GOVERNMENT OF THE REPUBLIC OF LITHUANIA

RESOLUTION NO 440
ON
THE STABILITY PROGRAMME OF LITHUANIA FOR 2015

29 April 2015

Vilnius

Acting pursuant to Article 3 of Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (OJ 2004, Special Edition, Chapter 10, Volume 1, p. 84), as last amended by Regulation (EC) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 (OJ 2011 L 306, p. 12), which lays down a multilateral surveillance procedure of the European Union Member States carried out in the form of stability and convergence programmes, the Government of the Republic of Lithuania has r e s o l v e d :

1. To approve the Stability Programme of Lithuania for 2015 (as appended);
2. To delegate to the Ministry of Finance the task of submitting the Stability Programme of Lithuania for 2015 to the European Commission.

Prime Minister

Minister of Finance

APPROVED BY
Resolution No 440 of 29 April 2015
of the Government of the Republic of
Lithuania

STABILITY PROGRAMME OF LITHUANIA FOR 2015
CHAPTER I
FINANCIAL POLICY OVERVIEW

1. As of 1 January 2015, Lithuania has become the nineteenth member of the Eurozone, and has for the first time drafted the Stability Programme of Lithuania for 2015 (hereinafter referred to as "the Programme"), which lays down the public finances policy for 2015–2018.

2. The Programme reflects the economic policy outlined in the Programme of the Sixteenth Government of the Republic of Lithuania for 2012–2016 approved by Resolution No XII-51 of the Seimas of the Republic of Lithuania of 13 December 2012 on the Programme of the Government of the Republic of Lithuania (hereinafter referred to as "the Programme of the Government") as well as in the Law of the Republic of Lithuania on the Approval of Financial Indicators of the State Budget and Municipal Budgets of 2015. The Programme has been submitted to the Seimas of the Republic of Lithuania (hereinafter referred to as "the Seimas).

3. To implement the public finances policy, counter-cyclical fiscal policy will be pursued, which will stimulate aggregate demand in 2015–2016, and will stabilize prices in 2017–2018. Hence sustainable economic growth and creation of jobs is going to be ensured. The primary focus during the Programme period will be given to the improvement of the quality of public finances: better tax administration and enhancement of public expenditure efficiency. Better tax administration outcomes will determine larger revenues of budgets attributable to the state.

4. In 2014 Lithuania achieved a medium-term objective[1], which will be maintained in 2015–2016 as well, and it is planned that the structural general government balance will be improved in 2017–2018, therein achieving structural general government surplus during the final year of the Programme. As it has been laid down by the draft Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets of 2015, general government will be nominally balanced in 2017.

5. The Programme overviews recent economic changes in Lithuania as well as the planned budgetary policy over the medium-term, assesses factors of economic development and fiscal risk, presents alternative measures to achieve fiscal objectives, the quality of general government finances, and Lithuania's readiness to tackle the population ageing effects. The Programme of the

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[1] Lithuania's medium-term objective is a structural general government deficit of 1% of GDP, or the one that is very close to this value (while assessing the results achieved), based on the EC's explanatory documents on the Stability and Growth Pact.

Government sets forth guidelines for structural reforms in Lithuania, and the National Reforms Agenda 2015 lays down the course of implementation of structural reform measures.

6. The Programme examines and assesses external conditions that would allow achieving economic policy objectives, and is based on preconditions on the euro exchange rate as well as prices of oil and other raw materials that the European Commission (hereinafter referred to as “the EC”) has used while drafting its 2015 Winter Forecasts.

7. The Programme provisions are in compliance with the fiscal discipline obligations, as regulated by the Constitutional Law of the Republic of Lithuania on the Implementation of the Fiscal Treaty (hereinafter referred to as “the Constitutional Law”).

8. In accordance with the rules on economic governance that were introduced on the European Union (hereinafter referred to as “the EU”) level by 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) (hereinafter referred to as “Council Regulation (EC) No 1466/97”), as well as the Constitutional Law, the medium-term objective shall be set no more often than every three years. The last time medium-term objective of Lithuania was set in 2013.

9. 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 this information in detail. 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.

CHAPTER II
ECONOMIC OUTLOOK
SECTION I
ASSUMPTIONS FOR ECONOMIC DEVELOPMENT SCENARIO

10. The key assumptions for the external economic environment (trading partner developments, oil prices, the euro and the dollar exchange rate) correspond to the EC’s 2015 Winter Forecasts.

Table 1. Key assumptions

Indicator	2014	2015	2016	2017	2018
Short-term interest rates (annual average)	0.3	0.1	0.1	0.2	0.2

Indicator	2014	2015	2016	2017	2018
Long-term interest rates (annual average)	2.8	1.7	2.2	2.4	2.5
USD/EUR exchange rate (annual average)	1.33	1.17	1.17	1.17	1.17
Nominal effective exchange rate	6.7	0	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), %	3.7	4.0	4.4	4.4	4.4
EU GDP growth, %	1.3	1.7	2.1	2.1	2.1
Growth of relevant foreign markets, %	1.0	0.2	1.7	1.7	1.7
World import growth (excl. EU). %	2.1	4.2	5.3	5.3	5.3
Oil prices (Brent, USD/barrel)	99.7	53	61.5	61.5	61.5

Sources: Ministry of Finance of the Republic of Lithuania, Bank of Lithuania, EC (2015 Winter Forecast)

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

Upon the coming into effect of the Constitutional Law as of 1 January 2015, an independent budgetary policy control institution shall draw a conclusion on the economic development scenario; in accordance with Resolution No XII-592 of the Seimas of the Republic of Lithuania of 14 November 2013 and the Law No I-907 of the Republic of Lithuania on National Audit Office of 30 May 1995, National Audit Office of the Republic of Lithuania (hereinafter referred to as "the National Audit Office") shall perform functions of the aforementioned institution. Conclusion No Y-4 of the National Audit Office of 31 March 2015 on the approval of the economic development scenario reads: "the scenario drafted by the Ministry of Finance of the Republic of Lithuania has been determined by the selected and stated assumptions, is based on existing statistical data, and does not contradict economic patterns. National Audit Office of the Republic of Lithuania approves the economic development scenario for 2015–2018, which has been made public on the website of the Ministry of Finance of the Republic of Lithuania on 20 March 2015".

SECTION II
MEDIUM-TERM ECONOMIC DEVELOPMENT SCENARIO

The real sector

11. In 2014 Lithuania's economy proved resistant to negative external factors and remained one of the fastest-growing economies across the EU. In 2014, positive impact of the domestic demand became stronger and turned to be the major engine of economic growth.

In 2014 growth in gross value added was the most remarkable in the construction (15.7%), manufacturing (3.3%), agriculture, forestry, and fisheries (3.5%), and trade, transportation, accommodation, and food services (2.4%). The value added that was generated in Lithuania's economy in 2014 in comparable prices exceeded the level seen before the economic crisis in 2008 by 1.4%.

In 2014 investments into the gross fixed capital formation grew by 8% (this indicator saw the highest growth in the 1st quarter, 16.4%). In 2014 investment growth was determined by active construction sector, low interest rates, favourable borrowing conditions, business needs to revive their production capacities, and the euro adoption-related household behaviour: the desire to invest into the real property before the currency changeover.

Over the medium term, investment will be encouraged by pursuing projects financed by the EU funds from the 2014–2020 financial perspective as well as investment projects related to national defence, and accessibility of bank loans. It is expected that the policy encouraging investment climate, pursued both by Lithuania and on the EU level, will ensure gradual growth of gross fixed capital formation as a percentage of GDP, which at the end of the medium-term will be larger compared to 2014.

In 2014, with the growth in real household incomes, household consumption expenditure grew more rapidly. Real household disposable income grew due to favourable employment trends and wages dynamics as well as the falling inflation. The anticipated introduction of the euro made noticeable impact on household consumption.

Table 2. Macroeconomic indicators

Indicator	ESA* code	Indicator value in 2014, million EUR	Change, %				
			2014	2015	2016	2017	2018
Real GDP	B1g	32792.1	2.9	2.5	3.2	3.5	3.9
Nominal GDP	B1g	36287.9	3.8	3.0	5.4	6.0	6.5
Components of real GDP							
Private consumption expenditure + NPI serving households	P.3	21386.7	5.6	3.7	4.3	5.7	5.7
Government consumption expenditure	P.3	5762.5	1.3	1.3	0.6	0.6	0.6
Gross fixed capital formation	P.51	6430.7	8.0	5.2	2.5	4.3	5.2
Changes in inventories and net acquisition of valuables (% of GDP)	P.52+P.53	–	–	–	–	–	–
Exports of goods and services	P.6	26704.2	3.4	–2.8	3.8	4.9	5.9
Imports of goods and services	P.7	26342.0	5.4	–1.2	4.6	5.7	6.4
Contributions to real GDP growth, %							
Final domestic demand		–	4.5	3.8	3.7	4.1	4.4

Indicator	ESA* code	Indicator value in 2014, million EUR	Change, %				
			2014	2015	2016	2017	2018
Changes in inventories and net acquisition of valuables	P.52+P.53	–	–	–	–	–	–
External balance of goods and services	B.11	–	–1.6	–1.4	–0.5	–0.6	–0.5

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

* European System of Accounts

Inflation

12. Average annual inflation, calculated in accordance with the Harmonised Index of Consumer Prices (hereinafter HICP) amounted to 0.2% in 2014 and was the lowest in the last 11 years. The inflation decline was largely due to consumer-friendly trends in administered prices, as well as fuel and food prices. These trends were related to external factors, i.e. the changes in energy and food raw material prices in global markets.

The low average annual inflation rate in 2014 was mostly affected by the 0.2% drop in commodity prices. Prices of energy commodities went down by 4 per cent, dropping the most since 1997, when the HICP started being applied to calculate the average annual inflation. Prices of non-energy industrial goods remained relatively unchanged, while food prices (including alcohol and tobacco products) went up by 1.6 per cent. Prices of alcoholic beverages and tobacco products rose by 3.8 per cent (this was due to the increased excise duty tariffs for these products in 2014), while prices of food products and non-alcoholic beverages (excluding alcohol and tobacco products) went up by 0.8 per cent.

Prices of services rose by 1.6 per cent, but accounted for only one fourth of the consumer's basket of goods and services; therefore, their effect on the inflation rate was insignificant. Communication services prices fell the most – by 6.3 per cent, as compared to prices of other services, while housing services prices rose the most – by 7.7 per cent.

The 0.1 per cent annual deflation, detected in December 2014, accelerated and rose to 1.4 per cent in January 2015, then reached 1.5 per cent in February. This acceleration was largely due to the changes in energy prices: fuel prices fell by one fifth in one year, electricity and heating energy prices kept rapidly declining. Food prices (excluding alcohol and tobacco products) also declined faster. Annual deflation was modestly mitigated only by the prices of services, non-durable industrial goods, alcohol and tobacco products that kept rising in a moderately rapid pace.

It is estimated that in 2015, due to the dropping energy prices, the average annual inflation in Lithuania will be negative and amount to -0.4 per cent. In 2016, with energy commodity prices gradually recovering, the demand increasing and the price level rising, in the main export market of

Lithuania – the EU, the average annual inflation will amount to 1.7 per cent. Taking into account the assumption on stable energy commodity prices, a moderate acceleration of inflation is envisaged for 2017-2018, due to the trends in rising labour demand and wage growth.

Since labour productivity will keep increasing in the country, the demand for labour force will continue growing, unemployment levels will keep decreasing and the supply of labour force will slightly diminish, the wages will grow faster than in 2014. Wages are expected to increase by 4.8–6.2% in the 2015–2018 period.

Table 3. Price indicators

Indicator	ESA code	Indicator value in 2014	Change, %				
			2014	2015	2016	2017	2018
1. GDP deflator		110.7	0.9	0.5	2.2	2.4	2.5
2. Private consumption deflator		108.5	0.1	–0.4	1.7	1.9	2.2
3. HICP (average annual)		140.1	0.2	–0.4	1.7	1.9	2.2
4. Public consumption deflator		107.4	3.9	4.0	4.0	4.0	4.0
5. Investment deflator		108.4	1.5	0.0	1.0	1.0	1.0
6 Export price deflator (goods and services)		111.1	–2.4	–3.0	1.6	1.8	1.8
7. Import price deflator (goods and services)		112.2	–3.1	–5.2	1.9	2.3	2.4

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

Labour Market

13. In 2014, the unemployment rate dropped by 1.1 percentage points to 10.7%. The unemployment rate of male persons in 2014 amounted to 12.2 per cent, of female persons – to 9.2 per cent. In one year the unemployment rate of male persons dropped by 0.9 percentage points, of female persons – by 1.3 percentage points. The unemployment rates dropped in all age groups: the average rate of unemployment for persons aged 15–24 reduced by 2.6 percentage points, for persons in the age group 25–54 – by 1.1 percentage points, and in the age group 55–64 – by 0.5 percentage points.

The activity rate within the working-age (15–64) population amounted to, on average, 73.7 per cent, reaching the highest since 1998. In 2014, the rate of activity of persons aged 15 and higher amounted, at an average, to 58.9 per cent and went up by 0.9 per cent, if compared to 2013. The activity rate of the population was effected by the successful implementation of the Employment Enhancement Program in the Republic of Lithuania for 2014–2020, approved by the Government of Lithuania in Resolution No 878 of 25 September 2013 On the Approval of the Employment Enhancement Program 2014–2020, implemented by the Government of the Republic of Lithuania (hereinafter the Government), as well as the increasing supply of jobs and rising wages. The activity rate of persons aged 15-24 went up notably (which is largely due to the Youth Guarantee Initiative that was launched in the beginning of 2014), as did the activity rate of persons aged 55-64. Despite the slower decline in unemployment rate (in 2011-2013, unemployment rate declined by 2 percentage points per year, while in 2014 it went down by only 1.1 percentage points), the trends in growth of the number of employed persons remained optimistic in 2014, as against 2013, when the percentage of the employed went up by 2 per cent or 26.2 thousand.

Within the year the number of employed persons in the private sector grew by 31.2 thousand or 3.4 per cent, while in the public sector their number dropped by 5 thousand or 1.4 per cent. The employment rate was most positively affected by the increase in numbers of the employed in the activities of agriculture, forestry and fishing (0.9 percentage points), wholesale and retail trade, repairs of motor vehicles and motorcycle (0.4 percentage points), transportation and storage (0.5 percentage points).

In 2014, 647.1 thousand men and 671.9 thousand women were employed. Within the year the number of employed men grew by 11 thousand (1.7 per cent), women – by 15.2 thousand (2.3 per cent). In 2014, the employment level of both men and women in all age groups was the highest in the last 5 years. The employment rate of persons aged 15–64 went up by 2 per cent in 2014 and amounted to 65.7 per cent. The rate of employment of male persons aged 15–64 grew by 1.8 percentage points in a year and amounted to 66.5 per cent, while that of female persons grew by 2.1 per cent and amounted to 64.9 per cent. The employment rate of persons aged 20–64 increased by 1.9 per cent in a year and amounted to 71.8 per cent. The rate of employment of elderly persons (aged 55–64) went up by2.8 per cent in the year 2014 and amounted to 56.2 percent.

According to the data of the Statistics Lithuania, by the end of 2014 there were 11.6 thousand job vacancies, which is 8.5 per cent more than in 2013. More than half of all the vacancies were in the activities of manufacturing (2.4 thousand), wholesale and retail trade, repair of motor vehicles and motorcycle (1.3 thousand), transportation and storage (1.4 thousand), public administration and defence (1.3 thousand). It should be noted that in 2014 the number of employed persons in the manufacturing activity as well as the professional, scientific and technical activities decreased, and the supply of job vacancies increased. This may signify a lack of sufficiently qualified employees in these areas.

The number of job vacancies increased most significantly in companies carrying out professional, scientific and technical activities (0.4 thousand), transportation and storage, as well as the administrative activities and support service (0.2 thousand each), but decreased in companies carrying out construction as well as human health and social work activities (0.1 thousand each). In 2014, the job vacancy rate in the country amounted to 0.9 per cent, which is the same amount as in 2013. The highest job vacancy rate was traced in companies engaged in financial and insurance activities (2.3 per cent), information and communication activities (1.8 per cent), public administration and defence, compulsory social security activities (1.7 per cent). The lowest job vacancy rate was estimated in educational institutions (0.3 per cent) and real estate companies (0.4 per cent).

The long-term unemployment rate in 2014 went down by 0.3 percentage points and amounted to 4.8 per cent.

Low prices in domestic and foreign markets and the decline in corporate profits (operational surplus and mixed income went down by 0.8 per cent in 2014) indicate that wage growth in 2015 should slow down. However, due to the lack of qualified labour force in subsequent years in the medium-term, the pressure to raise wages will increase.

The expected improvement in the economic situation of the EU states as well as the labour market reforms, undertaken in recent years, will contribute to the increase in employment and the decrease in unemployment. Therefore, the situation in the labour market will consistently improve in the medium-term.

Table 4. Labour market indicators

Indicator	ESA code	Indicator value in 2014	Change, %				
			2014	2015	2016	2017	2018
1. Employment, persons (thou)		1319.0	2.0	0.6	0.6	0.9	0.9
2. Employment, hours worked		–	–	–	–	–	–
3. Unemployment rate (%)*		10.7	–	9.9	9.1	8.1	7.1
4. Labour productivity (real GDP per employed person), thou EUR		24.8	0.9	1.9	2.5	2.6	3.0
5. Labour productivity, hours worked (real added value per actual hour worked), EUR		13.5	1.3	–	–	–	–
6. Compensations of employees, million EUR	D.1	14526.4	6.1	5.5	5.9	6.6	7.1
7. Compensation per employee, EUR		11013.2	4.0	4.9	5.3	5.7	6.2

Sources: Statistics Lithuania, Ministry of Finance
* Indicator value is given.

SECTION III
BALANCE OF PAYMENTS OF LITHUANIA

14. The converging economy of Lithuania is supposed to result in poorer current account balance, however, it was positive or nearly balanced during the previous few years. According to the data on the balance of payments announced by the Bank of Lithuania on 24 March 2015, in the year 2014 the current account was nearly balanced and accounted for EUR 44.9 million or 0.1 per cent of GDP. Compared to 2013 the current account surplus diminished mainly due to poorer trade in goods balance and primary income balance. The evaluation of announced data on quarters of the year 2014 indicates that changes in current account balance were irregular at different periods.

In the first half of the year 2014 the current account balance was negative mainly due to poorer balance of trade in goods: the decline of nominal export of goods was rather sharp, while the decline of import of goods was more moderate. The decline of export of goods was mainly due to the export of mineral products that has fallen by half and has worsened the balance of trade in mineral products. Poorer balance of trade in goods was also the result of sluggish export of fertilizers. Such developments were in fact determined by decline in prices of fertilizers as well as lower real export of fertilizers producing companies. In the first half of the year, the payment of dividends to non-residents was one more factor responsible for poorer current account balance. At the end of a less favourable period of development during the first half of the year the current account balance had improved for a short while and was positive. Such a change was mainly due to better foreign trade balance.

At the end of 2014 the current account balance had worsened again. The main determinant was poorer balance of goods and services that has experienced the impact of one-off factor, i.e. the imported Liquefied Natural Gas Terminal. Since the value of such a transaction was high, its impact on trade balance was not offset by cereal export that has reached a record high during the last two years and contributed to a significant improvement of balance of trade in agriculture and food products.

The evaluation of the year 2014 as a whole shows that as usually the balance of secondary income and the balance of services were the main factors that made the most positive influence on the current account balance. Positive balance of secondary income was mainly the result of the balance of transfers by private persons; the ratio of the latter to the GDP during the first three quarters of this year was higher by 0.5 per cent in comparison to the ratio during the same period the year ago. Yet the annual growth of transfers by emigrants to Lithuania has slowed down. Despite the impact of conflict between Russia and Ukraine the growth of service export exceeded the GDP growth as well as the growth of service import, thus the ratio of this constituent of the current account balance to the GDP was higher in comparison to the previous year.

Table 5. Sectoral balances

Indicator	ESA code	Percentage of GDP				
		2014	2015	2016	2017	2018
1. Net lending/borrowing vis-à-vis the rest of the world	B.9N	3.0	3.6	1.0	0.0	–0.8
of which:						
balance on goods and services		0.3	0.7	0.0	–1.0	–1.8
balance of primary and secondary income*		–0.2	–0.2	–0.9	–0.9	–0.9
capital account*		2.9	3.1	1.9	1.9	1.9
2. Surplus (+)/deficit (-) of the private sector		3.7	4.8	2.1	0.0	–1.5
3. Surplus (+)/deficit (-) of general government	B.9N	–0.7	–1.2	-1.1	0.0	0.7
4. Statistical discrepancy		0	0	0	0	0

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

The evaluation of the prospect of current account balance allows to suppose a nearly balanced current account in the year 2015. It is foreseen that in the course of economic growth the current account balance will worsen during 2016–2017 in comparison to the year 2015 due to a more speedy import growth, which will surpass the growth of export.

SECTION IV
RISK-RELATED ASPECTS OF ECONOMIC DEVELOPMENT

15. The prospect of Lithuanian export markets continues to represent the main risk factor in terms of changes in the economic development scenario. The economic development scenario introduced in the Programme depends on other factors as well.

Uncertainty of the geopolitical situation poses negative risk to the economic development scenario presented in the Programme. Information on the abovementioned risk is constantly monitored and evaluated.

There is also positive risk that the pace of economy development will be more rapid than foreseen in the economy development scenario if EU business sector expectations will increase more rapidly than suggested in the European Commission Winter Forecast 2015. In March 2015 the European Central Bank (hereinafter referred to as ECB) has launched the expanded asset purchase programme, i.e. it organizes the purchase of private and public sector securities in secondary markets and plans that purchases will amount to EUR 60 billion each month (according to the plans purchases of securities will amount to EUR 1 trillion). The purchases are intended to be carried out at least until September 2016; they will in any case be conducted until a sustained level of inflation in the euro zone will be achieved that meets the main goal of ECB monetary policy. The abovementioned measures of ECB monetary policy will contribute to the recovery of foreign trade partners of Lithuania as well as bring benefit to Lithuania's exporters.

Negative risk in relation to the economic development scenario presented in the Programme will be reduced by the Investment Plan for Europe approved in December 2014 by the European Council with the aim of concentrating approximately EUR 315 billion for additional public and private investments during 2015–2017; the plan is supposed to improve the investment environment in the EU as well as in Lithuania.

Measures aimed at strengthening energy independence, namely the Liquefied Natural Gas Terminal active from 2015 and nearly established electricity interconnections with Sweden and Poland (the end of 2015 is foreseen as the final date of full establishment), should be considered as solid and positive factors that guarantee economic stability. The new EU energy strategy aiming to reduce the dependence on Russian energy suppliers to the minimum offers Lithuania the possibility to become the country that ensures the transit of gas in the region.

The success of the economic development scenario will depend on the flexibility and ability of Lithuania‘s enterprises to function and compete on rapidly changing export markets as well.

CHAPTER III
FISCAL FRAMEWORK

SECTION I
FINANCIAL POLICY GUIDELINES

16. Taking into account the economic development scenario presented in the Programme the following priorities when implementing the public financial policy during 2015–2018 are established:

16.1. to implement anti-cyclic fiscal policy aiming to stimulate aggregate demand during the period of 2015–2016 and to stabilize prices during the period of 2017–2018;

16.2. in case of favourable circumstances to consider the introduction of such new taxes or changes to such applicable tax tariffs that are not capable of slowing down economic growth;

16.3. to improve the conditions for the collection of taxes by means of legislative measures and increase the infectiveness of the activity of tax administrator by applying up-to-date information technologies as well as other modern technologies;

16.4. to check the effectiveness of public expenditure in essence, limit the increase of expenditure in ineffective fields that receive support from the Lithuania’s public sector and make efforts to exclude the causes of such ineffectiveness;

16.5. to perfect the system aimed at monitoring the finances of the general government sector, to acquire the know-how from other countries and practice from the private sector that could be useful in governing the Lithuania’s public finances as well as making decisions on the government of public finances, to use the data on financial accountability;

16.6. to effectively provide information on the use of taxes and fees collected into the budgets attributed to the government sector to the public.

SECTION II
GENERAL GOVERNMENT REVENUE

17. It is expected that the State Budget revenue will increase due to the fight against smuggling and application of strict shadow economy reducing measures. According to the plans the ratio of revenue from taxes to GDP in 2015 will be higher in comparison to the year 2014 due to the application of measures that improve tax administration. In the future, i.e. during 2017–2018, the ratio of revenue from taxes (excluding tax receipts in the state-owned company “Deposit and Investment Insurance”) to GDP will increase as well due to the launch of tax administrator information systems based on the most recent technology solutions. It is expected that lower revenue that is a result of slower economic growth will be offset by revenue related to the application of tax administration improvement measures in 2015 as well as in the years to come when such additional measures are planned to be applied.

18. In 2015 the application of new measures that improve tax administration will start:

18.1. Resolution No 1460 of the Government of the Republic of Lithuania of 23 December 2014 amending Resolution No 482 of the Government of the Republic of Lithuania of 28 April 2004 on the Implementation of Article 104 of the Law of the Republic of Lithuania on Tax Administration that specifies additional cases when tax administrator may ask the risk posing taxpayers to submit a guarantee or assurance certificate; such a requirement is an additional precondition ensuring the fulfilment of tax obligations;

18.2. aiming to ensure a more effective collection of value added taxes (hereinafter referred to as VAT) in the construction sector, on 1 July 2015 the Law amending Article 96 of the Law No IX-751 of the Republic of Lithuania on Value Added Tax will come into force specifying that a taxable person that is a VAT payer and that orders construction works shall be required to deduct VAT and pay it into the budget;

18.3. the State Tax Inspectorate (hereinafter referred to as STI) is planning to make a wider use of the possibility prescribed in the Law No IX-2112 of 13 April 2004 on Tax Administration of the Republic of Lithuania to receive data from taxpayers on issued and received VAT invoices (hereinafter referred to as VAT invoices). The STI informs that in early May 2015 it plans to launch the VAT Invoices Project according to which 7000 Lithuania's companies that STI selected on the basis of risk analysis will be required to submit data on received and issued VAT invoices each month. This information will allow STI to improve VAT administration, help to evaluate business behaviour in real time, perform crosschecks, identify companies that avoid VAT on the basis of feigned invoices;

18.4. the Government of the Republic of Lithuania approved the launch of the tax administration information system based on the most recent technology solutions (Smart Tax Administration System) at the State Tax Inspectorate by its Meeting Protocol No 12 of 16 March 2015. The Smart Tax Administration System or i.MAS will ensure competitive conditions for good faith business as well as reduce shadow economy. The established system will contribute to the quality of tax administration and effectiveness of tax collection. The first stage of i.MAS introduction includes the application of measures that improve VAT administration; the system will be implemented in three stages. First of all the STI will start to develop and launch the i.SAF (invoice subsystem) and i.VAZ (consignment note subsystem) aiming to narrow the scope of clandestine economic operations and reduce the number of feigned operations. Such measures will reduce the number of cases when VAT is not paid.

19. Changes in tax rates that come into force in 2015:

19.1. aiming to ensure taxation that is less harmful to economic growth, the Law amending Articles 6 and 7 of the Law No X-233 of the Republic of Lithuania on Immovable Property Tax came into effect on 1 January 2015 that broadens the taxation on immovable property by reducing the non-taxable amount to EUR 220 000 that is applied to non-commercial property of natural persons. In addition the amendments specify that a 0.5 per cent tax rate is applied to the portion of taxable amount of the abovementioned property exceeding the non-taxable amount;

19.2. as a result of amendments to Articles 23, 24, 25, 26, 30 and 31 of the Law No IX-569 of the Republic of Lithuania on Excise Duties as from 1 March 2015 excise duties on cigarettes, cigars and cigarillos, ethyl alcohol and alcoholic beverages as well as intermediate products have been increased.

20. Aiming to improve tax administration related activities and taking into account the world wide practice as well as recommendations of international organizations a consolidated strategy for the period 2014–2017 ensuring the implementation of tax obligations of taxpayers and collection of taxes prepared by the State Tax Inspectorate is under implementation in the field of practical tax administration. The strategic documents regulating the activity of tax administrator stipulate integrated measures that are under implementation. Such measures are aimed at inducing voluntary payment of taxes as well as ensuring tax law infringement prevention and control. In addition the STI consolidated measure plan ensuring the implementation of tax obligations of taxpayers and collection of taxes during 2014–2015 is under implementation.

21. The following draft laws of the Government aimed at improving tax collection are submitted for reading to the Seimas:

21.1. Draft Law of the Republic of Lithuania on the Limits to the Settlements in Cash that sets limits to the settlements in cash (EUR 5 000 in case of natural persons not engaged in economic-commercial activity and EUR 3 000 in case of all other persons);

21.2. Draft Law amending Articles 28, 41, 55, 61, 68, 87, 89, 101, 104-1, 104-2, 110, 111, 129, 131, 154, supplementing by Article 55-1 and repealing Articles 56, 57, 58, 59 and 60 of the Law No IX-2112 of the Republic of Lithuania on Tax Administration that aims at optimizing the processes for submitting information necessary for the identification of undeclared income and unjustified sources of asset acquisition, establishment of tax obligation, securement of its fulfilment as well as cooperation with tax administrations of other countries.

22. The EU *acquis* in the field of excise duties will continue to be implemented during the Programme implementation period.

SECTION III
GENERAL GOVERNMENT EXPENDITURE

23. The key expenditure targets and priorities of the State Budget as well as of municipal budgets have been set in the Programme of the Government of the Republic of Lithuania. Each year, before drawing up the State Budget, the Government of the Republic of Lithuania in line with the methodology for the strategic planning approved by the Resolution No 827 of the Government of the Republic of Lithuania of 6 June 2002 on the Approval of the Methodology for the Strategic Planning drafts and adopts priority activities of the Government for the respective year. According to these priorities, funds are allocated to areas of responsibility of relevant ministers for the implementation of programmes of the institutions and bodies under their charge.

24. Pursuant to the Resolution No 527 of the Government of the Republic of Lithuania of 4 June 2014 on the Main Preliminary Indicators of the Consolidated State and Municipal Budgets of the Republic of Lithuania of 2015–2017, the Ministry of Finance of the Republic of Lithuania when notifying the State Budget appropriation managers of the budgetary ceilings allowable for 2015–

2017, calculated the 2015 maximum limits of the State Budget allocations (for expenditure and asset acquisition):

24.1. for state institutions that are required to indicate management expenditure according to the classification of revenue and expenditure of State budget and municipal budgets of the Republic of Lithuania as approved by the Order No 1K-184 of the Minister of Finance of the Republic of Lithuania of 3 July 2003 on the Approval of Classification of Revenue and Expenditure of State Budget and Municipal Budgets of the Republic of Lithuania by reducing allocations that were used to cover maintenance (management) expenditure (apart from EU and other international financial support, co-financing funds, contributions from the revenues of budgetary institutions to the State Budget as well as part of tax revenues and other funds envisaged by laws and other legislative acts for programme funding) of such institutions from the 2014 State Budget by 5 per cent (in cases when there was no possibility to reduce allocations given to cover maintenance (management) expenditure of the abovementioned institutions, other allocations given for such institutions had to be reduced by the appropriate amount);

24.2. by evaluating the programmes to be discontinued and/or programme measures, which will be completed in 2014 and which do not require allocations from the 2015 budget;

24.3. taking into account the provisions of the Agreement of the Seimas political parties of 29 March 2014 on Strategic Guidelines for foreign, security and defence policy of the Republic of Lithuania for the period of 2014–2020 (hereinafter referred to as the Agreement) stipulating the aim to increase funds for defence so that they account for 2 per cent of GDP in 2020;

24.4. considering the agreements on the maximum limits of State Budget allocations during 2015–2017 applied to the areas governed by relevant ministers, negotiated during discussions between the Prime Minister of the Republic of Lithuania, Minister of Finance and relevant government ministers on strategic goals, the results planned to be achieved in the area governed by relevant minister and State Budget allocations, arranged by the Office of the Government.

25. State budget allocations of 2015 (apart from EU and other international financial support) approved by the Law of the Republic of Lithuania on Approval of Financial Indicators of the State Budget and Municipal Budgets of 2015 increased by almost EUR 307 million in comparison with the year 2014 (from which approximately EUR 116 million were allocated to the Ministry of Defence on the basis of the Agreement, EUR 52 million were allocated on the basis of the Law of the Republic of Lithuania on Compensation for State Social Insurance Pensions and Work Incapacity (Disability) Pensions, EUR 25 million were allocated as contributions to the EU budget, EUR 21 million were allocated to the Ministry of Social Security and Labour, i.e. for the maintenance of the Lithuanian Labour Exchange and its territorial units, EUR 12.6 million were allocated with the aim to increase lowest wages of people employed at budget institutions and organizations from March 2015, EUR 14.4 million were allocated with the aim to increase from 1 July 2015 the minimum monthly wage from EUR 300 to EUR 325). The EU and other international financial support increased by EUR 170 million.

The approved Law of the Republic of Lithuania on Approval of Financial Indicators of the State Budget and Municipal Budgets of 2015 restricts the rights of the Ministry of Environment of the Republic of Lithuania to undertake financial obligations – according to the law, the Ministry of Environment of the Republic of Lithuania may use for payments in 2015 from the Special Climate Change Programme no more than EUR 37.7 million of the total amount paid in 2015 and / or of the amount paid in the previous year.

26. During the period of 2015–2018 plans are underway to pay more attention to the analysis of effectiveness of public expenditure, evaluate and compare public expenditure related qualitative and quantitative indicators of Lithuania and other similar countries. In case the distribution of public finance resources is identified as not properly effective, the analysis of reasons will be initiated aiming to eliminate the causes of such ineffectiveness.

SECTION IV
MEDIUM-TERM GENERAL GOVERNMENT FINANCE PROJECTIONS

27. The government finance projections were developed on the basis of the economic development scenario set out in the Programme, the State's commitments under its legislation, the fiscal discipline rules laid down in the national legislation (the Constitutional Law, the Law of the Republic of Lithuania on Fiscal Discipline, the Law of the Republic of Lithuania on the Budget Structure, the Law of the Republic of Lithuania on the Approval of Financial Indicators of the State Budget and Municipal Budgets of 2015) and EU legal acts (Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (OJ special edition, 2004, Chapter 10, Volume 1, p. 84), as last amended by Council Regulation (EU) No 1175/2011 of 16 November 2011 (OJ 2011 L, 306, p. 12); Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ special edition, 2004, Chapter 10, Volume 1, p. 89), as last amended by Council Regulation (EU) No 1177/2011 of 8 November 2011 (OJ 2011 L 306, p. 33)), as well as the planned medium-term appropriations and revenues of the consolidated state of the national and municipal budgets, as approved by the Seimas Resolution No XII-1373 of 4 December 2014 'On the target indicators for the consolidated state of the national and municipal budgets for 2015, 2016 and 2017'.

28. In 2014, the general government deficit accounted for 0.7 per cent of the GDP. If the financial performance result of the State enterprise 'Deposit and Investment Insurance' (hereinafter referred to as SE Deposit and Investment Insurance), included in the general government as of October 2014, was disregarded, the 2014 general government deficit would equal 2 per cent of the GDP. The general government deficit will amount to 1.2 per cent of the GDP in 2015 (or 1.5 per cent of the GDP if SE Deposit and Investment Insurance is excluded). In 2016, the general government deficit will shrink to 1.1 per cent of the GDP (an insignificant positive impact of SE Deposit and Investment Insurance on the general government balance is anticipated). A balanced general government is expected in 2017.

29. The general government finance structure in 2015–2018, as compared with 2014, will change as a result of tax revenues: the launch of tax efficiency instruments is expected to offset the

risks posed by the uncertainty of the external environment and to increase tax revenue (excluding the tax revenues of SE Deposit and Investment Insurance) ratio to the GDP.

In 2015, the general government expenditure to GDP ratio has been rising due to two important reasons– in 2015 the EU general government expenditure, which is fully covered by the revenues, has been growing as a result of the juncture of two EU financial periods (2007–2013 and 2014–2020). Additionally, one-off expenditure is projected for 2015 to compensate persons receiving pay from the funds of the State and municipal budgets for the loss suffered due to the disproportionate wage (salary) cuts that resulted from the economic crisis (Resolution No 429 of the Government of the Republic of Lithuania of 29 April 2015 ‘On the submission to the Seimas of the Republic of Lithuania of the Draft Law on Partial Repayment of Wages (Salaries), Disproportionately Reduced due to the Economic Crisis, to Persons of the Republic of Lithuania Receiving Pay from the Funds of the State and Municipal Budgets’).

Social payments, as a percentage of the GDP, will slightly decrease in 2017–2018 as a result of the gradual raising of the retirement age as well as the unemployment reduction trends. As the wage increases will be moderate, the percentage of compensations for employees in the GDP, excluding one-off factors, will account to roughly 9 per cent of the GDP. Successful use of the EU funds of the 2007–2013 financial period, sound preparation for the new 2014-2020 financial period for the use of EU funds and the increasingly wide application of financial instruments will ensure a stable share of gross capital formation, accounting for 3.5 per cent of the GDP (if EU and other international assistance to the private sector is taken into account, gross capital formation will amount to approximately 5.1 per cent of the GDP). Interest expenditure will decline due to the expected improvement in the general government balance, cheaper borrowing due to Lithuania’s membership in the euro zone, investor confidence in the Lithuanian fiscal policy and sustainable economic development prospects.

Table 6. General government indicators (S13), 2014-2018*

	ESA 2010 code	2014		2015	2016	2017	2018
		EUR million	GDP %	GDP %	GDP %	GDP %	GDP %
Net borrowing (+)/net lending (–) (B.9) by subsector							
1. General government	S.13	–242.0	–0.7	–1.2	–1.1	0.0	0.7
2. Central government	S.1311	171.7	0.5	–0.7	–0.9	–0.4	–0.1
3. State government	S.1312	–	–	–	–	–	–
4. Local government	S.1313	41.3	0.1	–0.1	–0.1	0.0	0.0
5. Social security funds	S.1314	–455.1	–1.3	–0.4	–0.1	0.4	0.8
General government (S13)							
6. Total revenue	OTR	12433.7	34.3	34.4	33.2	33.1	33.1
7. Total expenditure	OTE	12675.7	34.9	35.6	34.3	33.1	32.5
8. Net lending/borrowing	B.9	–242.0	–0.7	–1.2	–1.1	0.0	0.7
9. Interest expenditure	D.41	572.2	1.6	1.7	1.5	1.5	1.2
10. Primary balance		330.1	0.9	0.5	0.5	1.5	1.9

	ESA 2010 code	2014		2015	2016	2017	2018
		EUR million	GDP %	GDP %	GDP %	GDP %	GDP %
11. One-off and other temporary measures		101.0	0.3	0.1	0.1	0.0	0.0
Items of revenue							
12. Total taxes (12=12a+12b+12c)		5964.8	16.4	17.2	17.1	17.1	17.1
12a. Revenue from indirect taxes	D.2	4119.5	11.4	12.0	11.7	11.6	11.5
12b. Revenue from direct taxes	D.5	1844.0	5.1	5.2	5.4	5.5	5.6
12c. Capital taxes	D.91	1.3	0.0	0.0	0.0	0.0	0.0
13. Social insurance contributions	D.61	4125.9	11.4	11.8	11.6	11.6	11.6
14. Property income	D.4	145.3	0.4	0.4	0.3	0.2	0.3
15. Other		2197.7	6.1	5.0	4.3	4.2	4.1
16=6. Total revenue	OTR	12433.7	34.3	34.4	33.2	33.1	33.1
Tax burden (D.2+D.5+D.61+D.91-D.995)		10075.6	27.8	28.9	28.7	28.6	28.6
Tax revenue (excl. tax revenues from SE Deposit and Investment Insurance)		5908.8	16.3	17.0	17.0	17.1	17.1
Items of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	5188.7	14.3	15.0	14.3	13.9	13.8
17a. Compensation of employees	D.1	3450.5	9.5	9.8	9.1	8.8	8.7
17b. Intermediate consumption	P.2	1738.2	4.8	5.2	5.2	5.1	5.1
18. Social payments (18=18a+18b)	D.6M	4545.4	12.5	12.9	12.5	11.9	11.4
of which, Unemployment benefits	D.6M	65.5	0.2	0.2	0.2	0.2	0.2
18a. Social transfers in kind supplied via market producers	D.632	642.9	1.8	1.7	1.7	1.6	1.5
18b. Social transfers other than in kind	D.62	3902.5	10.8	11.2	10.8	10.3	9.9
19=9. Interest expenditure	D.41	572.2	1.6	1.7	1.5	1.5	1.2
20. Subsidies	D.3	118.9	0.3	0.4	0.4	0.3	0.3
21. Gross fixed capital formation	P.51G	1268.2	3.5	3.6	3.6	3.5	3.8
22. Capital transfers	D.9	505.9	1.4	0.4	0.4	0.3	0.3
23. Other		476.5	1.3	1.7	1.6	1.7	1.7
24=7. Total expenditure	OTE1	12675.7	34.9	35.6	34.3	33.1	32.5
Government final consumption (nominal)	P.3	6185.9	17.0	17.4	17.3	17.1	16.8

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

*Due to rounding, the sum of revenue and expenditure components may differ from the amounts given under 'total revenue' and 'total expenditure'.

Table 7. No policy change projections, 2014-2018

Indicator	Indicator value in 2014 EUR million	% of GDP				
		2014	2015	2016	2017	2018
1. Total revenue, assuming no policy changes	12433.7	34.3	34.4	33.2	33.1	33.1
2. Total expenditure, assuming no policy changes	12675.7	34.9	35.6	34.3	33.1	32.5

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 2014 (EUR million)	% of GDP				
		2014	2015	2016	2017	2018
1. Expenditure on EU programmes fully matched by EU funds revenue	725.5	2.0	2.6	2.2	2.3	2.5
2. Cyclical unemployment benefit expenditure	–5.6	–0.02	–0.02	–0.02	–0.02	–0.02
3. Effect of discretionary revenue measures	–17.6	–0.05	0.27	0.17	0.03	0.02
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 2014, presented in Table 8, cyclical unemployment benefit expenditure amounted to EUR 5.6 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 2013–2017 were calculated according to the amount of unemployment benefits per unemployed person in 2013.

General government subsector balances

30. In 2014, the general government deficit decreased by a 1.9 percentage point of the GDP, compared with the year 2013, and totalled 0.7 per cent GDP deficit. The central government surplus for 2014 amounted to 0.5 per cent of the GDP, the local government surplus totalled 0.1 per cent of the GDP, and the deficit of social security funds stood at 1.3 per cent of the GDP.

The central government surplus in 2014 owed to the overall EUR 456.5 million surplus of non-budgetary funds[2] as well as State enterprises and public institutions falling within the central government subsector. The largest share of the said surplus came from the EUR 473.8 million surplus of SE Deposit and Investment Insurance. The State budget deficit amounted to EUR 284.8 million in 2014. The local government surplus resulted from the redistribution of a part of the personal income tax. The municipal budgets’ share of the personal income tax in the overall budget of the State and municipalities rose from 57.34 per cent in 2013 to 67.78 per cent in 2014. The local government balance was improved due to over performance of personal income tax collection of EUR 24.4 million as well as a decrease in 2014 in municipal payables, which augmented the local government deficit by EUR 47.2 million in 2013 and improved the local government balance by EUR 6.6 million in 2014.

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[2] The Privatisation Fund, the Guarantee Fund, the Reserve (Stabilisation) Fund, SE INPP Decommissioning Fund, UAB Agricultural Credit Guarantee Fund (funds are kept in the State Treasury account), the Licensed Warehouse Compensation Fund, the Account for partial reimbursement of insurance premiums to insurants and the costs of insurance companies in relation to crops subject to direct premiums, the manager of State property under centralised management, SE *Turto bankas*, SE Ignalina Nuclear Power Plant, SE Agricultural Information and Rural Business Centre, SE National Centre of Remote Sensing and Geoinformatics *GIS-Centras*, SE Lithuanian Oil Products Agency, SE Deposit and Investment Insurance, UAB Invega, UAB Agricultural Credit Guarantee Fund, public institution Lithuanian Radio and Television, as well as health care establishments and schools of higher education falling within the central government subsector.

The social security funds deficit increased in 2014 with comparison of the 2013 outcome due to the amount committed for the compensation of State social insurance pensions for old-age and lost working capacity (disability). In 2015–2018, the projections for the general government subsector balances show that the convergence of the social insurance and central government subsector balances towards surplus balances will prevent deviation from the achieved medium-term objective.

SECTION V
STRUCTURAL GENERAL GOVERNMENT BALANCE INDICATOR

31. In 2014, the structural general government deficit decreased by 1.1 percentage points of the GDP and accounted for 1.1 per cent of the GDP, hitting the medium-term objective[3]. During the deflation period, in an attempt to coordinate the fiscal policy with the monetary policy and to stimulate the GDP growth that has slowed down due to the external demand shock, the 2015 structural general government deficit will remain at the 2014 level.

A structural general government deficit equal to 1.1 per cent of the GDP is expected in 2016. The anticipated 0.1 per cent GDP deviation from the medium-term objective is in line with the provisions of the Stability and Growth Pact. The current stage of the structural pension reform will raise the State budget expenditure as of 2016 (by 0.1 per cent of the GDP).

Due to the application of the surplus general government rule, set forth in the Constitutional Law, as well as the measures increasing structural revenues, the structural government balance indicator will improve in 2018 to 0.1 per cent of the GDP surplus.

The structural general government balance indicator for 2014–2018 was calculated by subtracting the cyclical component, obtained by multiplying the output gap by the elasticity of the general government balance indicator, from the general government balance indicator. The value of elasticity of the general government balance corresponds to the respective EU estimate, as available at the time of Programme drafting, and equals 0.305. Calculation of the structural general government balance indicator took into account the following one-off measures: the revenue and expenditure of SE Deposit and Investment Insurance related to ensured events (net of revenue and expenditure equals to 1.17 per cent of the GDP in 2014; 0.28 per cent of the GDP in 2015; 0.13 per cent of the GDP in 2016; and 0.05 per cent of the GDP in 2017); net of the revenue and expenditure of the Climate Change Programme (the revenue-expenditure gap equals to 0.06 per cent of the GDP in 2014; 0.03 per cent of the GDP in 2015; and 0 per cent of the GDP in 2016); the expenditure related to the implementation of the Resolution of the Constitutional Court of the Republic of Lithuania of 6 February 2012 ‘On compliance with the Constitution of the Republic of Lithuania of the Lithuanian legal provisions governing the recalculation and payment of pensions previously reduced due to a very difficult national economic and financial situation’ concerning pension reduction during the crisis (-0.83 per cent of the GDP), as well as the Resolution of 1 July 2013 ‘On

[3] According to the document ‘The significant deviation procedure in the preventive arm of the SGP’ of the European Commission (3 April 2014).

compliance with the Constitution of the Republic of Lithuania of the provisions of Lithuanian laws reducing wages for civil servants and judges due to a very difficult national economic and financial situation' and the Resolution of 22 December 2014 'On compliance with the Constitution of the Republic of Lithuania of the provisions of Lithuanian laws reducing the professional wage coefficients for prosecutors and certain other civil servants due to a very difficult national economic and financial situation' concerning compensation for the reduction of wages of civil servants and judges (in 2015 – post-tax amount of 0.26 per cent of the GDP,).

With regard to the expenditure benchmark alternatives presented in the EC document 'The reference rate in the expenditure benchmark: current practice and an alternative implementation', Lithuania has selected the expenditure benchmark calculated using data from the 2008–2017 period, which will have to be applied when assessing the 2016 budget.

Impact of the structural reform of pensions on public finance in 2016–2018

32. In implementing the Law on Pension Reform of the Republic of Lithuania, 2 per cent of the average of the domestic employees' average monthly gross earnings of four quarters of the year preceding the last year will be allocated for the supplement from the State budget to persons participating in Tier II private pension funds. For comparison, in 2015 the supplement from the State budget was 1 per cent of the average monthly gross wage.

Table 9. Stages in the pension reform involving transfers to private pension funds:

Year	Transfers from the State Social Insurance Fund's budget (hereinafter – *Sodra*) to pension funds, %	Additional transfers by employees (% of wage)	Incentive payments from the State budget (% of average gross wage)
2014	2	1	1
2016	2	2	2
2020	3.5	2	2

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

The stage of the pension reform from 2016 will increase State budget expenditure (for additional payments to the pension funds). According to estimates, the amount of State budget-funded incentive payments to pension funds will be EUR 37.1 million in 2015, EUR 75.4 million in 2016, EUR 80.7 million in 2017 and EUR 86.8 million in 2018. Due to the increase of the tariff of supplement from the State budget from 1 to 2 per cent, the State budget will incur an additional expenditure of EUR 38.3 million or 0.1 per cent of the GDP in 2016.

Table 10. Qualitative evaluation of the pension reform

Characteristics of the reform	Lithuanian reform in 2016
Has a positive effect on the sustainability of general government finances in the long-term	An increase in the rate of transfers from *Sodra* to pension funds as of 2020 will reduce pension expenditure in 2040, 2050 and 2060 by, respectively, 0.1 per cent of the GDP, 0.2 per cent of the GDP and 0.2 per cent of the GDP. The purpose of the incentive payment from the State budget is to encourage residents

	to accumulate assets in pension funds, and this instrument is an integral part of the pension reform aimed at reducing pension expenditure from 2040 onwards.
Has a wide scope and major significance	Due to rapid emigration in 2009, the ageing problem in Lithuania will become very acute around the year 2037. While managing the risks to public finance sustainability, the continuity of the pension reform must be ensured.

Source: Ministry of Finance of the Republic of Lithuania

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

33. In case of lack of measures for the achievement of the 2015-2018 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;

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

33.3. revision of the excise duty tariffs for alcohol in order to achieve a more balanced taxation of certain groups of alcoholic beverages;

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 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 VII
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 using 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 potential GDP at constant prices is calculated on the basis of the statistical indicators for the GDP, demographics, employment, labour market and investment, published by the Statistics Lithuania, the EU statistical office (Eurostat) and the annual macroeconomic database of the EC (AMECO)[4], as well as on the basis of the latest economic development scenario, drawn up and published by the Ministry of Finance of the Republic of Lithuania. When estimating the level of the potential GDP at constant prices, account is taken of the EC forecasts for Lithuanian demographic indicators, and data smoothing is applied.[5]

When calculating the potential GDP, the estimates for the total factor productivity trend[6] and NAWRU were obtained with the help of spreadsheets prepared by the EC. For data smoothing in calculations, the Kalman filter and the Hodrick-Prescott methods were employed. As no Lithuanian institution offers official national population projections, the potential GDP estimation relied on the 2014–2018 projection for the working-age (15–74) population of the country. The EC used this projection when calculating the estimates for Lithuania’s potential GDP and output gap, published in February 2015.

The findings obtained show that in 2015 and in 2016 the output gap will be negative, at -0.2 and -0.4 per cent, respectively, which means that the rule on general government expenditure growth restrictions, as defined in Article 3(3) of the Constitutional Law, should not be applied in that period.[7]

The estimates for potential GDP and output gap in the medium-term are predetermined by a turning-point foreseen in the working-age population projection (in 2017), resulting from the specificities of the projection methodology and causing a significant decline in the potential GDP growth as of the year 2017. Consequently, starting with 2017, the effect of the labour factor on the pace of potential GDP growth will be negative. The EC plans to enhance the methodology for this projection in the near future (the countries whose projections contain this turning-point should benefit from a temporary exception permitting the elimination of this turning-point), which means that, with a change in the working-age population projection, the estimates for the potential GDP and output gap in the medium-term should change as well. Yet, it is likely that the effect of the labour factor on the pace of potential GDP growth will remain less significant than the effect of total factor productivity or capital.

As attested by the experience of various countries and international institutions, the disadvantage of the production function approach lies in the variable estimates obtained by calculation, which requires them to be treated with caution.

Table 11. Cycles of economy

Indicator	ESA code	% of GDP*				
		2014	2015	2016	2017	2018

[4] AMECO is an EC database collecting annual data on key national accounts since 1960.
[5] Data smoothing is performed in order to identify the systematic component of the time series and to exclude any accidental fluctuations.
[6] Productivity trend is a time series component, illustrating the general upward or downward tendency.
[7] If it was to be applied, the expenditure limit would be calculated as a half of the average multi-annual growth of the potential GDP at current prices. The average multi-annual growth of the potential GDP at current prices is calculated by multiplying the geometrical mean of the annual change, expressed in times, in the level of potential GDP at constant prices over ten calendar years $t_e - 6$ to $t_e + 3$ by the annual change, expressed in times, in the GDP deflator of year t (t_e stands for current calendar year and t for calendar year). The annual change in the deflator is calculated as the mean of the last two GDP deflator projections for year t, made by the Ministry of Finance of the Republic of Lithuania.

Indicator	ESA code	% of GDP*				
		2014	2015	2016	2017	2018
1. GDP growth/chain linked volume growth		2.9	2.5	3.2	3.5	3.9
2. Net lending/borrowing of general government	PDP B.9	–0.7	–1.2	–1.1	0.0	0.7
3. Interest	PDP D.41	1.6	1.7	1.5	1.5	1.2
4. One-off and other temporary measures		0.28	-0.01	0.13	0.05	0.00
5. Potential GDP growth, %**		3.1	3.1	3.4	2.4	2.6
contributions:						
labour		0.6	0.4	0.6	–0.5	–0.5
capital		1.1	1.2	1.2	1.2	1.3
total factor productivity		1.3	1.5	1.6	1.7	1.8
6. Output gap		0.4	–0.2	–0.4	0.6	1.9
7. Cyclical budgetary component		0.1	–0.1	–0.1	0.2	0.6
8. Cyclically-adjusted balance (2 – 7)		–0.8	–1.2	–1.0	–0.2	0.1
9. Cyclically-adjusted primary balance (8 + 3)		0.8	0.5	0.6	1.3	1.3
10. Structural balance (8 – 4)		–1.06	–1.09	–1.08	–0.23	0.10

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

** – for some years, the sum of lines may not coincide with the values of calculated indicators due to rounding.*

*** if a stable labour factor is maintained, potential GDP growth in 2017 and 2018 will be roughly 1 percentage point higher.*

SECTION VIII
GENERAL GOVERNMENT DEBT LEVELS AND DEVELOPMENTS

35. Taking into account the derivative financial instruments used, the general government debt at the end of 2014 was 40.9 per cent of the GDP (against 38.8 per cent of the GDP in 2013). Excluding funds accumulation for the redemption of Eurobonds worth USD 1 500 million in January 2015, the debt accounted for 38.1 per cent of the GDP in 2014.

The central government debt structure poses no threat to public finances. At the end of 2014, short-term liabilities (by residual maturity) accounted for 14.9 per cent of the total debt, and the average residual maturity of the debt was 5.2 years. The floating interest rate debt, including the impact of financial derivatives, accounted for 0.5 per cent of the total debt. Taking financial derivatives into account, the central government debt was 100 per cent denominated in the litas and the euro.

Table 12. General government debt projections

Indicator	**% of GDP**				
	2014	2015	2016	2017	2018
1. Gross debt as of year-end	40.9*	42.2*	37.7	39.4*	32.9
2. Change in gross debt ratio	2.1	1.4	–4.5	1.7	–6.6
Factors determining changes in gross debt					
3. Primary balance	0.9	0.5	0.6	1.5	1.9
4. Interest expenditure	1.6	1.7**	1.5**	1.5**	1.2**

5. Stock-flow adjustment	2.6	1.3	–3.3	3.9	–3.5
of which:					
differences between cash and accruals	–	–	–	–	–
net accumulation of financial assets, of which: privatization revenues	0	0	0	0	0
implicit interest rate on debt (%)	3.9	4.0	4.1	3.7	3.7
other relevant variables contributing to gross debt	–	–	–	–	–
6. Liquid financial assets	–	–	–	–	–
7. Net financial debt (7 = 1 – 6)	–	–	–	–	–
8. Debt amortization (existing bonds) since the end of the previous year	–	–	–	–	–
9. Percentage of debt denominated in foreign currency	–	–	–	–	–
10. Average debt maturity	–	–	–	–	–

Source: Ministry of Finance of the Republic of Lithuania

* If we disregarded the possible accumulation of funds aimed at the management of the refinancing risk of the Eurobond redemptions, the general government debt would stand at 38.1 per cent of the GDP at the end of 2014, 39.5 per cent of the GDP at the end of 2015 and 36.1 per cent of the GDP at the end of 2017.
** The projections do not reflect the deduction of FISIM.

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 for the medium-term:

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 I
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 7 million, EUR 29 million, EUR 45 million and EUR 60 million respectively in the period 2015-2018 or about 0.1% of GDP annually on average.

Taking into account the fact that, including financial derivatives, the central government debt (inclusive of 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 2015–2018, a success in retaining economic growth, depends on geopolitical situation, the speed of structural reform implementation and rational investment of EU funds.

SECTION II
FISCAL RISK

38. The major projected sources of fiscal risk include: deposit insurance, securing of financial stability of the banking system 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 amount of insured deposits on 31 December 2014 was EUR 13 792.9 million and increased by 14% over the year. This marked growth in deposits is attributable to the introduction of the euro in Lithuania – population and enterprises took advantage of the opportunity to deposit their funds and convert the litas held with credit institutions into euros free of charge. The total amount of presumptive insurance compensations at the end of 2014 stood at EUR 10 533.3 million, including deposits held with commercial banks and credit unions.

Creditor claims of the state-owned company “Deposit and Investment Insurance” are being met according to the court-approved plans of settlement between bankrupt financial institutions and creditors. By 31 December 2014, the total amount of funds recovered from credit institutions that went bankrupt in 2011–2014 was EUR 606.38 million: EUR 593.72 million was recovered from the insolvent AB Bankas Snoras, EUR 2.61 million – from the failing AB Ūkio bankas and a further EUR 10.05 million – from the credit unions. The state-owned company “Deposit and Investment Insurance” collects nearly EUR 4.56 million deposit insurance payments. As of 31 December 2014, the residual debt of the state-owned company “Deposit and Investment Insurance“ to the Ministry of Finance of the Republic of Lithuania was EUR 311.39 million, of which EUR 82.68 million was due to the bankrupt AB Bankas Snoras and EUR 228.71 million – to the failing AB Ūkio bankas. Funds collected by the state-owned company “Deposit and Investment Insurance” are transferred to the Ministry of Finance of the Republic of Lithuania for repayment of loans.

Securing of financial stability

40. With a view to strengthening financial stability, the Law Amending Articles 8, 11, 27, 51, 55 and Annex 2 of the Law No I-678 on the Bank of Lithuania and Supplementing the Law on the Bank of Lithuania with Section 7^2 and Article 52^1 was adopted in 2014, empowering the Bank of Lithuania to formulate and implement Lithuania’s macro-prudential policy.

Macro-prudential policy seeks to contribute to the safeguarding of the stability of the financial system, including by means of strengthening its resilience and mitigating a build-up of systemic risk, in order to ensure a sustainable contribution of the financial sector to economic growth. Pursuant to this Law, the Bank of Lithuania has approved by Resolution No 03-31 “On Approval of the Macro-prudential Policy Strategy“ of the Board of the Bank of Lithuania of 12 March 2015 a macro-prudential policy strategy, setting out the ultimate and more specific intermediate macro-prudential policy objectives as well as macro-prudential instruments for achieving these goals. The strategy also outlines the procedures of making macro-prudential policy decisions, public communications and co-operation with other institutions.

The objective of the macro-prudential policy is elaborated by identifying the following intermediate goals: to limit excessive credit growth and financial leverage and seek to avoid them; to limit and prevent excessive maturity mismatch, excessive currency and liquidity risk in the financial system and seek to avoid them; to limit exposure concentrations by type of economic activity, asset class or other criteria; to limit the systemic impact of misaligned incentives of financial institutions, with a view to reducing their moral hazard to strengthen the resilience of the financial market infrastructure.

The Bank of Lithuania will pursue the intermediate objectives having at hand at least one macro-prudential instrument designed for achieving a specific goal. Most of macro-prudential instruments are set in the Law on Banks of the Republic of Lithuania No IX-2085, which transposes 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** (OJ L 176, 27.6.2013, p. 338) (i.e. new capital conservation buffers aimed at reducing structural risk, also, countercyclical buffers, including their rates). All the instruments are expected to be fully implemented in Lithuania between the years 2014–2018.

In addition to the mentioned macro-prudential instruments, the Bank of Lithuania since 2011 has been applying the Responsible Lending Regulations approved by Resolution No 03-144 “On Responsible Lending Regulations“ of the Board of the Bank of Lithuania of 1 September 2011. The Regulations provide for measures, such as loan-to-value and debt service-to-income ratios. The Bank of Lithuania plans to reconsider the Responsible Lending Regulations by 2018 in order to ensure the practice of responsible lending and providing consumer credit by credit institutions, while taking into account the risks due to low interest rates.

With a view to ensuring the stability of credit institutions, enhancing the resilience of credit institutions' sector and guaranteeing further financing to the economy, on 17 July 2014, the Law Amending Articles 2, 4, 5, 9, 10, 12, 13, 14, 15, 16, 18, 22, 23, 24, 26, 27, 28, 29, 30, 32, 33, 34, 35, 36, 37, 38, 39, 42, 45, 47, 52, 53, 58, 61, 62, 64, 65, 70 and 74 of the Law No I-796 on Credit Unions of the Republic of Lithuania, Supplementing the Law on Credit Unions of the Republic of Lithuania with Articles 251, 391, 481, 641 and 651 and Repealing Articles 8 and 11 of the Law on Credit Unions of the Republic of Lithuania was adopted imposing stricter requirements on credit union capital, risk-taking and management.

In 2015, the legislative work undertaken in 2014 regarding the transposition of EU legislation on the Banking Union into the national law should be completed. Thus, on becoming a fully-fledged member of the Banking Union, Lithuania will take one more step towards strengthening the financial stability, more efficient supervision (to be exercised in a partially centralized manner on a European level) of financial institutions (i.e. banks and large investment firms) as well as prevention of problems, while arising challenges will be dealt with more efficiently and less costly without taxpayers having to bear the financial burden of the process, and also, by preventing inadequate public response and destabilization in the financial sector, and protecting the interests of retail banking clients.

Since November 2014, the ECB has taken over the supervision of the largest Eurozone banks and the three most significant banks of each Eurozone Member State. The objective 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 increasing transparency will help reduce the likelihood of bank rescue which could arise from the links with financial systems of the Member States and will allow taking timely efficient measures to reduce the related risk.

After Lithuania joined the euro area on 1 January 2015, the ECB now exercises direct supervision of AB SEB bankas, Swedbank AB and AB DNB bankas. Direct supervision of other financial institutions continues to be exercised by the Bank of Lithuania, though the ECB has the power to take over the control if deemed necessary. Banks, direct supervision of which is now exercised by the ECB, had been subject to a comprehensive asset quality review and stress testing. This led to greater transparency as well as increased confidence in the sustainability of banking activities and stability of the Lithuanian financial system.

Government guarantees

41**.** The Government-guaranteed debt portfolio at the end of 2014 accounted for about 0.7% of the GDP of 2014. Taking into account the guarantees planned to be provided in 2015, 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 projected to increase to 1.3% of GDP.

Table 13. Contingent liabilities

Indicator	% of GDP	
	2014	2015
Public guarantees	0.7	1.3
of which linked to the financial sector	0	–

Source: Ministry of Finance of the Republic of Lithuania

SECTION III
COMPARISON WITH PREVIOUS PLANS

42. Taking into account the actual figures for 2014 provided by the Lithuanian Department of Statistics 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 projections. The 2015–2017 objectives of the general government balance indicator have been revised according to the Government’s objective formulated in the course of drafting of the Law of the Republic of Lithuania on the Approval of the Financial Indicators of the State Budget and Municipal Budgets for 2015, i.e. to balance the government sector in 2017 and mitigate the pro-cyclical consolidation effects on economic growth in the period where the output gap remains negative, while interest rates stay low.

Table 14. Change in GDP, general government deficit and general government debt estimates compared to the Convergence Programme of Lithuania for 2014

Indicator	ESA’2010 code	% of GDP				
		2014	2015	2016	2017	2018
1. Real GDP growth:						
Previous update		3.4	4.3	4.0	4.3	–
Current update		2.9	2.5	3.2	3.5	3.9
Decrease (-) / Increase (+)		–0.5	–1.8	–0.8	–0.8	–
2. General government net lending(+)/borrowing(-):	PDP B.9					
Previous update		–1.9	–0.9	0.1	1.1	–
Current update		–0.7	–1.2	–1.1	0.0	0.7
Worsening (-) / Improvement (+)		1.2	–0.3	–1.2	–1.1	–
3. General government gross debt:						
Previous update		41.6	40.7	35.3	34.8	–
Current update		40.9*	42.2*	37.7	39.4*	32.9
Decrease (-) / Increase (+)		–0.7	1.5	2.4	4.6	–.

Sources: Department of Statistics of the Republic of Lithuania, Ministry of Finance of the Republic of Lithuania.
*Excluding the possible accumulation of funds aimed at managing the refinancing risk by Eurobond redemption, the general government debt at the end of 2014 is forecast at 38.1% of GDP, at the end of 2015 – 39.5% of GDP and at the end of 2017 – 36.1% of GDP.

CHAPTER V
QUALITY OF GENERAL GOVERNMENT FINANCES

43. The Office of the Government (titled the Prime Minister's Office from 15 September 2009 under the previous Government), since March 2009, has been implementing a project aimed at introduction of performance-driven management, following the best international practice. Successful implementation of the project will contribute to the enhancement of performance efficiency of the Government and its subordinate institutions, by improving institutional performance monitoring and accountability, functional analysis, evaluation of budget programmes as well as decision impact assessment. The project is implemented in co-operation with the Ministry of Finance of the Republic of Lithuania and financed by the European Social Fund.

44. In 2014, continuing the implementation of the reform of the system of monetary social assistance that was launched by the Government of the Republic of Lithuania on 1 January 2012, in accordance with the Law No XI-1772 Amending the Law on Monetary Social Assistance for Low Income Families and Persons Living Alone, the provision of pecuniary assistance has been delegated to the five pilot municipalities (Akmenė, Panevėžys, Radviliškis, Raseiniai and Šilalė), as an independent municipal function, taking into consideration the best practice and results of the provision of monetary social assistance to the deprived residents of these municipalities; as of 1 January 2014, in accordance with the Law No XI-621 Amending and Supplementing Articles 4 and 23 of the Law on Monetary Social Assistance for Low Income Residents, the provision of social benefits, as an independent municipal function, has been assigned to other 55 municipalities. The reform of monetary social assistance along with decentralisation of its financing have brought positive results, i.e. the number of people on social benefits in the municipalities is decreasing every year and so is the amount of expenses for the payment of social assistance, the cases of abuse of monetary social assistance are becoming less common, while population's proactive participation and its integration into the labour market are improving. Within one month of 2014, in all the 60 municipalities, on average, 140 100 persons (4.8% of the total population of Lithuania) received social benefit. Compared to 2013, the average number of persons receiving social benefits on a monthly basis decreased by 26.3% (from 190 000 to140 100 persons), while social benefit spending contracted by 29.5%. In 2014, taking into account the best practice and results of the pilot municipalities, pursuant to the Law No XII-1366 Amending Articles 4, 8, 10, 12, 17, 21 and 23 of the Law No IX-1675 on Monetary Social Assistance for Low Income Residents, as of 1 January 2015, all the municipalities have adopted a single model of provision of monetary social assistance (i.e. social benefits and compensations) to low-income residents, while performing their independent municipal function.

45. In 2014, implementation began on the Inter-institutional Action Plan for the Implementation of the Employment Enhancement Programme 2014–2020, approved by the Government Resolution No 878 of 25 September 2013 "On the Approval of the Employment Enhancement Programme 2014–2020", containing measures to promote job creation and labour demand, address the problems of mismatch between workforce skills and labour market needs, and support the integration of unengaged workforce into the labour market.

Table 15. Expenses for employment enhancement measures (EUR million)

Measures	2014	2015	2016	2017	2018
Promotion of job creation and labour demand	17.713	81.669	54.759	53.527	45.274
Development of better matching between workforce skills and labour market needs	54.602	27.972	7.168	9.051	6.082
Integration of unengaged workforce into the labour market	63.552	104.087	112.754	107.983	102.487
–of which implementation of “*Youth Guarantee Initiative*“	0	20.252	20.444	20.444	8.035

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

46. Under the Operational Programme “Human Resources Development“ 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 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 application of more flexible labour relations is to attract more investment and create additional jobs.

47. According to the data provided by the Lithuanian Department of Statistics, public administration expenditure in Lithuania in 2013 decreased to 35.5% of GDP (in 2012, this indicator was 36.1% of GDP). Following the provisions of the Constitutional Law, public administration expenditure should continue to decrease to 32.5% of GDP until 2018.

Table 16. General government expenditure by function

Indicator	COFOG Code	% of GDP	
		2013	2018
1. General public services	01	5.3	
2. Defence	02	1.0	
3. Public order and safety	03	1.7	
4. Economic affairs	04	3.5	
5. Environmental protection	05	0.5	
6. Housing and community amenities	06	0.2	
7. Health care	07	5.6	
8. Recreation, culture and religion	08	0.8	
9. Education	09	5.6	
10. Social protection	10	11.4	
11. Total expenditure		35.5	32.5

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

CHAPTER VI
SUSTAINABILITY OF GENERAL GOVERNMENT FINANCE

48. Long-term sustainability of public finances represents a problem for all 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.

49. 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 2014) or by 37.6% in the period from 2014 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 2014 to 2060, the number of the working age population (15-64) will decrease from 66.9 per cent to 56.2 per cent, whereas the number of elderly people (65+) will increase from 18.4 to 26 per cent of the total population. 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 the GDP. Considering the fact that since 2010 the emigration rate has been decreasing in Lithuania on annual basis, the Eurostat‘s assumptions seem overpesimistic as regards the migration of the Lithuanian population. According to Eurostat's new demographic projections for the growing birth rates from 2014 to 2060 the number of children will increase in Lithuania: children aged between 0-14 – from 14.6 per cent in 2014 to 17.8 per cent in 2060, school age children (7-16) – from 9.9 per cent to 12.4 per cent, while 15-19 year olds – from 6 per cent to 6.2 per cent of the total population.

50. 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-2018, the economic scenario drafted by the Ministry of Finance in spring 2015, as well as economic and employment assumptions for 2019-2060 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	32.3	34.7	35.6	35.2	34.5
of which: age-related expenditure	17.2	20.7	16.2	18.6	19.5	19.2	18.4
pension expenditure*	6.6	8.6	6.8	8.7	9.3	8.5	7.4
social security pension	6.6	8.6	6.8	8.7	9.3	8.5	7.4
old-age and early pensions	4.7	6.2	5.0	6.7	7.5	6.8	5.9
other pensions (disability, survivors’)	1.8	2.4	1.7	1.9	1.8	1.7	1.5
occupational pensions (if in general government)	–	–	–	–	–	–	–
health care	4.8	4.8	4.4	4.7	4.8	4.7	4.5
long-term health care	0.6	1.1	1.1	1.4	1.6	1.8	1.7
education expenditure**	5.2	6.2	3.9	3.8	3.7	4.1	4.7
other age-related expenditure***	0.1	0.4	0.2	0.1	0.1	0.1	0.1
interest expenditure	0.7	1.8	2.6	3.9	5.1	5.8	6.1
2. Total revenue	34.3	35.4	33.1	33.1	33.1	33.1	33.1
of which: property income	0.6	0.7	0.3	0.3	0.3	0.3	0.3
of which: from pensions contributions (or relevant social insurance contributions)****	6.4	6.8	5.7	5.6	5.5	5.5	5.5
Pension reserve fund assets	2.9	–	–	–	–	–	–
of which: consolidated public pension fund assets*****	1.7	4.1	9.1	21.9	34.7	44.6	52.1
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
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, Ministry of Social Security and Labour, Ministry of Education and Science, Ministry of Health, and Economic Policy Committee

* Pension expenditure has been calculated following the methodology of the European Commission presented in the document “Pension projection exercise 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.

51. 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 Convergence Programme 2014, approved by Resolution No 346 of the Government of the Republic of Lithuania of 16 April 2014 on Lithuania‘s Convergence Programme 2014, table 14 shows that pension spending will decrease 2.2 percent of GDP in 2060.

The main reason for this is the modified Eurostat demographic assumptions, as the number of older people at the end of the projection period (their share in the population) was reduced, while the birth rate increased throughout the projection period. The ratio of pension benefits and pension contributions vis-a-vis the GDP changed in 2007-2010 compared with the Lithuanian Convergence Programme 2014 due to the recalculation of the GDP under the ESS 2010. In 2014, pension spending increased due to EUR 160.46 million used for the compensation of pension cuts in 2010-2011. Pension spending will be the highest in 2037, reaching 9.4 per cent of the 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 2013-2060 pension spending will increase by 0.2 per cent of GDP.

52. Pension spending is likely to grow the fastest, though it will be mitigated by the pension reform launched in 2004, which created the sub-scheme of voluntary pension accumulation (Pillar II of the state social insurance pension scheme) which is financed with a part of mandatory state social insurance contributions that is shifted to private pension funds. Growing spending for pensions will be tamed by an increased rate of contributions to Pillar II pension funds, making 3.5% as of 2020. At the end of 2014, there were 1.1486 million people participating in the private pension funds. Tax revenues intended for the implementation of the pension reform in 2014-2018, and transferred to private pension funds, will amount on average to 0.52 per cent of GDP. State budget pension contribution will increase from 0.09 to 0.2 per cent of the GDP, reaching on average 0.15 per cent of the GDP. To ensure that there are sufficient funds for all the commitments of the State Social Insurance Fund, in 2012, the pension accumulation tariff was reduced to 1.5 per cent, and in order to compensate for this reduction, it was increased by 2.5 per cent in 2013. In 2014-2019 the contribution rate of state social insurance will stand at 2 per cent, and as of 2020 – at 3.5 per cent. According to the pension spending projection, in 2014-2015, the accumulation scheme participants, which had made a decision in 2013 regarding extra contributions, and concluded new pension accrual 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. Since 2016, both individual and the state budget pension contribution rates will increase to 2 per cent. In the long term, the contributions credited to private pension funds (including contributions transferred from the state social security funds, extra contributions by individuals and the state budget) will annually make about 1.2 per cent of GDP and will be 0.17 per cent GDP below the projected value specified in the convergence programme of Lithuania in 2014 due to the modified population age and sex structures

used for the demographic projections in Lithuania by the Eurostat, as well as EC macroeconomic assumptions;

53. Pension fund assets in 2060 will reach 52.1 per cent of GDP. Benefits paid from private pension funds will amount to 1.2 per cent of GDP in 2060.

54. The growing number of the elderly population will call for larger spending on long term health care in per cent of the GDP: in 2014-2060, spending for long-term health care will increase 0.7 per cent GDP.

55. Considering the modified demographic projections of Eurostat 2013, education spending will remain stable in 2014-2060, accounting for 4.7 per cent of GDP. Considering the political targets, education expenditure should gradually rise until the year 2020, 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

56. 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 recent 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 the 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 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.

As per Resolution No XII-592 of the Seimas of the Republic of Lithuania of 14 November 2013 and Republic of Lithuania Law No I-907 of 30 May 1995 on National Audit Office, the functions of the independent budget policy monitoring authority have been assigned to the National Audit Office of the Republic of Lithuania to be exercised 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 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.

57. The Draft Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets for 2016 is drafted in accordance with Resolution No 212 of the Government of the Republic of Lithuania of 25 February 2015 “On the Approval of the Plan for Drafting Financial Indicators of the State Budget and Municipal Budgets”.

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

Table18 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. General government expenditure rule	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".

CHAPTER VIII
ASSESSMENT OF CONSISTENCY OF LITHUANIA'S CONVERGENCE PROGRAMME 2014 WITH THE NATIONAL REFORMS PROGRAMME

59. The direct impact of the structural reforms-related measures, specified in the National Reforms Programme, approved by protocol resolution No 18 at the Government meeting of 7 April 2015, on the government sector balance has been fully taken into account in calculating general government financial indicators covered in the Programme. The impact of the structural reforms on the budget is illustrated by Table 19, which shows data related to the 2014 reform allocations and year-on-year changes as of 2015.

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)**	**2014**		**2015**		**2016****		**2017**		**2018**	
			mln. euros*	GDP %	**mln. euros***	GDP %	**mln. euros***	GDP %	**mln. euros***	GDP %	**mln. euros***	GDP %
1	Education and science reform	IC and GFCF	506.3	1.40	-56.7	-0.15	-379.2	-0.96	74.8	0.18	6.7	0.16
2	Agriculture reforms: Entrepreneurship incentives; the implementation of the Republic of Lithuania Law on Renewable Energy Sources; national climate change management, youth employment policy measures; promotion of innovation-related activities	IC and GFCF	127.8	0.4	5.5	0.0	–23.8	–0.1	37.6	0.1	19.0	0.0
3	Energy: Increasing renewable energy consumption, increasing end-use energy efficiency;	IC and GFCF	0.03	0.00	21.4	0.06	207.7	0.53	-43.2	-0.10	-10.0	–0.02

No	Major measures of structural reforms[1]	Spending/ revenue category (according to ESA'2010)	2014		2015		2016**		2017		2018	
			mln. euros*	GDP %	mln. euros*	GDP %	mln. euros*	GDP %	mln. euros*	GDP %	mln. euros*	GDP %
	implementation of EU Council recommendations to promote competition by improving the energy networks of electricity and gas interconnections with the EU Member States											
4	Health reform	IC and GFCF	27.6	0.08	3.4	0.01	-13.8	-0.03	14.8	0.04	3.3	0,01
5	Taxation reform	RDT	43.0	0.12	-10.9	-0.03	-8.8	-0.02	-4.0	-0.01	0.00	0,00
		RIT	-23.3	-0.06	-49.0	-0.13	-44.4	-0,11	-10.4	-0.02	-10.80	-0.03
6	Environment protection: implementation of the renovation (modernisation) of apartment houses; energy consumption and production efficiency projects; promotion of renewable energy sources; introduction of environmentally friendly technology projects; renovation and development of water supply and wastewater treatment systems; waste management system development	IC	172.4	0.48	321.2	0.86	-412.7	-1.05	108.9	0.26	-57.0	-0.13
7	Economy: promoting innovations; encouraging exports; industrial development, investment promotion; entrepreneurship promotion; better regulation, improving the business environment; improvement of public procurement; implementation of Energy Independence Strategy	IC and GFCF	163.7	0.45	43.7	0.12	-136.7	-0.35	86.2	0.21	16.13	0.04
8	Upgrading or building new transport and communications network	GFCF	342.6	0.94	268.3	0.72	-53.4	-0.14	10.2	0.02	0.00	0.00
9	Active labour market policy measures	IC	135.9	0.37	98.1	0.26	-38.9	-0.10	-4.12	-0.01	-29.13	-0.07

No	Major measures of structural reforms[1]	Spending/ revenue category (according to ESA'2010)	2014		2015		2016**		2017		2018	
			mln. euros*	GDP %	mln. euros*	GDP %	mln. euros*	GDP %	mln. euros*	GDP %	mln. euros*	GDP %
Overall direct impact on the state budget			1496.0	4.12	108.3	0.29	-903.9	-2.29	270.8	0.65	1.2	0.00
10	Total spending on pension accrual reform		161.6	0.45	13.8	0.04	47.1	0.12	15.3	0.04	17.6	0.04

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

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

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

** In 2016, a temporary decline in EU funds due to the juncture of the two EU financial periods: the outgoing 2007-2013, and the incoming 2014-2020.

[1] Measures under the National Reforms Programme.