APPROVED BY
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of the Government of the Republic of
Lithuania

STABILITY PROGRAMME OF LITHUANIA FOR 2016

CHAPTER I
FINANCIAL POLICY OVERVIEW

1. In 2015, Lithuania's general government deficit was the lowest over its monitoring period since the declaration of the independence of the Republic of Lithuania, namely – 0.2 per cent of the gross domestic product (hereinafter referred to as GDP). No deviations from the medium term objective[1] have occurred in 2015, where the structural general government deficit stood at 0.5 per cent of GDP and corresponded with the provisions of the Stability and Growth Pact on structural balance indicator. Tax revenue to GDP ratio (or reallocated share of GDP) has increased and amounted to 29.5 per cent of GDP (28 per cent of GDP in 2014). The increase has resulted from the fast growth of GDP components (wage income, consumption expenditure) that are key for tax collection, as well as from the technological solutions applied for better tax administration.

2. In 2015 the general government debt, excluding the funds accumulated for the Eurobond redemption comprised 40 percent of GDP. It was also impacted by the imbalance of the European Union (hereinafter referred to as the EU) assistance cash flows, which was neutral to government sector balance. If this factor was excluded, the debt would comprise 36.9 per cent of GDP.

As published by statistical services, the general government debt inclusive of the accumulated funds and temporary imbalance of EU assistance cash flows, accounts of 42.7 per cent of GDP in 2015.

Prudent management of public finances and the global financial market trends have made it possible to reduce the cost of interest payment. The Government of the Republic of Lithuania (hereinafter referred to as the Government) refinanced its previously assumed debt obligations at the time of maturity at much lower interest rates payable (1-2 per cent interest rate for the debt of 10-20 years duration).

3. The condition of the general government finances – i.e. close to balance general government finances – provides for prudent acceleration of structural reforms, but it is necessary to continue in the medium term sustainably reducing the debt and maintaining it below 40 per cent of GDP. The surplus in the government sector would in the medium term minimise the risk of sustainability of general government finances and greatly reduce the level of debt – close to 35 per cent of GDP. With structural reforms gaining momentum, a challenge will be faced of ensuring compliance with the Lithuanian and EU legislation providing for restriction on growth in spending.

[1] Medium term objective – general government structural balance deficit below 1 per cent of GDP.

It will be possible to gain more fiscal space and to accelerate structural reforms compatible with the Stability and Growth Pact.

4. Structural reforms in the areas of social security, labour market, education and health care are of great relevance for Lithuania. At present, social security and labour market legislation (hereinafter referred as the new social model) is under deliberation in the Seimas of the Republic of Lithuania (hereinafter referred to as the Seimas). A more detailed information on new social model is provided for in the National Reform Agenda, which also discusses other ongoing structural reforms. The general government financial projections (general government balance and debt indicators) provided in the Stability Programme of Lithuania for 2016 (hereinafter referred to as the Programme) do not as yet reflect the implications of the new social model, but, submitting the Programme, Lithuania turns to the European Commission (hereinafter referred to as the EC) with a request for a possibility to benefit from the structural reform clause in the assessment of the compliance of general government financial indicators with the Stability and Growth Pact in the year 2017. The implications of the new social model on government finances will be updated and specified together with Lithuania's draft budgetary plan 2017 to be submitted to the European Commission in autumn, taking into account the *de facto* new social model legislation and the Council of Europe recommendations for Lithuania.

5. General government medium-term financial projections have been drawn up in accordance with the latest economic development scenario, providing a faster GDP growth in 2016 against 2015 (2.5 per cent against 1.6 per cent in 2015). In 2017-2019, GDP will witness further growth – up to more than 3 per cent. Despite the strong domestic demand, in 2015, GDP growth was slower, which was basically the result of the loss of the export markets in the East. With the economic downturn in their trading partners in the East, Lithuanian exporters looked for and found other markets (not only EU countries). The exports of goods and services are expected to grow more rapidly in 2016. In the medium term, as of 2016, Lithuania's economic growth will again reach balance: GDP growth will be driven by the domestic demand (consumption and investment) and the external demand (exports). The potential GDP in 2016 will be slightly higher than the real GDP, this trend will change post-2016 however. As a result demographic (including migration) trends, the economy, as of 2017, will grow by exhausting all its capacities. Furthermore, the economic trends show the declining unused labour resources, which will result in the medium term, in shortages of both skilled as well as unskilled labour. Therefore, the scarcity of labour resources and their growing price will force Lithuanian companies to modernize production and to focus more not on competing in prices, but exporters' ability to focus on higher value-added products. The structural reforms in labour market, education, social security and other areas will contribute to increased economic potential while creating a more favourable environment for investment and new high value-added jobs, and while ensuring a better match between the systems of the labour market and education, and improved expectations for adequate old age social security.

6. It is projected that with further efforts to improve tax collection through the new tax administration improvement measures and the gradual increase of the tax rates favourable for economic growth (reducing the use of products harmful for the people and the environment), the

general government deficit in 2016 will account for less than 1 per cent of GDP and will be below the projections. In 2017-2019, the general government finances are projected to strike balance and reach surplus. It is expected to continue to increase defence funding in accordance with NATO commitments, increase salaries for lowest paid public sector employees, health care funding in accordance with the adopted legislation, to increase capital investment, while implementing EU-funded projects. The increase of pensions is expected to happen through the pension indexation mechanism, which is one of the measures of the new social model.

7. The introduction of the new social model would result in the deterioration of the general government balances over the medium term due to the costs of the beginning period of structural reforms, which in the long run will reduce general government expenditure.

8. The increase of the non-taxable allowance has reduced the tax burden for minimum wage earners and those with two children in 2016 by 4 percentage points (depending on the salary). In the medium term a further increase of the non-taxable allowance for low income earners is to continue, in combination with other structural reforms.

9. The implementation of the new tax administration improvement measures in 2016-2019 will result in an increased tax revenue to GDP ratio moderately to close to 31 per cent of GDP. A higher redistributable GDP share enables adherence to social and other commitments, as well as the implementation of structural reforms.

10. In the medium term, efficiency in public spending and public service will grow. Government spending share in GDP is one of the lowest in the EU, and education and health-care quality indicators have not reached the adequate level, compared to other EU countries. Therefore, public service quality is gaining ever higher priority, with quality indicators becoming an important factor for deciding on increasing funding for the areas mentioned.

Here are the major conclusions of the main sectoral analysis covering the fields of education, health and social security:

10.1. Lithuanian government expenditure on education (GDP share) – is not below the relevant EU average, but the quality indicators in education have failed to reach an adequate level compared to the EU countries. Higher education quality and increased salaries in the education system are possible through a structural education reform, namely – through a more efficient use of the internal resources in the system.

10.2. Lithuanian government expenditure on health care (GDP share) – is below the EU average. International experience shows that the richer countries (in terms of GDP per capita) tend to allocate more funds for health care than less developed countries. Given the differing level in the development of the countries, the Lithuanian health funding level becomes closer to the EU average. Furthermore, the Lithuanian households account for much higher share of private funds used for health services compared with the EU average. As regards health care quality indicators in Lithuania, they are still inadequate. It would only be possible to improve health care quality indicators and increase the salaries of workers after the structural reorganization of the health care system.

10.3. Lithuanian government expenditure on social security (GDP share) – is below the EU average, particularly – pension spending. Social security system funding needs to be increased. To match the increase in social security funding with the fiscal discipline, a structural reform is needed through the introduction of the new social model.

More information and data on sectoral analysis is available in the new chapter of the Programme “Sectoral analysis”.

11. Law Amending Articles 1, 9, 11 of the Law of the Republic of Lithuania on State Treasury No I-712 and Supplementing it with Section Four[1] , enacted on 1 January 2016, and Resolution No XII-2020 of the Seimas of the Republic of Lithuania Regarding Resolution No. IX-912 of the Seimas of the Republic of Lithuania of 30 May of 2002 ‘On the Regulations of the Reserve (Contingency) Fund’ facilitate accelerated accumulation of financial resources, by annually depositing share of income received from dividends and from the sale of state property.

12. The medium-term objective is set in accordance with the EU rules on economic governance, provided for 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 *special edition*, 2004, chapter 10, volume 01, 2004, 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), as well as the Constitutional Law of the Republic of Lithuania on the Implementation of the Fiscal Compact (hereinafter referred to as the Constitutional Law). The last time the medium-term objective of Lithuania was set by Seimas Resolution No XII-2147 of 8 December 2015 ‘On a Medium-term Objective’, which provided for up to 1 per cent structural government deficit as of GDP at current prices.

13. 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 shall make public their national medium-term fiscal plans in accordance with their medium-term budgetary framework. The Programme provides all this information. The Programme is in full compliance with the provisions on information to be provided in stability programmes, as laid down in Article 3 of Council Regulation (EC) No 1466/97. The Programme was presented before the Seimas Committee on European Affairs in the meeting of 29 April 2016.

14. Following the entry into force of the Constitutional Law as of 1 January 2015, a conclusion on the economic development scenario shall be made by an independent monitoring budget policy institution. Under the rules of the reformed EU economic governance, the National Audit Office (hereinafter referred to as the National Audit Office) has been entrusted as of 1 January 2015 with the function of monitoring budget policy. The National Audit Office submitted Conclusion No Y-5 of 30 March 2016 “regarding the Approval of the Economic Development Scenario”, stating that “the scenario by the Ministry of Finance of the Republic of Lithuania is based on the selected and identified assumptions, supported by the existing statistics and in line with economic regularities. The monitoring institution approves the economic development

scenario for 2016-2019, published on the website of the Ministry of Finance of the Republic of Lithuania on 18 March 2016”.

CHAPTER II
ECONOMIC OUTLOOK

SECTION ONE
ASSUMPTIONS FOR ECONOMIC DEVELOPMENT SCENARIO

15. The key assumptions for the external economic environment (trading partner development, oil prices, the euro-dollar exchange rate) correspond to the EC’s 2016 Winter Forecast (drawn up in February 2016)

Table 1. Key assumptions

Indicator	2015	2016	2017	2018	2019
Short-term interest rates (annual average)	0.2	0.0	0.0	0.0	0.1
Long-term interest rates (annual average)	1.4	1.7	1.8	1.9	2.0
USD/EUR exchange rate (annual average)	1.11	1.08	1.08	1.08	1.08
Nominal effective exchange rate	–6.8	1.2	0	0	0
Exchange rate vis-à-vis the euro (annual average) (for countries not in euro area or ERM II)	–	–	–	–	–
World GDP growth (excl. EU), %	3.2	3.6	3.8	3.8	3.8
EU GDP growth, %	1.9	1.9	2.0	2.0	2.0
Growth of relevant foreign markets, %	0.5	1.3	1.8	1.8	1.8
World import growth (excl. EU), %	0.8	2.9	3.7	3.7	3.7
Oil prices (Brent, USD/barrel)	53.4	35.8	42.5	42.5	42.5

Sources: Ministry of Finance of the Republic of Lithuania, Bank of Lithuania, EC (2016 Winter Forecast)

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

SECTION TWO
MEDIUM-TERM ECONOMIC DEVELOPMENT SCENARIO

Real sector

16. The economic development scenario for 2016-2019 drawn up by the Ministry of Finance envisages that decreased dependence on the Russian market, relatively stable development of the

main Lithuanian export markets, economic stimulus policy carried out at EU level in the medium term will serve as the basis for the Lithuanian economic growth to be faster than in 2015 and balanced. In 2016 Lithuania's GDP growth might be by 0.6 percentage points higher than in the previous year – about 2.5%. It is projected that in 2016, as a result of decrease in dependence on the Russian market and recovery of external demand, acceleration in exports of goods and services will enable even higher growth of GDP in 2017 – about 3.2%. In subsequent years of the medium term due to unfavourable demographic trends slightly slower GDP growth than in 2017 is projected; however, it should be still above 3%. The domestic demand will continue as a strong factor in GDP growth, and the impact of exports on GDP growth will continue to increase consistently over the medium term.

The external environment has not been favourable for Lithuanian exporters in recent years, and it insisted on the redirection of exports to more stable markets. The main markets for Lithuanian origin-exports in 2015 were Germany, Latvia, the US, Poland, United Kingdom, Sweden, the Netherlands, Estonia, Norway and France. Lithuanian real exports of goods increased by 0.4 per cent, and together with services accounted for 1.2 per cent, which resulted in about 0.9 percentage points of 2015 GDP growth rate. In 2015, Russia was outside the top ten markets for the export of goods of Lithuanian origin, it ranked just 15th; the share of the goods of Lithuanian origin exported to Russia declined by almost half – from 4.3 percent in 2014 to 2.3 percent in 2015.

The rapid reorientation of Lithuanian exporters to more stable markets resulted in that exports of goods of Lithuanian origin decreased just by 2.4 per cent (at current prices). Excluding mineral products (the value of which was negatively affected by the falling oil price), the value of the export of the goods of Lithuanian origin grew by 2.7 per cent. Given the unfavourable external conditions, this is a good result, which shows the flexibility and competitiveness of Lithuanian exporters. However, with the slowing down export growth rate, the domestic demand remained as the major engine of the economy in 2015.

The growth in domestic demand was driven forward by an active investment process – in 2015 gross fixed capital formation expenses increased almost two times faster than in 2014 (10.3 percent). The high industrial production capacity utilization level in 2015 (73.9 per cent) boosted growth of investments in tangible fixed assets. Investment in the manufacturing industry in 2015 increased by 15.3 per cent (extremely fast growth observed in II and III quarters, 25 and 34 per cent respectively). The increase in investments was also stimulated by the implemented strategic Lithuanian electricity energy projects and the objective to finish the projects financed from the 2007-2013 EU Structural Funds assistance period. Low oil prices in 2015 served as a favourable factor for Lithuania, contributing to higher purchasing power of the population and lower production costs. Due to the increased purchasing power, household consumption expenditure (at constant prices) in 2015 was 0.7 percentage points higher than in 2014. More than two-fold increased profit margins (mainly due to decrease in oil prices) had a particularly favourable effect on Lithuanian refinery business. Oil product exports (in constant prices) in 2015 increased by about 12 per cent, and oil refining business financial results were the best since 2006. Cheaper fuel mitigated the negative impact of the recession in Russia and its embargo on the transport sector, and had a positive impact on the performance of other sectors (trade, tourism and agriculture), where transportation costs account for a large share of operating costs. The wholesale and retail trade, repair of motor vehicles and motorcycles, transportation and storage, accommodation and food services predetermined for about half (0.77 percentage points) of GDP growth rate in 2015. Manufacturing, although affected by negative external environment factors, generated about 0.5 percentage points of GDP growth rate. Construction activities that has seen fast growth for several consecutive years and which in 2014 predetermined about 1 percentage point of GDP growth rate, in 2015 did not contribute to GDP growth rate. Although in the first half of 2015, the added value generated by the construction was 8.1 per cent higher against the same period in 2014, it slowed down in the second half of the year following the completion of the projects funded from the financial period of the EU Structural Funds 2007-2013; in general, 0.3 per cent less added value was generated in 2015 in total. The negative trends were formed by the results of construction activity in the second half of 2015, where the added value was by 6 per cent lower against the same period of the previous year (mainly due to the decline of about 12 per cent in civil engineering works).

Changing construction activity trends and downgraded construction confidence indicator in the second half 2015 (according to Statistics Lithuania, in February 2016 this indicator was 11 percentage points lower than in the same period in 2015) have led to lower investment projections for gross fixed capital formation (earlier construction accounted for the largest share in this investment) in 2016, if compared to autumn 2015.

In 2016 investment growth will be reduced also by the effect of the change in the EU financial assistance periods – lower EU structural assistance due to doubling of the 2007–2013 and the 2014–2020 financial periods in 2015 – in 2015 the funds from both financial periods were invested, while in 2016 – just the funds from the new 2014–2020 period.

The volumes of the projects implemented from the EU funds will increase from 2017. In the 2014–2020 financial period investments into infrastructure projects in the areas of transport, environment, energy, research and experimental development, and regional development are planned, also works of modernisation and renovation of multi-apartment houses and public buildings are to be financed.

Table 2. Macroeconomic indicators

Indicator	ESA* code	Indicator value in 2015, million EUR	Change %				
			2015	2016	2017	2018	2019
GDP, chain-linked volume	B1g	33 449.7	1.6	2.5	3.2	3.1	3.1
GDP, at current prices	B1g	37 189.7	2.0	3.6	5.2	5.5	5.5
Components of real GDP (chained volume statistics)							

Indicator	ESA* code	Indicator value in 2015, million EUR	Change %				
			2015	2016	2017	2018	2019
Household consumption expenditure + NPI serving households	P.3	22 130.5	4.9	4.3	4.1	4.0	3.8
Government final consumption expenditure	P.3	5 829.3	2.0	0.9	0.6	0.6	0.6
Gross fixed capital formation	P.51	7 030.7	10.3	2.1	5.2	5.3	5.5
Changes in stocks and acquisitions less disposals of valuables (% of GDP)	P.52+P.53	–	–	–	–	–	–
Exports of goods and services	P.6	26 980.8	1.2	3.6	4.4	4.5	4.8
Imports of goods and services	P.7	27 604.2	7.0	4.7	5.3	5.5	5.6
GDP (chained volume statistics) growth factors, %							
Final domestic demand		–	6.2	3.4	3.9	3.9	3.9
Change in stocks and acquisitions less disposals of valuables	P.52+P.53	–	–	–	–	–	–
Balance of goods and services	B.11	–	–4.6	–0.9	–0.7	–0.8	–0.8

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

* European System of Accounts

Inflation

17. In 2015, average annual deflation of 0.7 % was recorded in Lithuania, as calculated in accordance with the Harmonised Index of Consumer Prices (hereinafter HICP). The decline of prices of consumer goods and services was largely due to negative price changes in energy goods, particularly – transport fuel. Core inflation (calculated in accordance with the overall index excluding energy goods and unprocessed food), showing the inflation rate without external shocks-intensive consumer goods, over the past 2 years was marked by stability, and accounted for the average of 1.2 per cent in 2015. Given the rapid increase in wages, consumer services, which accounted for a quarter of the basket of consumer goods and services, went up by 3.4 per cent.

Due to low comparative base the impact of low oil prices (according to the EC 2016 Winter Forecast, oil prices, expressed in euro per barrel will decline by 31.4 per cent in 2016) on consumer prices will be weaker in 2016 than the year before. Lower than last year energy goods weight in the basket of consumer goods and services will also result in lower negative impact on the HICP. Therefore low inflation (0.7 per cent) is projected for 2016, and as of 2017, after the disappearance of the negative impact of external factors (recovery of global oil prices), the inflation will pick up.

Consistent increase in alcoholic beverages and tobacco excise rates over 2016-2018 will slightly contribute to inflation growth. It is likely that in the medium term, global food commodity prices will remain stable, so food prices in Lithuania will be mainly influenced by the domestic demand-supply ratio. On the one hand, the rising consumer income will increase the pressure on prices, on the other hand, the decline in the number of consumers and, as expected, increased competition in the retail market, will weaken this pressure. Thus, it is anticipated that over the medium term food prices will continue going gradually upwards. The core inflation due to growing domestic demand over the medium term will gradually pick up and come closer to the multi-annual average. It is expected that with the rapid growth of salaries, prices for services, which started their rise in 2015, will continue to grow over the medium-term.

Table 3. Price indicators

Indicator	ESA code	Indicator value in 2014	Change %				
			2015	2016	2017	2018	2019
1. GDP deflator		111.2	0.4	1.1	2.0	2.3	2.3
2. Household consumption expenditure deflator		107.6	–0.9	0.7	2.2	2.5	2.5
3. HICP (average annual)		100.0	–0.7	0.7	2.2	2.5	2.5
4. General government consumption expenditure deflator		111.6	3.4	3.4	3.4	3.4	3.4
5. Gross fixed capital formation deflator		109.6	1.3	2.0	2.0	2.0	2.0
6. Exports of goods and services deflator		106.5	–4.0	–2.1	2.0	2.0	2.0
7. Imports of goods and services deflator		104.3	–6.9	–3.0	2.5	2.3	2.3

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

Labour market

18. In 2015, the unemployment rate dropped by 1.6 percentage points to 9.1 %. The long-term unemployment rate accounted for 3.9 per cent, which was 0.9 percentage points lower against 2014. Youth (15-24 years of age) unemployment rate was 16.3 per cent in 2015 and was 3 percentage points lower than in 2014. In 2015, there were 134 thousand unemployed persons, which was 24 thousand (15.2 per cent) less than in 2014, the long-term unemployed persons accounted for 57.5 thousand, or 42.9 per cent of the total unemployed, which was 13.2 thousand (18.7 per cent) less than in 2014.

Over the past four years, there was a rapid increase in the number of the employed persons, while the number of the working-age population declined, so in 2015 the employment rate and labour force participation rate was the highest since the beginning of the Labour Force Survey in 1998 – accounting for respectively 67.2 and 74.1 per cent (in the 15-64 age group, which partly mitigated labour force supply problem in the labour market. Amount of employed persons increased across many economic activities, and in total there was 1.2 per cent increase in 2015.

The rapid decline in unemployment and working age population and increasing demand for labour force will increase tension in labour market over the medium term, while the depleting unused labour force resources will slow down employment growth.

Unused labour force resources in Lithuania have been shrinking, so over the medium term companies may face shortage of not only skilled but also unskilled labour. Since the labour force is declining, and it is becoming more expensive, there will be a need over the medium term to enhance productivity and invest in less labour-intensive production (manufacturing facilities).

Low unemployment and tensions in the labour market over skilled labour, as well as government decision on the increase in the minimum monthly wage (hereinafter referred to as the MMW) resulted in growing earnings in 2015. According to preliminary data, the average monthly gross earnings (including individual enterprises) in Lithuania in 2015 increased by 5.1 per cent (by 6 per cent in the private sector, and 3.8 per cent in the public sector). Earnings grew across all kinds of economic activities in the country.

Due to the increasing labour force demand, over the medium term earnings will continue their fast upward trend. They will grow fastest in the private sector – particularly where labour productivity is high, labour force demand is intense, and earnings are low. The increased MMW will also have an effect on growth of earnings (as of January 2016, the MMW increased by 25 euros to 350 euros). The growth of earnings will result in consistent growth of household income over the medium term. Following the previous trend, most of the income will be spent on goods and services, but the rising inflation will reduce the purchasing power of the population, so household consumption expenditure (at constant prices) over the medium term will grow more slowly than in 2015.

Table 4. Labour market indicators

Indicator	ESA code	Indicator value in 2015	Change, %				
			2015	2016	2017	2018	2019
1. Employment, persons, thou		1 334.9*	1.2	0.6	0.3	0.1	0.1
2. Employment, hours worked, thou		2 481 927	2.7	–	–	–	–
3. Unemployment rate (%)**		9.1	9.1	8.0	7.1	6.3	5.4
4. Labour productivity, persons (gross value added at constant prices per person employed), thou EUR		25.0	0.3	1.9	2.9	3.0	3.1
5. Labour productivity, hours worked (gross value added at constant prices per hour worked), EUR		13.4	–1.1	–	–	–	–
6. Compensation of employees, million EUR	D.1	15 269.4	5.3	6.2	6.5	6.5	6.6
7. Compensation per employee, EUR		13 039.6	4.1	5.6	6.2	6.4	6.5

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

SECTION THREE
BALANCE OF PAYMENTS OF LITHUANIA

19. In 2015 current account balance fluctuated significantly. At the beginning of the year it worsened due to the international trade deficit increase (shrinking export of goods and increasing import of goods). Recession in Russia and trade restrictions applied by Russia made the worst effect on Lithuania’s export. In 2015 export of goods to Russia declined by 38.2 per cent and export of services to Russia declined by 33.6 per cent compared to 2014. Moreover, due to economic and political crisis in Russia Lithuania’s export to other countries of the Commonwealth of Independent

States had also declined; it is likely that Lithuania faced shrinking possibilities to export to the EU that was also adversely affected by decline in the East. Deficit of trade in goods was also the result of increased import of goods, especially import of machinery and equipment that is necessary for the development of production capacities.

In the second half of 2015 the balance of trade in goods improved and reached the level of the year 2014. The export of products to Russia that were not subject to any restrictions has increased, the decline of exports of services to Russia has stabilized and certain amount of products and services was successfully exported to other countries, mainly to the EU countries. Drop of euro rate resulted in slight increase of export to the USA and United Kingdom and abundant harvest led to increased export of agricultural products. In addition, the import of machinery and equipment has declined. These factors contributed to the fact that at the end of the year the current account balance became positive.

The second important factor of the current account in 2015 was a deterioration of primary income balance. That was a result of increasing income of foreign investors. Although the total amount of direct foreign investment remained almost the same, the amount of equity related direct foreign investment that mainly depends on the profitability of activity has increased. Another important fact is that Lithuania’s direct investment abroad recently has not increased; in 2015 it even declined.

In 2015 capital account surplus that is mainly influenced by transfers of capital from the EU funds was similar to that in 2014 (3 per cent of GDP). It is foreseen that in the years to come the capital account surplus will be slightly smaller since the year 2015 was the last year to expect to receive receipts from the financial perspective for the period of 2007 to 2013 and the possibility to use resources of the new financial perspective will take some time to gather momentum.

Table 5. Sectoral balances

Indicator	ESA code	GDP %				
		2015	2016	2017	2018	2019
1. Net lending/borrowing vis-à-vis the rest of the world	B.9N	1.3	0.5	-0.4	-1.4	-2.3
from which:						
balance of goods and services		-0.1	-0.2	-1.4	-2.4	-3.3
Balance of primary and secondary income*		-1.5	-1.5	-1.5	-1.5	-1.5
capital account*		2.9	2.2	2.5	2.5	2.5
2. Surplus (+)/deficit (-) of the private		1.4	1.2	-0.4	-2.1	-3.2
3. Surplus (+)/deficit (-) of the general government	B.9N	-0.2	-0.8	0.0	0.8	0.9
4. Statistical discrepancy		0	0	0	0	0

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

SECTION FOUR
RISK-RELATED ASPECTS OF ECONOMIC DEVELOPMENT

20. The prospect of Lithuanian export markets continues to represent the main risk factor in terms of changes in the economic development scenario. Whether the economic development scenario introduced in the Programme will come true also depends on other factors.

The geopolitical tension still persists; mutual Russian and EU sanctions extended till 2016 may be not lifted for a longer period. In addition, a certain downside risk stems from possible further development slowdown of China and other developing markets as well as from possible deeper recession in Russia. Unstable global financial markets and the problem of refugees flooding Europe that has not yet been resolved are additional negative risks. If the United Kingdom decides to leave the EU at the referendum of 23 June of 2016, this would lead to introduction of protectionist measures and depreciation of the pound. This would restrict the export of goods to the United Kingdom; in recent years Lithuania's export to the United Kingdom accounted for more than 4 per cent of the total export of goods.

There is a risk that due to a problem of refugees, which recently became more complicated, the Schengen Agreement may be repealed. This would mean introduction of border control and would aggravate foreign trade, reduce foreign investments, have a negative effect on transport and logistics activities, tourism sector.

The prospects of economic development would be seriously undermined by prolonged period of deflation or oil prices that increase more rapidly than foreseen in the economic development scenario.

Changes in the working age population development trends would influence the labour market performance. Poorer demographic trends would result in a lower amount of labour force and employed persons. More positive demographic trends would allow the number of employed persons to increase, however, due to higher amount of labour force the unemployment rate would decline more slowly. The changes in the labour market would have an impact also on projections of wages and wage fund.

However, there are positive risk factors, the appearance of which would improve economic indicators foreseen in the economy development scenario. In case the euro value depreciated more than it is foreseen at the scenario preparation stage, Lithuania's exporters could make advantage of that when trading with non-euro area member states and accelerate export development at a higher rate than the one foreseen in the scenario for 2016–2019 prepared by the Ministry of Finance of the Republic of Lithuania. Higher economic activity in the EU and euro area would also be a factor of positive risk. Structural reforms implemented in the fields of labour market, education, social security, etc. will also contribute to economic potential enhancement. More favourable conditions for imigrants who would contribute to the creation of social and economic wealth of a country and to the increase of competitiveness of the country would make a positive impact on economic trends as well.

CHAPTER III
FISCAL SYSTEM

SECTION ONE
FINANCIAL POLICY GUIDELINES

21. The following priorities when implementing the public financial policy for the period of 2016–2019 are established:

21.1. To implement fiscal policy taking into account the state of economic cycle;

21.2. To meet fiscal discipline rules stipulated in the legal acts of Lithuania and EU;

21.3. To reduce the general government debt below 40 per cent of GDP;

21.4. To increase the share of GDP to be redistributed by improving the operational efficiency of tax administrator, applying up-to-date modern technologies and maintaining consistent increase of economic growth-friendly tax rates (by reducing consumption and use of products that are harmful for individuals and the environment);

21.5. To implement structural reforms, in particular to launch the New Social Model and to increase the non-taxable allowance for the low income earners and to ensure the compliance of impact made by structural reforms on general government finances with fiscal discipline rules and the aim to reduce the debt level;

21.6. To continue the application of existing measures as well as to apply new measures that ensure enhanced efficiency of public spending and public services in the fields of education and health care in particular, to limit spending increase (taking into account the share of GDP that such spending accounts for) in ineffective fields of Lithuania's public sector, except for short-term spending incurred when implementing structural reforms aimed at the optimization of costs;

21.7. To improve the dissemination of information on the use of collected taxes and levies among the public[2].

SECTION TWO
GENERAL GOVERNMENT REVENUE

Redistribution to the budgets

22. It is expected that the budget of the Republic of Lithuania (hereinafter referred to as 'State budget') revenues will be increased as a result of fight against smuggling and implementation of measures aimed at shadow economy reduction. It is foreseen that further implementation of measures launched in 2015 and aimed at improving tax administration as well as establishment of tax administrator information systems based on the most recent technology solutions would result in the increase of redistribution to budgets attributed to the government sector (GDP share of revenue from taxes) in the medium term.

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[2] In 2016 the Ministry of Finance of the Republic of Lithuania has made the information on scheduled budget spending for 2016 available on the following site: http://finmin.lrv.lt/lt/veiklos-sritys/biudzetas/suzinok-kam-valstybe-isleidzia-tavo-pinigus.

In 2015 GDP share of revenue from taxes accounted for 29.2 per cent (around 29.5 per cent including taxes related to EU institutions) and was higher than in 2014 (27.8 per cent and 28 per cent respectively), but still lower than the EU average in 2014, i.e. 40 per cent. Rapid growth of GDP components that are important to the collection of taxes was one of the factors that has led to higher redistribution to the budgets. Due to tax administration improvements in 2015 GDP share of revenue from taxes increased by 0.2 per cent, from which 0.1 percent GDP increase was due to the instrument for the administration of registers of Value Added Tax (hereinafter referred to as 'VAT') e.invoices applied in the second half of 2015. More rapid increase of revenue from taxes in comparison to correlating GDP components has demonstrated positive effect of tax administration measures on general government finances already in 2015.

Having evaluated the results achieved in 2015 by applying tax administration measures as well as new administrative measures implemented in line with Law of 25 June 2015 amending Articles 28, 41, 55, 68, 87, 89, 101, 104^1, 104^2, 129, 131, 154 and Annex, supplementing with Articles 55^1 and 61^1 and repealing Articles 56, 57, 58, 59, 60 of Tax Administration Law No IX-2112 of the Republic of Lithuania, that came into effect on 1 January 2016, it is expected that in 2016 revenues to budgets will increase by 0.2 per cent of GDP in comparison to scheduled revenue from taxes. For example, the Organisation for Economic Cooperation and Development (hereinafter referred to as OECD) after having evaluated Lithuania's economy and tax administration initiatives of the Government for the first time in March of this year has foreseen that in 2016 the general government deficit will be smaller by 0.2 per cent GDP in comparison to the scheduled one.

As from 2017 and later in the medium term, tax collection will experience positive impact of extensive intelligent tax administration system (hereinafter referred to as 'i.MAS') that is being gradually introduced in 2016. Cautious evaluation allows to project that GDP share from tax revenue at the end of medium term will increase to reach 31 per cent of GDP.

The increase of other revenue in the medium term, especially in 2018, in comparison to the year 2017 will depend on the increase of EU support and other financial support as well as on the amount that the state-owned company "Deposit and Investment Insurance" plans to recover from bankruptcy procedures.

Improvements in tax administration in Lithuania is one of the most effective measures that increase public finance resources and pose no risk to economic growth (in comparison to the accumulation of public resources by means of higher tax rates or introduction of new taxes). According to information of OECD[3], in Lithuania only 64 per cent of VAT is collected in comparison with the potential amount. Potential additional revenue from VAT accounts for 4.4 per cent of GDP. The launch of i.MAS and application of other administrative measures may contribute significantly to the improved collection of revenue from VAT in the medium term. The expected effect of measures aimed at improving tax administration on general government sector indicators in 2017 will be reassessed when preparing the draft state budget for 2017.

[3] See the link to the OECD report http://www.oecd.org/countries/lithuania/oecd-economic-surveys-lithuania-2016-eco-surveys-ltu-2016-en.htm.

Legal basis for tax policy and administrative means

23. In order to improve tax administration related activity and taking into account the global best practice and recommendations of international organizations on practical tax administration issues, the Consolidated Strategy concerning Tax Compliance by Tax Payers and Tax Collection for 2014–2017 prepared by the Sate Tax Inspectorate is being implemented. The strategic documents regulating the activity of tax administrator stipulate integrated measures aimed at inducing voluntary payment of taxes as well as ensuring tax law infringement prevention and control that are under implementation.

In 2016 new measures that improve tax administration were introduced:

23.1. Law amending Articles 28, 41, 55, 68, 87, 89, 101, 104^1, 104^2, 129, 131, 154 and Annex, supplementing with Articles 55^1 and 61^1 and repealing Articles 56, 57, 58, 59, 60 of Tax Administration Law No IX-2112 of the Republic of Lithuania was adopted on 25 June 2015 aiming to optimize the procedure for provision of information that is necessary for the identification of undeclared income, unjustified sources of asset acquisition and establishment of tax obligation, its fulfilment as well as cooperation with tax administrations of other countries. Lithuania's financial institutions are obliged to handle information on the accounts of Lithuania's residents that is important for taxation purposes and to submit such information by automatic means once a year to the tax administrator, if the amount in the account at the end of the year exceeds 5 000 EUR or annual revenue exceeds 15 000 EUR. As from 2017 plans are under way to exchange information on accounts of foreign entities at financial institutions in line with the OECD model and Council Directive 2014/107/EU of 9 December 2014, amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation (OJ 2014 L 359, p. 1) with almost 60 countries of the world starting with the data of the beginning of the year 2016. The information on assets held abroad will allow the tax administrator to detect possible tax evasion, wealth earned by unlawful means and cases of money laundering.

In addition, tax administrator is entitled to define tax obligation of a tax payer on the basis of available information and recover tax obligation in case a tax payer fails to submit a tax declaration. This will ensure a more prompt recovery of taxes that one failed to pay and declare.

23.2. On 19 November 2015 the following legal acts were adopted: Law amending Articles 40 and 75 and supplementing by Articles 42^2 and 42^3 of Tax Administration Law No IX-2112 of the Republic of Lithuania, Law amending Articles 78, 79 and 89 and repealing Article 88^2 of Value Added Tax Law No IX-751 of the Republic of Lithuania and Law amending Articles 29 and 38 of the Road Transport Code of the Republic of Lithuania, the provisions of which constitute a legal basis for the launch of tax administration information system based on the most recent technology solutions (i.MAS) at the State Tax Inspectorate. The use of i.MAS will enable to ensure competitive conditions for good faith business, reduce shadow economy, improve quality of tax administration and increase effectiveness of tax collection. Plans are under way to launch the sub-systems for e.invoices, e.consignment note, analysis and risk management by October of 2016. It should be noted that the tax administrator has already instructed high risk tax payers and entities acting in sectors that pose highest risk in relation to tax evasion to periodically submit data from VAT invoice registers. It is foreseen that nearly half of VAT payers will be submitting such notifications by the middle of the year 2016 and later, when the i.MAS measures will be launched, the abovementioned obligation will be imposed on each VAT payer.

24. Changes in the tax area in 2016

24.1. With a view to reduce the burden of taxation on low income earners, the Law amending Articles 17, 20 and 21 of the Law No IX-1007 on Personal Income Tax of the Republic of Lithuania was adopted and the maximum non-taxable allowance was increased from 166 EUR to 200 EUR as from January 1, 2016. In addition, the non-taxable allowance for disabled people was increased (from 175 EUR to 210 EUR for those with minor disability and from 235 EUR to 270 EUR for those with maximum disability) and the additional non-taxable allowance for individuals raising children (increase from 60 EUR to 120 EUR) was established.

For the purpose of ensuring a more even distribution of the tax burden between labour income and capital profits, the provisions of the abovementioned Law narrowed the application of income tax exemptions on capital income. The tax-exempt amount applied to capital gains income from the alienation of securities and interest was reduced from 3 000 EUR to 500 EUR; the period for holding immovable property, other than for residence purposes (a place of residence of a resident, declared in line with the procedure stipulated in legal acts), was prolonged from 5 to 10 years in order to qualify to the exemption in respect of gains from alienation of such property.

24.2. Law amending Article 37 and Annex 3 of the Law No IX-569 on Excise Duties of the Republic of Lithuania was adopted; it imposes excise duty of 21 EUR per 1 000 litres for gas oils used for agricultural activity (including aquaculture or commercial inland fishing).

As a result of the Law amending Articles 1, 2, 48, 53, 57, 58, 58^1, 59, 60 and Annex I of Law No IX-569 on Excise Duties of the Republic of Lithuania, as from 1 January 2016 the minimum excise duty on natural gas used as heating fuel is applied in line with EU *acquis*.

In line with the provisions of Law amending Articles 23, 24, 25, 26, 30 and 31 of Law No IX-569 on Excise Duties of the Republic of Lithuania excise duties on all alcoholic beverages and ethyl alcohol, including beer, all kinds of wine and other fermented drinks, will be gradually increased during the period from 1 Match 2016 to 2018; excise duties on all intermediate products will be increased by 8 per cent annually and excise duties on ethyl alcohol will be increased by 2.5 per cent annually. As from 1 March 2016 excise duties on cigarettes, cigars and cigarillos will be increased by approximately 5 per cent.

In line with Law amending Article 40 of Law No IX-569 on Excise Duties of the Republic of Lithuania as from 1 January 2016 the scope of excise duty relief applied to energy products derived from materials of biological origin will be limited; the application of such excise duty relief becomes limited to mixtures of biofuel and fuel of higher concentration.

25. The EU *acquis* in the field of excise taxes will continue to be implemented (excise duties on cigarettes and tobacco products will be increased) during the Programme implementation period;

moreover, as it was already stated, during the period of 2017–2018 excise duties on ethyl alcohol and other alcoholic beverages will be increased.

SECTION THREE
GENERAL GOVERNMENT EXPENDITURE

26. The share of GDP that constitutes general government sector expenditure is among the smallest in EU. According to Eurostat data, in 2014 Lithuania's general government sector expenditure made up 34.8 per cent of GDP (EU average – 48.2 per cent of GDP). In 2015 in Lithuania general government sector expenditure increased to 35.1 per cent of GDP. Improvements in tax administration and tax revenue/GDP ratio result in proportionately growing opportunities to increase the public funding for the most important fields by harmonizing the expenditure growth with the rules of expenditure limitation set forth in the EU and national legislation as well as with the aim to reduce the level of debt.

In the medium term defence expenditure will be increased to reach 2 per cent of GDP. It will be necessary to ensure gradual increase in wages for the lowest earners that are employed at budget institutions. The further increase in capital investments will be ensured by means of national, EU and other international support resources. A moderate inflation increase will raise spending on goods and services. The financing of the abovementioned goals as well as other Government priorities is included into the general government sector expenditure projection for 2016–2019.

Lithuania's expenditure on social security is much lower than the EU average. The introduction of the New Social Model that *inter alia* includes the pension indexation mechanism would result in the increase of general government sector expenditure for social security in the medium term. As a result the share of GDP that constitutes general government sector expenditure would increase more rapidly. In case the European Commission approves the reform (the New Social Model) meeting the terms of exemptions from the provisions of the Stability and Growth Pact, fiscal space to implement the structural reform in the field of social security will be created.

SECTION FOUR
GENERAL GOVERNMENT SECTOR FINANCE PROJECTIONS FOR THE MEDIUM TERM

27. General government sector finance projections have been made taking into account the economic development scenario, obligations of the State under legal acts, fiscal discipline rules stipulated in Constitutional Law, Law on Fiscal Discipline of the Republic of Lithuania, Law on the Budget Structure of the Republic of Lithuania, Law on Approval of Financial Indicators of the State Budget of the Republic of Lithuania and Municipal Budgets of 2016 and EU legislation[4].

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[4] In Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (OJ *2004* Special Edition, Chapter 10, Volume 1, p. 84) as last amended by Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 (OJ 2011 L 306, p. 12), in Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ *2004 Special Edition*, Chapter 10, Volume 1, p. 89) as last amended by Regulation (EU) No 1177/2011 of the Council of 8 November 2011 (OJ 2011 L306, p. 33).

28. In 2015 the general government sector deficit made up 0.2 per cent of GDP or 0.9 per cent of GDP if the results of financial activity of the state-owned company “Deposit and Investment Insurance” are not taken into account.

In 2016 the general government sector deficit will make up 0.8 per cent of GDP or 0.9 per cent of GDP if the results of financial activity of the state-owned company “Deposit and Investment Insurance” are not taken into account. Taking no account of the impact of the New Social Model on the finances of the general government sector, in 2017 the general government sector would be balanced and surplus in the years to come.

Taking into account general government expenditure necessary for the implementation of the New Social Model, a slight deficit of general government sector would be projected in the medium term.

Table 6. General government indicators (S13), 2015-2019*

	ESA 2010 code	2015		2016	2017	2018	2019
		EUR million	GDP %	GDP %	GDP %	GDP %	GDP %
Net borrowing (+)/net lending (–) (B.9) by subsector							
1. General government sector	S.13	-77.6	-0.2	-0.8	0.0	0.8	0.9
2. Central government	S.1311	-199.3	-0.5	-0.7	-0.4	0.0	-0.2
3. State government	S.1312	–	–	–	–	–	–
4. Local government	S.1313	122.5	0.3	0.1	0.1	0.0	0.0
5. Social security funds	S.1314	-0.8	0.0	-0.1	0.3	0.7	1.1
General government sector (S13)							
6. Total revenue	OTR	12 974.9	34.9	34.6	35.2	35.7	35.3
7. Total expenditure	OTE	13 052.5	35.1	35.4	35.2	34.9	34.4
8. Net lending/borrowing	B.9	-77.6	-0.2	-0.8	0.0	0.8	0.9
9. Interest expenditure	D.41	565.0	1.5	1.4	1.3	1.0	0.9
10. Primary balance		487.4	1.3	0.6	1.3	1.8	1.9
11. One-off and other temporary measures		94.8	0.3	-0.1	0.0	0.3	0.0
Items of revenue							
12. Revenue from taxes (12=12a+12b+12c)		6 435.5	17.3	17.5	17.9	18.1	18.3
12a. Revenue from indirect taxes	D.2	4 398.9	11.8	11.9	12.2	12.3	12.2
12b. Revenue from direct taxes	D.5	2 035.2	5.5	5.6	5.6	5.8	6.0
12c. Capital taxes	D.91	1.4	0.0	0.0	0.0	0.0	0.0
13. Social insurance contributions	D.61	4 456.3	12.0	12.2	12.3	12.4	12.5
14. Property income	D.4	157.6	0.4	0.4	0.4	0.4	0.4
15. Other		1 925.4	5.2	4.5	4.6	4.8	4.1
16=6. Total revenue	OTR	12 974.9	34.9	34.6	35.2	35.7	35.3
Revenue from taxes and contributions (D.2+D.5+D.61+D.91-D.995)		10 874.3	29.2	29.7	30.2	30.5	30.7
Items of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	5 516.2	14.8	15.0	14.8	15.0	14.8
17a. Compensation of employees	D.1	3 593.9	9.7	9.7	9.6	9.6	9.5
17b. Intermediate consumption	P.2	1 922.3	5.2	5.3	5.2	5.3	5.3
18. Social payments (18=18a+18b)	D.6M	4 672.3	12.6	12.8	12.5	12.2	11.8
of which, unemployment benefits	D.6M	76.0	0.2	0.2	0.2	0.2	0.2

	ESA 2010 code	2015		2016	2017	2018	2019
		EUR million	GDP %	GDP %	GDP %	GDP %	GDP %
18a. Social transfers in kind	D.632	695.6	1.9	1.8	1.7	1.7	1.6
18b. Social transfers other than in kind	D.62	3 976.8	10.7	11.0	10.8	10.5	10.2
19=9. Interest expenditure	D.41	565.0	1.5	1.4	1.3	1.0	0.9
20. Subsidies	D.3	147.6	0.4	0.3	0.3	0.3	0.3
21. Gross fixed capital formation	P.51G	1 332.7	3.6	3.5	4.0	4.3	4.3
22. Capital transfers	D.9	267.2	0.7	0.3	0.2	0.2	0.2
23. Other		551.6	1.5	2.2	2.1	2.0	2.0
24=7. Total expenditure	OTE1	13 052.5	35.1	35.4	35.2	34.9	34.4

Sources: Lithuanian Department of Statistics, Ministry of Finance of the Republic of Lithuania
* Due to rounding, the sum of revenue and expenditure components may be different from the amounts given under "Total revenue" and "Total expenditure".

Since the general government finance projections take into account only expenditure and revenue measures approved by legal acts, expenditure and revenue projections in Table 6 and Table 7 are the same.

Table 7. General government revenue, 2015-2019

Indicator	Indicator value in 2015, million EUR	GDP %				
		2015	2016	2017	2018	2019
1. Total revenue on assumption that there will be no policy change	12 974.9	34.9	34.6	35.2	35.7	35.3
2. Total expenditure on assumption that there will be no policy change	13 052.5	35.1	35.4	35.2	34.9	34.4

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

Table 8. General government expenditure to be excluded from the expenditure benchmark

	Indicator value in 2015, million EUR	GDP %				
		2015	2016	2017	2018	2019
1. Expenditure on EU programmes fully matched by EU funds revenue	701.2	1.9	2.0	2.1	2.3	2.0
2. Cyclical unemployment benefit expenditure	-12.9	-0.03	-0.04	-0.03	-0.01	0.00
3. Effect of discretionary revenue measures	132.9	0.4	0.4	0.5	0.2	0.0
4. Revenue increases mandated by law	0	0	0	0	0	0

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

According to the projection of cyclical unemployment benefit expenditure for 2015, presented in Table 8, cyclical unemployment benefit expenditure amounted to EUR –12.9 million. Assessment of the cyclical unemployment benefit expenditure was based on the estimates of the non-accelerating wage rate of unemployment (NAWRU), obtained using the calculator developed by the EC. In the medium term, a negative cyclical unemployment benefit constituent is anticipated due to the unemployment level below the NAWRU estimates. In terms of the classification of state functions (code 10.5), unemployment benefit projections for 2015–2019 were calculated according to the amount of unemployment benefits per unemployed person in 2014.

General government subsector balances

29. In 2015, the general government deficit decreased by a 0.5 percentage point of GDP, compared with the year 2014, and totalled 0.2 per cent GDP deficit. The central government deficit for 2015 amounted to 0.5 per cent of GDP, the local government surplus totalled 0.3 per cent of GDP, and the sector of social security funds was balanced. In 2015 the balance of social funds was better due to the compensation calculated in favour of the State Social Insurance Fund (0.3 per cent of GDP commitments of the state budget) for the compensations of pensions for working pensioners that were reduced during the crisis implementing the Ruling of the Constitutional Court of the Republic of Lithuania of 6 February 2012 and mechanism for the compensation stipulated in the Law on Compensation for State Social Insurance Old-Age Pensions and State Pensions Reduced due to Insured Income Received of the Republic of Lithuania.

The state-owned company “Deposit and Investment Insurance” belongs to the central government sub-sector; its surplus in 2015 made up 0.6 per cent of GDP.

The local government surplus in 2015 owed to higher revenue and lower expenditure as compared to those that were planned.

SECTION FIVE
STRUCTURAL GENERAL GOVERNMENT BALANCE INDICATOR

30. In 2015, the structural government deficit declined, standing at 0.5 per cent of GDP. For the second year in a row, there was no deviation from the medium-term objective. The structural general government balance in 2016 will remain no worse than the medium-term objective, constituting a deficit of 0.7 per cent of GDP.

The structural general government balance indicator for 2015–2019 was determined by subtracting the cyclical component, obtained by multiplying the output gap for the respective year by the elasticity of the general government balance indicator, from the general government sector indicator. The value of the elasticity of the general government balance indicator equals 0.413 and corresponds to the European Commission estimate known at the time of preparation of the Programme. Calculation of the structural general government balance indicator took into account the following one-off measures: the revenue and expenditure of the SE “Deposit and Investment Insurance“ related to insured events, the net of revenue and expenditure of the Climate Change Programme, the expenditure related to the implementation of the rulings of the Constitutional Court of the Republic of Lithuania concerning compensation for pension reduction and for losses incurred by public sector employees due to disproportionately reduced salaries during the crisis.

Information on compliance of the structural reform (the new social model[5]) with the exemption of the Stability and Growth Pact

31. Under the Human Resources Development Operational Programme for 2007–2013, Priority 4 “Strengthening of Administrative Capacities and Increasing Efficiency of Public Administration“, implementation measure VP1-4.3-VRM-02-V “Promotion of Public Policy Reforms“, a new social model for Lithuania has been developed by Vilnius university in co-operation with partners from the Social Research Centre, Mykolas Romeris University and other independent experts, proposing a comprehensive structural labour market and social reforms. The proposed reform packages include more flexible labour relations, higher employment, more sustainable social insurance and reduction of poverty. The new social model aims at ensuring the necessary guarantees as well as a better match between work and family commitments for employees, while for employers it offers creating a more favourable environment for the recruitment and retention of workforce. The purpose of the introduction of more flexible labour relations is to attract more investment and create additional jobs.

32. The Government Resolution No 560 of 9 June 2015 ”On Submission to the Seimas of the Republic of Lithuania of Drafts of the Law of the Republic of Lithuania on the Approval, Entry into Force and Implementation of the Labour Code, the Law Amending the Law of the Republic of Lithuania on State Social Insurance No I-1336, the Law Amending the Law of the Republic of Lithuania on Sickness and Maternity Social Insurance No IX-110, the Law Amending the Law of the Republic of Lithuania on Unemployment Social Insurance No IX-1904, the Law Amending the Law of the Republic of Lithuania on Social Insurance of Occupational Accidents and Occupational Diseases No VIII-1509, the Law Amending the Law of the Republic of Lithuania on State Social Insurance Pensions No I-549, the Law of the Republic of Lithuania on Employment and other Related Draft Laws“ gave approval to the package of laws on the legal-administrative model of labour relations and state social insurance (hereinafter – the new social model), constituting a set of legislative acts, notably the Labour Code of the Republic of Lithuania (hereinafter – the Labour Code), the draft Law of the Republic of Lithuania on Employment, the draft Law Amending the Law of the Republic of Lithuania on State Social Insurance No I-1336, the draft Law Amending the Law of the Republic of Lithuania on State Social Insurance Pensions No I-549 and the draft Law Amending the Law of the Republic of Lithuania on Unemployment Social Insurance No IX-1904. On 15 October 2015, the new social model was presented in the Seimas.

The new Labour Code aims to eliminate the deficiencies of regulation of employment relations, reduce undeclared employment, encourage different labour contract forms, balance employment guarantees and combine flexibility with employment security. The provisions of the new Labour Code are expected to help employees better combine work with other responsibilities either towards family or science, while encouraging employers to create legal jobs, and not rush with employee dismissal at the onset of crisis.

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

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

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

Implementation of these legislative acts will allow for improving labour market operation, making the labour market more dynamic and labour relations more flexible, workers will be offered guarantees of staying in the labour market, the coverage and adequacy of the unemployment social insurance payments will improve.

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

The said draft Law proposes:

32.1. to increase the pension age after 2026 when it will have reached age 65 for men and women, taking into account the future gains in life expectancy;

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

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

32.4. to gradually increase the required period of service qualifying for full pension from 30 to 35 years;

32.5. to award and pay early old age pensions no sooner than 3 years before reaching the retirement age;

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

A more detailed information concerning the phase of adoption of the draft legislation constituting the new social model is provided in the Lithuanian National Reform Agenda 2016. The draft legislative acts related to the new social model are to be considered during the Seimas spring session of 2016.

The information on impact of the new social model measures on general government finances will be updated together with the 2017 Lithuanian Draft Budgetary Plan to be presented to the European Commission in autumn this year, after taking into account the legal status of the new social model and the European Council's recommendations for Lithuania.

Table 9. Impact of the new social model on general government finances in 2017

Source of impact	Impact assessment, million EUR
1. Reduction of the State Social Insurance Fund revenues due to set contribution ceilings (revenue loss)	–31
2. Reduction of the State Social Insurance Fund revenues due to a 1 percentage point reduction of social insurance contributions rate (revenue loss)	-108
3. Reduction of the State Budget expenditure due to a 1 percentage point reduction of social insurance contributions rate (expenditure reduction)	+23
4. Increase of the unemployment contribution rate by 0.7 percentage point (revenue increase)	+77
5. Increase of the State Budget expenditure due to a 0.7 percentage point increase of the unemployment contribution rate (expenditure increase)	-16
6. Widening of the social insurance contributions base for persons engaged in individual activities (revenue increase)	+27
7. Extension of the cases in which sickness allowance is to be paid (expenditure increase)	-2
8. Raising of unemployment expenditure (expenditure increase)	-58
9. Indexation of pensions (expenditure increase)	-150
10. Changes in the social insurance of occupational accidents and diseases (expenditure reduction).	+5
Total: consolidated impact on the general government balance	-233 (–0.58 per cent of GDP)

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

Table 10. Qualitative assessment of compliance of the new social model to the Stability and Growth Pact

Essential signs of reform	The impact of the new social model on economy and general government finances
Has a positive effect on the sustainability of general government finances in the log-term	Based on the calculations done according to the draft legislation on the new social model being currently considered, indexation of pensions linked to the growth rates of the wages fund coupled with other measures under the pension reform (such as extension of the retirement age, increase of the required length of service, reduction of the period of receiving of early old age pensions), in the long term, would allow for a balanced pension system and a reduction of pension expenditure according to the current macroeconomic assumptions to 3.7 percentage points of GDP on average (compared to the baseline pension projections scenario)

Essential signs of reform	The impact of the new social model on economy and general government finances
Has a positive effect on the economy and its potential	Introduction of new types of employment contracts, shorter periods of notice on termination of employment and smaller severance payment amounts will encourage employers (as well as foreign enterprises) to invest in Lithuania and create new jobs. All the novelties (such as a more flexible regulation of working time, new types of employment contracts, adaptation of dismissal provisions to the market conditions, reduction of administrative burden) are expected to contribute to the creation of about 85 thousand new workplaces. Improved population expectations concerning social security would have a positive impact on migration flows

Sources: Ministry of Social Security and Labour of the Republic of Lithuania, Ministry of Finance of the Republic of Lithuania

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

33. In case of lack of measures for the achievement of the 2016–2019 structural general government budgetary targets as indicated in line 10 of Table 11, they may be supplemented by the following measures:

33.1. abolishment of some of the existing tax exemptions (the budgetary impact of the existing tax exemptions is approximately 2.4 per cent of GDP);

33.2. reduction of general government expenditure share to GDP ratio;

33.3. revision of the excise duty tariffs for processed tobacco;

33.4. revision of the base for property taxes, with regard to the share of tax yield from property taxes, in order to avoid real estate price bubbles and apply the principle of progressive taxation;

33.5. revision of the base for environment taxes in order to increase the share of tax yield from such taxes with a view to fulfilling environmental objectives.

SECTION SEVEN
ESTIMATION OF THE ECONOMIC CYCLE

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

The potential GDP and output gap were estimated in accordance with the Procedure for the Estimation of the Level of the Chained Volume of Potential Gross Domestic Product and the Output

Gap, approved by Order No 1K-315 of the Minister of Finance of 19 October 2015 "On Approval of the Procedure for the Estimation of the Level of the Chained Volume of Potential Gross Domestic Product and the Output Gap". Pursuant to the Procedure, the output gap estimates are calculated using the potential GDP figures, estimated according to the following methods: the method approved by the EU Economic and Financial Affairs Council and developed by the EC, which is based on the Cobb-Douglas production function; the Hodrick Prescot filter approach. If the current-year and/or subsequent first one-year output gap estimates, obtained using potential GDP estimates that were calculated according to these two methods, have a different sign, the assessment of the sign of the output gap for the respective year is provided by the Countercyclical State Fiscal Policy Commission, set up by Order No 1K-355 of the Minister of Finance of 4 December 2015 "On Setting up a Commission". The output gap estimate for the respective year is considered equal to the figure with a sign corresponding to that indicated in the conclusion of the Countercyclical State Fiscal Policy Commission.

The findings obtained show that in 2016 the output gap will be negative, although close to zero, at -0.1 of potential GDP. From 2017 [6] the output gap will become positive, however it is projected to also remain close to zero.

The estimates for potential GDP and output gap in the medium-term are predetermined by unstable working-age population trends, affected by the changing population migration tendencies. For example, when calculating output gap estimates according to the economic development scenario of September 2015, it was expected that in 2016 the working-age population will decrease by 0.4 per cent (based on the European Commission spring forecast 2015), however, current expectations are that it will shrink by 1.3 per cent (according to the European Commission winter forecast 2016). The worsening of the demographic trends have a negative impact on the labour factor potential, which implies a slowdown of growth potential and an increase in positive output gap.

Table 11. Economic cycles

Indicator	ESA code	% of GDP				
		2015	2016	2017	2018	2019
1. GDP growth / chain linked volume growth		1.6	2.5	3.2	3.1	3.1
2. Net lending (+)/borrowing (-) of general government	PDP B.9	-0.2	-0.8	0.0	0.8	0.9
3. Interest	PDP D.41	1.5	1.4	1.3	1.0	0.9
4. One-off and other temporary measures		0.3	-0.1	0.0	0.3	0.0
5. Potential GDP growth, %		2.5	2.7	3.0	3.1	3.1
of which:						

[6] Pursuant to the provisions of the Procedure for the Estimation of the Level of the Chained Volume of Potential Gross Domestic Product and the Output Gap, the Countercyclical State Fiscal Policy Commission was approached for a decision on the sign of the output gap and the Commission in its conclusion, presented to the Fiscal Policy Department of the Ministry of Finance, determined a positive output gap for 2017. This corresponds to the sign of the output gap calculated by the Ministry of Finance of the Republic of Lithuania using the potential GDP estimate, obtained according to the Cobb-Douglas production function.

Indicator	ESA code	% of GDP				
		2015	2016	2017	2018	2019
labour		0.6	0.8	0.9	0.8	0.8
capital		1.3	1.3	1.3	1.4	1.4
total factor productivity		0.5	0.7	0.8	0.9	0.9
6. Output gap		0.2	-0.1	0.1	0.1	0.1
7. Cyclical budgetary component		0.1	0.0	0.0	0.0	0.0
8. Cyclically-adjusted balance (2–7)		-0.2	-0.7	0.0	0.7	0.9
9. Cyclically-adjusted primary balance (8+3)		1.3	0.6	1.2	1.8	1.9
10. Structural balance (8-4)		-0.5	-0.7	0.0	0.5	0.9

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

SECTION EIGHT
GENERAL GOVERNMENT DEBT LEVELS AND DEVELOPMENTS

35. At the end of 2015, the general government debt, excluding the funds accumulated in advance for Eurobond redemption, accounted for 40 per cent of GDP (in 2014 – 37.9 per cent of GDP). Taking into account the funds accumulated in advance for EUR 1 billion Eurobond redemption in February 2016, the debt at the end of 2015 comprised 42.7 per cent of GDP. The debt, excluding the advance accumulation of funds and the financing of the imbalances of the EU support funds, would stand at about 37 per cent of GDP in 2015.

The central government debt structure poses no threat to public finances. At the end of 2015, short-term liabilities (by residual maturity) accounted for 11 per cent of the total debt, the average residual maturity of the debt was 6.2 year, and the average outstanding maturity of the debt prior to the changes in interest rates was 5.5 years. The floating interest rate debt, including the impact of financial derivatives, accounted for 0.1 per cent of the total debt. Taking into account financial derivatives, the central government debt was 100 per cent denominated in the euro.

Table 12. General government debt projections

Indicator	% of GDP				
	2015	2016	2017	2018	2019
1. General government debt at the end of the year excluding the accumulation of funds for managing the refinancing risk	40.0*	41.1	39.9*	38.1	35.7*
1.a. Statistical debt including accumulation of funds for managing refinancing risk	42.7	–	–	–	–
2. Change of gross debt	2.1	1.1	-1.2	-1.8	-2.4
Contributions to changes in gross debt					
3. Primary balance	1.3	0.6	1.3	1.8	1.9
4. Interest	1.5	1.4	1.3	1.0	0.9

Indicator	% of GDP				
	2015	2016	2017	2018	2019
5. Debt change adjustment	2.7	1.7	0.8	1.0	0.5
of which:					
difference between cash and accruals	–	–	–	–	–
net accumulation of financial assets of which: privatization revenues	0	0	0	0	0
implicit interest rate on government debt (%)	3.6	3.3	3.0	2.7	2.5
Other relevant variables	–	–	–	–	–
6. Liquid financial assets	–	–	–	–	–
7. Net financial debt (7=1-6)	–	–	–	–	–
8. Debt amortization since end of previous year	–	–	–	–	–
9. Percentage of foreign currency denominated debt	–	–	–	–	–
10. Average debt maturity	–	–	–	–	–

Source: Ministry of Finance
*Taking into account the accumulation of funds for managing the refinancing risk by Eurobond redemption, the general government debt at the end of 2015 would stand at 42.7% of GDP, 43.3% of GDP at the end of 2017 and 39% of GDP at the end of 2019.

36. Government Resolution No 1437 of 15 December 2014 approving the guidelines on borrowing and debt management in 2015–2017 for the Government of the Republic of Lithuania sets out the Government borrowing and debt management targets:

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

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

36.3. to apply the re-financing risk management instruments when redeeming major (equivalent to EUR 1 billion and above) Eurobond emissions, such as Eurobond buy-back, exchange of Government securities, signature of agreements on credit lines with financial institutions (the rating requirement does not apply in the case of a credit line agreement with international institutions), advance accumulation of financial resources or a combination of the said measures;

36.4. to develop relations with investors and to develop and maintain an effective and liquid market in Government securities;

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

36.6 to issue liquid Governments securities when borrowing in foreign capital markets.

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

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

37. A medium-term growth of floating and fixed market interest rates by 1 percentage point would entail an increase of the interest payable on the newly-assumed central government obligations of EUR 4 million in 2016, EUR 10 million in 2017, EUR 30 million in 2018 and EUR 40 million in 2019 or about 5 basis points of GDP annually on average.

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

The economic development scenario, predicting, in the period of 2016-2019, a success in retaining economic growth, depends on the geopolitical situation, the speed of structural reform implementation and rational investment of EU funds.

SECTION TWO
FISCAL RISK

38. The major projected sources of fiscal risk are deposit insurance and state guarantees.

Deposit insurance

39. The Lithuanian deposit insurance system is in compliance with the requirements of the EU acquis in this field. The Seimas adopted, on 19 November 2015, a Law Amending the Law of the Republic of Lithuania No IX-975 on Insurance of Deposits and Liabilities to Investors, which transposes into the national law the provisions of the Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (OJ L 173, 2014, p. 149). The amount of core insured deposits, from which, after the entry into force of the new version of the above-mentioned Law, insurance premiums are to be calculated, was EUR 10 983 million as at 31 December 2015, increasing by 4 per cent over the year. Over the year 2015, the credit institutions paid EUR 46.68 million to the Deposit Insurance Fund, which is by 14.61 per cent less than over the year 2014. This can be explained by the reduction, pursuant to EU legislation, of the base of deposits on which insurance premiums are paid (insurance premiums are paid only on deposits of up to EUR 100 000 that are eligible for coverage) and the change of the procedure for calculating insurance premiums. Creditor claims of the SE “Deposit and Investment Insurance“ are being paid under the court-approved plans of settlement between bankrupt financial institutions and creditors. By 31 December 2015, the total amount of funds recovered from credit institutions that went bankrupt in 2011–2014 was EUR 819.47 million: EUR 768.72 million was recovered from the insolvent AB bankas Snoras, EUR 19.01 million – from the failing AB Ūkio bankas and another EUR 31.74 million – from the credit unions. As at 31 December 2015, the residual debt of the SE

“Deposit and Investment Insurance“ to the Ministry of Finance of the Republic of Lithuania was EUR 82.79 million. Funds collected by the SE “Deposit and Investment Insurance“ are transferred to the Ministry of Finance of the Republic of Lithuania for repayment of loan.

Government guarantees

40. The Government-guaranteed loan portfolio at the end of 2015 accounted for about 0.7 per cent of GDP of 2015. Taking into account the guarantees planned to be provided in 2016, including the guarantees in respect to the state-supported loans specified in the Law of the Republic of Lithuania on Science and Studies and, also, in respect of the ongoing state investment projects, the Government-guaranteed debt is expected to possibly increase to 1.1 per cent of GDP.

Table 13. Contingent liabilities

Indicator	% of GDP	
	2015	2016
Government guarantees	0.7	1.1
of which linked to the financial sector	0	–

Source: Ministry of Finance

SECTION THREE
COMPARISON WITH PREVIOUS PLANS

41. Taking into account the actual figures for 2015 provided by the Statistics Lithuania along with the emerging trends in economic development and the changes in geopolitical situation, the Ministry of Finance of the Republic of Lithuania has released the revised GDP estimates.

General government deficit and debt estimates have been made according to the accounting standards of the European System of Accounts (ESA′2010) considering the revised GDP estimates. There has been no significant change in the 2016–2018 objectives of the general government balance indicator.

Taking into account the financial flows from EU assistance and the refinancing risk management, also, the GDP projections, the projected level of government debt compared to previous forecasts, presented in the Stability Programme for Lithuania for 2015, approved by Resolution No 440 of the Government of the Republic of Lithuania of 29 April 2015 “On the Stability Programme for Lithuania for 2015”, has increased.

Table 14. GDP, general government deficit and general government debt estimates compared to the Stability Programme for Lithuania for 2015

Indicator	ESA′2010 Code	% of GDP				
		2015	2016	2017	2018	2019
1. GDP growth:						
Previous update		2.5	3.2	3.5	3.9	–
Current update		1.6	2.5	3.2	3.1	3.1
Decrease (-) / Increase (+)		-0.9	-0.7	-0.3	-0.8	–

Indicator	ESA′2010 Code	% of GDP				
		2015	2016	2017	2018	2019
2. Net lending (+)/borrowing (-) of general government	PDP B.9					
Previous update		-1.2	-1.1	0.0	0.7	–
Current update		-0.2	-0.8	0.0	0.8	0.9
Worsening (-) / Improvement (+)		1.0	0.3	0.0	0.1	–
3. General government gross debt:						
Previous update		42.2	37.7	39.4	32.9	–
Current update		40.0*	41.1	39.9*	38.1	35.7*
Decrease (–) / Increase (+)**		-2.2	3.4	0.5	5.2	–

* Taking into account the accumulation of funds in advance, the general government debt at the end of 2015 stood at 42.7 % of GDP, and would comprise 43.3% of GDP at the end of 2017 and 39% of GDP at the end of 2019.
** Data are not comparable due to exclusion of the funds accumulated in advance for Eurobond redemption in the previous projection.

Sources: Statistics Lithuania, Ministry of Finance.

CHAPTER V
QUALITY OF GENERAL GOVERNMENT FINANCES

Sectoral analysis

42. *System of education.* This and other sections of the chapter present the latest data published by Lithuanian and international institutions in the course of Programme drafting.

According to Eurostat data for 2014, the EU general government expenditure on education on average amounted to 5 per cent of GDP, compared to 5.4 per cent in Lithuania. Based on preliminary data, public education expenditure in 2015 and 2016 did not grow faster than GDP.

The Lithuanian results of the international assessment of performance of 15-year-olds (*Programme for International Student Assessment*, PISA) in mathematics, reading and science were below the EU average. The 2016 OECD review of school resources in Lithuania[7] revealed that the difference in average test results in the cities compared with rural areas totalled 57 points, against the EU average of 31.

In Lithuania, the rate of employment of recent graduates from upper secondary to tertiary education who are no longer in education is above the EU average, yet still below the benchmark under the Strategic Programme for Education and Training for 2020 (82 per cent). In this area, Lithuania has shown the greatest progress among EU states since 2011, raising this indicator to 80.7 per cent in 2014, against the EU average of 76.1 per cent. Although in 2015 Lithuania led the entire EU based on the share of people with higher education, 56.4 per cent, among those aged 30–34, the International Monetary Fund (IMF) noted in the 2015 study on public expenditure efficiency in Lithuania[8] that the majority of students still opted for social sciences, business and law, instead of

[7] Link: http://www.oecd.org/countries/lithuania/oecd-reviews-of-school-resources-lithuania-2016-9789264252547-en.htm
[8] Link: https://www.imf.org/external/pubs/cat/longres.aspx?sk=43496.0

physics or other exact sciences. This trend in choice of a study field does not match the needs of the labour market and results in situation where a sizable portion of residents aged 30–34 in Lithuania hold a job that does not match their completed field of study.

The Lithuanian education expenditure structure differs from the EU average. Although intermediate consumption (which accounted for 16.2 per cent of the entire education expenditure in 2014) is close to the EU average of 16.4 per cent, the share of expenditure on wages of education system workers (63.6 per cent of total education expenditure) is roughly 3 percentage points above the EU average of 60.6 per cent. The IMF determined in 2015 that the education expenditure in Lithuania was high due to the payment of wages to a large number of workers in the education system. Wages remain low, especially for young people. The share of education expenditure for gross fixed capital formation (15.7 per cent of total education expenditure in 2014) is nearly double the EU average (7.4 per cent).

According to Eurostat data for 2012, Lithuania spends a larger share of total education funding to finance higher education but a smaller share of total funding for education to finance secondary education (including vocational and other training), compared with other EU countries (7.14 percentage points in Lithuania, against the EU average of 12.8). In the view of IMF, there are too many establishments in Lithuania that provide higher education, i.e. the number is disproportionate to the national population.

As reported by Statistics Lithuania, the number of pupils and students has been declining every year since 2012/13 school year, by approximately 20 000 per year. According to UNESCO data for 2013, the pupil–teacher ratio at Lithuanian secondary schools stood at 8.1, which was below the European average of 10.9. Based on Eurostat data for 2012, the average class size in Lithuania at lower secondary level was also below the EU average. The OECD report of 2016 on the resources of the Lithuanian education system indicates that the indicator of an average class size at lower secondary level of education is low in Lithuania due to the fact that this indicator in rural areas is just above half that in the cities: 20.6 in Lithuanian cities, compared to 11.4 in rural areas in 2015.

As reported by Statistics Lithuania, the pupil–teacher and student–teacher ratios remained nearly the same between school years 2012/13 and 2014/15.

According to Eurostat data for 2013, 86.5 per cent of Lithuanian children aged 4 to 6 were participating in education. This indicator value was more than 7 percentage points lower than the EU average. Lithuania was 8.5 percentage points below the benchmark under the Strategic Programme for Education and Training for 2020.

The life-long learning results are also not good enough. Participation rates of persons aged 25–64 in training of a minimum 4-week duration went down by 0.7 percentage points to mere 5 per cent (10.7 per cent is the EU average) from 2013 to 2014.

43. *Health care.* According to Eurostat data for 2014, the EU general government expenditure on health care amounted to 7.2 per cent of GDP on average, compared to 5.5 per cent in Lithuania. On preliminary data, the pace of growth in public health care expenditure in the State budget has been in sync with GDP growth in 2015 and 2016. Starting with 2017, health care

expenditure will grow owing to the increases in health care insurance contributions for persons insured from State resources under newly passed legislation. Two things are significant in the assessment of general government expenditure on health care: what is the household out-of-pocket expenditure on health care (according to Eurostat data for 2012, these contributions averaged 1.4 per cent of GDP in the EU and 2 per cent of GDP in Lithuania); the development level of the country (more developed countries, with a higher GDP per capita, tend to spend more on health care compared to less developed countries). As reported by Eurostat, GDP per capita in Lithuania amounted to 75 per cent of the EU average in 2014 and 70 per cent of the EU average in 2012. Based on IMF study from 2015, comparative average expenditure on health care in 2012 accounted for 5.8 per cent of GDP in the EU and 5.9 per cent of GDP in Lithuania.

One of the indicators reflecting the quality of a health care system is life expectancy. According to Eurostat, life expectancy in Lithuania came to 74.7 years in 2014, trailing the EU average of 80.9. Over the 2013–2014 period, life expectancy in Lithuania grew faster than the EU average (0.6 years in Lithuania, compared to 0.3 years in the EU). According to OECD[9], one of the possible reasons behind the rather short average life expectancy is an unhealthy lifestyle. Based on Eurostat data for 2012, the mortality rate per 100 000 residents was nearly 50 per cent higher than the EU average. As reported by Statistics Lithuania, there were no significant changes in the indicator over 2012–2014.

Eurostat reports that the structure of the Lithuanian general government health care expenditure differs from the EU average. Lithuania's intermediate consumption in 2014 accounted for 16.8 per cent of total expenditure and 0.9 per cent of GDP, which was below the respective EU averages of 20.9 and 1.5 per cent. Expenditure on wages for health care system workers in Lithuania (35.8 per cent of the entire 2014 expenditure) were 9 percentage points above the EU average of 26.7 per cent, while its ratio to GDP (2 per cent) came very close to the EU average of 1.9 per cent. Gross fixed capital formation expenditure in Lithuania accounted for a similar share in total expenditure as in the EU.

Based on Eurostat data for 2013, Lithuania had 45.9 practising physicians per 10 000 residents, compared to the estimated EU average of 38.9. According to Statistics Lithuania, this indicator went up slightly in Lithuania in 2014. Eurostat reports that the ratio of practising physicians and practising nurses stood at 1.6 in Lithuania, below the EU average estimate of 2.2. IMF regards an indicator value of 4 as an economical level for a country.

According to Eurostat data for 2013, Lithuania had 728.2 hospital beds (excluding nursing beds) per 100 000 residents, which is 200 beds above the EU average of 526 beds. This indicator hardly changed in Lithuania, according to the Statistics Lithuania data for 2014. The OECD informed that Lithuania's indicator is too high and that merger of hospitals and improvement of their administration could contribute to the efficiency of the health care system.

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

44. *Social security.* According to Eurostat data for 2014, the Lithuanian general government spending on social security increased by 0.1 percentage points of GDP to 11.5 per cent of GDP, yet this indicator was below the EU average of 19.5 per cent of GDP in 2014.

The Gini coefficient is one of the qualitative indicators in the field of social security, reflecting the scale of social inequality. The higher the coefficient, the more severe social inequality is. Eurostat reported Lithuania's Gini index at 34.6 and 35 for 2013 and 2014, which was above the EU averages of 30.5 and 30.9.

According to Eurostat data for 2014, the risk of poverty or social exclusion is experienced by 27.3 per cent of the Lithuanian population (compared to 24.5 per cent in the EU on average). However, in 2014 this indicator declined by 3.5 percentage points in Lithuania, compared to 2013.

Based on Eurostat data for 2013 and 2014, birth rate per 1 000 residents in Lithuania amounted to 10.1 and 10.4, slightly surpassing the EU averages of 10.0 and 10.1. The fertility rate in Lithuania was also slightly higher than the EU average. In 2014, this rate stood at 1.63 in Lithuania, i.e. 0.05 above the EU average.

As reported by Eurostat for 2014, the ratio of pension income of residents aged 65-74 to the average income from employment of residents aged 50-59 declined to 0.45 in Lithuania, falling further behind the EU average of 0.56 for the same year.

In Lithuania, general government expenditure on pensions in 2012 accounted for 7.6 per cent of GDP, compared to the EU average of 12.5 per cent of GDP. In 2013 and 2014 this indicator decreased in Lithuania and, according to Statistics Lithuania, amounted to 7 per cent of GDP in 2014. Expenditure on ill and disabled people in 2012 accounted for 3 per cent of GDP, which was 0.2 percentage points above the EU average for the same year. In 2013, expenditure on ill and disabled people shrank to 2.8 per cent of GDP, reaching the EU average; this expenditure in 2014 stayed nearly on the same level as in 2013. As highlighted in the IMF study of 2015, although reforms have tried to address high disability spending through tightening the certification system, the number of disabled beneficiaries has continued to increase in recent years, preventing any reduction in expenditure in this area. Expenditure on families and children in 2013 and 2014 were 0.7 percentage points below the EU average of 1.7 per cent of GDP. As reported by Eurostat, general government expenditure on the unemployed did not change in any significant manner from 2012 to 2014 and amounted to 0.4 per cent of GDP in 2014. This indicator was 1.1 percentage points below the EU average of 2014.

Statistics Lithuania reports that the total number of pension recipients went down from 932 600 in 2012 to 923 200 in 2014. According to Eurostat data, the change in population (measured in units per 1 000 residents) due to birth and mortality rates was negative in 2014, totalling -3.4 against the EU average of 0.3. The change in population (in units per 1 000 residents) due to immigration was also negative in 2014, totalling -4.2 against the EU average of 1.9.

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

Measures to improve the quality of finances

45. As of 2015, a single model for providing monetary social assistance is applicable in all municipalities of Lithuania. The function of providing monetary social assistance to low-income residents in the form of compensations for home heating costs as well as hot and drinking water costs has been transferred to municipalities as an independent function funded from the municipal budgets.

This is a successful step as monetary social assistance is now provided in a more targeted and transparent manner, the municipal communities are more involved in the process of providing assistance, and interinstitutional cooperation has been reinforced to address each case more carefully and to provide adequate services in order to integrate socially vulnerable persons into the labour market and society.

The consistent reform of the provision of monetary social assistance, Lithuania's improving economic situation, along with positive changes on the labour market have contributed to the decrease in the number of assistance beneficiaries as well as lower assistance expenditure. In every month of 2015, social benefits were received by an average of 110 700 persons (3.8 per cent of the Lithuanian population). This represents a 21 per cent decrease compared to the year 2014 (from 140 100 down to 110 700 persons). As a result social benefits spending shrank by 25.5 per cent (from EUR 103.8 million to EUR 77.3 million). The ongoing monitoring of the monetary social assistance scheme has shown that the majority of social assistance beneficiaries exiting the scheme succeed in finding a job (47 per cent in 2014 and 36.4 per cent in the first half of 2015).

In implementing the EU Council Recommendation of 14 July 2015 on the 2015 National Reform Programme of Lithuania and delivering a Council opinion on the 2015 Stability Programme of Lithuania, bearing in mind the results of the monitoring of the implementation of legal regulation of monetary social assistance, and striving to improve access to social assistance for low-income residents, amendments to the Law of the Republic of Lithuania on Monetary Social Assistance for Low-income Residents have been drafted with the aim to improve the adequacy of monetary social assistance and to encourage working-age employable persons to join in the labour market.

46. In 2015, major attention was devoted to the system of vocational training as well as higher education reform. The improve the quality and attractiveness of vocational training, 20 module-based vocational training programmes (division of the process of acquisition of qualifications into modules will increase the flexibility of the vocational training system) and 10 professional standards (to serve as a basis for developing vocational training and study programmes) have been developed.

In 2015, the Seimas was presented with a draft Law Amending the Law of the Republic of Lithuania on Higher Education and Research, intended for the implementation of a higher education reform: the model of targeted funding of higher education is to be abolished and replaced with a more accurate and rational mechanism for planning student admissions, based on individual study areas or groups thereof, which will ensure the training of specialists required by the State; tougher student admission requirements are to be imposed, reserving the places in first-stage and continuous studies at State and private schools of higher education to persons meeting the minimum standards set by the Minister of Education and Science. The above law is scheduled to be adopted during the Seimas spring session in 2016. 2015 saw an improvement in the accessibility and attractiveness of higher education: additional EUR 0.640 million, compared with 2014, have been allocated to reimburse tuition for students with good grades that do not receive State funding for their studies (in total, EUR 4.618 have been allocated in 2015), and 2 450 non-State funded students with the best grades will be reimbursed for the tuition paid. Doctoral students have also enjoyed a 25 per cent hike in stipends as of 1 October 2015. To support visits by foreign lecturers to Lithuanian schools of higher education, funding was provided for visits by 80 foreign lecturers to Lithuanian schools of higher education.

As of 2016, pre-school education has been made mandatory for children turning 6 in the respective calendar year. Additional EUR 1.448 million will be allocated in 2016 to establish compulsory pre-school education.

According to the data of Statistics Lithuania, the level of participation in life-long learning among Lithuanian residents aged 25–64 rose in 2015 compared to 2014 (5.6 per cent in 2015, 5 per cent in 2014). Lithuanian schools of higher education developed their life-long learning services in 2015. Following the approval of an updated Procedure for funding informal adult education, a competition for informal adult education programme funding in 2015 was held (EUR 289 620 were distributed to 23 programmes). A project for the development of a network of regional adult education coordinators is being implemented in 2016 from EC resources, and its participants are municipality-appointed implementers of the informal adult education policy. They will receive informational, coordinative and methodological assistance as well as training.

47. To raise the level of activity of residents, the Government has been successfully implementing the Employment Enhancement Programme 2014–2020, as approved by Government Resolution No 878 of 25 September 2013 "Approving the Employment Enhancement Programme 2014–2020" (hereinafter referred to as "the Employment Enhancement Programme"), which is aimed at maximising resident employment, so that every resident could find a job matching his qualifications and ensuring a decent standard of living.

To implement the Employment Enhancement Programme, the objectives set out in the Interinstitutional Action Plan for 2015–2017 were pursued, the tasks and measures to create jobs and stimulate labour demand as well as to deal with the mismatch between the workforce skills and labour market needs were carried out and the integration of unengaged workforce into the labour market was supported.

Table 15. Expenditure for the implementation of employment enhancement measures (EUR million)

Measures	2015	2016	2017	2018	2019
Promotion of job creation and labour demand	108 833	61 448	48 895	57 110	69 072
Development of better matching between workforce skills and labour market needs	20 281	22 886	40 070	65 204	37 110
Integration of unengaged workforce into the labour market	106 859	116 212	114 957	86 979	94 961

Measures	2015	2016	2017	2018	2019
– of which implementation of “Youth Guarantee Initiative“	16 581	29 444	28 300	14 400	10 890

Source: Ministry of Social Security and Labour in the Republic of Lithuania

48. Government Resolution No 1290 of 9 December 2015 "Approving the Plan for Stage Four of Health Care System Development and Hospital Network Consolidation" is intended to improve the quality and accessibility of health care services, to optimise the scope and structure of provided services, to rationalise the use of the financial and infrastructural resources of the health care system, to stabilise the financial state of health care institutions and to provide the possibilities for higher wages of health care system employees. An objective for 2016 is to develop a model for a more efficient and accurate monitoring of health inequality indicators in the course of the project "Development of a Model for the Strengthening of the Capacities to Identify and Reduce Health Inequalities" (NOR-LT11-SAM-01-TF-02-001), jointly implemented by the Lithuanian University of Health Sciences, the Institute of Hygiene, Vilnius University and Klaipėda University. To enable a more objective assessment of the health system activities, a model for the evaluation of health condition outcomes will be developed in 2016, which will describe the processes required to improve the quality of cause of death coding and to improve the accuracy of disease registration in order to reduce the likelihood of systemic errors. To reduce the level of corruption at health care institutions, there are plans to develop measures for reducing and eliminating the practices of unofficial payments in the health care sector and to introduce a single system for monitoring and assessment of corrupt practices in the health system. The anti-corruption initiative "Clean Hands" is already being implemented at the institutions of the national health system.

These measures were approved by Order No V-1565 of the Minister of Health of the Republic of Lithuania of 30 December 2015 "Approving the Strategic Activity Plan of the Minister of Health of the Republic of Lithuania for 2016–2018".

49. General government expenditure based on classification by function is presented in the table below:

Table 16. General government expenditure by function

Indicator	COFOG Code	% of GDP	
		2014	2019
1. General public services	01	4.6	
2. Defence	02	1.1	
3. Public order and safety	03	1.7	
4. Economic affairs	04	3.2	
5. Environmental protection	05	0.6	
6. Housing and community amenities	06	0.3	
7. Health care	07	5.5	
8. Recreation, culture and religion	08	0.9	
9. Education	09	5.4	
10. Social protection	10	11.5	
11. Total expenditure		34.8	34.4

Sources: Statistics Lithuania, Ministry of Finance

CHAPTER VI
SUSTAINABILITY OF GENERAL GOVERNMENT FINANCE

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

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

The Projection is based on the demographic projection for Lithuania until 2060, done by Eurostat in 2013. According to this Projection, Lithuania's population is to shrink to 1.8 million (from 2.9 million in 2015) from 2015 to 2060. Compared with the Eurostat demographic projections made in 2011, the number of the population in 2060 will decrease by 311 thousand, or 9.5 per cent of the population, having taken into account the results of the 2011 census, and 836 thousand of the population due to the expected negative net migration. From 2015 to 2060, the number of the working age population (15-64) will decrease from 66.7 per cent to 56.2 per cent, whereas the number of elderly people (65+) will increase from 18.7 to 26 per cent of the total population. Based on the new methodology used by Eurostat, the number of the working-age population will be shrinking at a particularly rapid pace between 2020 and 2030 – at about 3 per cent per year, which will have a negative impact on GDP. According to Eurostat's new demographic projections for the growing birth rates from 2015 to 2060 the number of children will increase in Lithuania: children aged between 0-14 – from 13.4 per cent in 2015 to 17.8 per cent in 2060, school age children (7-16) – from 9.5 per cent to 12.4 per cent, while 15-19 year olds – from 5.7 per cent to 6.2 per cent of the total population.

52. Table 17 below gives projections on long-term expenditure of public finances (pensions, health care and education systems) for the period until 2060. The projections have been made under the assumption of non-changing policy post-2019, the economic scenario drafted by the Ministry of Finance of the Republic of Lithuania in spring 2016, as well as economic and employment assumptions for 2020-2060 agreed by the Economic Policy Committee (EPC) in autumn 2014. The projections have been built on the basis of the existing Lithuanian national social security legislation.

Table 17. Long-term sustainability of general government finances

Indicator	% of GDP						
	2007	2010	2020	2030	2040	2050	2060
1. Total expenditure	35,3	42,3	34,2	36,5	37,3	36,9	36,3
of which: age-related expenditure	17,2	20,7	15,9	18,2	19,0	18,7	18,0
pension expenditure*	6,6	8,6	6,7	8,6	9,3	8,4	7,4
social security pension	6,6	8,6	6,7	8,6	9,3	8,4	7,4
old-age and early pensions	4,7	6,2	5,0	6,7	7,5	6,8	5,9
other pensions (disability, widows' and survivors')	1,8	2,4	1,7	1,9	1,8	1,7	1,5
occupational pensions (general government sector)	–	–	–	–	–	–	–
health care	4,8	4,8	4,2	4,4	4,5	4,5	4,2
long-term health care	0,6	1,1	0,8	1,1	1,3	1,5	1,5
education expenditure**	5,2	6,2	4,0	3,9	3,8	4,2	4,9
other age-related expenditure***	0,1	0,4	0,2	0,1	0,1	0,1	0,1
interest expenditure	0,7	1,8	2,5	3,9	5,1	5,6	6,0
2. Total revenue	34,3	35,4	35,3	35,3	35,3	35,3	35,3
of which: property income	0,6	0,7	0,4	0,4	0,4	0,4	0,4
of which: from pensions contributions (or relevant social insurance contributions)****	6,4	6,8	5,9	5,7	5,7	5,7	5,7
Pension reserve fund assets	2,9	–	–	–	–	–	–
of which: consolidated public pension fund assets*****	1,7	4,1	9,2	22,4	35,5	45,8	53,5
Systemic pension reforms							
Social insurance contributions diverted to mandatory private scheme	0,9	0,3	0,6	0,7	0,7	0,7	0,7
Pension expenditure paid by mandatory private scheme	0,0	0,0	0,0	0,2	0,5	0,8	1,2
Assumptions							
Labour productivity growth	7,2	6,1	3,9	2,4	1,7	1,7	1,5
Real GDP growth	11,1	1,6	1,5	–0,1	1,2	1,2	1,7

Indicator	% of GDP						
	2007	2010	2020	2030	2040	2050	2060
Participation rate males (aged 20–64)	79,9	80,6	81,1	80,6	81,2	82,0	82,5
Participation rate females (aged 20–64)	72,2	76	75,7	76,6	76,0	76,9	78,1
Total participation rate (aged 20–64)	75,9	78,2	78,3	78,5	78,6	79,5	80,3
Unemployment rate (aged 20-64)	4,2	17,8	10,7	9,5	7,4	7,4	7,4
Population aged 65+ over total population (beginning of the year)	16,6	17,3	20,7	27,7	30,8	28,3	25,8

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

* Pension expenditure has been calculated following the methodology of the European Commission presented in the document "Pension projection exercise 2015: Revised framework – 1 amendment" (Brussels, 21 November 2013).
** Excluding spending on payments to households and private entities and direct capital spending on education establishments.
*** Unemployment benefits.
**** Contributions for social security pensions, from 2004 and onwards – excluding transfers to private pension funds.
***** Financial assets of the Pension Scheme (Pillar II) accumulated in individual accounts of pension accumulation participants and the annuity funding reserve.

53. Table 17 demonstrates the revenue from social insurance contributions (excluding private pension funds run by pension accumulation companies) and the expenditure pertinent to actual social security pension schemes, i.e. the social insurance pension scheme and the state pension scheme (including social assistance benefits). State pensions (including social assistance benefits) are funded directly from the state budget. As compared to the pension spending projection provided in Lithuania's Stability Programme 2015, the pension spending remains almost unchanged in 2060 (the difference is 0.02 percent of GDP). Pension spending will be the highest in 2037, reaching 9.3 per cent of GDP. From 2040, with the decreasing trend in the elderly population and growing trend in the children and working-age population, pension spending will gradually come down, accounting for 1.9 per cent decrease of GDP in 2060 as compared to 2040. In 2015-2060 pension spending will increase by 0.5 per cent of GDP.

54. Pension spending will grow the fastest, though it will be mitigated by the pension reform launched in 2004, which created the sub-scheme of voluntary pension accumulation (Pillar II of the state social insurance pension scheme) which is financed with a part of mandatory state social insurance contributions that is shifted to private pension funds. Growing spending for pensions will be tamed by an increased rate of contributions to Pillar II pension funds, making 3.5% as of 2020. At the end of 2015, there were 1.2138 million people participating in the private pension funds. Tax revenues intended for the implementation of the pension reform in 2015-2019, and transferred to private pension funds, will amount on average to 0.58 per cent of GDP. Contributions transferred from State budget will increase from 0.1 to 0.2 per cent of GDP, reaching on average 0.19 per cent of GDP. In 2015-2019 the contribution tariff of pension accumulation from state social insurance will stand at 2 per cent, and as of 2020 – at 3.5 per cent. According to the pension spending projection, the accumulation scheme participants, which had made a decision in 2013 regarding extra contributions, and concluded new pension accumulation agreements, will pay 1 per cent extra contribution of their

salary and their pension account will be contributed from the state budget with 1 per cent of the average salary of the penultimate year. As of 1 January 2016, both individual and the state budget pension contribution rates will increase to 2 per cent. In the long term, the contributions credited to private pension funds (including contributions transferred from the state social security funds, extra contributions by individuals and the state budget) will annually make about 1.3 per cent of GDP and will be 0.1 per cent of GDP above the projected value specified in the stability programme of Lithuania in 2015 due to the modified medium-term macroeconomic assumptions.

55. Pension fund assets in 2060 will reach 53.5 per cent of GDP and benefits paid from private pension funds will amount to 1.2 per cent of GDP.

56. The growing number of the elderly population will call for larger spending on long term health care (share of GDP): spending for long-term health care will increase 0.6 per cent of GDP in 2015-2060.

57. According to the demographic projections of Eurostat in 2013, education spending will increase by 0.2 of GDP in 2015-2060. Considering the political targets, education expenditure should gradually rise until the year 2022, when it will reach 6 percent of GDP. This level of expenditure should stay until 2060.

CHAPTER VII
INSTITUTIONAL FEATURES FOR THE IMPROVEMENT OF GOVERNMENT FINANCES

58. To increase 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 and 3 and the Annex of the Republic of Lithuania Law No X-1316 on Fiscal Discipline, which came into effect on 1 January 2015.

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

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

The Law provides for the rules applicable to the budgets attributable to the general government category. Any budget attributable to the general government category, with the exception of the State Social Insurance Fund, the State Budget and the budgets under 0.3 per cent of

GDP, shall be balanced or be in surplus in terms of structural balance. The structural budget deficit of the State Social Insurance Fund could rise only when there is a negative output gap.

For the purpose of the implementation of the EU requirements for budget control and fiscal policy strengthening, the Constitutional Law has provided 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; and advice on preventive, remedial and enforcement actions. In order to ensure the independence of the economic development scenario, which serves the basis for the budget, this authority is tasked with drawing up of an opinion on the economic development scenario developed by the Ministry of Finance of the Republic of Lithuania.

For the purpose of ensuring the sustainability of government finances, stable economic development and to implement the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union of 2 March 2012 between the Kingdom of Belgium, the Republic of Bulgaria, the Kingdom of Denmark, the Federal Republic of Germany, the Republic of Estonia, Ireland, the Hellenic Republic, the Kingdom of Spain, the French Republic, the Italian Republic, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Grand Duchy of Luxembourg, Hungary, Malta, the Kingdom of the Netherlands, the Republic of Austria, the Republic of Poland, the Portuguese Republic, Romania, the Republic of Slovenia, the Slovak Republic, the Republic of Finland and the Kingdom of Sweden, on 6 November 2015 the Constitutional Law was adopted together with the Law Amending Articles 2 and 3 and the Annex of the Republic of Lithuania Law No X-1316 on Fiscal Discipline and the Law Amending Articles 2, 4, 6, 9 and 23 of Law on the State Control of the Republic of Lithuania. 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.

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

59. The legal conditions for the accumulation of the fiscal reserve have been improved in 2015. The provisions of the Reserve (Stabilisation) fund were amended with Resolution No XII-2020 of Seimas of 17 November 2015. After the amendments came into force on 1 January 2016 the resources from the Reserve (Stabilisation) fund may be used to finance the state budget

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

60. The Draft Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets for 2017 is drafted in accordance with Resolution No 154 of the Government of the Republic of Lithuania of 18 February 2016 "On the Approval of the Plan for Drafting Financial Indicators of the State Budget of 2017 of the Republic of Lithuania and Municipal Budgets".

61. Medium-term government finances are planned in accordance with the legal acts specified in Table 18.

Table 18. Medium-term government sector regulation

Numerical fiscal rules	
1. Borrowing limits	Budget Law[1]
2. Municipal debt limits	Budget Law[1]
3. Rule of municipal balance indicator*	Law on the Budget Structure[2]
4. General government surplus rule	Article 3 of the Constitutional Law
5. Rule binding growth in general government expenditure	Article 3 of the Constitutional Law, Article 3 of the Law on Fiscal Discipline[3]
6. Rules for budgets attributable to general government	Article 4 of the Constitutional Law
7. Medium-term oriented structural adjustment	Article 6 of the Constitutional Law
The medium-term tasks	
1. Medium-term objective	Approved by parliamentary legislation
2. The structural adjustment target for the coming year and the structural adjustment guidelines for the remaining years of the medium-term	Annually approved by parliamentary legislation
3. The overall indicators of state and local government revenues and spending over the three-year period	The three-year targets annually approved by parliamentary resolution[4]
4. Plans for the coming year and forecasts for the remaining years of the medium-term of sub-sector budgets of the State Social Insurance Fund	Law on the Approval of Financial Indicators of the Budget of the State Social Insurance Fund, Law on the Approval of Financial Indicators of the Budget of the Compulsory Health Insurance Fund

Source- Ministry of Finance of the Republic of Lithuania

[1]Annually endorsed The Republic of Lithuania Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets.

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

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

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

Securing Financial Stability

62. In order to enhance stability of the financial sector, on 19 March 2015 the Seimas adopted the Law amending Articles 2, 3, 4, 5, 9, 10, 11, 12, 13, 14, 15, 16, 17, 19, 20, 21, 22, 23, 24, 34, 35, 36, 40, 44, 48, 52, 53, 57, 59, 61, 64, 65, 67, 69, 70, 70^1, 71, 72, 73, 74, 75, 76, 78, 81, 82, 86, and the Annex, supplementing by Articles 65^1, 68^1, and 70^2, and Repealing Articles 6, 7, 8, 18, 26, 37, 38, 39, 43, 49, and 50 of the Law No IX-2085 of the Republic of Lithuania on Banks, the Law amending Articles 2, 3, 8, 9, 10, 11, 22, 23, 24, 31, 34, 37, 41, 42, 47, 50, 53, 55, 56, 57, 58, 59, 60, 61, 65, 66 and the Annex, supplementing by Articles 51^1 and 54^1, and repealing Articles 28, 29, 30, 33, 38, and 39 of the Law No VIII-168 of the Republic of Lithuania on the Central Credit Union, Law amending Articles 2, 3, 7, 12, 13, 70, 71, 76, 81, 84, 88, and 89, the title of Section Two of Chapter VI, and the Annex, supplementing by Articles 12^1, 12^2, 25^1, and 73^1 of the Law No X-1024 of the Republic of Lithuania on Markets in Financial Instruments, and laws amending secondary legislation, which transpose into the national law the provisions of the Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (hereinafter, CRD IV) (OJ L 176, 2013, p. 338), and anchor links with the directly applicable Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 2013, p. 1). Application of prudential requirements (capital structure and amount, quality of capital instruments, liquid asset buffers, leverage ratio, capital reserves) laid down in Regulation No 575/2013 will contribute to ensuring safer performance of credit institutions and investment firms, limit excessive risk taking, increase loss absorption capacities by own resources, available liquid asset and capital reserves of firms, and will strengthen their resilience to adverse changes in the market.

In compliance with the Law amending Articles 8, 11, 27, 51, 55, and Annex 2, and supplementing by Section 7^2 and Article 52^1 of the Law No I-678 on the Bank of Lithuania, which empowers the Bank of Lithuania to implement macro-prudential policy, the Board of the Bank of Lithuania approved the Macro-Prudential Policy Strategy by its Resolution No 03-31"On Approval of the Macro-Prudential Policy Strategy" of 12 March 2015, which sets out the primary and the intermediate macro-prudential policy objectives as well as instruments to achieve thereof. CRD IV regulates the majority of macro-prudential policy instruments aimed at achieving intermediate objectives. Major provisions of CRD IV have been transposed into the national law, hence authorizing the Bank of Lithuania to apply to the Lithuanian financial institutions the new liquidity and capital reserve requirements aimed at reducing structural and cyclical risk.

In compliance with the first intermediary objective set by the Macro-Prudential Policy Strategy – to limit excessive credit growth and excessive financial leverage, and seek to avoid them – the Bank of Lithuania started to apply the requirement for countercyclical capital buffer in 2015. This macro-prudential instrument shall be set quarterly, taking into account the situation in the credit and real estate markets; the Rules for the Formation of Capital Buffers, adopted by Resolution No 03-51 of 9 April 2015 of the Board of the Bank of Lithuania, regulate the procedure for setting the instrument. CRD IV obliges the EU Member States to start applying the requirement for countercyclical capital buffer as of 2016, yet the Bank of Lithuania has implemented the requirement earlier, and fixed the rate of 0 per cent in the 2nd quarter of 2015, which came into force on 30 June 2015. The decision was adopted given the fact that no imbalances were formed in the credit and housing markets in the 2nd quarter of 2015. On 29 March 2016, the Bank of Lithuania made a decision, on the basis of the data from the 3rd and 4th quarters of 2015, to maintain the rate of countercyclical capital buffer at 0 per cent (similar decision was taken in the 3rd and 4th quarters of 2015). Higher than 0 per cent rate of countercyclical capital buffer is set where it is observed that systemic risk is growing due to an excessive credit sector growth in the financial system, and risk is arising to sustainable economic development.

With a view to ensuring responsible borrowing at low interest rate conditions, and to prevent households from excessive indebtedness arising from long-term credits, Responsible Lending Regulations have been reconsidered and amendments thereto adopted; they came into force on 1 November 2015. Due to the prevalence of low interest rates, the debt service-to-income (DSTI) requirement of 40 per cent is not sufficient to contain over-indebtedness; hence, credit institutions must ensure that the ratio does not exceed 50 percent, using a 5 per cent annual interest rate as a basis for calculations. The aim of this amendment is to safeguard households that borrow at a DSTI ratio close to 40 per cent in the environment of low interest rates from the risk of exceeding this limit and encountering difficulties due to the increased loan repayments in case interest rates rise in the future. To make these regulatory amendments neutral for credit supply, credit institutions were allowed to issue 5 per cent of new loans over a calendar year (in terms of value) at a DSTI ratio of up to 60 per cent. In addition, to reduce the probability of loan delinquency, the Bank of Lithuania shortened the maximum loan term from 40 to 30 years.

In 2015, four systemically important institutions were designated in Lithuania, which were made subject to the capital buffer rates applicable to other systemically important institutions. Pursuant to the Rules for the Formation of Capital Buffers, other systemically important institutions' capital buffer should be composed of 0 to 2 per cent of the amount of total risk weighted assets. This macro-prudential policy instrument is set at the end of each year with an aim to enhance the resilience of systemically important institutions against possible losses, and reduce their incentives for excessive risk-taking. 2 per cent capital buffer rate, applied to other systemically important institutions, was set for AB SEB bankas, Swedbank, AB, and AB DNB bankas, and 0.5 per cent capital buffer rate was set for AB Šiaulių bankas. The systemically important institutions, designated as such in 2015, will have to comply with the additional capital buffer requirement starting from 31 December 2016.

On 14 May 2015, the Law amending Articles 8, 11, 42, 43, and 44 of the Law No I-678 of the Republic of Lithuania on Banks as well as amendments to other related legislation were adopted with a view to implementing the EU legal acts regulating the Single Supervisory Mechanism for banks and granting the European Central Bank functions to supervise credit institutions. Hence, the European Central Bank has taken over direct supervision of the three largest banks in Lithuania (AB SEB bankas, Swedbank, AB, and AB DNB bankas). The Bank of Lithuania continues to exercise supervision of other financial institutions, yet the European Central Bank monitors national supervision practices and has powers to adopt guidelines and recommendations on harmonisation of national practices. The aim of the centralized supervision is to ensure a uniform application of supervisory requirements in different Member States as well as to increase the market confidence in the Eurozone banking sector. Furthermore, strengthening of the supervisory mechanisms and increased transparency will help to reduce the likelihood of bank failure and the need for a rescue, and will allow taking timely efficient measures to reduce the related risk.

On 19 November 2015, the Law amending the Law No XI-393 of the Republic of Lithuania on Financial Sustainability and amendments to other related legislation were adopted, which transpose into the Lithuanian law provisions of the Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 2014, p. 190). Henceforth, the Bank of Lithuania, a designated national resolution authority in Lithuania, together with the Single Resolution Board, the Banking Union resolution authority, as well as national resolution authorities of banks from other EU member states functioning in Lithuania, will be responsible for planning of resolution of banks and other important financial institutions and implementing of resolution, if needed.

In accordance with the new regime, large banks, instead of failing, will have to be resolved in line with the plan drafted in advance. Resolution does not mean that banks will not be able to go bankrupt in general; first, it will be aimed to ensure continuity of critical banking functions, such as cash withdrawals and payments. Ordinary bankruptcy procedures will be applied to commercial banks that do not have a systemic impact on the stability of financial sector and national economy in general. Henceforth, in addition to the previously available resolution tools, such as sale-of-business, appointment of a temporary administrator, and asset separation, the bail-in tool will also be applicable. The bail-in (conversion of liabilities into equity) ensures that shareholders and creditors of the failing bank bear an appropriate part of the costs arising from the failure of the institution first. With a view to ensuring sufficient capital and liability buffer to cover losses, banks will have to comply with the minimum requirement of own funds and eligible liabilities, set by the Bank of Lithuania. While preparing for a resolution, the Bank of Lithuania will have a right to demand from the financial institution to change its structure, sell its assets, and restrict or stop certain exercised or planned activities, where its business model might hamper carrying out smooth resolution in case of crisis. Furthermore, upon implementation of the Bank Recovery and Resolution Directive, a Resolution Fund has been established, with banks and major investment firms paying contributions thereto. The fund will be used to resolve problematic financial institutions, so that their own funds, and not those by the taxpayers are used to cover the costs.

In November 2015, a new version of the Law on Insurance of Deposits and Liabilities to Investors was adopted, establishing a higher protection of the depositor rights. The law provides for better provision of information to depositors on the deposit insurance conditions, additional protection of residents’ deposits in major life events, and faster payment of compensations.

Hence, after Lithuania has become a full member of the Banking Union, one more step towards strengthening of financial stability has been taken, which will allow more efficient supervision (partially centralized on the European level) and problem prevention, and tackling problems more efficiently and safely: not to transfer the financial burden resulting from the process onto the taxpayers, avoid inadequate public reaction and disruption of the financial sector, and to protect the interests of retail banking consumers (depositors).

Experience of the recent years shows that sustainability of the credit union sector performance faces a number of challenges: 5 credit unions went bankrupt in Lithuania in 2013-2014, while as many as 23 credit unions worked at a loss in 2015. At present, credit union sector does not have a proper regulation in Lithuania: credit union capital is not sustainable and cannot efficiently cover the accrued losses. In order to stabilize and strengthen the credit union sector in Lithuania, and to set legal conditions for the implementation of the Concept of Sustainable Credit Union Activity, draft legal acts of the Republic of Lithuania, required for the implementation of the planned systemic reform of the credit union sector, were submitted to the Seimas in 2015. The aforementioned Concept establishes specific guidelines to reform Lithuania’s credit union sector, so that it is safe, reliable, transparent, and competitive, hence ensuring appropriate contribution of this sector into the national economic and social prosperity. With a view to successful consolidation of the sector’s integration and creation of efficient self-regulatory system, the laws establish that all credit unions belong to one of the unifying central credit unions. To ensure the sustainable and long-term development of credit unions, further legislative work needed to implement the Concept of Sustainable Credit Union Activity will be carried on in 2016.

As of 1 January 2016, a new insurance company solvency assessment system “Solvency II” took effect, with major attention given to corporate risk management, stricter internal control, information disclosure, and supervision of insurance company groups. It is expected that risk-based capital demand calculation will ensure financial stability of the insurance market and higher protection of interests of the assured. In the run-up to the launch of the system “Solvency II”, amendments to the Law No IX-1737 of the Republic of Lithuania were adopted in 2015, providing an opportunity to make use of the tools enabling smoother adjustment to the new risk-based requirements.

CHAPTER VIII

ASSESSMENT OF CONSISTENCY OF LITHUANIA'S STABILITY PROGRAMME WITH THE NATIONAL REFORM PROGRAMME

63. The direct impact of reforms specified in the National Reform Programme, as well as other structural reforms-related measures, on the government sector balance has been taken into account in calculating general government financial indicators covered in the Programme. Table 19 illustrates the impact of the structural reforms on the budget. It shows the data related to the 2015 reform allocations and year-on-year changes as of 2016.

Table 19. Direct impact of major structural reforms on general government finances
(increased spending or decreased revenues (+); decreased spending or increased revenues (-)

No	Major measures of structural reforms[1]	Spending/ revenue category (according to ESA'2010)	2015		2016		2017		2018		2019	
			m. euros*	GDP %	change, m. euros	GDP %	change, m. euros	GDP %	change, m. euros	GDP %	change, m. euros	GDP %
1.	Education and science reform [2]	IC and GFCF	317.2	0.9	82.5	0.2	51.0	0.1	94.9	0.2	51.5	0.1
2.	Agriculture reforms: entrepreneurship incentives; implementation of the Law of the Republic of Lithuania on Renewable Energy Sources; national climate change management, youth employment policy measures; promotion of innovation-related activities	IC and GFCF	160.4	0.4	5.0	0.0	–31.2	–0.1	3.8	0.0	1.3	0.0
3.	Energy: increasing renewable energy consumption, increasing end-use energy efficiency	IC and GFCF	19.0	0.1	–5.0	0.0	53.0	0.1	44.3	0.1	–32.6	–0.1
4.	Healthcare reform[3]	IC and GFCF	23.1	0.1	1.1	0.0	11.6	0.0	23.9	0.1	7.6	0.0
5.	Taxation reform [4]	RDT	–18.3	0.0	14.3	0.0	–11.1	0.0	0.0	0.0	0.0	0.0
		RIT	–92.8	–0.2	–100.4	–0.3	–157.2	–0.4	–66.1	–0.2	–7.1	0.0
6.	Environment protection policy: Multi-Apartment House Renovation (Modernisation)	IC	336.2	0.9	–157.0	–0.4	–11.5	0.0	69.2	0.2	–106.8	–0.2

No	Major measures of structural reforms[1]	Spending/ revenue category (according to ESA'2010)	2015		2016		2017		2018		2019	
			m. euros*	GDP %	change, m. euros	GDP %	change, m. euros	GDP %	change, m. euros	GDP %	change, m. euros	GDP %
	Programme; energy consumption and higher production efficiency projects; promotion of the use of renewable energy sources; introduction of environmentally friendly technology projects; renovation and development of water supply and wastewater treatment systems; waste management system development											
7.	Economy: promoting innovations; encouraging exports; industrial development; investment promotion; entrepreneurship promotion; improving the business environment; human resource development	IC and GFCF	140.9	0.4	–37.4	–0.1	129.0	0.3	–1.6	0.00	–40.4	–0.1
8.	Upgrading/ building new transport and communications network [5]	GFCF	234.0	0.6	41.2	0.1	150.2	0.4	–57.7	–0.1	0.0	0.0
9.	Measures increasing employment	IC	236.0	0.6	–35.4	–0.1	–4.5	0.0	19.3	0.0	–3.4	0.0
Overall direct impact on the budget			1 355.8	3.6	–191.2	–0.5	179.3	0.4	129.9	0.3	–129.8	–0.3
10.	Total spending on pension accumulation reform		178.2	0.5	52.3	0.1	22.3	0.1	25.9	0.1	28.5	0.1

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

Lithuania, Ministry of Agriculture of the Republic of Lithuania, Ministry of Energy of the Republic of Lithuania, Ministry of Social Security and Labour of the Republic of Lithuania

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

* National funding, EU funding, or national and EU funding (in case of co-financing).
[1] Measures under the National Reform Programme.
[2] Implementation of the National Education Strategy for 2013-2022; National Programme for the Development of Studies, Scientific Research and Experimental (Social and Cultural) Development for 2013-2020 (Action Plan for 2013-2015, Action Plan for 2016-2018).
[3] Programme on Reducing Morbidity and Mortality from Major Noncommunicable Diseases; Programme for Continuity of the ***Health Care*** System ***Reform*** and Optimisation of ***Health Care Infrastructure;*** Action Plan for 2014-2023 to Ensure Healthy Ageing in Lithuania; Action Plan for 2014-2023 to Reduce Health Inequalities in Lithuania.
[4] Amendments to the laws of the Republic of Lithuania related to taxation system changes: in accordance with the up-to-date information, as provided in the Programme.
[5] National Programme for the Development of Transport and Communications for 2014-2022; Information Society Development Programme for 2014-2020: “Digital Agenda of the Republic of Lithuania”.