stability Programme of Lithuania.

will be subject to the medium-term objective of up to 1 % structural government deficit as of GDP at current prices set by the Seimas Resolution No XII-2147 of 8 December 2015 ‘On a Medium-Term Objective’.

Considering the structural reform - the social model<sup>4</sup> - aimed at a long-term financial sustainability and enhanced potential economic growth, Lithuania has been granted the flexibility under the SGP. For the assessment of Lithuania’s compliance with the rules of fiscal discipline under the SGP, account will be taken of the social model implementation costs of 0.4 % of GDP for 2017-2018, and 0.5 % of GDP for 2019. Also, Lithuania has been subject to the 0.1 % of GDP flexibility for 2016-2018 due to the implementation of the systemic pension reform.

The Recommendation for Lithuania was discussed at the Seimas Committee on European Affairs and the Seimas Committee on Health Affairs. On the basis of the recommendation, an Action Plan for Implementation of Council Recommendation for Lithuania for 2017-2018 was drafted and submitted to the Government and the Seimas Committees in September 2017. The implementation plan was submitted to the EC as an integral part of the DBP 2018.

The Programme provides for general government finance projections that build on the economic development scenario drawn up by the Ministry of Finance for 2018-2021 and is approved by the National Audit Office<sup>5</sup>. According to the National Audit Office’s conclusion of 27 March 2018 on the economic development scenario “the scenario drawn up by the Ministry of Finance is based on the selected and identified assumptions, on the existing statistics, and is in line with the economic regularities. The fiscal institution approves the economic development scenario for 2018-2021, published on the website of the Ministry of Finance of the Republic of Lithuania on 21 March 2018. The economic development scenario is suitable for the preparation of the Stability Programme of Lithuania for 2018 and for the budgets attributable to the general government.<sup>6</sup>” The economic development scenario and the related conclusion was made public and went through the deliberation at the Committee on European Affairs, the Committee on Budget and Finance and the Committee on Audit of the Seimas.

### **CHAPTER III ECONOMIC OUTLOOK**

---

<sup>4</sup> Lithuania’s legal-administrative model for labour relations and social security. Information on the social model is available in Chapter VI ‘Structural Reforms and other Structural Measures’.

<sup>5</sup> Under the rules of the reformed EU economic governance, the National Audit Office of the Republic of Lithuania was entrusted as of 1 January 2015 with the function of monitoring budget policy. In pursuance with the Constitutional Law, the National Audit Office draws up and submits to the Seimas its conclusion regarding the approval of the economic development scenario.

<sup>6</sup> Conclusion No BP-1 of the National Audit Office of 27 March 2018 on the approval of the economic development scenario. <http://www.vkontrole.lt/bp/isvada.aspx?id=10223>.

## SECTION ONE ASSUMPTIONS FOR ECONOMIC DEVELOPMENT SCENARIO

The key assumptions for the external economic environment (trading partner development, oil prices, the euro-dollar exchange rate) correspond to the projections under Commissions' 2018 winter forecast and the Economic outlook January 2018 of the International Monetary Fund.

Table 1 (8). Key assumptions

Indicator	2017	2018	2019	2020	2021
Lithuania's short-term interest rates (annual average)	-0.1	0.1	0.4	0.8	1.2
Lithuania's long-term interest rates (annual average)	1.1	1.6	2.1	2.4	2.6
USD/EUR exchange rate (annual average)	1.1	1.2	1.2	1.2	1.2
Nominal effective exchange rate*	2.1	4.5	0.1	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), %	3.9	4.1	4.1	4.1	4.1
EU GDP growth, %	2.5	2.3	2.0	2.0	2.0
Growth of key export markets, %	2.4	2.3	2.0	2.0	2.0
World import growth (excl. EU), %	5.1	4.7	4.5	4.5	4.5
Oil prices (Brent, USD/barrel)	54.8	68.3	64.2	64.2	64.2

Sources: Ministry of Finance, Commission (2018 winter forecast), International Monetary Fund.

\*European Central Bank's March 2018 forecast data.

\*\*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

According to the economic development scenario, over the medium term, the economy will continue to be driven by strong household consumption, an intensive investment process and exports of goods and services. Lithuania's economy is expected to grow on average by 2.7 % a year over the medium term.

The year 2017 was exceptionally successful for the Lithuania's economy, which led to the increased country's macroeconomic stability and laid the foundations for further economic development in the short term. The recent simultaneous economic recovery of the main foreign trade partners of Lithuania should, according to international experts' forecasts, continue for at least another two years, which will facilitate the growth in demand for goods and services from Lithuania. The exports of goods and services are estimated to grow in 2018 by 7 %, in 2019 - by 5.7 %, in 2020 - by 5 %, and in 2021 - by 4.7 %.

The determination to meet the strong external demand and to retain the international competitiveness will further motivate the exporting companies to make efforts to bring down



the production costs and increase operational efficiency. All this, together with the planned implementation of investment projects funded by foreign direct investments and the EU, will accelerate the investment process in the country. The breakthrough observed in productive investments in 2017 (10.4 % faster than in 2016, and 11.9 % faster than in 2007) may be seen as the beginning of a change in the business model that has hitherto been dominant: from now on, the economic growth in the country will be driven more by new technologies, automation and by making processes more efficient and effective rather than hiring more staff. The need to make operational processes more effective and efficient will stimulate investment growth in 2018: gross fixed capital formation will grow by 7.6 %, and in 2019-2021, the average annual growth rate will reach 4.7 %.

The improved financial position of households has led to an increased household consumption expenditure in 2017. In the medium term, disposable income will be grow not only due to the relatively fast growing employment income but also due to the automatic indexation of pensions and social benefits that began in 2017, as well as tax measures increasing the income for minimum wage-earners, and the universal child benefits. In the medium term, the household consumption expenditure is expected to grow on average by 3.7% annually.

Table 2 (1a). Macroeconomic indicators

Indicator	ESA code	Indicator value in 2017, million EUR	Change %				
			2017	2018	2019	2020	2021
GDP, chain-linked volume	B1g	35 854.5	3.8	3.2	2.8	2.5	2.5
GDP, at current prices	B1g	41 857.0	8.2	5.9	4.9	4.2	4.2
Components of GDP (chained volume statistics)							
Household consumption expenditure + consumption expenditure of non-profit institutions serving households (NPI)	P.3	23 790.1	3.9	4.0	3.8	3.8	3.5
Government final consumption expenditure	P.3	5 821.1	1.2	1.1	1.0	0.9	0.9
Gross fixed capital formation	P.51	7 151.4	7.3	7.6	5.3	4.8	4.0
Changes in stocks and acquisitions less disposals of valuables, % of GDP	P.52+P.53	—	—	—	—	—	—
Exports of goods and services	P.6	31 455.7	13.2	7.0	5.7	5.0	4.7
Imports of goods and services	P.7	32 240.9	12.8	7.6	6.5	5.5	5.1
Contributions to real GDP growth, percentage points							
Final domestic demand		36 763.2	4.2	4.3	3.8	3.7	3.4
Changes in stocks and acquisitions less disposals of valuables	P.52+P.53	—	—	—	—	—	—

Indicator	ESA code	Indicator value in 2017, million EUR	Change %				
			2017	2018	2019	2020	2021
External balance of goods and services	B.11	-785.2	0.5	-0.4	-0.6	-0.4	-0.4

Sources: Statistics Lithuania, Ministry of Finance

In 2017, average consumer prices of goods and services (methodically with other EU Member States HICP) rose by 3.7 %, thus demonstrating the fastest growth over the last six years. Recently, there has been a surge in service prices, which has been mainly driven by the rapid growth in the wages across the service sector, where the vast majority of labour costs, unlike in the sale of goods, reflects in the final price; as well as by the higher disposable income of households having led to increased consumption of services. For this reason, in the year 2017, prices were rising fast (5 % on average) across many services.

Increased from March 2017, the excise tariffs for alcoholic beverages and tobacco products had a 0.7 percentage point impact on the average annual inflation in 2017. The moderate increase in excise duty rates for diesel (from 1 January) and tobacco products (from 1 March) in 2018, will have a small (0.1 percentage point) impact on the average annual inflation in 2018.

The rising international fuel prices for energy commodities and for heating consumed in production (natural gas, biofuels) have resulted in higher heat energy prices since the autumn 2017. The average price of district heat supply in the country is projected to be slightly higher in 2018 than the previous year due to the rise in fuel prices for heating consumed in production. The stabilisation of international energy commodity prices over the later mid-term years, should result in a stable average price for heat energy.

The 19.1 % rise in the price for *Brent* crude/barrel (in euros) in 2017 drove fuel prices up by 8.4 % and had a direct impact of 0.5 percentage points on average annual inflation in 2017. According to EC forecasts released in February 2018, oil prices will increase by 15.6 % in 2018, and they will drop by 5.9 % in 2019. In 2018, the rising oil prices will drive transport fuel prices, which will reflect in business operating costs. Therefore, it is likely that the pressure on passing some of the increased costs on to the consumer will increase. Should the presumption of cheaper oil in 2019 come true, this may result in somewhat lower transport fuel price.

The increased economic activity and the processes of convergence with the EU average in the medium term will stimulate price growth in Lithuania, but it will not be as fast as the one in 2017. The projected expansion of productive investments in the medium term will allow for a reduction in the gap between labour productivity and wage growth that has occurred over the recent years, while reducing the pressure on price increases. The HICP is projected to grow annually by 2.9 % in 2018, by 2.4 % in 2019, by 2.5 % in both 2020 and in 2021.

Table 3 (1b). Price indicators

Indicator	ESA code	Indicator value in 2017	Change %				
			2017	2018	2019	2020	2021
1. GDP deflator		116.7	4.3	2.6	2.0	1.7	1.7
2. Household consumption expenditure deflator		112.6	3.8	2.9	2.4	2.5	2.5
3. HICP (average annual)		104.4	3.7	2.9	2.4	2.5	2.5
4. General government consumption expenditure deflator		118.7	2.9	3.0	3.0	3.0	3.0
5. Gross fixed capital formation deflator		110.2	0.4	1.5	2.0	2.0	2.0
6. Exports of goods and services deflator		108.2	4.4	2.3	1.3	1.7	1.7
7. Imports of goods and services deflator		102.9	4.0	2.6	1.0	1.8	1.8

Sources: Statistics Lithuania, Ministry of Finance

The rapid growth of the number of job vacancies in recent years and a shrinking number of the employed in 2017 show the declining labour force resources in the country. Therefore, the tension that has built up over the recent years in the labour market, resulting in stronger negotiating powers of the employees and a more rapid wage growth, will hardly subside in the coming years. As the country continues to face the demographic challenges leading to a decline in the working-age population, businesses will continue to compete for workers of appropriate qualification, for whom the demand will grow over the medium term. Due to the gradually increasing retirement age, the participation of the older workforce should increase over the medium term, and the favourable economic situation in Lithuania should drive faster immigration from non-EU countries. This will mitigate the tension in the labour market - not sufficiently though - as the number of labour force and employed persons will keep decreasing over the entire medium term. The overall unemployment rate in the country is projected to constitute 6.5 % in 2018, 6.1 % in 2019, and 5.9 % in both 2020 and 2021.

In 2017, the average monthly gross wage in the country (including individual enterprises) increased by 8.5 % (9.5 % - in the private sector, and 6.8 % in the public sector) at almost the same rate as in 2016. According to quarterly data, wages grew in companies of all types of economic activities, whether export- or domestic-oriented.

The strong demand for skilled labour and the decline in its supply, the sharper business competition for skilled workers, the entry of new investors into the Lithuanian market, the development of export-oriented manufacturing enterprises and the projected productivity growth will promote the average growth in monthly gross wage over the medium term, particularly in the private sector.

Over the medium term, the demand for labour will continue to exceed the supply, and pressures to raise wages will persist. Increased to EUR 400 since 1 January 2018, the MMW will have the upward effect on the average wage growth in the country in 2018. The average wage growth of 6.6 % is projected in the country. It is projected that starting from the year

2019, due to a slower recovery of employment, the wage growth will be more moderate, however, it will exceed the projected price change, and therefore, the real income of the population will not decrease. In 2019, the average wage growth rate will slow down to 6.2 %, and it will account for 6 % in both 2020 and in 2021.

Table 4 (1c). Labour market indicators

Indicator	ESA code	Indicator value in 2017	Change %				
			2017	2018	2019	2020	2021
1. Employment, persons, thou		1 354.8*	-0.5	-0.4	-0.5	-0.5	-0.5
2. Employment, hours worked, thou		2 497 002	-2.7	–	–	–	–
3. Unemployment rate (%)**		7.1	7.1	6.5	6.1	5.9	5.9
4. Labour productivity, persons (gross value added at constant prices per person employed), thou EUR		26.5	4.4	3.7	3.3	3.0	3.0
5. Labour productivity, hours worked (gross value added at constant prices per hour worked), EUR		14.4	6.7	–	–	–	–
6. Compensation of employees, million EUR	D.1	18 449.6	9.0	6.1	5.7	5.4	5.4
7. Compensation per employee, EUR		15 481.7	9.1	6.6	6.2	6.0	6.0

Sources: Statistics Lithuania, Ministry of Finance

\*Labour force survey.

\*\* Value of the indicator.

### Comparison of the economic development scenarios

Taking into account the actual figures for 2017 provided by the Statistics Lithuania, the current trends in economic development and the improved assumptions regarding the prospects of the environment abroad, the Ministry of Finance has increased the GDP projections.

Table 5 (6.1). GDP projections compared to the indicators provided for in the SP2017.

Indicator	2017	2018	2019	2020	2021
Real GDP change (%):					
20-03-2017 projection	2.7	2.6	2.5	2.4	–
21-03-2018 projection	3.8	3.2	2.8	2.5	2.5
decrease (-)/increase (+)	1.1	0.6	0.3	0.1	–

Source: Ministry of Finance

There are no significant differences in Lithuania's economic development provided for in the Commissions' 2018 winter forecast and in the economic development scenario of the Ministry of Finance. The economic development scenario of the Ministry of Finance was developed building on the prevailing economic trends and more detailed statistical data on national accounts for 2017 published on 1 March 2018.

Table 6. Comparison of Lithuania's GDP and inflation projections

Indicator	Year	Ministry of Finance, March 2018	EK, 2018 winter	Difference between the projection of the Ministry of Finance and the Commission's forecast, in percentage points
GDP growth, %	2018	3.2	2.9	0.3
	2019	2.8	2.6	0.2
HICP, %	2018	2.9	2.9	0.0
	2019	2.4	2.5	-0.1

Sources: Ministry of Finance, Commission

### SECTION THREE LITHUANIA'S BALANCE OF PAYMENTS

In 2017, the current account balance was in surplus that accounted for 0.8 % of GDP. The foreign trade balance improved (the balance of services surplus significantly increased, while the balance of goods deficit saw but a slight increase), the primary income balance deficit decreased, and the surplus of the secondary income balance saw a slight increase. The projected further increase in the trade balance deficit will have a negative impact on the current account balance and will contribute to the formation of the deficit.

The surplus of the service balance grew due to exports outpacing imports of services. Most groups of services showed improvement in their trade balance, particularly transport services. Over the recent years, this sector has been actively investing in capacity-building and recruiting a large number of people from non-EU countries. The facilitation of the employment of these people in 2017 should encourage further development of the sector. Other services are also expected to improve their trade balance indicators.

The deficit of the goods balance was mainly driven by a larger deficit in trade in mineral products, chemical products and vehicles. There was an increase in the surplus of trade in other goods. This is mainly due to the trade surplus in furniture and tobacco products, as well as the trade deficit in machinery and equipment. In the future, the deficit in trade in goods should grow due to increased imports of vehicles, machinery and equipment needed for investment.

The primary income balance deficit has decreased, but the components of this balance have undergone different changes. The balance of labour and investment income remained broadly unchanged, while the balance of other primary income improved. Its improvement was mainly due to an increase in EU funds allocated to agricultural subsidies. It should be noted that, unlike in 2016, foreign companies in 2017 were less likely to pay out the dividends earned. Furthermore, over the recent years, the general government financial situation in the Republic of Lithuania has been improving, the need for additional borrowing has been decreasing, and thus the public debt-related non-residents' income. In the future, the development of the primary income balance will depend mostly on the development of the foreign direct investment in Lithuania and the profitability of foreign capital companies, as well as on the state of the general government finances in the Republic of Lithuania.



The surplus of the secondary income balance increased over the year. All major secondary income balances have improved: general government, personal transfers and other balances. In the near future, the development of the secondary income balance should remain broadly unchanged. The increased use of EU support should favour this balance, but it is likely to be suppressed by non-resident personal transfers to Lithuania.

The capital account surplus decreased. It was about half less in 2017 compared to 2016. The lower capital account surplus was due to the lack of energy in using the support under the new EU financial perspective. The capital account surplus is expected to markedly grow in the years to come.

The financial account structure was mostly affected by the Eurosystem Quantitative Easing Programme. This Programme should be carried out at least until the end of September 2018. It increases Bank of Lithuania's commitments to non-residents and its portfolio investments. The balance of the financial account was also improved by foreign direct investments, mainly reinvestments.

Table 7 (1d). Sectoral balances

Indicator	ESA code	% of GDP				
		2017	2018	2019	2020	2021
1. Net lending/borrowing	B.9N	1.9	1.8	1.6	1.1	0.6
including:						
balance of goods and services		2.0	1.3	1.0	0.5	0.0
balance of primary and secondary income*		-1.3	-1.4	-1.6	-1.6	-1.6
capital account*		1.2	1.9	2.2	2.2	2.2
2. Net lending (+)/borrowing (-) of private sector		1.4	1.2	1.0	0.5	0.3
3. Net lending (+)/borrowing (-) of general government	B.9N	0.5	0.6	0.6	0.6	0.3
4. Statistical discrepancy		0	0	0	0	0

Sources: Ministry of Finance, \*Bank of Lithuania

## CHAPTER IV THE CURRENT STATUS AND FUTURE PROSPECTS OF GENERAL GOVERNMENT FINANCE

### SECTION ONE FISCAL POLICY GUIDELINES

The following major objectives of the public finances policy for 2018-2021 have been foreseen:

1. To implement fiscal policy in accordance with Council recommendation of 22 November 2017 on the economic policy of the Euro area, the Recommendation for Lithuania, the economic cycle and the internal challenges arising due to the ageing population. That is, in the years 2019-2021, with a positive output gap and part of government revenues being temporary, aiming at an annual government surplus, which would secure the fiscal space needed to stimulate global demand during the recession.

2. To increase the share of GDP<sup>7</sup> to be redistributed to 31.3 % of GDP level by improving the efficiency of the tax administration, applying the latest state-of-the-art information technologies and new analytical tools, and to reduce benefits or to increase taxes on products that are harmful to the environment and human health.

3. To implement structural reforms aimed to increase the economic growth potential and the long-term sustainability of government finances by continuing the social model reform and planning for structural changes during the period of the Programme in the fields of education, health care, fight against shadow economy, innovations, social security (pensions) and tax regulation<sup>8</sup>.

4. To reduce social exclusion, increasing the income of the poorest, promoting employment, facilitating business, creating incentives for families with children.

5. To increase budget orientation towards performance, strengthening the principles of medium-term budget planning at institutional level, developing the capital market, alternative sources of financing, and improving conditions for the development of *Fintech*, optimising state property management and taking other measures to improve the quality of public finances<sup>9</sup>.

6. To ensure that the defence funding meets the NATO's commitments and reaches 2.05 % of GDP in 2019.

7. To maintain the general government debt level close to 35 % of GDP.

8. To form and approve budgets attributable to general government ensuring the compliance of general government finance indicators with the fiscal discipline rules stipulated in the national and EU legislation.

9. To accumulate general government fiscal reserves.

## **SECTION TWO**

### **GENERAL GOVERNMENT FINANCES IN 2017**

In 2017, the general government surplus amounted to 0.5 % of GDP. Article 21 of the Law of the Republic of Lithuania on Approval of Financial Indicators of the State Budget of the Republic of Lithuania and Municipal Budgets of 2017 stipulates that, in 2017, the general government deficit shall not be worse than 0.7 % of GDP. The better than planned result of general government finances was mainly driven by higher than expected municipal and social security funds' revenues, lower expenditure of the state budget and social security funds, better performance of the SOE DII and lower contributions to the EU budget. A positive impact on the general government balance was made by the statistical recording of the expenditure on arms, military equipment and the inventories according to ESA methodology.

---

<sup>7</sup> Corresponds to the tax and contribution income shown in Table 11 of the Programme.

<sup>8</sup> Information on social security, education and other reforms is available in NRA 2018 and Chapter VI 'Structural Reforms and Other Structural Measures' of the Programme.

<sup>9</sup> For more information, please see Chapter V 'Quality of Public Finances'.

Table 8. 2017 balance indicator projections

Indicator	Projection submitted 2017 DBP	Projection submitted SP2017	Projection submitted 2018 DBP	Factual data	Difference in factual data and the projection submitted 2017 DBP
	GDP, %				
General government balance	-0.7	-0.4	0.1	0.5	1.2
Central government balance	-0.8	-0.6	-0.6	-0.2	0.6
Local government balance	0.0	0.1	0.3	0.2	0.2
Social security funds balance	0.1	0.2	0.4	0.5	0.4

Sources: Sources: Ministry of Finance, Statistics Lithuania

Table 9. 2017 general government expenditure and revenues projections\*

Indicator	ESA code	Projection submitted 2017 DBP	Projection submitted SP2017	Projection submitted 2018 DBP	Factual data
		GDP, %			
1. Total revenue	OTR	36.0	36.0	35.8	33.8
2. Total expenditure	OTE	36.7	36.3	35.7	33.3
3. General government balance	B.9	-0.7	-0.4	0.2	0.5
General government balance					
4. Revenues from taxes (4=4a+4b+4c)		18.1	17.9	17.6	17.2
4a. Revenues from indirect taxes	D.2	12.5	12.4	12.0	11.7
4b. Revenues from direct taxes	D.5	5.6	5.6	5.6	5.4
4c. Property taxes	D.91	0.0	0.0	0.0	0.0
5. Social contributions	D.61	12.7	12.8	12.9	12.7
6. Revenues from property	D.4	0.4	0.5	0.4	0.4
7. Other		4.8	4.8	4.9	3.6
8=1. Total revenue	OTR	36.0	36.0	35.8	33.8
General government expenditure					
9. Compensation of employees + intermediate consumption	D.1+P.2	15.4	15.2	15.1	14.2
9a. Compensation of employees	D.1	9.8	9.7	9.6	9.6
9b. Intermediate consumption	P.2	5.6	5.5	5.5	4.6
10. Social benefits	D.6M	13.3	13.3	13.3	12.6
including unemployment benefits	D.6M	0.2	0.2	0.2	0.2
11. Interest payment	D.41	1.3	1.3	1.2	1.1
12. Subsidies	D.3	0.3	0.3	0.3	0.3
13. Gross fixed capital formation	P.51G	3.8	3.6	3.6	3.2
14. Capital transfers	D.9	0.3	0.4	0.3	0.4
15. Other		2.3	2.3	2.1	1.4
16=2. Total expenditure	OTE1	36.7	36.3	35.7	33.3

Sources: Ministry of Finance, Statistics Lithuania

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

Table 10. General government balance by subsector\*

Year	State budget	Extra-budgetary funds	Social security funds	Local government	General government
------	--------------	-----------------------	-----------------------	------------------	--------------------

Year	State budget		Extra-budgetary funds		Social security funds		Local government		General government	
	EUR million	% GDP	EUR million	% GDP	EUR million	% GDP	EUR million	% GDP	EUR million	% GDP
2017	-127.5	-0.3	61.4	0.1	200.6	0.5	86.7	0.2	221.2	0.5
2016	-265.2	-0.7	160.6	0.4	15.8	0.0	191.8	0.5	103.0	0.3
Change	137.7	0.4	-99.2	-0.3	184.8	0.5	-105.1	-0.3	118.2	0.2

Source - Ministry of Finance

\*General government indicators calculated on accrual basis.

Tax and contributions revenue to the GDP ratio accounted for 29.8 % of GDP in 2017<sup>10</sup>. This share has increased over the last four years by 2.8 % of GDP. With the EU institution taxes, the indicators are higher by approximately 0.3 % of GDP.

The share of general government expenditure to GDP is among the smallest in the EU. General government expenditure in 2016 amounted to 34.2 % of GDP in Lithuania, the EU average being 46.5 % of GDP. General government expenditure in Lithuania has dropped to 33.3 % of GDP in 2017, mostly due to the decreased expenditure on interest on debt, intermediate consumption expenditure and subsidies.

The level of general government revenue and expenditure was significantly affected by the difference in the planned and actual costs related to the EU and other international financial assistance - EUR 564.8 million, i.e. 1.35 % of GDP difference.

**The central government subsector's** deficit in 2017 stood at 0.2 % of GDP, amounting to EUR 208 million, or 0.5 % of GDP better than planned. The decline in central government subsector deficit was driven by faster than expected growing income and somewhat underperformed expenditure plan. A significant positive increase in the general government balance was made by the recalculation of expenditure on arms, military equipment and inventories according to ESA methodology.

The planned state budget deficit amounted to EUR 321 million. In fact, the state budget deficit in 2017 amounted to EUR 127.5 million. The state budget balance was improved by EUR 122 million of the saved state budget expenditure, including EUR 50.1 million for intermediate consumption, EUR 39.1 million for social benefits, EUR 42.4 million for payments to the EU budget. The balance deteriorated by EUR 13 million failure to comply with budget revenue plan. The most significant revenue changes were as follows: profit tax revenues EUR 46.8 million less than planned, PIT revenues EUR 13.6 million more than planned, dividend revenues EUR 25.6 million less than planned and super dividends of EUR 20.2 million, revenues from excise duties EUR 12.7 million less than planned, VAT revenues EUR 11.1 million more than planned, and the remaining unlisted revenues were EUR 47.2 million more than planned.

<sup>10</sup> Corresponds to the tax and contribution revenues shown in Table 11 of the Programme.

The SOE DII is classified in the subsector of the central government. The surplus of this company in 2017 amounted to 0.1 % of GDP, which was about EUR 11 million improvement on the planned target. The balance of the central government was positively affected by EUR 45 million better balance of healthcare institutions and higher education institutions that are classified in the central government subsector. The central government balance was negatively affected by extra-budgetary funds balance, which was EUR 25.4 million less than planned.

The year 2017 was a good year for the **SSIF**. For the second year in a row, the budget of the SSIF kept positive. The main reason for the non-deficit budget result was the growing economy. Growing wages and the efforts of all the institutions and businesses to reduce the scale of the shadow economy improved the collection of contributions. Based on the SSIF data, the wage fund of those covered with all types of social insurance in 2017 increased by 9.5 % against 2016, the number of those covered with all types of social insurance increased by 0.9 % , while the average income that serves as the basis for the calculation of social insurance contributions increased by 8.1 %.

In 2017, the revenues of the **SSIF** accounted for EUR 3 792.6 million, which was EUR 53.4 million or 1.4 % more than planned, and EUR 353.8 million or 10.3 % more than in 2016. In 2017, the expenditure of the SSIF accounted for EUR 3685.9 million, which was EUR 21.7 million or 0.6 % less than planned, and EUR 249.2 million or 7.2 % more than in 2016. In 2017, revenues were EUR 106.7 million higher than the expenditure, i.e. the result of the current year was EUR 75.2 million better than planned.

The rules for indexing social insurance pensions<sup>11</sup> adopted in 2016 led to the 7 % increase in the insured income and social insurance basic pension as of 1 January 2017. As a result, the average old-age pension has increased by 7.3 % since January 2017 compared to the same period in 2016, or from EUR 255.05 in January 2016 to EUR 273.78 in January 2017.

In 2017, the **CHIF** budget revenue plan in cash flows amounted to EUR 1574.5 million. Last year, there were EUR 1640.3 million in actual revenues, which was EUR 65.8 million more than planned. Compared to 2016 (EUR 1484.2 million), the revenues in 2017 were EUR 156.1 million more.

In 2017, the budget expenditure plan, approved by the Law, amounted to EUR 1574.5 million, while the actual expenditure was EUR 1532.4 million, which was EUR 42.1 million less than planned. Compared to 2016 (EUR 1431.2 million), the expenditure in 2017 was EUR 101.2 million more. Furthermore, in 2017, EUR 30.6 million were used from the CHIF budget reserve to compare with EUR 43.0 million in 2016. At the beginning of 2017, the CHIF reserve amounted to EUR 75.6 million, with the major share accounting for EUR 23.6 million and risk management - EUR 52 million.

0 % of GDP **local government subsector**'s balance was planned when preparing the budgets attributable to general government for 2017. The rapid increase in wages in 2017 and

---

<sup>11</sup> Law Amending Law No I-549 of the Republic of Lithuania on State Social Insurance Pensions.



existing favourable economic circumstances led to the surplus of EUR 86.7 million in the local government subsector, which accounted for 0.2 % of GDP surplus. In 2017, all municipal extra revenues amounted to EUR 107 million, including EUR 57.5 million extra PIT revenues. As the PIT share for municipalities has been increased for several years on the row, the municipal budgets in 2017 had 78.2 % of the total PIT revenues collected. The positive effect on the balance of the local government subsector from the extra revenues was reduced by somewhat higher municipal expenditures and poorer than usual performance of the healthcare institutions classified in the local government subsector.

### **SECTION THREE GENERAL GOVERNMENT FINANCES IN 2018**

The general government surplus of 0.6 % of GDP was projected in the DBP 2018 and set in Article 22 of the Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets for 2018. The value of this target indicator was set following the fiscal discipline rules stipulated in the Constitutional Law and the provisions of the SGP, as well as SP2017, which is part of the medium-term planning system, the projected general government finance indicators, and the Recommendation for Lithuania. The Seimas approved budgets attributable to general government providing for the surplus of 0.6 % of GDP. These budgets are aimed to achieve fiscal policy goals, including the reduction in general government debt.

The general government structural deficit of 2018, assessed taking into account the output gap projections made by the Ministry of Finance in the autumn of 2017 and the cyclical budget component, and the planned surplus of the general government, did not deviate from the -0.1 % of GDP medium-term objective under the *ex-ante* evaluation of the Ministry of Finance.

Following the assessment of the updated projections of budgets attributable to general government under the March update of the economic development scenario, the general government surplus is projected to stand at 0.6 % of GDP in 2018 - i.e. at its planned value. The projected general government balance ratio is based on the assumption that the additional CHIF expenditure of 0.2 % of GDP due to the increased wages of healthcare workers as of May 1 this year<sup>12</sup> will be offset by savings on government spending and additional revenues from PIT and social security contributions received on the account of the increased salaries. The historical data show the annual saving of up to 2 % of the total planned state budget expenditure. Considering the fact that the latest economic scenario results in a moderate increase in revenue projection bases compared to the revenue projection bases applied in the autumn of 2017, with cautious projection however, the general government revenue is projected to be close to the plans.

---

<sup>12</sup> On 13 December 2017, a collective bargaining agreement was concluded providing for 20 % increase, as of 1 May 2018, in wage fund of the health care staff who provide personal health care services in health care institutions of the Lithuanian national health system subject to this collective agreement, particularly focussing on the lowest-paid health professionals.

DBP 2018 has provided for around EUR 225 million **central government subsector deficit** in 2018 or about 0.5 % of GDP, the state budget deficit of about EUR 237 million and the extra-budgetary funds attributable to the central government accounting for about EUR 13 million surplus. The improvement of the central government balance of 2018 is projected at about 0.3 % of GDP, while the deficit - at 0.2 % of GDP. Such a projection is based on the assumptions that the projection of state revenues will remain close to the planned revenues and that there will be, as every year, savings on state budget expenditure.

The **SSIF budget** revenues planned for 2018 represent EUR 4 252.8 million, i.e. they are EUR 460.2 million or 12.1 % more than in 2017. The planned expenditure is EUR 4 012.3 million, i.e. it is EUR 326.4 million or 8.9 % more than in 2017. EUR 240.5 million or 0.5 % of GDP surplus is projected for 2018.

State social insurance pensions have been recalculated in 2018 relying on the system of the units of account. The pensions spending will increase due to the recalculation of pensions by about EUR 59 million, and due to pension indexation - by 6.94 % or about EUR 170 million.

In accordance with the Article 14 of the Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets of 2018, starting from 1 January 2018 the State Treasury took over the total balance of the SSIF debt obligations amounting to EUR 3 682.3 million and interest accrued at EUR 3 million.

The SSIF reserve account is expected to get about EUR 200 million at the beginning of 2019.

The CHIF budget revenue plan for 2018 amounts to EUR 1 763.8 million, which is EUR 189.3 million more than in 2017. EUR 72.4 million have been intended for the replenishment of the reserve of this fund, and EUR 1 691.4 million for the fulfilment of its obligations under the law. Thus, the Seimas has approved the surplus CHIF budget, the surplus accounting for 0.2 % of GDP.

At the beginning of 2018, the CHIF reserve amounted to about EUR 153 million, which was made up of the of EUR 45 million reserve which was accumulated by the end of the year 2017, the EUR 65.8 million overperformed revenues and EUR 42 million of the expenditure savings in 2017. The main part of the reserve is close to EUR 27 million, while the reserve risk management part is EUR 126 million.

Wages for healthcare workers have been planned to be increased as of 1 May this year. This increase will lead to an increase in the CHIF expenditure by 0.2 % of GDP. Considering the additional costs and the fact that the revenue is projected to be close to the plans, the projected CHIF budget will be close to the balance. The source for wage increases in 2018 is the CHIF reserve.

According to the DBP 2018 data, **surplus of local government subsector** of 0.3 % of GDP has been planned for 2018. The positive balance indicator has been planned in consideration of the fiscal discipline rules provided for in the Constitutional Law for the municipalities, and the actual surplus of the local government subsector over the last four

years. From 1 January 2016, small municipalities of Lithuania (with budgets less than 0.3 % of the previous year's GDP) are obliged to plan, approve and implement budgets so as to ensure that the revenues are equal to expenditure. As of 1 January 2018, the fiscal discipline rule established by the Constitutional Law have applied to the major municipalities of Lithuania with budgets more than 0.3 % of GDP of the previous year. According to this rule, the municipalities of Vilnius, Kaunas and Klaipėda cities had for the first time to approve structurally balanced budgets. To avoid increasing municipal debt in the times of economic stability, Article 13 of the Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets of 2018 has provided for a restriction on municipal borrowing.

The evaluation of the latest data available at the time of the preparation of the Programme, the surplus of the local government subsector is projected to reach 0.2 % of GDP in 2018.

#### **SECTION FOUR**

#### **2019–2021 GENERAL GOVERNMENT FISCAL PROJECTIONS**

The general government fiscal projections have been made taking into account the economic development scenario, the legal obligations of the State, including measures provided for in NRA, and the fiscal discipline rules stipulated in the Constitutional Law and the SGP.

During 2019-2021, when the positive output gap is still projected, but the economic growth is projected to slow down, the general government finances are planned to be managed in such a way as to ensure that surplus of the general government foreseen on the basis of the budgets' indicators guarantees almost structurally balanced general government sector over the medium term. Part of the unspent cyclical revenue will create favourable conditions for increasing reserves and contribute to the implementation of the growth-oriented fiscal policy in the times of recession, with a view to minimizing negative migration and maintaining higher multi-annual potential GDP growth. The containment of the general government expenditure will contribute to the reduction of excess aggregate demand.

Table 111 (2a). General government indicators (S13), 2017-2021\*

Indicator	ESA code	2017		2018	2019	2020	2021
		million EUR	GDP %	GDP %	GDP %	GDP %	GDP %
Net borrowing (+)/net lending (-) (B.9) by subsector							
1. General government	S.13	221.2	0.5	0.6	0.6	0.6	0.3
2. Central government	S.1311	-66.1	-0.2	-0.3	-0.2	0.4	0.2
3. State government	S.1312	–	–	–	–	–	–
4. Local government	S.1313	86.7	0.2	0.2	0.1	0.0	0.0
5. Social security funds	S.1314	200.6	0.5	0.6	0.7	0.1	0.1
General government (S13)							
6. Total revenue	OTR	14145.9	33.8	36.2	36.3	36.3	36.1
7. Total expenditure	OTE	13924.7	33.3	35.7	35.7	35.7	35.9
8. Net lending/borrowing	B.9	221.2	0.5	0.6	0.6	0.6	0.3
9. Interest expenditure	D.41	470.7	1.1	0.9	0.9	0.7	0.6

Indicator	ESA code	2017		2018	2019	2020	2021
		million EUR	GDP %	GDP %	GDP %	GDP %	GDP %
10. Primary balance		691.9	1.7	1.5	1.5	1.2	0.8
11. One-off and other temporary measures		8.4	0.0	-0.1	0.1	0.1	0.0
Items of revenue							
12. Total taxes (12=12a+12b+12c)		7 178.9	17.2	17.4	17.7	18.0	18.3
12a. Revenues from indirect taxes	D.2	4 914.6	11.7	11.7	11.7	11.7	11.8
12b. Revenues from direct taxes	D.5	2 262.7	5.4	5.7	6.0	6.3	6.5
12c. Property taxes	D.91	1.7	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	5 300.4	12.7	13.1	13.3	13.0	13.2
14. Property income	D.4	149.0	0.4	0.7	0.5	0.5	0.5
15. Other		1 517.6	3.6	5.0	4.8	4.8	4.2
16=6. Total revenue	OTR	14 145.9	33.8	36.2	36.3	36.3	36.1
Revenues from taxes and contributions** (D.2+D.5+D.61+D.91-D.995)		12 476.2	29.8	30.6	30.9	31.0	31.4
Items of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	5 939.8	14.2	14.8	14.6	14.8	14.8
17a. Compensation of employees	D.1	4 011.9	9.6	9.7	9.5	9.6	9.6
17b. Intermediate consumption	P.2	1 928.0	4.6	5.1	5.2	5.3	5.2
18. Social payments (18=18a+18b)	D.6M	5 292.2	12.6	14.5	14.3	14.5	14.9
of which, unemployment benefits	D.6M	95.1	0.2	0.3	0.3	0.3	0.3
18a. Social transfers in kind	D.632	676.9	1.6	2.0	1.9	2.0	2.0
18b. Social transfers other than in kind	D.62	4 615.3	11.0	12.5	12.3	12.6	12.9
19=9. Interest expenditure	D.41	470.7	1.1	0.9	0.9	0.7	0.6
20. Subsidies	D.3	144.1	0.3	0.3	0.3	0.3	0.3
21. Gross fixed capital formation	P.51G	1 323.2	3.2	3.1	3.5	3.6	3.4
22. Capital transfers	D.9	167.6	0.4	0.3	0.1	0.1	0.1
23. Other		587.1	1.4	1.7	1.9	1.7	1.8
24=7. Total expenditure	OTE1	13 924.7	33.3	35.7	35.7	35.7	35.9

Sources: Statistics Lithuania, Ministry of Finance.

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

\*\* Revenues from taxes and contributions, excluding payments to EU institutions. With payments to EU institutions included, the indicator would increase by about 0.3 % of GDP.

Table 112 (2b). Revenue and expenditure of the general government under the no-policy change scenario

Indicator	2017, million EUR	GDP %				
		2017	2018	2019	2020	2021
1. Total revenue at unchanged policy scenario	14 145.9	33.8	36.2	36.2	36.2	36.0
2. Total expenditure at unchanged policy scenario	13 924.7	33.3	35.5	35.3	35.4	35.6

Sources: Statistics Lithuania, Ministry of Finance.

It is foreseen that at the end of medium term the **central government subsector** will become in surplus. Surplus should be the result of adherence to the fiscal discipline rules, moderate economic growth and cautious planning of budgets. Given the output gap which is still positive, the limitation of the State budget expenditure will also help to improve the balance of the central government.

The forecasts of the **State budget revenue** for 2019-2021 rest upon the most recent economic development scenario and the provisions of the tax legislation in force.

Provisional estimates suggest that in 2019 the State budget revenue (excluding EU and other international financial support) will amount to EUR 7 016.5 million or 3.7 % more than it is expected in 2018. It is foreseen that in 2019 the EU and other international financial support will amount to EUR 1 928.6 million. In 2019 the total of the State budget revenue and EU and other international financial support will amount to EUR 8 945.1 million or 19.2 % GDP.

It is foreseen that in 2020 the State budget will receive EUR 7 391 million revenue and EU and other international financial support will amount to EUR 2 098.9 million in 2020. In 2020 the total of the State budget and municipal budget revenue including EU and other international financial support will amount to EUR 9 489.9 million or 19.6 % GDP.

It is foreseen that in 2021 the State budget revenue will amount to EUR 7 753.2 million and EU and other international financial support will amount to EUR 1 812.3 million. In 2021 the total of the State budget revenue and EU and other international financial support will amount to EUR 9 565.5 million or 18.9 % GDP.

It is foreseen that in 2019-2021 approximately 90 % of the State budget revenue (excluding EU and other international financial support) will consist of the revenue generated as a result of 4 main taxes applied – VAT, PIT, excise duty and profit tax. The revenue from the said taxes is expected to increase each year and in 2019 it will account for 13.5 % of GDP, in 2020 – 13.8 % of GDP and in 2021 – 13.9 % of GDP.

In 2019–2021 the revenue from the PIT is forecasted taking into account the dynamics of income from the PIT and wages' fund ratio as well as the forecasted annual wages' fund growth rate. The revenue from the VAT is forecasted taking into account the assessment of anticipated change in final consumption expenditure, final consumption expenditure and dynamics of the VAT tax base percentage ratio. The forecasts concerning the excise duty are made taking into account the foreseen sale of excise goods, multi-annual data on the interdependence of changes in the sale of excise goods and changes in household consumption expenditure or final consumption expenditure and excise rates. The revenue from the profit tax is foreseen taking into account the assessment of the dynamics of revenue generated from this tax, planned VAT growth and foreseen trends in the payment of advance corporation tax.

As a result of the assumed NATO obligations in 2018, the planned expenditure for defence amounted to 2 % of GDP. In the medium term the financing of defence amounting to



2 % of GDP is planned to be maintained and increased, if possible. With a view to reducing poverty, actions will be taken to further increase the pensions, ensure the payment of child's money and increase other social benefits, if possible. Salary increase for statutory officials, doctors, teachers, civil servants and people working in the public sector is planned. The MMW increase is also possible. Priority is also given to the issues related to migration, ageing of the society, policy on promoting innovation as well as to the implementation of structural changes in the fields of education, health and culture.

The implementation of the said priorities of the Government as well as of other priorities is planned to be financed by part of the growing revenue as well as by inner public finance resources generated as a result of a more efficient management of public resources<sup>13</sup>.

### Medium-term indicators of the budgets attributable to the general government

The key medium-term indicators of revenues and expenditure of the State budget and municipal budgets have been projected on the basis of the Government priorities, data of the economic development scenario, the statutory EU and national provisions on fiscal discipline, and following the medium-term budgetary framework in Lithuania, established in accordance with the Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States (OJ L 306, 2011, p. 41). The projected indicators are consistent with the medium-term indicators of the budget expenditure attributable to the general government for 2019-2021 specified in Chapter XI of the Programme.

Table 113. Key medium-term indicators of revenues and expenditure of the State budget, municipal budgets, the State Social Insurance Fund and the Compulsory Health Insurance Fund

Indicator	million EUR			
	2018, approved	2019	2020	2021
<b>Revenues</b>				
1. The totality of State and municipal budgets consolidated with the EU and other international financial assistance, <i>cash flows</i>	10 911.4	10 961.2	11 649.5	11 867.5
including:				
State budget	6 767.3	7 016.5	7 391.0	7 753.2
EU and other international financial assistance funds*	2 303.9	1 928.7	2 098.9	1 812.3
2. State Social Insurance Fund	4 057.3	4 253.6	4 265.4	4 479.8
3. Compulsory Health Insurance Fund, <i>cash flows</i>	1 763.8	1 915.8	2 040.9	2 176.4
<b>Expenditure</b>				
1. The totality of State and municipal budgets consolidated with the EU funds and other international financial assistance, <i>cash flows</i>	11 399.0	11 198.3	11 657.6	12 098.3
including:				
State budget	7 459.1	7 322.0	7 437.9	8 023.5

<sup>13</sup> For more information see Chapter V 'Quality of Public Finances' of the Programme.

Indicator	million EUR			
	2018, approved	2019	2020	2021
EU and other international financial assistance funds*	2 101.2	2 165.1	2 321.6	1 897.9
2. State Social Insurance Fund	3 816.9	4 031.7	4 293.2	4 514.5
3. Compulsory Health Insurance Fund, <i>cash flows</i>	1 691.4	1 867.9	2 019.3	2 169.1

*Sources: Ministry of Finance of the Republic of Lithuania, State Social Insurance Fund, Ministry of Health of the Republic of Lithuania*

\* EU and other international financial assistance for Lithuania (for private and public sectors).

### Social insurance funds fiscal projections

It is foreseen that in 2019 the revenue of **the SSIF** will exceed expenditure and EUR 198 million will be used to index the pensions (by 6.8 %). It is foreseen that, taking into account positive cash flows in 2019, approx. EUR 200 million will be transferred to the SSIF reserve account at the beginning of 2020.

As from 2020, the rate of contributions paid to pension funds is increased from 2 % to 3.5 %. Since the expenditure will increase due to transfers to the pension funds, the SSIF budget deficit will amount to EUR 27 million in 2020 and EUR 34 million in 2021.

Although in 2020 and 2021 the SSIF budget deficit is foreseen, pension insurance balance will remain positive. This allows to foresee pension increase by 6.6 % due to the indexation in 2020 requiring approx. EUR 203 million, and by 6.1 % due to the indexation in 2021 requiring approx. EUR 199 million.

During 2019-2021, the balanced growth of the **CHIF** budget revenue is foreseen. The provision of the Constitutional Law came into effect on 1 January 2018 obliging to plan, approve and enforce a structurally balanced CHIF budget. The main challenge in the nearest term will be to follow the fiscal discipline rule that obliges to seek for structurally balanced budget and ensure the fulfilment of obligations to increase the salary of healthcare specialists by means of CHIF resources. The fiscal discipline rule will be applied for the first time when drawing up the 2019 CHIF budget.

It is foreseen that in the medium term the local government subsector will be nearly balanced: surplus will amount to about 0.1 % of GDP on average. The largest part of municipal revenue consists of revenue from the PIT. It is foreseen that in the medium term the said revenue will increase by 7 % a year on average. In case of favourable economic circumstances, the financial situation of local government will remain rather good. Whereas the positive output gap is projected, municipal expenditure will be restrained in such a way as to ensure that their budgets are in line with the fiscal discipline rules stipulated in the Constitutional Law and applied to municipal budgets.

### Comparison of indicators of the general government fiscal projections

The general government balance indicator of 2017 is better than the one projected in the SP2017. The latest balance indicator projection for 2018 is by 0.2 % of GDP better than the previous one. The said improvement is brought about by the fact that the budgets of the general government are approved in line with the provision of the Constitutional Law that stipulates that the nominal balance of the general government of 2018 must improve by 1 % of GDP. This improvement was calculated on the basis of -0.4 % of GDP balance indicator for 2017 foreseen in the SP2017. The latest projection for the general government in 2019 is also better than the previous one. Such improvement is brought about by better actual balance indicator of 2017 and new projection of the balance indicator of 2018. Better projection is also brought about by the compliance with the rule of the Constitutional Law on the structural balance that stipulates that the structural balance must improve by at least 0.1 % of GDP.

The latest projections for 2020 and 2021 reflect neutral fiscal policy and the objective to ensure structural surplus of the general government in the medium term. The 2020 surplus projection was updated by reducing the size of the surplus having assessed the provision of the Constitutional Law on the positive five-year balance average of the general government – national expenditure limitation rule which would rapidly increase general government surplus is no longer applied.

Table 114 (6.2). Comparison of indicator's projections of the general government balance with the SP2017

Indicator	ESA code	2017	2018	2019	2020	2021
Net lending (+)/borrowing (-) of general government	PDP B.9	GDP %				
previous projection (of 30 April 2017)		-0.4	0.4	0.3	1.3	–
recent projection (of 30 April 2018)		0.5	0.6	0.6	0.6	0.3
worsening (-)/improvement (+)		0.9	0.2	0.3	-0.6	–

Sources: Statistics Lithuania, Ministry of Finance.

It is possible that different dates on which the Ministry of Finance and the EC prepared the projections resulted in differences in the EC forecasts made in autumn of 2017 and indicators stipulated in the Programme (Table 16).

Table 115. Comparison of the general government fiscal projections

Indicator	Year	GDP %	
		Ministry of Finance (indicators of the Programme of April 2018)	EC (autumn 2017 forecasts)
General government balance	2018	0.6	0.2
	2019	0.6	0.2
Structural general government balance	2018	-0.3	-0.9
	2019	-0.2	-0.8

Sources: Ministry of Finance, EC.

## SECTION FIVE

### ASSESSMENT OF THE ECONOMIC CYCLE AND GOALS FORESEEN IN RELATION TO THE STRUCTURAL BALANCE INDICATOR

In order to assess 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 applied for their assessment. Application of different methods may yield different estimates for these indicators.

The potential GDP and the 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 the 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 Prescott filter approach.

The findings show that the output gap will be positive in 2018, accounting for 2.4 % of the potential GDP. Since 2019, the output gap will gradually decrease and will almost close at the end of the medium term.

Although the demographic trends continue to negatively affect the potential of the labour factor, the negative demographic implications for the economic potential are in part offset by the fast growth in the participation of the elderly population in the labour market, increased number of workers from the non-EU countries employed and rapid development of productive investment. It is foreseen that these factors, and in particular total factor productivity that will grow more rapidly, will speed up the potential for economic growth and ensure the decrease of the output gap in the medium term.

Table 116 (5). Economic cycles

Indicator	ESA code	GDP %*				
		2017	2018	2019	2020	2021
1. GDP growth / chain linked volume growth		3.8	3.2	2.8	2.5	2.5
2. Net lending (+)/borrowing (-) of general government	PDP B.9	0.5	0.6	0.6	0.6	0.3
3. Interest expenditure	PDP D.41	1.1	0.9	0.9	0.7	0.6
4. One-off and other temporary measures		0.0	-0.1	0.1	0.1	0.0
including:						
one-off measures – general government revenues		0.2	0.1	0.2	0.2	0.1
one-off measures – general government expenditure		-0.2	-0.2	-0.1	-0.1	-0.1
5. Potential GDP growth, %		2.6	3.1	3.4	3.3	3.2
of which:						
labour		0.0	-0.1	-0.1	-0.3	-0.5
capital		1.2	1.4	1.4	1.4	1.4
total factor productivity		1.4	1.8	2.1	2.2	2.2
6. Output gap		2.3	2.4	1.8	1.0	0.3
7. Cyclical budgetary component		0.9	1.0	0.8	0.4	0.1
8. Cyclically-adjusted balance (2–7)		-0.4	-0.4	-0.1	0.2	0.1
9. Cyclically-adjusted primary balance (8+3)		0.7	0.5	0.7	0.8	0.7



Indicator	ESA code	GDP %*				
		2017	2018	2019	2020	2021
10. Structural balance (8-4)		-0.4	-0.3	-0.2	0.1	0.1

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.

## SECTION SIX

### STRUCTURAL GENERAL GOVERNMENT BALANCE INDICATOR

Taking into account the SAP flexibility granted for structural reforms, the structural surplus of the general government in 2017 amounts to 0.1% of GDP. In 2017 the provision of Article 3(1)(1) of the Constitutional Law was observed – the general government sector is actually in surplus if estimated by the structural general government balance indicator. When preparing the Draft Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets of 2017, the structural general government deficit of 0.7 % of GDP for the year 2017 was planned and 0.9 % of GDP structural general government deficit for the year 2016 was planned. The ex-ante assessment of the provision of Article 3(1)(3) of the Constitutional Law was carried out; the absolute value of the structural general government balance indicator of 2017 was planned to be lower than the medium-term objective and will decline in comparison with 2016.

It is foreseen that in 2018 the general government structural deficit will account for 0.3 % of GDP without taking into account the SGP flexibility granted. In 2019, the structural deficit should decline by 0.1 % of GDP, standing at 0.2 % of GDP. Taking into account the SGP flexibility, in 2018 and 2019 the forecast balance indicator should be close to the structural surplus. The structural surplus of the general government in 2020 and 2021 is foreseen to amount to 0.1 % of GDP. Such structural balance projections correspond to the projected status of the economic cycle when, due to the closing output gap that still remains positive, it is appropriate to implement neutral fiscal policy.

Table 117. Structural general government balance

Indicator	2016	2017	2018	2019	2020	2021
	GDP %*					
Structural general government balance	-0.3	-0.4	-0.3	-0.2	0.1	0.1
Change in structural general government balance	0.3	-0.2	0.1	0.1	0.3	0.0
The option of flexibility offered by the EC taking into account the ongoing structural reforms in Lithuania	0.1	0.5	0.5	0.5	0.0	0.0
Structural general government balance taking into account the option of flexibility offered due to the ongoing structural reforms	-0.2	0.1	0.2	0.3	0.1	0.1
Change in the structural general government balance taking into account the option of flexibility	–	0.2	0.1	0.1	–	–

Source – Ministry of Finance

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

The structural general government balance indicator for 2017-2021 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 in relation to the economic cycle equals to 0.413 and corresponds to the EC estimate known at the time of the preparation of the Programme. The calculation of the structural general government balance indicator takes into account the following one-off measures: revenue and expenditure of the SOE DII related to insured events, revenue and expenditure of the Climate Change Programme (Emissions trading scheme). No other measures have been foreseen except the specified ones.

According to the projection of the cyclical unemployment benefit expenditure for 2017, presented in Table 18, the cyclical unemployment benefit expenditure amounted to EUR -30.3 million. The cyclical unemployment benefit expenditure was considered against the estimates of the non-accelerating wage rate of unemployment obtained by using the calculator developed by the EC. In 2018 and 2019, negative cyclical unemployment benefit constituent is anticipated due to the unemployment level below the non-accelerating wage rate of unemployment estimates. According to the classification of functions of government (code 10.5), the unemployment benefit projections for the medium term were calculated having regard to the amount of unemployment benefits per unemployed person in 2016.

Table 118 (2c). Expenditure taken into account when assessing the compliance of the general government expenditure with the SGP expenditure limitation rule (Expenditure benchmark).

Indicator	2017, million EUR	GDP %				
		2017	2018	2019	2020	2021
1. Expenditure on the EU programmes fully matched by the EU funds revenue	375.8	0.9	2.3	2.1	2.2	1.7
2. Cyclical unemployment benefit expenditure	-30.3	-0.07	-0.05	-0.02	0.01	0.04
3. Effect of discretionary revenue measures	28.2	0.1	0.7	0.1	0.0	0.0
4. Revenue increase mandated by law	0	0	0	0	0	0

Sources: Statistics Lithuania, Ministry of Finance.

## SECTION SEVEN GENERAL GOVERNMENT DEBT AND ITS PROJECTIONS

The general government debt ratio after financial derivatives at the end of 2017 was 39.7 % of GDP (40.1 % of GDP in 2016) and it was lower by 2.7 % as compared to the government debt forecast in the SP2017 (42.4 % of GDP) due to the more rapid GDP growth and lower State budget deficit as compared to its forecast at the beginning of the year. In addition, the SSIF prepaid loans to the commercial banks amounted to EUR 219 million.

The central government debt structure poses no risk to the sustainability of the government finances and reflects the main debt management objective, which is to ensure the financing of borrowing needs of the Government at the lowest possible cost and tolerable risk. At the end of 2017, the residual short-term debt amounted to 13.8 % of the total debt assumed on behalf of the State, the average weighted residual maturity of the debt assumed on behalf of the State was 7 years, and the average weighted residual maturity of the debt assumed on behalf of the State prior to the changes in interest rates was 6.6 years. The floating rate debt, after financial derivatives, amounted to 0.1 % of the total debt assumed on behalf of the State. Taking into account the financial derivatives, the central government debt was 100 % denominated in the euro.

It is projected that the level of the government debt in the medium term will continue to decline and the government debt will be reduced to 35 % of GDP by the end of 2021. However, excluding the accumulation of funds for the redemption of the large amount Eurobond issue at the beginning of 2022, the level of the government debt at the end of 2021 should account for 33 % of GDP. The dynamics of the debt ratio to GDP corresponds to the general macroeconomic trends, long-term obligations to international institutions and proposals of the Organisation for Economic Co-operation and Development.

Table 119 (4). General government debt developments

Indicator	GDP %				
	2017	2018	2019	2020	2021
1. Statistical debt including accumulation of funds for managing refinancing risk	39.7	35.8	38.1	36.6	35.3
1.a. General government debt at the end of year excluding the funds accumulated for managing the refinancing risk	36.6	35.8	35.2	34.3	33.1
2. Change of gross debt	-0.4	-3.9	2.2	-1.5	-1.2
Contributions to changes in gross debt					
3. Primary balance	1.7	1.5	1.5	1.2	0.8
4. Interest expenditure	1.1	0.9	0.9	0.7	0.6
5. Stock-flow adjustment	3.3	-1.1	4.5	0.6	0.5
of which:					
difference between cash and accruals	–	–	–	–	–
net accumulation of financial assets of which: privatization proceeds	–	–	–	–	–
implicit interest rate on government debt (%)	2.8	2.4	2.3	1.9	1.7
Other relevant variables leading to government debt	–	–	–	–	–
6. Liquid financial assets	–	–	–	–	–
7. Net financial debt (7=1-6)	–	–	–	–	–
8. Debt amortization since end of previous year	–	–	–	–	–
9. Percentage of debt denominated in foreign currency	–	–	–	–	–
10. Average debt maturity	–	–	–	–	–

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

The Government borrowing and debt management policy targets in 2018-2021 are to borrow at the lowest possible risk premiums, while ensuring the implementation of other

borrowing and debt management targets, 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 the management of credit, operational and liquidity risk.

When redeeming major (equivalent to EUR 1 billion and above) Eurobond issues in 2018, 2020 and 2021, the refinancing risk should be reduced by allocating the required funds in advance, i.e. at least 25 % 4 months before, at least 50 % 10 weeks before and 100 % 6 weeks before, respectively. When a credit line agreement is concluded 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) in order to reduce the risk, funds stipulated in such agreement must be borrowed (withdrawn) at least 6 weeks before the Eurobond redemption date and dates of repayment of loans granted on the basis of credit lines must be at least 60 days after the Eurobond redemption date. In addition, if circumstances allow, other measures to control the refinancing risk, i.e. Eurobond buy-back, GS exchange, are applied.

One of the aims is to improve the liquidity of the financial assets of the State Treasury by developing relations with the investors, by evaluating possible demand for alternative borrowing instruments, as well as by attracting 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 the general government).

It is important to develop and support an efficient and liquid internal GS market. In addition, the debt management strategy includes the targets to increase the domestic debt share in the total debt on behalf of the State to at least 27 % in the total debt on behalf of the State and to extend the weighted average maturity of the domestic debt for at least 3 years. When borrowing in foreign capital markets, the target is to issue liquid GS.

When assuming the new debt liabilities the Government will comply with the established risk limits that are in line with the international practice, the residual short-term debt will not exceed 25 % of the total debt assumed on behalf of the State; the average weighted residual maturity of the total debt assumed on behalf of the State will be longer than 4 years; the average weighted residual maturity of the total debt prior to the changes in interest rates will be longer than 3.5 year; the floating rate debt will not exceed 10 % of the total debt assumed on behalf of the State; the debt in EUR will account for 100 % taking into account the transactions in financial derivatives; overall level of the State obligations under the guarantees will not exceed 3 % of GDP.

Taking into account the financial risk measures applicable when redeeming the Eurobond issues, it is projected that the borrowing needs of the Government will amount to approximately EUR 2.3 billion during 2019-2021. Due to the Eurobonds redemptions at the beginning of 2020, 2021 and 2022, the total nominal value after financial derivatives amounts to EUR 3.6 billion.

In September 2017 the international credit rating agency Standard & Poor's, having positively evaluated the fiscal policy implemented in Lithuania, changed the status of the perspective of Lithuania's long-term credit rating from stable to positive. The long-term and short-term ratings of the country given by the agency (A– and A–2) remained unchanged. In March 2018 the agency Standard & Poor's positively evaluated the fiscal policy implemented in Lithuania and the economic growth perspective again and raised the long-term and short-term foreign and local currency sovereign credit ratings of the country from A– and A–2 to A and A–1. The long-term credit rating outlook determined by the agency remains stable. The upgrade reflects the strong economic development over the past years, as well as its growth perspectives in the nearest future as a result of increasing wages and a positive impact of the EU structural funds. A favourable foreign trade environment, increased domestic consumption and integration into the EU single market should result in a strong and balanced growth. The agency expects that the government debt will gradually decline and that particular attention will be given to the public financial management and closer integration into the EU.

Long-term credit rating established by the international credit rating agencies Moody's and Fitch Ratings on 31 December 2017 remained the same, i.e. A3 and A–, respectively.

### General government debt projections compared to previous projections

Taking into account the refinancing risk management, the updated GDP projections, and projections of the revenue and expenditure balance, the projected level of the government debt will be lower by 2.6 % in 2018, lower by 1 % in 2019 and higher by 2.8 % in 2020 as compared to the previous forecasts contained in the Stability Programme for Lithuania for 2017.

Table 20 (6.3). General government debt projections compared to the indicators in the Stability Programme for Lithuania for 2017

Indicator	ESA code	2017	2018	2019	2020	2021
Change of gross debt		GDP %				
previous projection (of 30 April 2017)		42.4	38.4	39.1	33.8	–
recent projection (of 30 April 2018)		39.7	35.8	38.1	36.6	35.3
Decrease (-)/Increase (+)		-2.7	-2.6	-1.0	2.8	–

Sources: Statistics Lithuania, Ministry of Finance.

## CHAPTER V QUALITY OF PUBLIC FINANCES

### Review of expenditure

When planning the 2019-2021 year budget, additional appropriations for appropriations managers, if compared to 2018, are planned to be allocated only for the implementation of obligations already envisaged in the legislation, structural changes planned to be carried out by the Government in the fields of education and science, health protection,

taxation, social insurance, innovations and shadow economy reduction as well as the implementation of strategic projects included in the strategic project package approved by the Government.

When preparing the budgets for the years 2019-2021 a lot of attention will be paid to the results of expenditure review – quality of appropriations planning performed by the appropriations managers of the past years and effectiveness of appropriations' use will be evaluated. The ministries and other appropriations managers will have to report on the results of past and present programmes, achievements in carrying out activities agreed by the Government to be undertaken during the negotiations on the budget of the previous year that include improvement of efficiency of institutions' work, optimisation of institutions' management structures and various other task related to the activities of institutions.

### **Budget framework reform**

In 2017 Lithuania started the reform of budget building framework and strategic planning (hereinafter – budget framework reform); the aim of the reform is to develop a sound and effective medium-term framework of budget building and programme management that is closely linked to the updated strategic planning framework of the State and includes the processes of strategic, regional and territorial planning. Such establishment of close links between the budget building and strategic planning processes is aimed at ensuring greater budget orientation towards results. Budget framework reform also aims to ensure a more efficient enforcement of the Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States.

Budget framework reform is carried out in two stages. The first stage of 2017-2019 covers the improvement of the current budget building framework and preparations for significant changes in the budget structure that will come into effect as from 2021. Improvements of the current budget framework encompass the strengthening of the rules on the medium-term budget planning. In 2018, as part of the State budget planning for 2019-2021, maximum expenditure ceilings to be applied by the appropriations managers for a three year period will be established, negotiations on budget appropriations will include expenditure plans presented by the appropriations managers not only for the year 2019 but for the years 2020 and 2021 as well.

During this transitional period of budget framework reform efforts will also be made to ensure a closer link between the budget programmes, their elements and goals stipulated in strategic documents, evaluation indicators. In addition, a lot of attention is given to the higher quality reporting on the results achieved, better publicity of such information. When preparing the State budgets for 2019-2021 'budget for everyone' will be prepared in order to present information on the budget to the society in a more clear and simple way. Moreover, in 2018 an updated procedure for developing budget programmes, scheme for linking of such programmes and the updated State's strategic planning documents and rules on their application will be drawn up; later the management and control system will also be updated.



The updated procedure for budget and strategic planning will be put to the test during the pilot test, i.e. when building the 2020-2022 budget. The completely updated system is planned to be applied when building the 2021-2023 budgets.

### **Enhancement of the efficiency of the Public Investment Programme**

The first phase of the reform of the State's capital investment planning system ended in 2017. The reformed State's investment planning will ensure a more efficient use of public sector resources aimed at increasing the productiveness and return of investments.

As from 2018, only projects of high importance to the State are included into the Public Investment Programme. It foresees no funds for financing the improvement of durable assets.

On this basis, the amount of the State budget funds (excluding the EU funds) planned for 2018 in the Public Investment Programme for 2018-2020 was reduced by EUR 220.2 million if compared to the year 2017; this amount was planned in general appropriations by the appropriations managers to be used to cover expenditure or purchase assets.

The Public Investment Programme for 2018-2020 shall include only those new investment projects that were reasonably subject to the cost-benefit analysis and meet the criteria stipulated in the revised procedure for making public evaluations of investment projects, selection and decisions taken.

The investment projects included into the Public Investment Programme will be monitored for 5 years following their implementation, thus the evaluation criteria of investment projects are currently reviewed aiming to ensure that they are suitable for long-term monitoring, i.e. reflect the anticipated results and benefits to be obtained after the implementation of investment projects.

Stricter procedure for selecting investment projects for inclusion into the Public Investment Programme and publicity requirements for decisions are applied – the selection criteria applied to investment projects were set up linking them with the operational goals of the institution and targeted results, a clear and uniform system of scores is applied, decisions on each investment project discussed taken by the selection panel are made public. This procedure will be applied when preparing the Public Investment Programme for 2019-2021.

### **Improvement of tax administration**

Improvement of tax administration in Lithuania is one of the most efficient measures that contributes to the increase of public finance resources.

Tax administration measures implement the Council recommendation for Lithuania '<....> to improve the fulfilment of tax obligations'.

In 2017, the application of measures aimed at improving tax administration was planned to generate additional budget revenue amounting to 0.4 % of GDP. Taking into account the fact that in 2017 the revenue from taxes collected exceeded the amount envisaged in the plan of the State budget and municipal budget revenue from taxes by 0.8 %; the amount of revenue exceeded by 7.9 % revenue of 2016, in 2017 achievements in the field of taxation were close to the planned results.

In 2017, in the context of tax administration improvement measures implemented in the field of VAT, the taxpayers declared additional EUR 52 million: the declared VAT obligation grew by 1.8 % more rapidly when compared to the growth of the final consumption expenditure in the same year. In 2017 the final consumption expenditure increased by 7 % when compared to the year 2016.

Following the change of focus of control over tax obligations of residents to persons whose assets are in conflict with income taxable in line with the defined procedure, the PIT paid in relation to income of class B (income from individual activity, sale of property and securities, etc.) increased by 37.8 % when compared to the same period in the previous year.

In order to ensure efficient tax administration system, the taxpayers were provided by the preliminary VAT declaration preparation services, cross-checks of VAT invoice data, e.invoice preparation and reporting services by applying innovative technological solutions, service for taxpayers involving the preparation of preliminary declarations of advance corporation tax that include calculations of tax on the basis of performance results of the previous year was developed and launched. In order to ensure the participation of the society in the fight against shadow economy, a cash register receipts game was started.

The development of the subsystem (i.APS) involving the provision of distance accounting services to small businesses was initiated and launched aimed at reducing the burden on the taxpayer, ensuring a more effective control over the accounting of small business revenue and fulfilment of tax obligations.

When implementing the OECD initiatives on the automated tax information exchange, information technology tools were developed – the development of the TIES (*Tax Information Exchange System*) portal to be used for receiving data from financial institutions as well as data processing tools and communication channels for the exchange of information was completed and tested. Data reports were sent to 43 countries and territories and were received from 36 countries and territories. In addition, the procedures for concluding bilateral agreements on the exchange of tax related information are carried out.

### **Goals of tax administration in 2018**

Taking into account the performance results of measures applied in 2017, the STI has quantified the expected improved collection of revenue due to tax administration measures applied in 2018 – as a result of plans to apply measures aimed at ensuring the fulfilment of tax obligations the STI plans to receive additional revenue amounting to 0.4 % of GDP during 2018.

It is foreseen that positive impact of tax administration measures on the SSIF and the CHIF belonging to the social security subsector will amount to 0.14 % of GDP in 2018.

When implementing the goals to reduce shadow economy and tax evasion, the STI will apply measures assumed to be most efficient in influencing the tax discipline of taxpayers and ensuring tax collection in a combined manner. The STI activity based on new analytic

measures and increased scope of digital data will focus on risk management related to the fulfilment of tax obligations and oriented towards the circumvention of activity registration and fulfilment of tax obligations, failure to enter revenue into accounts, VAT evasion and fraud (including sale of goods avoiding VAT, unlawful benefits from VAT), unlawful use of company's resources avoiding taxes, transfer of revenue to other jurisdictions (abusive acts aimed at avoiding the profit tax), evasion of employment related taxes (non-registered employment, salary given in envelopes), avoidance by residents to declare income and pay taxes, illegal excise goods turnover (smuggling, illegal production, unlawful distribution, failure to enter goods and income into accounts).

Successful implementation of measures aimed to improve tax administration create conditions for additional increase in revenue of central government and local government as well as social security funds.

On 23 May 2017 the Seimas adopted the Law amending Articles 14 and 61 and Annex of the Law No IX-2112 on Tax Administration of the Republic of Lithuania which puts an obligation on groups of international companies, the consolidated income indicated in consolidated financial statements of which is not less than EUR 750 000 000, to submit to the tax administrator the financial statements of groups of international companies to be used when assessing risks of ungrounded pricing of transactions. As regards liability regulation, in order to ensure inevitability of sanctions and deterrence in respect of tax violations, draft legislation is being drafted that provides for sanctions proportionate to violations of tax legislation. The said legislation is planned to come into force in 2018.

### **Measures that underlie additional revenue from tax administration in 2018**

By means of analytic measures aimed at improving the effectiveness of tax administration, the STI, when performing the automated cross-checks of VAT invoices submitted via i.SAF, is able to expeditiously detect the non-compliances (buyers submitted the invoices, but the seller did not submit it and vice versa) and inform about them the taxpayer as well as to take control actions in respect of the taxpayers in case of transactions that are likely to involve fraud. Taking into account of the fact that automated cross-checks of VAT invoices had been applied in 2017 only for six months, it is expected that the additional budget revenue will be collected in 2018 as well.

Efforts are made to ensure a more effective use of information received via the automated information exchange means. In 2017 the flow of information was supplemented by information received from 36 countries and jurisdictions and prepared by foreign finance institutions following the OECD cooperation model concerning accounts opened by the Lithuanian citizens in other countries and amounts kept there (in 2018 such information will be provided to Lithuania by more than 60 countries and jurisdictions); in addition, mutual exchanges of information on binding decisions and procedure for pricing (Council Directive (EU) 2015/2376 of 8 December 2015 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, OJ 2015 L 332, p. 1) and groups of

international companies (Council Directive (EU) 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, OJ 2016 L 146, p. 8) are foreseen in line with the provisions of the EU directives.

A service providing account-keeping tools to small businesses is planned to be developed and introduced; such service will enable the semi-automated keeping of accounts of revenue and expenditure. In 2018, a service providing account-keeping tools to small businesses is planned to be developed; it will reduce the administrative burden of a taxpayer which will result in more effective control of entry of small business revenue into accounts and implementation of tax obligations.

In 2018 in the light of incentives to voluntary payment of taxes and more effective collection of taxes more attention is planned to be paid to the education of taxpayers (updated complex STI 2017-2021 strategy on education and awareness raising of taxpayers and its action plan will be coherently implemented).

The cash register receipts game that increases the involvement of society into activities aimed to reduce shadow economy is organised. Residents who register receipts of payment of money for goods or services in certain places involving tax evasion risks win prizes in cash. It is estimated that during the first quarter of 2018 alone additional declarations of VAT obligation in the public catering sector amounted to EUR 0.9 million.

Programme on checks of groups of companies is planned to be initiated taking into account the fact that the profitability of groups of companies is lower than the profitability of companies that do not belong to groups. Control of groups of companies involves the assessment of risks related to the so-called tax planning where transactions are made between related persons in order to derive tax benefits.

### **Reform of the State real estate management**

State real estate management is an alternative source of financial resources; application of effective management measures may reduce its management and maintenance costs, receive additional revenue from the sale or lease of the real estate of the State that is not used or redundant.

In 2017 the Ministry of Finance together with the State owned enterprise 'Turto bankas' submitted to the Government the report on the management of State's real estate that specified for the first time the amount and type of real estate owned by the State.

More than 700 state institutions manage 28 thousands of objects the residual value of which amounts to more than EUR 3 billion. The management and maintenance costs of the said objects amount to approx. EUR 180 million each year. Part of real estate used for the administrative purposes (approx. 45 thousands of square metres) is leased by the State institutions. Highly decentralised real estate is an obstacle to the effective management of State's real estate, thus in 2015 the centralised management of State's owned real estate was started and is still carried out in two directions: transfer of State's real estate used for administrative purposes and not used real estate to a single manager.

At the end of the year 2017, 32 % of real estate used for the administrative purposes was transferred to the central manager of State's real estate, i.e. the State owned enterprise 'Turto bankas'. The programme of the Government envisages transferring 100 % of real estate used for the administrative purposes to the central manager by the end of 2020. The number of unused real estate that the State owned enterprise 'Turto bankas' auctions increased to 1500 objects since 2015. The sale of unused real estate reduces its maintenance costs paid by the State, but such sale should not be expected to generate significant budget revenue because the objects offered for sale are of low value (since 2015 the sale of 218 objects generated EUR 2.572 million).

In the years to come particular attention will be paid to the centralised management of real estate used for the administrative purposes. Maximum use of currently owned real estate, implementation of projects on energy efficiency and renovation of real estate used for the administrative purposes, achieve economies of scale in procuring maintenance services in relation to real estate used for the administrative purposes are the functions of the manager that manages in a centralised manner the State's real estate focused on the reduction of costs or effective use of them based on cost and benefit analysis. The costs are planned to be reduced by at least 10 % by 2020 by gradually increasing the scope of centralisation.

### **Securing financial stability**

In order to ensure the consolidation and optimisation of all supervision processes focused on financial market participants, in 2017 a package of draft legislation amending the Law on the Bank of Lithuania and laws related to it was drawn up and submitted to the Government (a package comprised of 27 laws in total). On 21 March 2018, the Government approved the submission of the package to the Seimas<sup>14</sup> (on 29 March 2018 the said package was registered in the Seimas). It is expected that the draft laws when approved will constitute a legal basis necessary to ensure the equal position for financial market participants in the supervisory process and contribute to the strengthening of financial stability.

The completion of the creation of the banking union should significantly contribute to the strengthening of financial stability.

The consideration in the Council of Europe of the EC legislative proposals on risk reduction measures related to the completion of the creation of the banking union was postponed to 2018. In addition, in 2018 the EC presented new legislative proposals on reducing the level of non-performing bank loans and other alternatives allowing to develop secondary market of non-performing loans and thus contributing to increased financial stability at the EU level. Particular attention will be given to the implementation of legislative initiatives on the completion of the creation of the banking union in 2018.

---

<sup>14</sup> Government Resolution No 279 on the draft Law amending Articles 2, 6, 8, 11, 21<sup>1</sup>, 42, 43, 47 of the Law on the Bank of Lithuania No I-678 and annexes 1 and 3 thereof as well as supplementing it with Articles 17<sup>1</sup>, 42<sup>1</sup>, 43<sup>1</sup>, 43<sup>2</sup>, 43<sup>3</sup>, 43<sup>4</sup>, 43<sup>5</sup>, 43<sup>6</sup> and 43<sup>7</sup> and Chapter seven<sup>3</sup> and submission of related draft laws to the Seimas of the Republic of Lithuania.

### Macroprudential policy

In order to reduce the threat of systemic risks on the Lithuanian financial system, the Bank of Lithuania, in exercising its macroprudential policy mandate, continued in 2017 to implement the Macroprudential Policy Strategy and was implementing<sup>15</sup> macroprudential instruments<sup>16</sup>. 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 CCB. Having assessed the development of the credit and real estate market in the recent years and with the view of limiting excessive credit growth, on 29 March 2018 the Bank of Lithuania took a decision to maintain in force the rate of 0.5 %<sup>17</sup> of CCB approved on 20 December 2017. The CCB requirement applied to credit institutions (banks and central credit unions) will come into force on 31 December 2018. This measure that is applied in Lithuania for the first time will help to strengthen the resilience of the financial system to potential shocks. The said measure is flexible: in case of the slow-down of economic growth or shock the CCB may be expeditiously reduced in order to increase the ability of credit institutions to maintain availability of lending during the decline period.

With the view of ensuring responsible lending in the environment of low interest rates and protecting the financial system from the formation of imbalances, lending procedures must observe the RLR. On 1 July 2017, the new version of the RLR came into force<sup>18</sup>. Its provisions are applied taking into account the activity basis, i.e. they are applied not only to housing loans of credit institutions but also to credits for the purchase of housing or loans secured by real estate provided by other credit providers (for example, peer-to-peer lending platforms). Moreover, RLR was started to be applied to natural persons in cases when the credit is sought for business activity (lease and exploitation or construction of real estate). The main lending principles and level of measures set in RLR remained the same<sup>19</sup>.

From the end of 2016, the capital buffer rate of other systemically important institutions is applied to the institutions of national systemic importance with the aim of enhancing the resilience of systemically important institutions against possible losses, and reduce their incentives for excessive risk-taking<sup>20</sup>. This additional capital buffer rate is set at the end of each year. The review carried out in 2017 found four systemically important institutions in Lithuania. A 2 % capital buffer rate, applied to other systemically important

---

<sup>15</sup> Law amending Articles 8, 11, 27, 51, 55 and Annex 2 of the Law on the Bank of Lithuania No I-678 and supplementing it with Chapter seven and Article 52 (18 September 2014, No XII-1097). Register of Legal Acts, No 2014-12712 of 23 September 2014.

<sup>16</sup> Resolution No 03-31 of the Board of the Bank of Lithuania of 12 March 2015 On the Approval of the Macroprudential Policy Strategy.

<sup>17</sup> For more information, see the website of the Bank of Lithuania, Financial stability section in <http://www.lb.lt/lt/finansinio-stabilumo-uztikrinimo-priemones#ex-1-3>.

<sup>18</sup> Resolution No 03-22 of the Board of the Bank of Lithuania of 24 January 2017 amending Resolution No 03-144 of the Board of the Bank of Lithuania of 1 September 2011 on the responsible lending regulations.

<sup>19</sup> For more detail, see 2017 [Financial stability review](#) of the Bank of Lithuania.

<sup>20</sup> Resolution No 03-185 of the Board of the Bank of Lithuania of 21 November 2017 on the setting of capital buffers for other systemically important institutions.



institutions, was set for AB SEB bankas, Swedbank, AB, and Luminor Bank, AB, a 0.5 % capital buffer rate was set for AB Šiaulių bankas.

### **Credit union sector reform**

The reform in the credit union sector ended in 2017 that aimed at solving the key problems of the sector. Two central credit unions started their activities in Lithuania, they were offered the possibility to ensure the solvency of their member credit unions and control the risks they take. The credit unions were required to decide by 1 January 2018 whether they start the procedure for transformation into a bank or continue their activities as part of one of the central credit unions with several mutual financial liability. Five credit unions made use of the possibility to become specialised banks and obtained the consent from the Bank of Lithuania for restructuring. With a view of obtaining the licence of a specialised bank they will be obliged to restructure their activities in such a way as to meet the bank institution requirements within the period of five years. In 2017, the overall assessment of quality of assets of credit unions was carried out following which the majority of credit unions had to increase their capital buffers. In 2017, temporary administrators were appointed for several credit unions that faced with financial problems and later a decision was taken to withdraw the operating licences of the said credit unions. At the beginning of 2018, the credit union sector has gained its financial strength and the long-term sustainability of the sector will be maintained by the restructured legal framework.

### **Implementation of the bank restructuring function**

The Bank of Lithuania, when implementing its function as an institution that performs the restructuring, helps to ensure that in case the banks face difficulties, they will be promptly restructured and their activities will be continued without the State aid. To this end, the Bank of Lithuania together with the joint restructuring board, restructuring institutions of Sweden, Denmark and Latvia draws up the bank restructuring plans. In 2017 the restructuring plans for groups of SEB and Swedbank that covered the subsidiaries of banks active in Lithuania and provided for minimum requirement for own funds and eligible liabilities (MREL) were drawn up and approved. MREL is an additional financial backstop tool that is applied in order to 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. The internal minimum requirement for own funds and eligible liabilities to be applied to the subsidiaries of banks is planned to be set in the years to come. In addition, the restructuring plans of bank group 'Citadele' (Latvia) and 'Danske' (Denmark) were updated. Moreover, in 2017 the amount of approx. EUR 7 million ex-ante contributions was collected from banks active in Lithuania that was transferred to the Joint Restructuring Fund and the amount of EUR 6.7 billion was collected from all the 19 banks in euro area states. By 2024 the Joint Restructuring Fund will have to account for at least 1 % of the covered deposits of the banking union's banks (about EUR 55 billion).

### **Development of financial markets**

In 2017, the legal framework and economic system for the development of the Lithuanian Fintech sector continued to be improved paying particular attention to financial stability. The Bank of Lithuania applied the one stop shop principle when organising meetings with potential financial market participants and consultations on innovative business models. Conditions allowing financial institutions to test innovative products or solutions in regulatory sandbox are created. Due to the spread of innovative financial services a lot of attention is paid to cyber risk management and measures preventing money laundering and terrorist financing: exercises are organised, market participants are actively consulted.

### **Development of capital markets**

In order to promote the development of Lithuania's capital markets and create a more competitive legal environment that will provide more possibilities for both enterprises seeking additional resources and investors alike, the draft Law of the Republic of Lithuania on securitisation and covered bonds will be drawn up. With a view to creating a more favourable jurisdiction for the activities of investment funds in Lithuania, thus preparing the grounds for increase of added value to the economy generated by their activities, laws related to the activities of investment funds will be revised. In order to improve the functioning of capital markets and identify the reasons for the inadequate level of investments by institutional investors in Lithuania, concrete proposals on possible new measures and creation of favourable investment environment for institutional investors will be submitted.

Lithuania has moved forward in terms of creating favourable conditions for the development of Fintech industry (information technologies sector was developed, different forms for the cooperation of state institutions and businesses were established, active publicity campaign is carried out abroad, the Bank of Lithuania implements a special programme Newcomer, sector development friendly legislation was adopted, access to SEPA (Single Euro Payments Area) infrastructure via the Bank of Lithuania was ensured for a wider range of financial market participants in comparison to other EU countries).

At the end of 2017, 117 Fintech companies were active in Lithuania with almost 1900 employees. The development of Fintech is planned in 2018 as well. Lithuania is attractive because of its well-developed infrastructure, financial market supervisory authority that is open to innovations, favourable regulatory environment, qualified and competitive workforce, possibility to carry out activities all over the EU while being in Lithuania. Further growth in this field will not only allow to be one of the centres of Fintech sector in the region but will attract private investments to Lithuania, increase the supply of innovative financial services in the market and share of GDP generated by High Tech in Lithuania.

## CHAPTER VI STRUCTURAL REFORMS AND OTHER STRUCTURAL INSTRUMENTS

### Taxation changes in 2018

In implementing the tax system efficiency improvement provisions 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, the following legislation was passed in 2017: the Law amending Articles 30, 31, 37, 58<sup>1</sup> and 59 and repealing Article 53 of Law No IX-569 of the Law of the Republic of Lithuania on the Excise Duties, the Law amending Articles 2, 6, 16, 17, 18, 18<sup>1</sup>, 19, 20, 22, 24, 27, 29, 33 and 34 of Law No IX-1007 of the Law of the Republic of Lithuania on the Personal Income Tax and adding Article 18<sup>2</sup> to the Law, the Law amending Articles 6, 7, 11, 12 and 14 of Law No X-233 of the Republic of Lithuania on the Real Estate Tax, the Law amending Articles 2, 4, 5, 12, 22, 30, 33, 46<sup>1</sup> and 58 of Law No IX-675 of the Law of the Republic of Lithuania on the Corporate Income Tax and the Law amending Articles 19 and 96 of the Law of the Republic of Lithuania on the Value-added Tax. The above-listed Laws have affected the following changes:

1. In order to decrease the tax burden on lowest-income earners, the monthly non-taxable income (NTI) has been raised from 310 to 380 euros as of 1 January 2018. Individual NTIs have been raised for persons with disabilities: from 320 to 390 for those with minor disabilities; and from 380 to 450 euros for those with more serious disabilities. Instead of the additional NTI, targeted child benefits, paid for all children regardless of the family's income, have been introduced.

2. In order to distribute the tax burden more evenly among small businesses, the principle of taxing individual business income has been altered by abandoning taxation based on types of professional activities and by introducing a single 15 % rate of the personal income tax (PIT) on all income from individual business, while regulating the real tax burden by means of a tax credit.

3. In order to provide additional incentives for productive investments to support regional development and entrepreneurship, the scope of the corporate income tax relief for activities aimed at technological upgrading has been expanded to the maximum (by reducing the taxable profit to 100 %), an additional tax relief has been introduced for undertakings investing in R&D (by applying a reduced corporate income rate of 5 % to revenues from the commercialisation of the assets generated in the course of R&D operations), the tax exemption applicable to capital investments has been expanded to exempt share transfer revenues if, among other conditions, more than 10 % (instead of 25 %) of the voting shares were held prior to the transfer, and a one-year corporate income tax exemption has been granted to small start-ups. In addition, more favourable tax conditions have been established for alternative business funding by exempting all the revenues received by collective investment undertakings as well as risk and private equity undertakings from the corporate

income tax and at the same time exempting the profits distributed by them to their corporate members.

4. In order to increase the progressivity of the tax system, progressive real estate tax rates, ranging from 0.5 % to 2 % have been set, depending on the taxable value of a non-commercial immovable property.

5. The exemptions laid down in the tax legislation have been reviewed to get rid of ineffective exemptions, such as the ones applicable to social enterprises, agricultural operators, etc.

6. In order to expand the framework of taxes less detrimental to economic growth, while contributing to the implementation of environmental goals through taxation measures, excise rates have been raised for gas oils to EUR 347 per thousand litres of product (including gas oils used in agriculture, aquaculture or commercial fishing in inland waters, for which the excise rate has been increased to EUR 56 per thousand litres of product), while the excise exemption for environmentally harmful coal, coke and lignite has been withdrawn. Additionally, the excise rate on smoking tobacco has been increased to EUR 60.24 per kilogram of product as of 1 January 2018, while the excise rates on cigarettes (up to EUR 96 per 1 000 cigarettes), cigars and cigarillos (to EUR 37 per kilogram of product) have been raised as of 1 March 2018.

7. In order to proceed with the consistent expansion of the network of agreements to avoid double taxation, an agreement between the Republic of Lithuania and Japan on the avoidance of double taxation and prevention of tax evasion or avoidance was signed on 13 July 2017. To review the existing agreements and to implement the measures envisaged in the OECD's final reports on the draft *Action Plan on Base Erosion and Profit Shifting* (BEPS), aimed at preventing abusive practices in the field of contracts and to enhance the dispute resolution mechanism, a Multilateral Convention was signed on 7 June 2017 to implement tax contract-related instruments intended to prevent tax base erosion and profit shifting. Legislation has been drafted to ratify the above-mentioned agreement and convention.

8. In implementing the Government's priorities in 2018, measures will be proposed to reform labour taxation, while at the same time considering possible additional sources to fund labour tax reduction.

### **Implementation of the social model**

Since 2017, Lithuania has been implementing a structural reform of labour relations and State social insurance, i.e. a social model. The part of the social model related to the regulation of the social sphere was put into effect as of 1 January 2017, while the part concerning labour market regulation has been applied since the entry force of the Labour Code and its implementing legislation on 1 July 2017. The reform is focused on more flexible labour relations, higher employment, more sustainable social insurance and reduction of poverty.

SP2017 provided comprehensive information on the social model and requested the EC to evaluate the compliance of the social model with the provisions of the SGP which enable the Member States implementing major structural reforms aimed at improving long-term financial sustainability and increasing potential economic growth to make use of the SGP's flexibility. The request to the EC has been repeated after the social model has fully entered into force *de jure* as of 1 July 2017. Updated information on the social model was presented in the 2018 DBP.

Together with the assessment of the 2018 DBP released on 22 November 2017, the EC issued an opinion that the social model is in line with the SGP provisions. Where compliance of the Lithuanian fiscal indicators with the SGP's fiscal discipline rules is evaluated, a GDP flexibility of 0.4 % for 2017-2018 and 0.5 % for 2019 is applied to Lithuania's social model costs.

**The Labour Code entered into force on 1 July 2017** aiming at a more flexible regulation of labour relations in order to encourage employers to create new high-quality jobs, while ensuring security for employees. The new Labour Code expands the range of employment contracts, provides for greater working time regulation, shorter employee dismissal notices and smaller severance payments, also allows fixed-term employment contracts for regular work, while making part of the severance payments payable from the Long-term Employment Benefits Fund, and lays down new provisions creating life-long learning opportunities and ensuring a balance between work and family life, non-discrimination at work and personal data protection. One of the central provisions of the Labour Code, enabling growth of wages, restricts the payment of the MMW to unqualified work only. This provision has resulted in a rise in wages for the lowest earners as well as a decrease in the number of employees earning the MMW.

According to the data presented by the SSIF, with the entry into force of the Labour Code, parties to the labour relations have used the possibility to agree on new types of labour contracts from July to December of 2017. 133 employee sharing contracts, 11 job sharing contracts, 154 apprenticeship employment contracts and 887 project-based employment contracts were concluded. Although the number of new-type employment contracts accounts for a very small share of all employment contracts, 0.4 %, it nevertheless indicates the employers' and employees' need for new types of employment agreements. A total of 308 452 employment contracts were signed in July-December of 2017. 65 324 fixed-term employment contracts were concluded over the said period, including 3 585 contracts with foreigners. Other 10 955 employment contracts are contracts of other types also having a set duration period, such as a fix-term employee sharing contract, a fixed-term temporary employment contract, a fixed-term seasonal work contract, etc., or contracts which are intrinsically fixed-term, such as apprenticeship or project-based contracts. Thus, the overall number of fixed-term contracts amounts to 76 279, indicating an increased labour market flexibility.

The **social insurance pension indexation rules**<sup>21</sup>, adopted in 2016, have brought about a 7 % increase in the insurable amount of the current year and in the basic social insurance pension as of 1 January 2017. As a result, the average old-age pension increased by 7.3 % as of January 2007, compared with the same period in 2016 (from EUR 255.05 in January 2016 to EUR 273.78 in January 2017).

In September 2017, a decision was adopted to raise the basic social insurance pension by additional 8.3 % (from 120 to 130 euros), with the result that the average old-age pension went up by 12.5 % in December 2017 year-on-year (from 255.05 to 287.09 euros)

A positive impact on the social environment has been observed, as all the social insurance pensions have increased and this increase has affected around 1 million of benefit recipients.

The measures implemented and continued in 2017 will have a positive impact on the social environment, prevent the exacerbation of poverty and lead to a lower risk of poverty. The provision of pilot community services will help improve the situation of the disabled, pension indexing will contribute to the purchasing power of the retirement-age population, while the amendments to the Law of the Republic of Lithuania on Monetary Social Assistance for Low-income Residents will, as a result of exclusion of child benefits from the household incomes, have a positive effect on the real incomes of poor families with children and reduce their poverty risk level, which is among the highest in the country. The said changes should have a positive impact on the allocations for social insurance as well.

### **Medium-term changes in the areas of education, health care, shadow economy reduction, innovations, social insurance (pensions) and tax regulation**

Lithuania's demographics is one of the country's main vulnerabilities and a crucial one in the context of national security. Lithuania's level of development has grown by nearly 50 % over the first 10 years of EU membership. Yet, for several years in a row there has been no progress: from 2014 to 2016 Lithuania has not moved forward towards the EU average in terms of the GDP per capita.

In order to reduce the effect of negative demographic trends on the general government finances and to reduce the risk of long-term sustainability, to boost the economic growth potential in the long term and to improve the quality of life for Lithuanian residents, the Government has made the structural reform of education, health care, shadow economy reduction, innovation, social insurance (pensions) and tax regulation one of its short-term priorities. In 2018, it is planned to create the pre-conditions for the reform of the said areas.

In the tax area, considering that labour taxation accounts for a significant part of the tax burden, especially among low and medium earners, there is a shortage of well-paid jobs and incentives to generate high added-value and the tax system is not sufficiently clear (an employee does not see all the taxes related to labour relations, a large portion of social insurance consists of benefits unrelated to insurance contributions; the possibilities of

---

<sup>21</sup> The Law amending Law No I-549 of the Republic of Lithuania on State Social Insurance Pensions.

additional budgetary revenues from real estate taxes that do not interfere with economic growth have not been utilised), the following steps are envisaged:

- (1) to reduce the overall burden of labour taxes by expanding the scope of the NTI;
- (2) to promote the creation of high-added value and to consider the introduction of a ceiling for State social insurance contributions;
- (3) to simplify and clarify the taxation system by proposing that social insurance contributions should be transferred from the employer to the employee and recalculating the net salaries accordingly;
- (4) to purify the social insurance scheme, by transferring to the State budget the social insurance contributions for the basic pension as well as the funding of the basic pension itself, which is not associated with insurance contributions;
- (5) to expand the taxation of secondary residential real estate, while maintaining the progressive character of the real estate taxation system;
- (6) to consistently increase the excise duties on tobacco.

In the area of innovations, bearing in mind that in Lithuania the export of high and medium-high technologies and employment in the knowledge-intensive sector is below the EU average, also taking into account business investments in R&D activities and innovation, the inadequate supply of the services provided by research and study institutions to businesses and insufficient commercialization of inventions, the following steps are planned:

- (1) to consolidate and enhance the system of research, technologies and innovation;
- (2) to create an innovation promotion package;
- (3) to strengthen the R&D and innovation system to meet the challenges of national importance;
- (4) to increase the supply of services provided by research and study institutions to businesses;
- (5) to increase invention commercialisation;
- (6) to promote innovative foreign investment projects.

In the area of health care, considering that due to long waiting lines some residents postpone seeing a doctor, that the Lithuanian life expectancy indicators are below the EU average, while the mortality indicators are among the worst in the EU, although many deaths could be avoided if residents paid more attention to healthy life-style and disease prevention and sought medical help in time, also in view of the high suicide rates, the following steps are envisaged:

- (1) to shorten the general practitioner waiting lines and to increase the accessibility of specialised services by increasing physician teams, promoting mobile services, introducing remote physician-to-physician consulting, managing patient lines more efficiently and optimising physicians' workloads;
- (2) to strengthen the capacities of medical assistance for heart attack or stroke patients by organising additional ambulance teams;



(3) to form healthy living habits from birth and to provide additional staff for health living training in schools;

(4) to invest in suicide prevention in order to train teachers, social workers, police officers, fire-fighters in suicide risk recognition assistance;

(5) to improve the performance of the institutional network for ensuring treatment quality, to increase the accessibility of palliative care and the capacities of in-patient nursing facilities.

In the area of education, considering that the disparities in pupils' achievements between cities, district centres and villages are vast, that the pupils' achievement level is below the OECD average, that the education process is based on the paradigm of teaching rather than of learning, also considering the lack of motivation, widespread bullying, lack of inclusive education and the fact that the education system does not meet the requirements of the market, the following steps are envisaged:

(1) to improve the education content on all levels of general education and to implement quality assurance measures in order to direct changes towards comprehensive personality development;

(2) to provide pupils with enhanced teaching tools by setting up laboratory facilities equipped with up-to-date laboratory equipment for natural sciences and technologies;

(3) to change and develop the training and promotion of teachers, lecturers and researchers;

(4) to improve pupils' communication skills, develop social and emotional competencies, introduce bullying prevention programmes and expand the full-day school network;

(5) to develop informal education and increase the accessibility thereof; to set up more activity groups in natural sciences and technologies;

(6) to increase student admissions to bachelor programmes in natural and technological sciences, engineering and agricultural sciences, which are crucial for the stimulation of the competitiveness of the national economy;

(7) to create a more effective network of vocational training, science and study institutions in order to ensure better quality and competitiveness and to orient study programmes towards labour market requirements.

In the area of shadow economy reduction, considering that, as a result of the measures in place, the shadow economy in Lithuania has been shrinking, yet it still exceeds the EU average by a third, and that unpaid taxes account for a significant part, a holistic package of measures for the reduction of shadow economy will be applied to create tax payment incentives, to raise awareness and ensure unavoidable liability. The following steps are, therefore, envisaged:

(1) to provide residents with more options for reducing their taxable incomes by purchasing services with a high risk of shadow, to extend social assistance to persons who

have found a job and to provide businesses with more electronic services in order to simplify tax payment;

(2) to invest in new awareness raising measures in cooperation with the EC;

(3) to implement new legal instruments that would reduce the possibility of and the intentions for hiding taxes by expanding the application of a reverse VAT, apply stricter licensing rules in risk sectors, change tax limitation periods and penalties for tax infringements and allow the use of tax risk data in public procurement and funding contracts.

In the area of pensions, considering the future challenges in an ageing society and the unfavourable demographic forecasts, there are plans to overhaul the pension accumulation system in order to cushion the negative demographic effects and to ensure larger pensions compared with the current system.

The new pension accumulation system will be based on the principles of economic incentives, when persons are automatically included into the pension accumulation system, with an option to withdraw from or suspend participation in the pension accumulation process. The incentives that the State would offer to a person in terms of pension accumulation would depend on the persons' income. Incentives will also be extended to employers contributing to the employees' pension insurance. Reduction of the cost of pension fund administration services and implementation of the life-cycle and fund investment strategy would boost confidence in the pension system.

## **CHAPTER VII RISK AND SENSITIVITY ANALYSIS**

### **SECTION ONE RISK OF FULLFLIMENT OF THE ECONOMIC DEVELOPMENT SCENARIO**

In the short-term, bearing in mind the positive forecasts from international institutions regarding the economic development of global and main Lithuanian export markets, there is a risk of a faster GDP growth compared with the estimate in the economic development scenario. Tax incentives for investors, the provisions of the new Labour Code, as well as the improved demographic and financial situation of Lithuanian residents may also contribute to economic activity more than projected in the economic development scenario.

Although the growing momentum of the investment process and the increase in productivity in 2017 have significantly limited the risk of a price/wage spiral, this risk still persists due to shrinking labour resources. However, there is a positive risk that, with the continuing stability of the external environment, the economy will smoothly adapt to the shortage of labour supply: to gain a competitive advantage, enterprises will invest in productivity enhancement measures and will consequently be able to offer attractive wages to employees, while the latter will be able to take up jobs with higher added-value generating companies. Thus, a limited labour supply may, in the medium term, become a stimulant to economic growth. The tax measures to simulate the investment process and to increase the income of the lowest earners, coming into force in 2018, are expected to help companies to withstand competitive pressure and adapt to the changed economic conditions.

The main risk in terms of the projected inflation rates persists due to the uncertain developments in the international oil prices, having a major effect on the consumer goods' prices in Lithuania. If in the medium term the oil price grows more than predicted in the technical assumptions, it would be reasonable to expect a faster growth in the prices of consumer goods and services, and vice versa: a decrease in the oil price would promise a lower inflation than the one predicted in the economic development scenario. Another inflation risk in 2018 is associated with the prices of dairy products: if dairy product prices go down together with the decreasing farm gate milk prices in Lithuania, a lower inflation can be expected in 2018, however, if dairy product prices in 2018 stay close to the 2017 Q4 level or even climb higher, a slight increase in inflation is possible.

The negative external environment factors persist and are potentially significant for the small and open Lithuanian economy. These include geopolitical tensions, growing protectionism, and uncertainty surrounding the outcome of the ongoing negotiations on the conditions of Brexit (the UK's withdrawal from the EU). At the time of preparation of the economic development scenario, it was known that the European Central Bank's Quantitative Easing Programme would continue until September 2018, therefore uncertainties as regards the direction of the monetary policy in the medium term remain. The risk of a hard landing of the Chinese economy still exists. If that happens, the Lithuanian economy will suffer an indirect negative effect.

### **Risk to the stability of the Lithuanian financial system**

In 2017, the key risk to the Lithuanian financial system (which has grown over recent years) came from the imbalances in the Nordic countries and a sudden increase in the risk premiums as well as its potential effect on the subsidiary banks. The imbalance in the Nordic countries is already reflected in the deceleration of the growth of, or even a decrease in, housing prices, while the growth of risk premiums may mean a decrease in lending for the subsidiary banks active on the international financial markets. Such a change in the lending policy may lead to a slowdown in economic growth in Lithuania, as the number of loans has been rising over the last few years. A small but nevertheless significant risk for Lithuania is a rapid growth in the real estate market and lending. The loan portfolio kept rising in Lithuania in 2017, mainly driven by mortgage loans. A rapid growth in mortgages, which exceeded the overall economic growth, has contributed to the fact that 2017 was the most active year for the Lithuanian housing market over a decade, while prices have kept climbing for five years in a row. In 2017, the portfolio of bank mortgages went up by 8.1 %, while the housing prices rose 8.5 %. Housing prices in Lithuania have recently become more consistent with the other macroeconomic indicators, however, with the continuing rapid growth in prices, more and more symptoms of overvaluing and thus potential market imbalances may appear. Cyber security challenges have not subsided in Lithuania, which in the long run may have a major influence on the stability of the Lithuanian financial system.

## SECTION TWO FISCAL RISK

### Deposit insurance

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 13 030 million on 31 December 2017, i.e. has increased by 10.25 % over the year. Over the year 2017, credit institutions paid EUR 21.99 million to the DIF, which is 32.3 % less than in 2016. This owes to the reduced amount of periodic ex ante deposit insurance contributions payable by all credit institutions to the DIF for the period from 1 July 2017 to 30 June 2018.

Five insurable events occurred in 2017 in respect of deposits, triggering payment of deposit insurance compensations in the amount of EUR 37.04 million:

1. On 7 March 2017, the Bank of Lithuania declared the credit union 'Žemaitijos iždas' insolvent and its depositors were paid EUR 1.63 million in insurance compensations.

2. On 17 March 2017, the credit union 'Pajūrio kredito unija' was declared insolvent, and the amount of deposit insurance compensations paid out to its depositors totalled EUR 2.15 million.

3. On 25 September 2017, the Bank of Lithuania declared the credit union 'Baltija' insolvent and its depositors received deposit insurance payments in the amount of EUR 11.52 million.

4. On 25 September 2017 the credit union 'Namų kredito unija' was declared insolvent and the amount of insurance payments to the depositors amounted to EUR 1.38 million.

5. On 10 November 2017, the Bank of Lithuania declared the credit union 'Vilniaus kreditas' insolvent and its depositors received deposit insurance payments in the amount of EUR 20.36 million.

Claims from the creditors of SOE DII concerning expenditure related to insurance payments to the depositors of credit institutions are satisfied according to court-approved plans for settlement by bankrupt credit institutions with creditors. The total amount of funds recovered until 31 December 2017 from credit institutions that went bankrupt in 2011-2017 was EUR 947.14 million: EUR 827.87 million was recovered from AB Bankas Snoras, EUR 51.46 million from AB Ūkio bankas and EUR 67.81 million from credit unions. All bankrupt credit institutions transferred EUR 48.44 million over 2017. By 31 December 2017, SOE DII's had completely discharged its debt obligations to the Ministry of Finance, i.e. EUR 62.26 were returned in 2017. The main part of the funds paid to SOE DII was used for payment of insurance compensations to depositors and for repayment of the loan to the Ministry of Finance.

On 31 December 2017, the DIF's financial resources totalled EUR 55.07 million. The amount of financial resources of the DIF on 31 December 2016 accounted for about 0.42 % of the total amount of the core insured deposits of all participants of the deposit insurance

system. By 3 July 2024, the amount accumulated in the DIF, after taking debt obligations into account, has to reach 0.8 % of the total core insured deposits.

### **Risk of SOE DII performance indicator projections**

The changes in the number of participants in the Lithuanian deposit insurance system and consequently in amount of the insurance premium basis and/or annual insurance premium, which is established by the Ministry of Finance, may lead to an increase or decrease in the amount of insurance premiums.

Withdrawal of participants from the Lithuanian deposit insurance system would also mean that the ex-ante premiums paid by them over a year to the DIF are transferred to another EU deposit insurance system.

The amount of funds due from the administered credit institution bankruptcy proceedings may change depending on the price at which the bankrupt credit institutions' assets are sold, successful or unsuccessful outcomes of the proceedings, the amounts awarded and recovered in those proceedings as well as other factors, which would in turn result in an increase or decrease in the DIF revenues from the bankruptcy procedures administered.

Decisions of the Bank of Lithuania concerning the solvency of credit institutions will have a major influence on the DIF's expenditure in 2018-2021. Depending on the stability of the activities of credit institutions and the decisions of the Bank of Lithuania, the expected insurance compensation amounts may increase or decrease.

Due to new unforeseen events, a borrowing need may emerge to fulfil the DIF's obligations, which would increase the DIF's expenditure on loan interest, not foreseen in the 2018-2021 period.

### **State guarantees**

The Government-guaranteed loan portfolio at the end of 2017 accounted for about 1 % of the GDP in 2017. Taking into account the guarantees planned to be provided in 2018, including the guarantees in respect of 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 1.2 % of GDP.

Table 21(7a). State guarantees

Indicator	% of GDP	
	2017	2018
State guarantees	1.0	1.2
of which linked to the financial sector	0	–

Source: Ministry of Finance

### **Other risks**

Table 22. Risks that can affect general government finances

Risk	Risk source	Risk level	Risk likelihood
Operations of State-owned enterprises	Performance improvement or worsening may increase or decrease the amounts of dividends paid to the State budget	medium	medium
Fluctuations of contributions to the EU budget	Changes made to the EU budget and, consequently, to the national contributions to the EU budget. These revisions may have a positive or negative effect on the general government balance.	medium	high
Statistical corrections to defence spending data	Significant differences between the estimates and actual data for expenditure on military equipment, arms and inventories, reported in general government financial statistics on accrual basis (under ESA). These differences may either increase or decrease the general government expenditure	high	high
Political cycle	Greater pressure to increase general government spending in the pre-election year	high	high
Conditions on the global financial markets	Changes on the global financial markets may augment the Government's borrowing expenses	medium	low
Changes in EU funds	Reduced funding to Lithuania from the EU budget in the coming EU funding periods.	high	high
Natural disasters	Heavy rains, fires and disease epidemics may increase general government expenditure.	medium	medium

Source: Ministry of Finance

### SECTION THREE SENSITIVITY ANALYSIS

Lithuania's economy is small and open, with export accounting for more than 80 % of the GDP (81.3 % in 2017), 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, published on 21 March 2018, could be either faster or slower. Due to continuing uncertainty about the future, there is both a positive and a negative risk of deviation from the 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). In case of a decrease/increase in GDP growth by 1 percentage point, the general government revenue would decrease/increase, on average, by about 0.4 % of the GDP.

Table 23. Alternative scenarios

Indicator	2017	2018	2019	2020	2021
Economic development scenario					
Change in GDP at constant prices, %	3.8	3.2	2.8	2.5	2.5
GDP at current prices, million EUR	41 857.0	44 327.5	46 484.6	48 441.1	50 490.2
Change in GDP at current prices, %	8.2	5.9	4.9	4.2	4.2
Pessimistic scenario					

Indicator	2017	2018	2019	2020	2021
Change in GDP at constant prices, %	3.8	2.2	1.8	1.5	1.5
GDP at current prices, million EUR	41 857.0	43 891.4	46 025.5	47 961.0	49 990.0
Change in GDP at current prices, %	8.2	4.9	3.8	3.2	3.2
Optimistic scenario					
Change in GDP at constant prices, %	3.8	4.2	3.8	3.5	3.5
GDP at current prices, million EUR	41 857.0	44 763.7	46 943.9	48 921.3	50 990.5
Change in GDP at current prices, %	8.2	6.9	5.9	5.2	5.3

Sources: Ministry of Finance, Statistics Lithuania

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 7 million, EUR 30 million and EUR 48 million respectively in the period 2019-2021 or about 6 basis points of the GDP annually on average.

Table 24. Sensitivity analysis for revenues and interest payable by central government

Indicator	2017	2018	2019	2020	2021
Change in revenues if the pessimistic* scenario is realized, million EUR	0.0	-176.5	-187.1	-196.9	-206.4
Change in revenues if the optimistic* scenario is realized, million EUR	0.0	176.8	187.5	197.2	206.8
Change in the general government balance due to revenue change under pessimistic* scenario, million EUR	0.0	-0.4	-0.4	-0.4	-0.4
Change in the general government balance due to revenue change under optimistic* scenario, million EUR	0.0	0.4	0.4	0.4	0.4
Change in the central government interest due, as a result of a 1 pp increase/decrease in floating and fixed interest rates	–	–	7 (-7)	30 (-30)	48 (-48)
Change in the general government balance after a respective increase/decrease in the central government interest due	–	–	0.0	-0.1 (0.1)	0.1 (0.1)

Source: Ministry of Finance

\*Income sensitivity was assessed according to the scenarios designed in Table 23 of the Programme.

## CHAPTER VIII SUSTAINABILITY OF GENERAL GOVERNMENT FINANCES

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

Long-term sustainability of general government finances is pre-determined by changes in the demographic structure of the population. The Programme includes an integrated budgetary projection of sustainability of general government finances (hereinafter in this



Chapter 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 the stability of these systems in the future. The Projection was made based on the assumption that the regulation of the areas of health, pensions and education applicable at the time of developing the projections will continue in the long-term as well, 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 to public finances that are associated with demographic changes.

The Projection is based on the demographic projection for Lithuania until 2060, issued by Eurostat in 2017, according to which Lithuania’s population will shrink by 35 %, to 1.83 million, by 2060 (from 2.829 million in 2017). From 2017 to 2060, the working age population (people aged 15–64) will decrease from 65.6 % to 51.4 %, whereas the number of elderly people (65+) will increase from 19.5 % to 32.9 % of the total population. Based on the new methodology used by Eurostat it has been determined that owing to migration the working-age population will be shrinking very rapidly between 2020 and 2030, i.e. at about 2.2 % per year, which will have a negative impact on the GDP. According to Eurostat’s new demographic projections, the number of children will grow in the 2017-2060 period: the share of children aged between 0 and 14 in the total population will increase from 14.9 % in 2017 to 15.7 % in 2060, the share of children of the school age (aged 7-16 years) will rise from 9.4 to 10.6 %, while the share of youths aged between 15 and 19 will decline from 5.2 to 4.8 %.

Table 25(7) of the Programme gives projections on long-term expenditure of public finances (pensions, health care and education systems) for the period until 2060, made under the assumption of a non-changing policy post-2021, the economic development scenario drafted by the Ministry of Finance in spring 2018 as well as the economic and employment assumptions for 2022-2060 agreed by the Economic Policy Committee (EPC) in the autumn of 2017. The projections have been built on the basis of the existing Lithuanian national legislation on social security, health care and education.

Table 25 (7). 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	36.2	36.1	35.8	36.3
of which, age-related expenditure:	17.2	20.7	17.5	17.9	17.8	17.5	18.0
pensions*:	6.6	8.6	6.9	6.9	6.8	6.3	5.8
social security pensions	6.6	8.6	6.9	6.9	6.8	6.3	5.8
old-age and early pensions	4.7	6.2	4.9	4.8	4.9	4.5	4.1
other pensions (disability, widows and survivors)	1.8	2.4	2.0	2.0	1.9	1.8	1.7
occupational pensions (in general government)	–	–	–	–	–	–	–
health care	4.8	4.8	5.2	5.3	5.4	5.5	5.6
long-term health care	0.6	1.1	1.2	1.3	1.6	1.8	2.0
education**	5.3	6.4	4.0	4.1	3.7	3.5	4.2
other age-related expenditure***	0.1	0.4	0.2	0.3	0.3	0.3	0.3

Indicator	% of GDP						
	2007	2010	2020	2030	2040	2050	2060
interest expenditure	0.7	1.8	0.7	0.7	0.5	0.2	0.1
2. Total revenue	34.4	35.4	36.0	35.9	35.9	35.9	35.9
of which: property income	0.6	0.7	0.5	0.5	0.5	0.5	0.5
of which: pension contributions (or respective social insurance contributions)****	6.4	6.8	7.0	6.3	6.3	6.3	6.3
Pension reserve fund assets	2.9	–	–	–	–	–	–
of which: consolidated public pension fund assets*****	1.7	4.1	10.2	22.3	34.5	44.1	46.2
Systemic pension reforms							
Social insurance contributions diverted to mandatory private schemes	0.9	0.3	0.8	0.8	0.8	0.8	0.8
Pension expenditure paid by mandatory private schemes	0.0	0.0	0.0	0.2	0.6	1.0	1.8
Assumptions							
Increase in labour productivity (per hour)	7.2	6.1	3.4	2.5	2.1	1.9	1.7
Real GDP growth	11.1	1.6	2.5	0.5	1.0	0.9	1
Participation rate males (aged 20-64)	79.9	80.6	83.6	83.8	84.3	85.0	86.3
Participation rate females (aged 20-64)	72.2	76	78.5	82.1	82.6	83.0	84.9
Total participation rate (aged 20-64)	75.9	78.2	81.0	82.9	83.4	84	85.6
Unemployment rate (aged 20-64)	4.2	17.8	5.9	8.0	7.9	7.8	7.8
Population aged 65+ in total population (beginning of the year)	16.6	17.3	20.5	26.9	31.8	32.3	32.9

Sources: Statistics Lithuania, Ministry of Finance, 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 2018: Revised framework” (Brussels, 14/10/2016).

\*\* 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 System (Pillar II) accumulated in individual accounts of pension accumulation participants and the annuity funding reserve.

Table 25(7) shows revenue from social insurance contributions and the State budget (excluding transfers to 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 benefits) are funded directly from the State budget. Compared with the projection made in SP2017, expenditure on social security pensions grew in 2060 by 1.6 % of the GDP due to an increase in the base pension in October 2017 from 120 to 130 euros and new demographic as well as macroeconomic assumptions. The projected smaller negative net migration, covering a period extended by 20 years (up to 2050), has moved the maximum value of the old-age dependency ratio from 2040 to 2060. Reduced emigration, together with a higher level of labour market activity, had a positive effect on the pension indexing rate (the average change in the wage bill over 7 years) until 2035. The lower mortality assumptions, together with reduced emigration, have led to a growing number of pensioners and a longer retirement-age life expectancy in the second half of the projected period.

At the end of the projected period, the expenditure on pensions will account for 5.8 % of the GDP and will be 1 percentage point lower than at the beginning of the period in 2017. 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. The growth in pensions expenditure is expected to be tamed by the increased rate of contributions to Pillar II pension funds, from 2 % to 3.5 % as of 2020. 1 268 million people accumulated pensions in private pension funds in late 2017, around 68 % of whom paid contributions. At the end of 2017, the participants contributing to the pension scheme were distributed as follows: those who paid an additional 2 % from their salary and received a contribution from the State budget of 2 % of the average wage in the year before last (52 %), and those who chose to accumulate only a part (2 percentage points) of the social pension insurance contribution rate (48 %). The tax revenues intended for pension reform implementation, transferred to private pension funds (including contributions transferred from the state social insurance funds and contributions paid from the State budget), are expected to increase from 0.61 % of the GDP in 2017 to 1.26 % of the GDP in 2060. Contributions transferred from the State budget are projected to grow from 0.2 % of the GDP in 2017 to 0.5 % of the GDP in 2016, as a result of a steadily growing number of people opting for full accumulation. Since the newcomers to the Pillar II pension accumulations scheme must accumulate additionally by contributing part of their wages, at the end of the projected period all those participating in the accumulation are expected to accumulate additionally.

The pension fund assets in 2060 are projected to reach 46.2 % of the GDP, while the benefits paid from private pension funds will amount to 1.8 % of GDP. Expenditure on social insurance pensions and private pension funds' expenditure on pensions will together reach 7.7 % of the GDP in 2060.

With the increasing number of elderly residents, the general government budget expenditure (GPD share) on long-term health care will rise too: in 2017–2060 it will increase by 0.9 % of the GDP.

According to the demographic projections of Eurostat in 2017, the estimated education spending in 2017-2060 will decrease by 0.1 % of the GDP. However, following the implementation of the provisions of the 2013-2022 National Education Strategy, approved by Government Resolution No XII-745 of 23 December 2013 on the approval of the 2013-2022 National Education Strategy, education expenditure may go up by 1.7 percentage points in 2022 against 2017 and reach 6 % of the GDP. It should remain at that level until 2060. In line with the National Education Strategy, expanding the scope of learning, improving the social guarantees of teachers and lecturers and education quality as well as implementation of other measures is envisaged.

## CHAPTER IX

### EVALUATION OF COMPATIBILITY BETWEEN THE PROGRAMME AND NRA

Lithuania is advised in the Recommendation to improve compliance with tax obligations and to expand the tax base in the years 2017 and 2018, by switching to tax sources that are less detrimental to growth; to address the issue of medium term fiscal sustainability in relation to pensions; to apply effective measures for an active labour market policy, promote adult education, address skilled workforce shortages and improve education results by rewarding training and higher education quality; to improve the performance of the health care system; to enhance outpatient care and disease prevention and increase service affordability; to improve the adequacy of the minimum social security system; to adopt measures for efficiency improvement by raising the effectiveness of public investments and establishing stronger links with the country's strategic objectives.

The NRA sets out the Government's actions and summarises the key ongoing structural reforms as well as those planned in the medium term, which are intended to meet the biggest economic and employment challenges, i.e. to maximise job creation and to ensure faster economic growth and investment, especially in human capital.

Calculation of the general government financial indicators set out in the Programme took into account the effect of the structural reforms envisaged in the 2018 NRA on the general government finances based on the areas of public administration.

In the area of **education and science**, resources will be provided to reinforce the evaluation and monitoring of pupils' performance, schools and education as a whole, to enable regular professional development of teachers, to adapt vocational training better to the needs of the labour market, and to create a system for professional development as well as personal and civic self-improvement of adults. The resources allocated for the implementation of the Programme for Studies and Research Development are intended to ensure conscious and well-informed choice and accessibility of studies, to develop the international character of studies, to increase international recognition of higher education in Lithuania, to modernise the studies infrastructure and the teaching and learning environment, to create favourable conditions for the development of life-long learning services at the schools of higher education, to prepare highly skilled researchers, to reinforce and consolidate the human R&D potential for the development of smart specialisation areas and implementation of other instruments.

**In the area of health care**, resources will be provided for the development of the activities of public health maintenance and improvement, implementation of disease prevention projects, organisation of social advertising and research and implementation of action plans for ensuring healthy ageing and reducing health disparities in Lithuania.

**In the area of environmental protection**, resources will be provided for the renovation/modernisation of multi-apartment buildings and public buildings of municipalities, implementation of the Special Climate Change Programme, renovation and development of

water supply and wastewater management systems, and creation of a waste management system.

**In the area of economy**, resources will be provided for the promotion of innovation, promotion of goods and services export, industrial development and modernisation, promotion of direct domestic and foreign investments, improvement of the investment environment, business promotion and human resource development.

**In the area of communications**, resources will be provided for measures laid down in the 2014-2020 National Programme for Communication Development, approved by Government Resolution No 1253 of 18 December 2013 on the approval of the 2014-2020 National Programme for Communication Development as well as in the 2014-2020 programme for information society development 'Digital Agenda of the Republic of Lithuania', approved by Government Resolution No 244 of 12 March 2014 on the approval of the 2014-2020 programme for information society development 'Digital Agenda of the Republic of Lithuania'.

**In the area of social security and labour**, resources will be provided to reinforce the main employment instruments, i.e. to promote job creation and demand, to better adapt workforce qualifications to the requirements of the labour market and to integrate unengaged workforce into the labour market.

**In the area of energy**, resources will be provided for the promotion of renewable sources of energy and energy efficiency.

Table 26. The impact of structural reforms on general government finances (increased spending or decreased revenues (+); decreased spending or increased revenues (-))\*

Public administration areas	2017		2018		2019		2020		2021	
	million EUR	GDP %	Change, million EUR	GDP %	Change, million EUR	GDP %	Change, million EUR	GDP %	Change, million EUR	GDP %
1. Education and science	268.1	0.6	24.2	0.1	297.8	0.6	96.5	0.2	0.0	0.0
2. Health care	1.1	0.0	67.1	0.2	-6.4	0.0	1.9	0.0	-	-
3. Tax changes**	28.4	0.1	336.6	0.8	24.5	0.1	2.0	0.0	0.0	0.0
4. Environment	183.6	0.4	-24.7	-0.1	139.9	0.3	-109.9	-0.2	-132	-0.3
5. Economic policy	56.4	0.1	82.1	0.2	-12.2	0.0	46.3	0.1	-40.1	-0.1
6. Communication	120.1	0.3	76.4	0.2	91.7	0.2	46.2	0.1	-94.0	-0.2
7. Social security	226.6	0.5	-15.0	0.0	-32.7	-0.1	-32.1	-0.1	16.2	0.0
8. Implementation of the social model***	220.0	0.5	286.0	0.6	191.0	0.4	-	-	-	-
9. Energy	2.3	0.0	22.4	0.1	46.2	0.1	-22.0	0.0	-13.4	0.0
<b>Overall effect on general government finances</b>	<b>1 106.7</b>	<b>2.6</b>	<b>855.1</b>	<b>1.9</b>	<b>739.8</b>	<b>1.6</b>	<b>28.8</b>	<b>0.1</b>	<b>-263</b>	<b>-0.5</b>
10. Spending on pension accumulation reform	259.8	0.6	32.2	0.1	27.5	0.1	196.1	0.4	34.1	0.1

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

\*Data for the year 2017 – resources provided for reform implementation measures in that year; data for 2018-2021 – change in the resources provided for the reform implementation measures, compared with the previous year; the totality of national and EU support funds.

\*\*More information on changes to the tax system is provided in Chapter VI ‘Structural reforms and other structural instruments’ of the Programme.

\*\*\* The SGP flexibility in respect of the reform costs has been granted for the years 2017-2019.

## **CHAPTER X**

### **THE INSTITUTIONAL SET-UP OF GENERAL GOVERNMENT FINANCES**

#### **National and EU fiscal discipline regulations**

With a view to increasing confidence in the long-term sustainability of public finances and the long-term rules of fiscal discipline ensuring economic development, on 6 November 2014, the Seimas adopted the Constitutional Law and the Law Amending Articles 2, 4, 6, 9 and 23 of 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 general government surplus rule laid down in the Constitutional Law sets out the principles for managing the structural general government balance indicator. According to that rule, the structural general government balance indicator must improve with every year where economic growth exceeds potential growth, until structural surplus is attained. Where the GDP is below the potential, the structural balance indicator cannot be below the medium-term objective, set by the Seimas for a maximum period of three years. The Law sets out procedures applicable in the event of deviation from the medium-term objective and the circumstances in which the structural adjustment target has to be set, the value of the target and actions to be taken in case of failure to meet it. A temporary deviation from this rule is allowed only under exceptional circumstances and it has to be adjusted within the prescribed period.

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

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



January 2016. The rule applicable to big municipality budgets and the CHIF budget entered into force on 1 January 2018.

For the purpose of the implementation of the EU requirements for budget control and fiscal policy strengthening, the Constitutional Law provides for the functions of an independent budget 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 approval of the economic development scenario developed by the Ministry of Finance.

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

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

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

The Draft Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets for 2019 will be drafted in accordance with the Plan for Drafting Financial Indicators of the State Budget of 2019 of the Republic of Lithuania and Municipal Budgets, approved by Government Resolution No 203 of 7 March 2018 on the approval of the Plan for

Drafting Financial Indicators of the State Budget of 2019 of the Republic of Lithuania and Municipal Budgets. Medium-term government finances are planned in accordance with the legal acts specified in Table 27.

Table 27. Medium-term government sector regulation

<b>Numerical fiscal rules</b>	
1. General government structural balance rule	Article 3 of the Constitutional Law
2. Rule limiting growth in general government expenditure	Article 3 of the Constitutional Law
3. Small municipality budget balance indicator rule	Article 4(4) of the Constitutional Law
4. Big municipality CHIF budget balance indicator rule	Article 4(2) of the Constitutional Law
5. SSIF budget balance indicator rule	Article 4(3) of the Constitutional Law
<b>Medium-term tasks</b>	
1. Setting the medium-term target	Approved by a legal act of the Seimas for a maximum period of three years.
2. The structural adjustment target for the coming year and the structural adjustment guidelines for the remaining years of the medium-term	Approved by a legal act of the Seimas if the need for structural adjustment is established.
3. The overall indicators of State budget and local government budget revenues and spending over the three-year period	The three-year indicators set out in the Lithuanian Stability Programme are approved by a Government resolution; approved by a resolution of the Seimas when drafting the budget for a particular year.
4. Next-year plans of the SSIF and CHIF budgets and forecasts for the remaining years in the medium-term	The law approving the SSIF indicators for a particular year; the law approving the CHIF budget indicator for a particular year.

Source: Ministry of Finance

### Regulation of the Reserve (Stabilisation) Fund

The Law amending Articles 1, 9 and 11 of Law No I-712 of the Republic of Lithuania on State Treasury and Supplementing it with Section Four<sup>1</sup>, and Resolution No XII-2020 of the Seimas of the Republic of Lithuania of 17 November 2015 amending Resolution No IX-912 of the Seimas of the Republic of Lithuania of 30 May of 2002 on the approval of 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, i.e. in exceptional circumstances. Another possibility of using 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 % 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 sources for 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 accumulation of the fiscal reserve.

By the end of 2018, the Reserve (Stabilization) Fund is expected to have accumulated 0.6 % of GDP in financial assets. By the end of 2021, the Reserve (Stabilization) Fund is expected to have accumulated 1 % of GDP in financial assets. In implementing the social model reform, financial reserves for future pensions have been accumulated in the SSIF as of 2017. These reserves are expected to account for 0.7 % of the GDP in 2021. The CHIF reserves will amount to roughly 0.3 % of the GDP in 2021. Thus, at the end of 2021 the reserves attributable to the general government will account for approximately 2 % of the GDP. Compliance with the fiscal discipline rules and the favourable economic growth prospects expected in the medium term allow constant replenishment of the reserves.

## **CHAPTER XI**

### **SETTING MEDIUM-TERM INDICATORS FOR THE EXPENDITURE OF BUDGETS ATTRIBUTABLE TO THE GENERAL GOVERNMENT**

To strengthen the medium-term budget planning system, when planning the 2019-2021 State budgets in 2018, the expenditure ceilings will be established for the appropriations managers for a 3-year period. To ensure proper functioning of the medium-term budgeting system, it is necessary to set reliable expenditure limits for State budget spending. This Chapter provides information on the general government expenditure limiting rules laid down in the Constitutional Law and the SGP and explains the setting of limits by specifying the assumptions and principles underlying the setting of expenditure limits.

General government expenditure is not limited by the expenditure limitation rule under the Constitutional Law where the output gap is positive and the arithmetic average of the general government balance indicator over at least five consecutive years is also positive. In that case, general government expenditure is limited by the general government surplus rule laid down in the Constitutional Law. As the actual and the projected structural balance indicators are approaching surplus, while the medium-term objective (-1 % of the GDP) is estimated under the SGP structural balance rule, the most restrictive SGP rule is the expenditure growth limitation rule.

A positive output gap is projected in the medium term. **In 2019**, the limits of the general government and the budgets attributable to the general government are set with regard to the targeted structural general government balance indicator of -0.2 % of the GDP. This provides room necessary to begin the implementation of the structural changes in the areas of taxes, education, health care and other areas considered by the Government. The 2019 structural balance target has been established pursuant to the provision of the Constitutional Law stating that, with a positive output gap, the structural balance needs to improve by at least 0.1 % of the GDP, compared with the 2018 indicator of -0.3 % of the GDP.

The general government expenditure planned for **2020 and 2021** is intended to ensure that the general government structural balance indicator has a surplus (0.1 % of the GDP) and

the expenditure does not exceed the general government expenditure growth limit established under the SGP's expenditure growth limitation rule. Due to a structural surplus, and with a positive output gap, the general government will have a nominal surplus. In that case, the general government balance indicator for five years in a row will be positive and the expenditure limitation rule under the Constitutional Law will not apply. The general government surplus rule established by the Constitutional Law means that, where the country has structural deficit, it must reduce it until structural surplus is achieved. Seeking structural surplus is not only economically reasonable in the sense that cyclical revenues are not spent, but also allows managing the country's finances in line with the general government surplus rule under the Constitutional Law and the expenditure growth limitation rule under the SGP. The purpose of structural surplus is to reduce the risk of long-term financial sustainability of the general government.

Based on the fiscal discipline rules and assumptions mentioned above, the general government expenditure in 2019-2021 is determined in line with the **following principles**:

1. A possible amount of the consolidated adjusted general government expenditure is determined in accordance with SGP's expenditure limitation rule (general government expenditure may grow to the extent of the potential GDP growth<sup>22</sup>). The adjusted general government expenditure is recalculated into non-consolidated expenditure of the total general government (excluding EU and other international financial assistance). This general government expenditure,  $G_{max}$ , stands for the maximum general government expenditure.

Table 28. Determination of the maximum general government expenditure (excluding EU and other international financial assistance)

Code	Indicator, million EUR	2019	2020	2021
<i>E</i>	The maximum consolidated adjusted general government expenditure based on the expenditure growth limit	15 489.8	16 197.4	16 957.4
	<i>Expenditure adjustments</i>			
<i>pal</i>	General government interest expenditure	404.0	322.4	283.4
<i>cni</i>	Cyclical unemployment benefit expenditure	-8.3	6.7	22.0
<i>inv</i>	Investment adjustment*	-123.7	-167.2	-161.2
<i>vpi</i>	One-off measure expenditure	45.5	50.0	50.0
<i>dpp</i>	Discretionary revenue measures	24.5	2.0	0.0
$G_{max\_nek}$	The maximum consolidated general government expenditure (excluding EU and other international assistance) = $E + pal + cni - inv + vpi + dpp$	16 079.2	16 745.7	17 474.0
<i>kon</i>	Consolidation	2 382.8	2 481.0	2 617.4
$G_{max}$	The maximum non-consolidated general government expenditure excluding EU and other international financial assistance = $G_{max\_nek} + kon$	18 462.0	19 226.8	20 091.4

Source: Ministry of Finance

\*The amount of investments in the planned year is subtracted and the arithmetic average of the investments made in the four years preceding the planned year is added.

<sup>22</sup> Vade Mecum on the Stability and Growth Pact, 2017 Edition, [https://ec.europa.eu/info/publications/economy-finance/vade-mecum-stability-and-growth-pact-2017-edition\\_en](https://ec.europa.eu/info/publications/economy-finance/vade-mecum-stability-and-growth-pact-2017-edition_en), p. 52.

2. The non-consolidated general government revenues projected in a particular year, calculated on accrual basis, are determined (excluding EU and other international financial assistance):

Table 29. Amounts of the revenues of the general government and non-consolidated budgets attributable to it

Code	Indicator (non-consolidated, calculated on accrual basis), million EUR	2019	2020	2021
$P_{VB}$	State budget revenues	7 197.0	7 564.2	7 929.2
$P_{SAV}$	Municipal budget revenues	2 997.9	3 132.5	3 304.8
$P_{VSDF}$	SSIF budget revenues	4 253.6	4 265.4	4 479.8
$P_{PSDF}$	CHIF budget revenues	1 915.8	2 040.9	2 176.4
$P_{KTI}$	Revenues from other budgets attributable to general government	1 909.3	2 013.9	2 118.2
$P$	General government revenues = $P_{VB} + P_{SAV} + P_{VSDF} + P_{PSDF} + P_{KTI}$	18 273.6	19 016.9	20 008.4

Source: Ministry of Finance

3. With regard to the projected general government revenues, the cyclical general government component and the net result of one-off measures, the non-consolidated general government expenditure, calculated on accrual basis, is determined so as to correspond to the planned structural balance of the general government.

Table 30. Determining the general government expenditure

Code	Indicator, million EUR	2019	2020	2021
$ck$	Cyclical general government component	350.5	194.7	63.4
$vp$	Net result of one-off measures	30.5	30.5	20.3
$p$	The amount matching the structural objective*	-94.5	48.4	50.5
$G$	The general government expenditure = $P - ck - vp - p$ (non-consolidated, calculated on accrual basis)	17 987.1	18 743.3	19 874.2

Source: Ministry of Finance

\*A structural deficit of 0.2 % of the GDP is estimated for 2019; a structural surplus of 0.1 % of the GDP is estimated for 2019 and 2020.

4. The determined general government expenditure ( $G$ ) is distributed to the budgets attributable to the general government, while respecting the limits prescribed by the Constitutional Law:

4.1. The expenditures for the budgets of the CHIF and the municipalities of Vilnius, Kaunas and Klaipėda cities are determined so that, given their expected budget revenues, their budgets are structurally balanced (Article 4(2) of the Constitutional Law), when calculated on accrual basis. For the rest of the municipalities, the expenditures are determined so that their budgets are nominally balanced (Article 4(2) of the Constitutional Law). As a result, the total of all municipal budget expenditures is smaller than the municipalities' budget revenues by the total of the cyclical components calculated for the budgets of the Vilnius, Kaunas and Klaipėda city municipalities. An additional assumption is made regarding the local

government sub-sector surplus based on the historic 2014-2017 data on the local government sub-sector balance.

4.2. The expenditure estimates for the SSIF budget and other budgets attributable to the general government match the expenditures planned in their budgets. The SSIF expenditure is not limited due to the demographic developments anticipated in the future.

Table 31. The total expenditure of the CHIF, SSIF and municipal budgets and the expenditures of other budgets attributable to the general government

Code	Indicator, million EUR	2019	2020	2021
$ck_{PSDF}$	Cyclical component of the CHIF budget	48.0*	21.6	7.3
$G_{PSDF}$	CHIF budget expenditure = $P_{PSDF} - ck_{PSDF}$ (non-consolidated, calculated on accrual basis)	1 867.9	2 019.3	2 169.1
$ck_{PSDF}$	Municipal budget balance	68.4	19.3	16.6
$G_{SAV}$	Total municipal expenditure = $P_{SAV} - ck_{SAV}$ (non-consolidated, calculated on accrual basis)	2 929.5	3 113.2	3 288.3
$G_{VSDF}$	SSIF budget expenditure (non-consolidated, calculated on accrual basis)	4 031.7	4 293.2	4 514.5
$G_{KITA}$	Expenditures of other budgets attributable to the general government (non-consolidated, calculated on accrual basis)	1 818.6	1 919.8	2 030.7

Source: Ministry of Finance

\* The cyclical component totals EUR 38.8 million; the remaining amount is the assumption on the positive effect on revenues due to a rise in the wages of health professionals.

4.3. The State budget expenditure limit is equal to the general government expenditure ensuring a structural surplus of 0.1 % of the GDP minus the total of the expenditures of all other budgets attributable to the general government. This difference represents the State budget expenditure limit, which is recalculated into the State budget expenditure limit in cash flows.

Table 32. Setting the State budget expenditure limit

Code	Indicator, million EUR	2019	2020	2021
$G_{VB}$	State budget expenditure = $G - G_{PSDF} - G_{SAV} - G_{VSDF} - G_{KITA}$ (non-consolidated, calculated on accrual basis)	7 339.3	7 397.6	7 871.6
$kaup$	Expenditure adjustment due to recalculation on accrual basis	-17.3	40.3	151.9
$G_{VB\_max}$	Non-consolidated State budget expenditure limit in cash flows = $G_{VB} + kaup$	7 322.0	7 437.9	8 023.5

Source: Ministry of Finance

Where the general government expenditure is smaller than the set maximum general government expenditure ( $G < G_{max}$ ), the general government expenditure (including the State budget expenditure) may be increased to the maximum expenditure amount, on condition that the total revenues of the general government are increased by at least the same amount. This is necessary to ensure a structural surplus of 0.1 % of the GDP.

Determined pursuant to the above principles, the expenditures of the budgets attributable to the general government, including the State budget, have led to the

implementation of a fiscal policy corresponding to the economic cycle. A positive output gap has resulted in a general government surplus, which remains in the reserves of the budgets attributable to the general government. The State budget and general government expenditure limits may be changed only due to factors attributable to the economic cycle: a change in the output gap and an ensuing change in the nominal surplus amount necessary to achieve a structural surplus, new one-off measures or application of new discretionary revenue measures. Otherwise, expenditure limits should not be modified.

---