

To the Seimas of the Republic of Lithuania

OPINION ON THE STRUCTURAL ADJUSTMENT TARGET

27 October 2023 No. BPE-6

Vilnius

WITH A SIGNIFICANT ECONOMIC STIMULUS FORESEEN IN 2024, FURTHER INCREASES IN EXPENDITURE WITHOUT SUSTAINABLE SOURCES OF REVENUE WOULD ENTAIL A RISK OF NON- COMPLIANCE WITH THE MAASTRICHT CRITERION IN THE FUTURE

The National Audit Office, in its capacity as the budgetary policy monitoring authority (NAO FI), submits its opinion on the Draft Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets of the Republic of Lithuania for 2024 to the Seimas.

Given the narrowed application of the fiscal discipline rules, according to the assessment of the NAO FI, the general government budgets in 2023–2024 are likely to comply with the requirements set out in the Constitutional Law on the Implementation of the Fiscal Treaty. For years of exceptional circumstances, no structural adjustment targets are set.

Exceptional circumstances have been in place in Lithuania from 2020, which allows for a higher general government deficit than the fiscal discipline rules would allow. The government, as the geopolitical situation remains tense, decided not to initiate their cancellation in 2024 either. However, according to the draft budget for 2024, even without the support to Ukraine and taking into account the impact of the adverse economic cycle, the general government balance would not be in line with the requirements of fiscal discipline. Also, according to the NAO FI's assessment, further regular policy decisions on the non-taxable income, social benefits or salary increases for public sector employees in 2025–2026 could bring the deficit closer to the Maastricht criterion threshold. With rising debt and interest rates, additional sustainable sources of revenue are needed to ensure the sustainability of general government finances.

- 1. Lithuania is among the few euro area countries increasing their general government deficit in 2024**
- 2. Support to Ukraine is not the only factor that would lead to non-compliance with national fiscal discipline rules in 2024 if exceptional circumstances did not apply**
- 3. The stimulus to the national economy is expected to be stronger in 2024 than in 2023**
- 4. Without additional sustainable sources of revenue and with the NAO FI projecting further long-term expenditure growth, there is a risk of non-compliance with fiscal discipline in 2025–2026**
- 5. With the increasing general government deficit projected by NAO FI, public debt could rise to almost 46% of GDP in 2026**

1. LITHUANIA IS AMONG THE FEW EURO AREA COUNTRIES INCREASING THEIR GENERAL GOVERNMENT DEFICIT IN 2024

The level of general government (GG) revenues in the draft budget of Lithuania for 2024 (DB2024) is based on the latest projections of the Economic Development Scenario, which was endorsed as cautious by the NAO FI in September¹. This macroeconomic scenario is also used by the NAO FI in its forecasts of fiscal indicators. The fiscal policy measures envisaged in the draft budget of Lithuania in 2024, such as increases in social benefits, salaries for groups of public sector employees or other measures, may have a positive impact on the macroeconomic indicator bases. This could contribute to higher GG revenues than foreseen in DB2024.

According to the assessment of the NAO FI, the draft budget for 2024 projects general government revenue for the period from 2023 to 2024 in a prudent manner. The draft budget for 2024 projects that revenue from PIT, VAT, excise duties and corporate income taxes (CIT) will exceed the 2023 target. The main reasons for this are that the outturn from PIT, VAT, excise duties and CIT from January to September 2023 is better than planned in the 2023 Budget Law and above the multi-annual average. This is due to the non-use of the tax deferral instrument by companies, as well as higher projections for the wage bill and GDP at current prices than in the September EDS of 2022. Against this background, the NAO FI estimates that the GG tax revenue in 2023 could be 0.4% of GDP higher than in DB2024. With the higher revenue projections for 2023 by the NAO FI and taking into account the expert judgement of upside risks to economic development, the tax revenue in 2024 could be 0.3% of GDP higher than projected in DB2024 (Annex 1, Table 1).

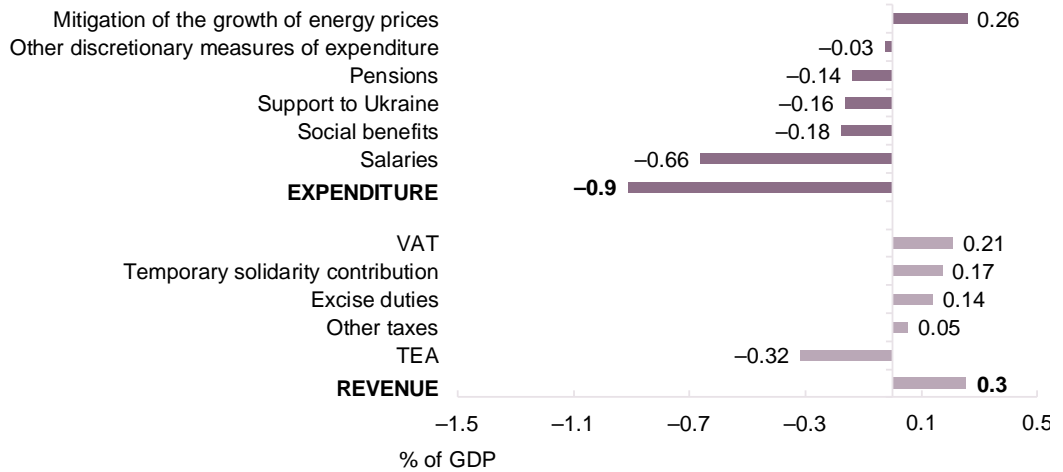
Taking into account fiscal policy decisions, the NAO FI projects general government expenditure in 2024 to be almost 1% of GDP higher than in 2023. The 2023 Budget Law foresaw EUR 889 million (1.2% of GDP) for the partial subsidy of the electricity price for households and business entities. According to the draft budget for 2024, the need for this measure in 2023 will amount to EUR 195.7 million (0.3% of GDP). In addition, the implementation of EU Structural Funds was lower from January to September 2023, with an execution in this period of about one third of the flows foreseen in the 2023 Budget Law. In preparing the projections for the GG expenditure in 2023, the NAO FI has taken into account this information and the multi-annual execution of plans. In projecting the GG expenditure in 2024, the NAO FI has included discretionary measures foreseen in the draft budget for 2024. In 2024, the expenditure projected by the NAO FI will amount to 40.7% of GDP, which is 0.2% lower than in DB2024. The NAO FI assumed that, in line with the multi-annual execution of plans, the projected expenditure on investment and intermediate consumption would be lower, amounting to 5.3% and 4.1% of GDP respectively (0.1% of GDP less).

The discretionary measures in the draft budget for 2024 will have a negative impact on the general government balance. Most of the expenditure is directed towards raising household income. The discretionary measures foreseen will increase GG expenditure in 2024 and have a negative impact on the budget balance am EUR 0.69 billion, or 0.9% of GDP (Figure 1). The main positive impact on the GG balance will be made by VAT revenues due to the expiry of the exemption for catering services, the temporary solidarity contribution and the green transformation as well as other excise duty changes (EUR 140.6 million, EUR 130.0 million and EUR 105.7 million respectively). The increase in the tax-

¹ On 19 September 2023, the NAO FI published its opinion on the endorsement of the Economic Development Scenario. Available online at: <https://www.valstybeskontrolė.lt/EN/Product/24198/opinion-on-the-endorsement-of-the-economic-development-scenario>.

exempt income (TEA) will reduce revenue collection by EUR 241.2 million or 0.3% of GDP, bringing the total impact of discretionary revenue measures on the GG balance to EUR 194.2 million or 0.3% of GDP.

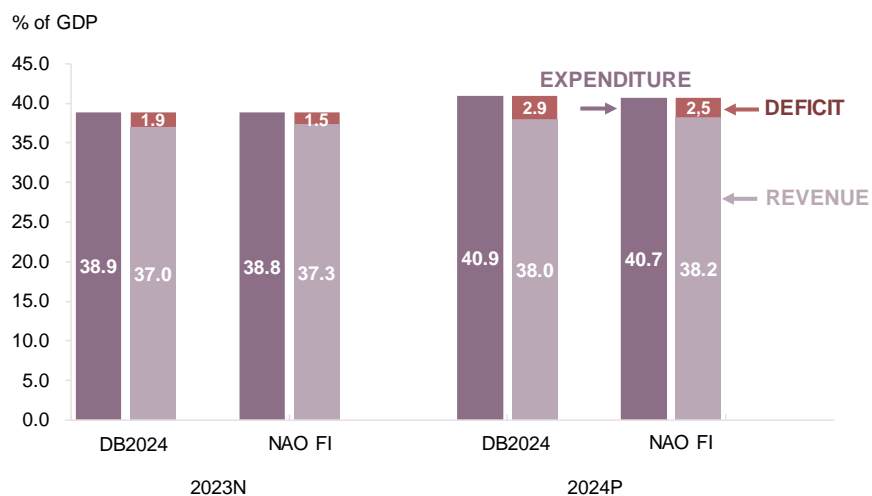
Figure 1. Discretionary measures in the draft budget for 2024 significantly increase general government expenditure in 2024



Source: DB2024, calculations by the National Audit Office implementing the function of a fiscal institution

The general government deficit projected by the NAO FI for 2023 and 2024 may be lower than in the draft budget for 2024, but risks remain. Taking into account the revenue and expenditure projections of the NAO FI, the projected GG deficits in 2023 and 2024 are 1.5% and 2.5% of GDP respectively (Figure 2). The NAO FI projects surplus budgets for the social security funds sub-sector, and balanced budgets for local governments over the medium term (Annex 1, Table 2). Meanwhile, the central government budget will remain in deficit. The GG debt level will be 37.5% and 39.0% of GDP in 2023 and 2024, respectively, and will be 0.4% and 0.8% of GDP lower than in the draft budget for 2024. However, if economic development is more sluggish than projected in the Economic Development Scenario of September 2023, this could put pressure on additional expenditure and reduce general government revenue. The projections for the GG balance could also be affected by the ESA2010 accrual principle adjustment and revisions to the national accounts.

Figure 2. The NAO FI projects general government deficits in 2023 and 2024 to be lower than in the draft budget for 2024

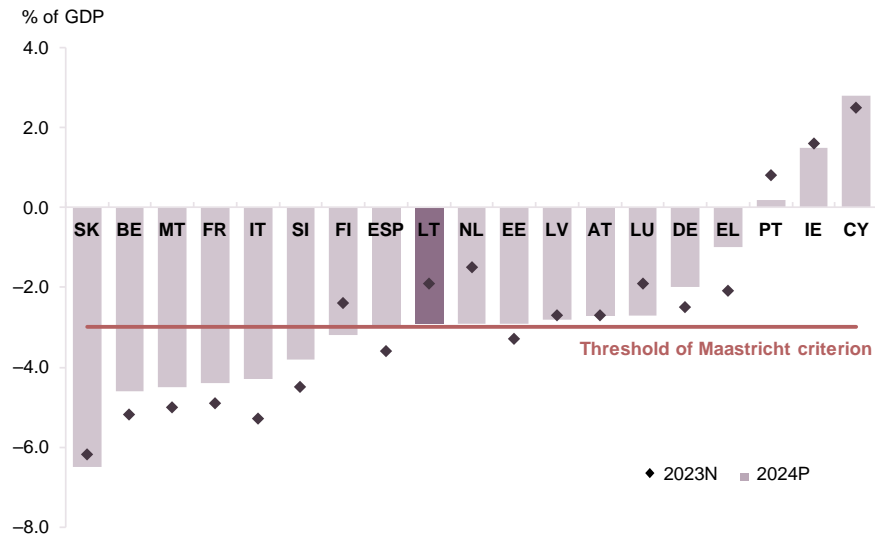


N – expected, P – forecast

Source: DB2024, calculations by the National Audit Office implementing the function of a fiscal institution

The general government deficit projected in DB2024 will be lower than the Maastricht threshold of 3% of GDP, but higher than in 2023. An analysis of the draft budgets of the euro area (EA) countries for 2024 shows that the majority of them are projecting their GG deficits in 2024 to be lower than in 2023. Many EA countries also plan to comply with the Maastricht criterion (Figure 3).

Figure 3. Lithuania's GG deficit in 2024 is projected to be higher than in 2023, unlike most EA countries



N – expected, P – forecast

Source: Draft budgets of EA countries for 2024

2. SUPPORT TO UKRAINE IS NOT THE ONLY FACTOR THAT WOULD LEAD TO NON-COMPLIANCE WITH NATIONAL FISCAL DISCIPLINE RULES IN 2024 IF EXCEPTIONAL CIRCUMSTANCES DID NOT APPLY

In the absence of the cancellation of exceptional circumstances initiated by the government, the application of the national fiscal discipline rules in 2024 remains limited. The exceptional circumstances in Lithuania have been in place since March 2020, when the COVID-19 pandemic started. On 20 September 2022, the NAO FI issued an opinion on the cancellation of the exceptional circumstances initiated by the Ministry of Finance of the Republic of Lithuania on 13 September 2022 on the grounds of the COVID-19 pandemic, and the establishment of exceptional circumstances in the Republic of Lithuania due to the geopolitical situation and its possible negative impact on general government finances. According to Article 7(2) of the CL, the establishment and cancellation of exceptional circumstances is initiated by the Government. If the exceptional circumstances are not cancelled, the GG deficit-constraining rules of the CL will not apply in 2024. This decision in DB2024 is based on the impact of the war in Ukraine on public finances. However, as the NAO FI has mentioned², while uncertainties remain high, in particular with regard to the course of the war, adequate surveillance of public finances and the preservation of fiscal space enhance the capacity to respond adequately to the challenges ahead. A return to full application of the fiscal discipline rules (FDR) would contribute to ensuring fiscal sustainability of the state. EU countries are returning to following common fiscal discipline rules from 2024. With the general clause of the Stability and Growth Pact no longer in force, the nominal GG deficit should not exceed 3% of GDP from 2024.

² On 19 September 2023, the NAO FI issued an opinion on the application of exceptional circumstances in 2024, No. YE-282. Available online at: <https://www.valstybeskontrolė.lt/EN/Product/Download/4572>.

Given the narrowed application of the fiscal discipline rules, according to the assessment of the NAO FI, the general government budgets in 2023–2024 are likely to comply with the requirements of the Constitutional Law (Table 1)³. The rules for limiting the growth of surplus GG and GG expenditure do not apply in periods of exceptional circumstances. The structural balance of the State Social Insurance Fund budget in 2023 and 2024 is estimated by the NAO FI at 1.3% and 1.2% of GDP respectively. The SSIF budget complies with the requirements of Article 4(3) of the CL, as a positive structural balance is projected for this sub-sector. The estimated structural balance of the Compulsory Health Insurance Fund budget is estimated at 0.0% and 0.2% of GDP in 2023 and 2024 respectively. According to Article 4(2) of the CL, the budget of this fund must be planned in such a way that it is in surplus or in balance, based on the structural balance indicator. The compliance of municipal budgets with fiscal discipline rules will be assessed in the first half of 2024. Structural adjustment targets are not set for the years of exceptional circumstances.

Table 1. Compliance with fiscal discipline rules in 2023 and 2024

Fiscal discipline rules	2023	2024
Surplus GG rule	Not applicable	Not applicable
GG expenditure growth limitation rule	Not applicable	Not applicable
Rules for the Budgets Attributable to GG, including:		
State Social Insurance Fund	✓	✓
Compulsory Health Insurance Fund	✓	✓
Local Government sub-sector	Compliance with the FDR will be assessed in the first half of 2024.	

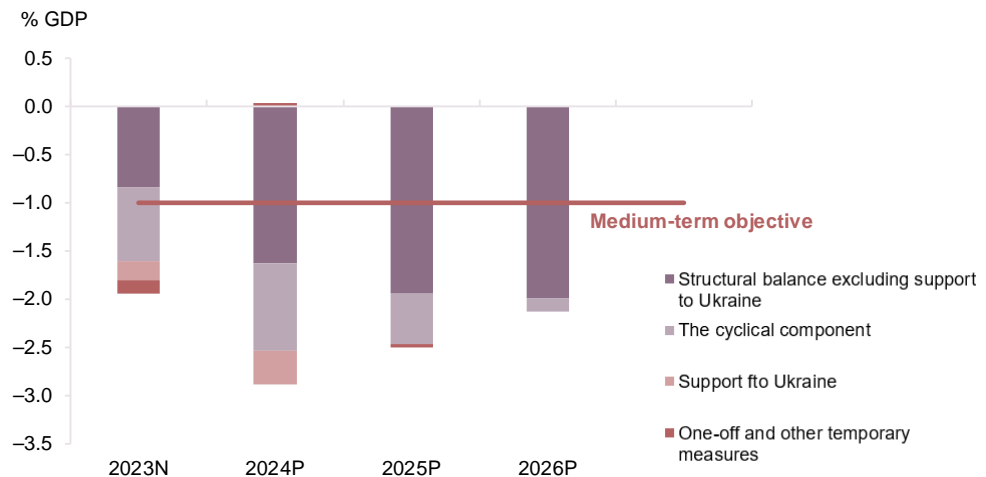
✓ – compliance, ✗ – risk of non-compliance

Source: calculations by the National Audit Office implementing the function of a fiscal institution

According to the draft budget, if the exceptional circumstances do not apply, the surplus general government rule would not be respected in 2024, even if support to Ukraine is eliminated. As mentioned above, the fiscal discipline rules limiting the GG deficit do not apply during the period of exceptional circumstances. However, according to the assessment of the NAO FI, considering the geopolitical situation as the basis for the continued application of the exceptional circumstances, it is important to assess whether the increase in the deficit is due to this reason. The discretionary temporary expenditure measures planned in the draft budget for 2024 related to support to Ukraine amount to 0.4% of GDP. Taking into account the Ministry of Finance’s estimate of the output gap and eliminating the measures of support to Ukraine, the structural deficit would be above the medium-term objective (MTO) (Figure 4).

³ A detailed assessment of compliance with the rules can be found online in the MS Excel workbook accompanying this opinion. Available online at: <https://www.valstybeskontrolė.lt/EN/BudgetPolicyMonitoring>.

Figure 4. The structural GG deficit in DB2024 exceeds the medium-term objective (MTO) for 2024–2026



N – expected, P – forecast

Source: DB2024, calculations by the National Audit Office implementing the function of a fiscal institution

The medium-term objective is the indicator that limits the size of the structural balance. The CL allows setting the MTO at a structural deficit of no more than 1% of GDP or a structural GG surplus. Currently, the MTO for Lithuania is set at -1% of GDP. However, it is important to note the uncertainty⁴ in the estimation of the output gap and the fluctuating projections of this estimate. It should be noted that even if the deficit is lower than projected in DB2024, a change in the cyclical component could lead to a structural deficit above 1% of GDP.

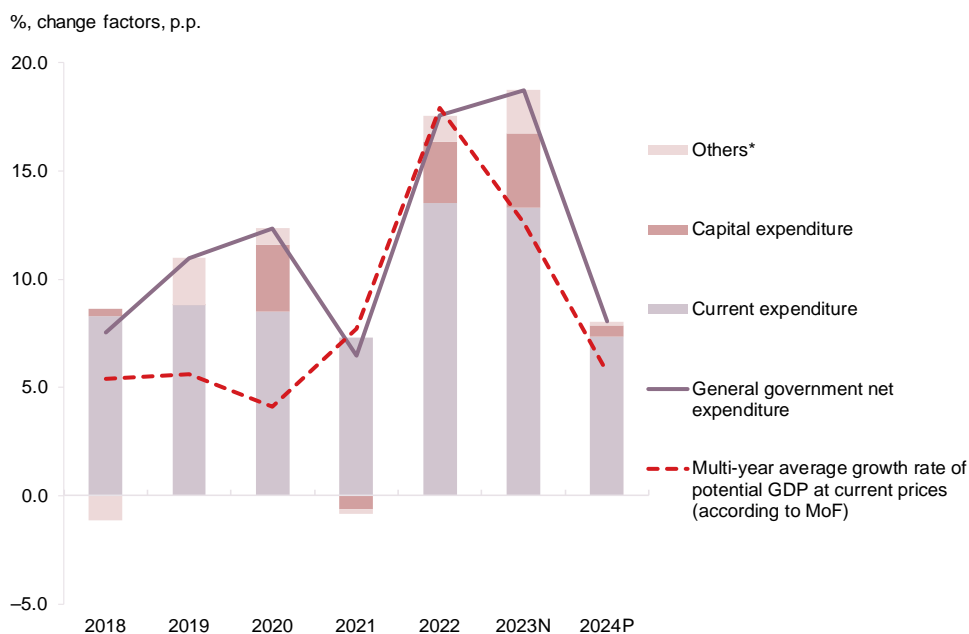
The increase in the structural deficit in 2024 is corroborated by the strong growth in net⁵ expenditure, which exceeds the long-term growth rate of potential GDP (Figure 5). To reduce the structural GG deficit, this expenditure would need to grow at a slower pace than the multi-annual growth rate of potential GDP at current prices, or they could grow faster if financed by additional revenue measures. The EC has also taken note of the rapid growth of expenditure. In its assessment of the draft budget for 2023, it noted that the growth rate of primary nationally financed current expenditure is not in line with the Council’s recommendations⁶.

⁴ The NAO FI’s estimate of the output gap with potential in 2024 is -4.1% of potential GDP, while the estimate of the Ministry of Finance is -2.3% of potential GDP. Against this background, the structural balance of the NAO FI is -0.9% of GDP in 2024.

⁵ The GG net expenditure is the sum of expenditure after the elimination of interest payments on public debt, unemployment benefits, EU and other international financial assistance, expenditure related to the mitigation of the impact of COVID-19, the increase in energy prices, and support to Ukraine, and after the subsequent adjustment of this total expenditure by discretionary revenue measures.

⁶ Available online at: https://economy-finance.ec.europa.eu/document/download/f90709fe-c921-4c8b-9a14-51127d8751fd?filename=c_2022_9513_1_lt_lt.pdf.

Figure 5. Net expenditure growth in 2023 and 2024 is likely to exceed the sustainable growth rate of multi-year potential GDP at current prices



* Changes in inventories and acquisitions less disposals of valuables, acquisitions less disposals of non-financial non-produced assets, other current transfers

N – expected, P – forecast

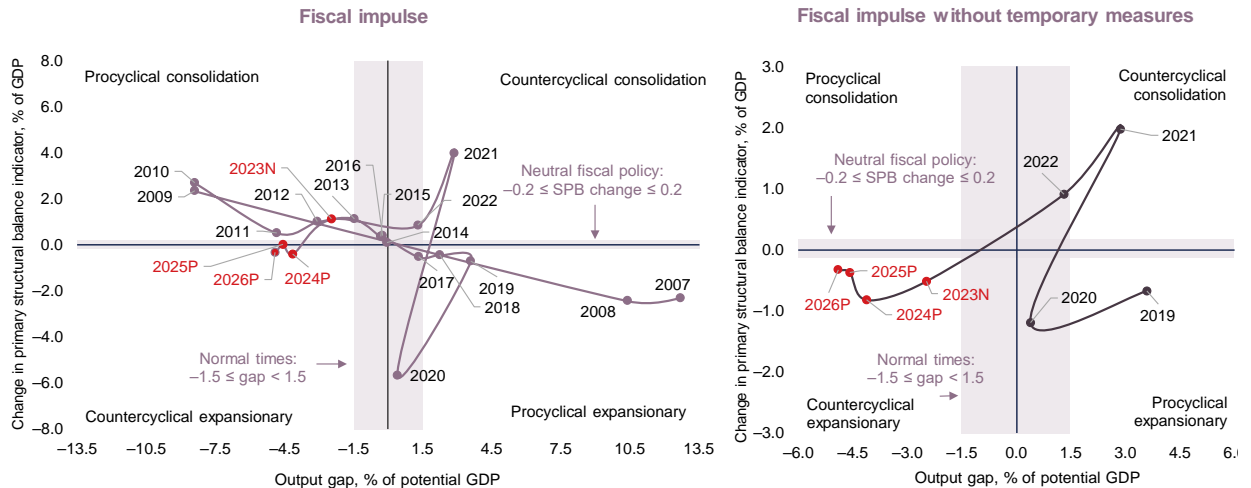
Source: State Data Agency, Ministry of Finance, calculations by the National Audit Office implementing the function of a fiscal institution

3. THE STIMULUS TO THE NATIONAL ECONOMY IS EXPECTED TO BE STRONGER IN 2024 THAN IN 2023

Excluding the impact of temporary measures, fiscal policy will stimulate the economy in 2023–2024. The NAO FI projects a negative output gap and an annual change of 1.1% of GDP in the structural primary balance (SPB) of the GG in 2023 (Annex 2). This indicates that fiscal policy is in the area of pro-cyclical consolidation. A negative change in the SPB in 2024 implies a countercyclical fiscal policy stance. If temporary measures (i.e. support to Ukraine, mitigating the impact of energy price increases, etc.⁷) are added to the one-off factors and thus eliminated from the structural balance assessment, the fiscal impulse in 2023 and 2024 remains stimulative (Figure 6). With the economy below its potential level, stimulation of the economy is warranted. Importantly, stimulation should also be based on investment spending. It should be noted that in both 2023 and 2024, DB2024 assumes that the level of investment will be maintained at around 1% of GDP higher than in 2022. It is noteworthy that while the economy is projected to grow in 2024, the fiscal impulse without temporary measures is stronger than in 2023, when real GDP is expected to contract. However, the current uncertainty about economic development complicates the assessment of the state of the economic cycle, and the revision of the national accounts on 2 October 2023 may also contribute to the future revision of the output gap.

⁷ Measures related COVID-19, installation of a physical barrier and security systems at the Lithuanian-Belarusian border, maintenance of Lithuanian railway infrastructure.

Figure 6. The fiscal impulse in 2023 and 2024 stimulates the economy excluding temporary factors



Under the hypothetical scenario of NAO FI

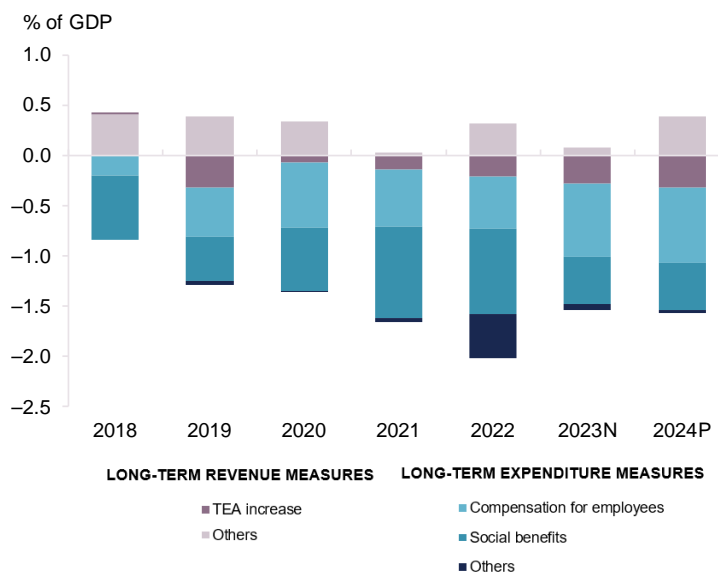
N – expected, P – forecast

Source: State Data Agency, Ministry of Finance, calculations by the National Audit Office implementing the function of a fiscal institution

4. WITHOUT ADDITIONAL SUSTAINABLE REVENUE SOURCES AND WITH THE NAO FI PROJECTING FURTHER LONG-TERM EXPENDITURE GROWTH, RISKS OF BREACHING FISCAL DISCIPLINE ARISE IN 2025–2026

Every year, decisions are taken that increase long-term general government expenditure. The draft budget foresees rising long-term expenditure in 2024, mainly for salary increases for public sector employees and social benefits (Figure 7). It should be noted that long-term expenditure averaged 1.3% of GDP over the period from 2018 to 2022. The bulk of the long-term revenue measures in 2024 are losses due to the TEA (0.3% of GDP), which averaged 0.1% of GDP over the period 2018–2022.

Figure 7. The largest share of discretionary long-term expenditure measures is accounted for by compensation for employees and social benefits, while the largest share of long-term revenue loss is accounted for by the increase in the TEA



N – expected, P – forecast

Source: DB2024, calculations by the National Audit Office implementing the function of a fiscal institution

In order to illustrate the impact of the usual annual discretionary decisions on the GG balance and debt ratios 2025–2026, the NAO FI has prepared two scenarios for 2025 and 2026: a no-policy-change scenario and a hypothetical scenario (Table 2).

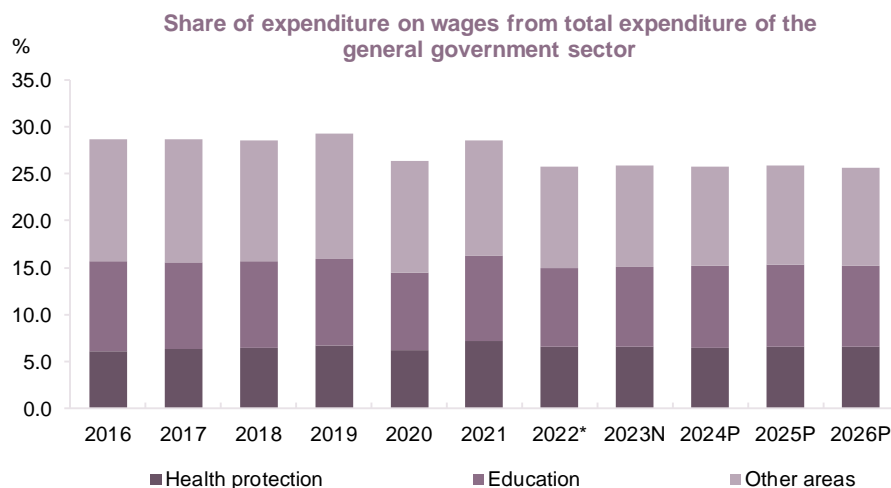
Table 2. NAO FI's scenarios for 2025 and 2026

No-policy-change scenario	Hypothetical scenario
Expenditure and revenue projections are based on the Economic Development Scenario of September 2023	
GG revenue and expenditure projected at the growth rate of macroeconomic indicators for 2025 and 2026	
No new potential discretionary decisions are foreseen or included, if no such decisions were made	Discretionary decisions that normally reduce GG revenue and increase long-term GG expenditure on an annual basis are included, such as: bringing the TEA closer to the MMW, increasing social benefits, pensions and salaries for public sector employees.

Source: National Audit Office (NAO) implementing the function of a fiscal institution

In the hypothetical scenario of the NAO FI, the level of expenditure in 2025 and 2026 would be higher than in 2024. In the period 2016–2022, salaries accounted for around 28.0% of total GG expenditure, or around 10.1% of GDP (Figure 8). The largest share was for education and health workers (15.5% of total expenditure, or 5.7% of GDP). Expenditure on compensation of employees is subject to the usual increases. In this context and considering the commitments made to increase salaries in health⁸ and education⁹, the NAO FI projects the compensation of employees in these areas to reach 6.5% of GDP in 2024. It will continue to grow and reach around 6.6% of GDP in 2025–2026. It is also assumed that social benefits will be increased. Compared to the no-policy-change scenario, expenditure increases of 0.1% and 0.2% of GDP are foreseen for compensation of employees, and 0.5% and 0.8% of GDP for social benefits (Annex 1, Table 1).

Figure 8. In the hypothetical scenario of the NAO FI, the share of expenditure on salaries for education and health workers will remain stable at more than 15% of total general government expenditure



* 2022 is included by the NAO FI as the 2022 statistical information on general government expenditure by function (COFOG) will be published in January 2024.

N – expected, P – forecast

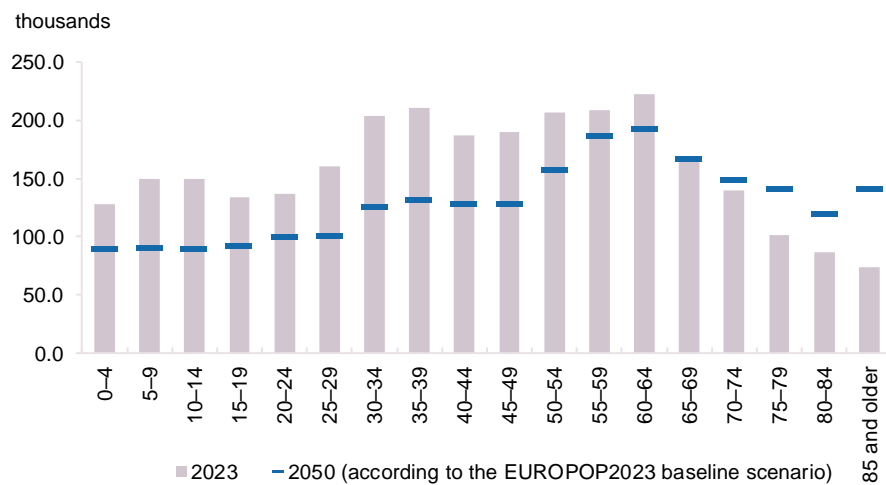
Source: State Data Agency, calculations by the National Audit Office implementing the function of a fiscal institution

⁸ According to the agreement of the Lithuanian national health system branch, which was updated on 16 October 2023, the average remuneration of medical staff in public health care institutions will increase by at least 10.0% in 2024, based on a higher base rate, which will be equal to the government’s MMW of 2023. Available online at: https://sam.lrv.lt/uploads/sam/documents/files/2023-10-16_Susitarimas_Nr_%20S-241.pdf.

⁹ Collective agreement of the Lithuanian education and science branch provides for a 10.0% pay increase between 2023 and 2024. Available online at: <https://www.svietimoprofsajunga.lt/wp-content/uploads/2021/11/2017-m.-lapkricio-22-d.-Lietuvos-svietimo-ir-mokslo-sakos-kolektyvines-sutarties-pakeitimas.pdf>.

Ageing population are likely to pose increasing challenges in the future to finance rising pension liabilities. At the beginning of 2023, Lithuania had the largest number of permanent residents in the 60-64 age group, which comprised 222.2 thousand people (Figure 9). The 50-54 and 55-59 age groups accounted for more than 205 thousand each. This age structure of the population warns of a significant increase in the number of people of retirement age in the near future. In the long term (over the next 30 years), according to Eurostat’s EUROPOP2023 demographic projections (baseline scenario), Lithuania will see a particular decrease in the population aged 15-64 and an increase in the population aged 65 and over. This means that there will be two persons of working age for every elderly person, compared to 3.3 in 2023.

Figure 9. The structure of the number of permanent residents in Lithuania at the beginning of 2023 warns of a significant increase in the number of people of retirement age in the future

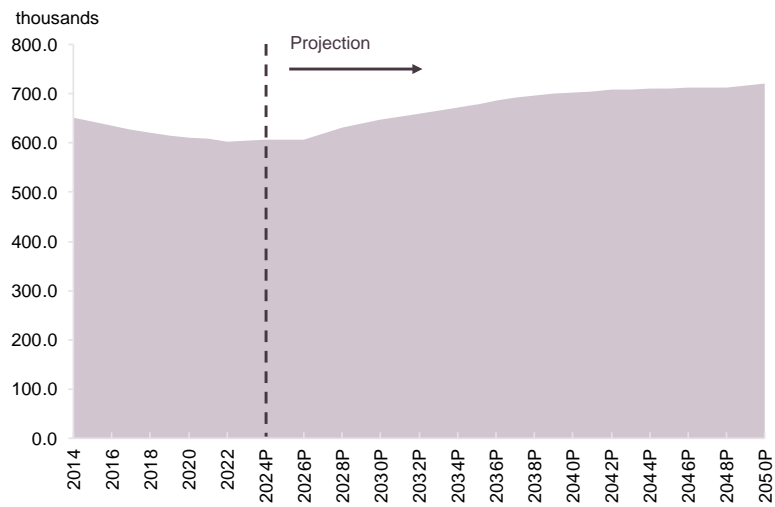


Source: State Data Agency, Eurostat

The retirement age will be gradually increased until it reaches 65 in 2026 for both women and men. According to the EUROPOP2023 projections mentioned above, this increase will keep the population of retirement age stable until 2026 (Figure 10). However, due to the large cohorts mentioned above, this number will then start to increase rapidly, which will lead to increasing social security liabilities for pension benefits. Accordingly, there may be increasing challenges in maintaining the available income replacement rate¹⁰. In the view of the National Audit Office in its capacity as fiscal institution, it is important to take these challenges into account when taking decisions that affect the sustainability of the pension system and to provide for long-term sources of revenue.

¹⁰ Percentage ratio of labour income in the year before retirement to the pension awarded.

Figure 10. A gradual increase in the retirement age until 2026 will keep the number of people of this age stable, but after that it will start to grow rapidly



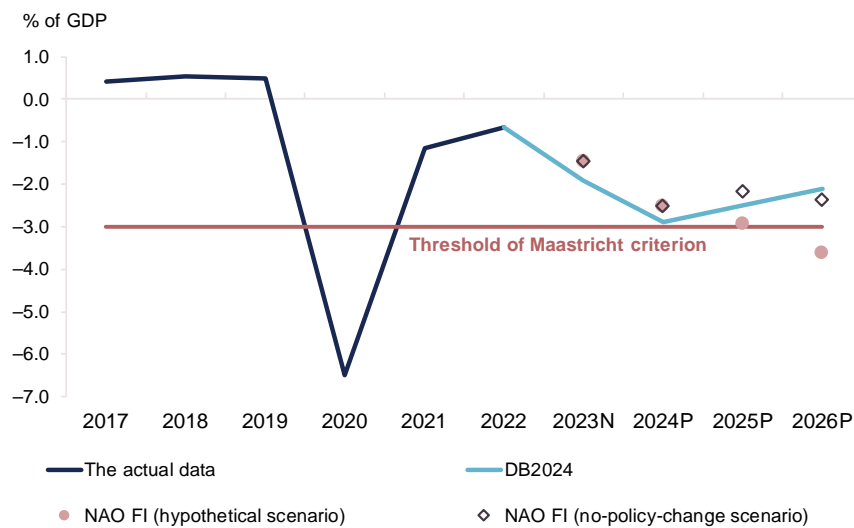
Source: State Data Agency, Eurostat, calculations by the National Audit Office implementing the function of a fiscal institution

The general government revenue level projected by the NAO FI for 2025–2026 will remain below the EU average. The level of government revenue in 2025 and 2026 in the hypothetical scenario could remain the same as in the no-policy-change scenario. According to the NAO FI’s assessment, the losses due to an increase in the TEA would be offset by increases in household income and consumption due to possible increases in social benefits and wages. Although the level of GG revenue would remain unchanged, according to the NAO FI, it would remain lower than in other EU countries. The EU average for GG revenues in 2022 was 46.4% of GDP, while in 2026 the NAO FI projects GG revenues at 37.5% of GDP (37.7% of GDP in DB2024).

Higher revenue levels are essential for quality public services. Given that financing areas of public interest without additional sources of revenue could lead to expenditure growth restraint or non-compliance with fiscal discipline rules, it is necessary to look for additional sources of revenue. One such initiative has been the tax changes proposed by the Government for 2023, the adoption of which is likely to contribute to a simpler and more neutral tax system. However, additional proposals are needed to increase the general government revenue-to-GDP ratio. International institutions recommend increasing the redistributive share of revenue, starting with an expansion of property taxes. For example, in Lithuania, GG revenues from property amounted to 0.4% of GDP in 2022, while the EU average is around 0.8% of GDP. Also, exemptions for PIT, CT, VAT and excise duties (excluding TEA) have reduced state budget revenues by 2.1% of GDP in 2015 and by 3.8% of GDP in 2022.

The general government deficit could be around 3% of GDP between 2025 and 2026. As no decisions have been taken on the tax-exempt income, social benefits or salary increases for public sector employees in 2025–2026, their impact is not reflected in the draft budget. According to the NAO FI’s assessment, if these decisions were taken, the general government deficit would be 2.9% of GDP in 2025 and 3.6% of GDP in 2026 (Figure 11). Under the no-policy-change scenario, the deficits would be 2.2% and 2.4% of GDP in 2025 and 2026 respectively.

Figure 11. In the hypothetical scenario, the GG deficit would be close to 3% of GDP in 2025 and above 3% of GDP in 2026



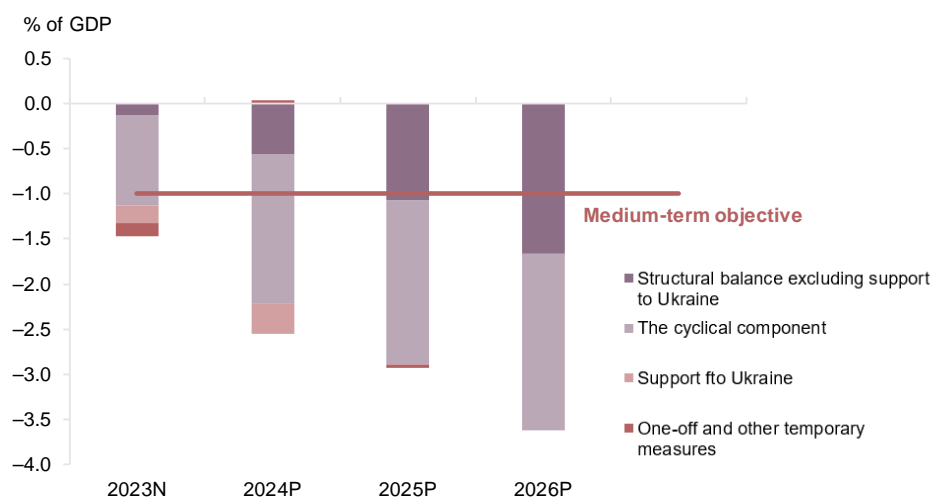
N – expected, P – forecast

Source: DB2024, calculations by the National Audit Office implementing the function of a fiscal institution

There is a risk of non-compliance with fiscal discipline rules in 2025–2026. If exceptional circumstances are not applied in 2025 and if the structural deficit is below the medium-term objective in 2024, structural impetus tasks should be set for 2025, i.e. the structural balance indicator should move towards the medium-term objective. DB2024 indicates that the structural deficit will widen in 2025, a dynamic that would be inconsistent with this requirement. Based on the no-policy-change projections of the DB2024 fiscal targets for 2025 and 2026 and the NAO FI estimate of the gap with potential, the GG surplus rule would not be breached as the structural deficit would be below 1% of GDP¹¹ (Annex 3). However, in the case of the hypothetical scenario of the NAO FI, the structural balance would be above the medium-term objective in 2025 and 2026 (Figure 12). In addition, according to the hypothetical scenario of the NAO FI, the deficit in 2025 would be close to the Maastricht criterion, which requires that the country’s headline deficit does not exceed 3% of GDP, while the projected deficit of 2026 would exceed this threshold. If the hypothetical scenario of the NAO FI were to materialise, there is a risk that the European Commission could decide to open an excessive deficit procedure for Lithuania.

¹¹ The fiscal institution’s estimate of the gap with potential is –4.6% of potential GDP in 2025 and –4.9% in 2026. The corresponding Ministry of Finance indicators are –1.3 and –0.3 % of potential GDP.

Figure 12. The structural GG deficit in the NAO FI's hypothetical scenario exceeds the medium-term objective in 2025 and 2026



N – expected, P – forecast

Source: DB2024, calculations by the National Audit Office implementing the function of a fiscal institution

5. WITH THE INCREASING GENERAL GOVERNMENT DEFICIT PROJECTED BY NAO FI, PUBLIC DEBT COULD RISE TO ALMOST 46% OF GDP IN 2026

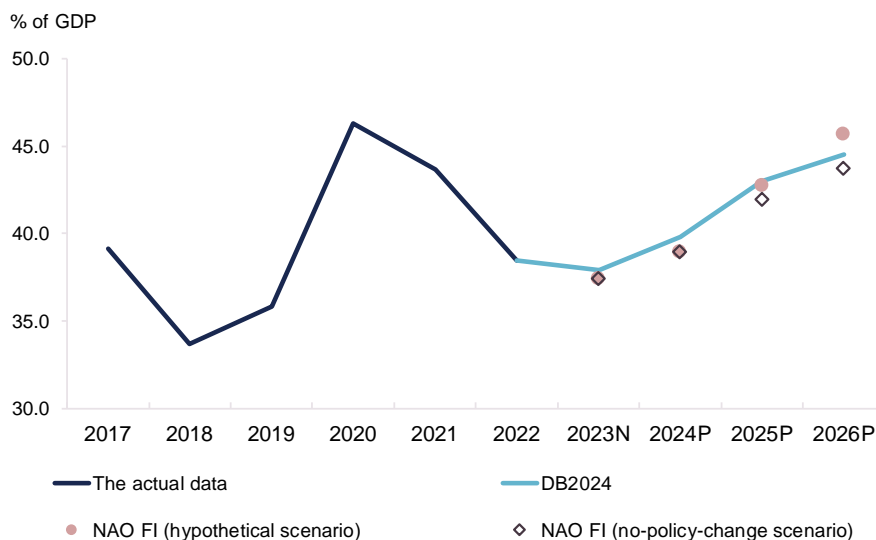
General government debt is projected to increase in the medium term, with possible discretionary decisions further accelerating its growth. The NAO FI, based on the International Monetary Fund (IMF) methodology¹², projects it to reach 37.5% and 39.0% of GDP in 2023 and 2024 respectively (Figure 13). The increase in the GG debt in 2024 will be mitigated by a lower SG deficit in 2023 than planned in the 2023 Budget Law. The accumulated balance of borrowed funds in 2023 will reduce the financing needs of the state budget expenditure in 2024 by around EUR 1.6 billion¹³ (2.1% of GDP). Under the no-policy-change scenario projected by the NAO FI, the GG debt will continue to grow over the rest of the medium term, reaching 43.8% of GDP in 2026. However, possible discretionary decisions are likely to lead to an even faster increase in debt growth over this period. In the hypothetical scenario projected by the NAO FI, this indicator would reach 42.8% and 45.7% of GDP in 2025 and 2026 respectively. In the no-policy-change scenario, the GG debt is projected to grow to 44.5% of GDP in 2026 under DB2024. On 21 September 2023, the Ministry of Finance published a report on general government debt and financial sustainability¹⁴. The NAO FI welcomes the analysis and considers that the analytical tool developed could contribute to the wider debate on the long-term impact of fiscal policy decisions on public debt dynamics.

¹² Staff Guidance Note for Public Debt Sustainability Analysis in Market-Access Countries of the IMF, 9 May 2013. Available online at: <https://www.imf.org/external/np/pp/eng/2013/050913.pdf>.

¹³ General government borrowing programme of 2024. Available online at: https://finmin.lrv.lt/uploads/finmin/documents/files/3pr_%20Aiskinamojo_3%20priedas_Skol_%20programa.pdf.

¹⁴ Available online at: <https://finmin.lrv.lt/uploads/finmin/documents/files/Vald%C5%BEios%20sektoriaus%20skolos%20ir%20finans%C5%B3%20tvarumo%20vertinimo%20atskaita.pdf>.

Figure 13. In the hypothetical scenario, public debt grows faster between 2025 and 2026 than projected in the DB2024



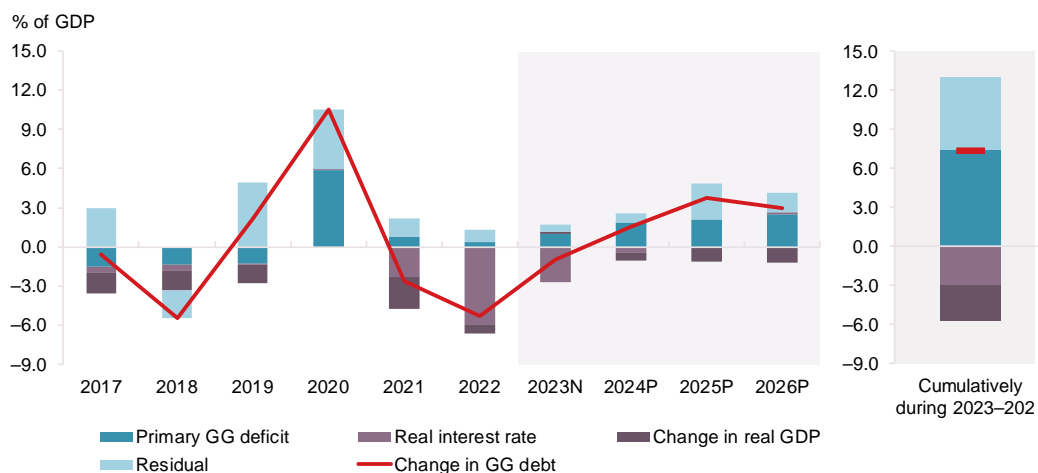
N – expected, P – forecast

Source: State Data Agency, DB2024, calculations by the National Audit Office implementing the function of a fiscal institution

The main contributor to the increase in the general government debt-to-GDP ratio between 2023 and 2026 will be the primary deficit, which is becoming increasingly costly to finance.

In the hypothetical scenario projected by the NAO FI, the primary GG deficit will increase the debt more and more each year over the period, from 1.0% of GDP in 2023 to 2.5% of GDP in 2026 (Figure 14). After the projected economic contraction in 2023, real GDP growth will moderate debt growth. As inflation slows down and borrowing becomes more expensive in domestic and external markets, the favourable impact of real interest rates on the GG debt will diminish and is likely to contribute to debt accumulation as early as 2026 (Annex 1, Table 3). The NAO FI projects the cost of interest payments on the GG debt to amount to EUR 344 million and EUR 506 million (0.5% and 0.7% of GDP) in 2023 and 2024. Interest expenditure is likely to increase to EUR 944 million (1.1% of GDP) in 2026.

Figure 14. In the hypothetical scenario projected by the NAO FI, the main contributor to the general government debt-to-GDP ratio from 2023 to 2026 will be the primary general government deficit



* The residual for 2023-2026 includes the stock-flow adjustment envisaged in DB2024.

N – expected, P – forecast

Source: State Data Agency, DB2024, calculations by the National Audit Office implementing the function of a fiscal institution

The National Audit Office of the Republic of Lithuania, in its capacity as the budget policy monitoring authority responsible for monitoring the compliance with the rules of fiscal discipline laid down in the Constitutional Law on the Implementation of the Fiscal Treaty of the Republic of Lithuania, carried out an assessment the draft Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets for 2024 submitted by the Government to the Seimas on 6 October 2023 and prepared an opinion. In accordance with Article 4(1) of the Constitutional Law of the Republic of Lithuania on the Implementation of the Fiscal Treaty and Article 8(7)(2) of the Law on National Audit Office, the National Audit Office submits its opinion to the Seimas of the Republic of Lithuania.

Head of Budget Monitoring Department

Jurga Rukšėnaitė

ANNEXES

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 Annex 1

NAO FI PROJECTIONS OF FISCAL INDICATORS

Table 1. General government revenue and expenditure projected by the NAO FI according to ESA 2010

Indicator, % GDP	ESA 2010 code	2022	2023N	2024P	No-policy-change scenario		Hypothetical scenario	
					2025P	2026P	2025P	2026P
Total revenue	OTR	36.0	37.3	38.2	37.9	37.5	37.9	37.5
Tax revenue		21.6	22.1	22.6	22.2	22.2	22.1	22.0
Revenue from indirect taxes	D.2	11.5	11.5	11.9	11.8	11.8	12.0	12.0
Revenue from direct taxes	D.5	10.1	10.6	10.7	10.4	10.4	10.1	10.0
Net social contributions	D.61	10.3	10.5	10.8	10.8	10.8	10.9	10.9
Other revenue, of which:		4.1	4.7	4.9	4.9	4.5	4.9	4.6
Revenue from property	D.4	0.4	0.5	0.4	0.3	0.3	0.3	0.3
Total expenditure	OTE	36.7	38.8	40.7	40.1	39.9	40.8	41.1
Compensation of employees	D.1	10.2	10.6	11.0	11.0	11.0	11.1	11.2
Intermediate consumption	P.2	4.3	4.8	5.3	5.1	5.0	5.2	5.2
Subsidies	D.3	1.7	0.7	0.3	0.3	0.3	0.3	0.3
Interest costs	D.41	0.4	0.5	0.7	0.9	1.1	0.9	1.1
Social benefits	D.6M	14.1	15.0	15.8	15.9	16.0	16.4	16.8
Other expenditure, of which:		5.9	7.2	7.6	6.9	6.5	7.0	6.6
Gross fixed capital formation	P.5L	3.2	3.9	4.1	3.8	3.4	3.8	3.4
Capital transfers	D.9	0.7	0.8	1.0	0.8	0.8	0.8	0.8
Net lending (+) / net borrowing (-)	B9	-0.7	-1.5	-2.5	-2.2	-2.4	-2.9	-3.6

N – expected, P – forecast

Source: State Data Agency, calculations by the National Audit Office implementing the function of a fiscal institution

Table 2. Projections of general government and sub-sectoral balances by the NAO FI

No.	Indicator, % GDP	2022	2023N	2024P	No-policy-change scenario		Hypothetical scenario	
					2025P	2026P	2025P	2026P
1.	Central government sub-sector	-2.3	-2.4	-3.4	-3.0	-3.1	-3.4	-3.9
2.	Social insurance funds sub-sector	1.5	1.0	0.9	0.8	0.7	0.7	0.6
3.	Local government sub-sector	0.2	-0.0	0.0	0.0	0.0	-0.2	-0.3
4.	General government	-0.7	-1.5	-2.5	-2.2	-2.4	-2.9	-3.6

N – expected, P – forecast

Source: State Data Agency, calculations by the National Audit Office implementing the function of a fiscal institution

Table 3. Projections of general government debt and its drivers of change by the NAO FI

No.	Indicator, % GDP	2022	2023N	2024P	No-policy-change scenario		Hypothetical scenario	
					2025P	2026P	2025P	2026P
1.	GG debt	38.4	37.5	39.0	42.0	43.8	42.8	45.7
2.	Change in GG debt (3+4+7)	-5.3	-1.0	1.5	3.0	1.8	3.7	3.0
3.	Primary GG deficit	0.4	1.0	1.9	1.3	1.2	2.1	2.5
4.	Automatic dynamics (5+6) debt	-6.6	-2.6	-1.0	-1.1	-1.0	-1.1	-1.0
5.	Real interest rate	-5.9	-2.7	-0.4	-0.1	0.2	-0.1	0.2
6.	Change in real GDP	-0.7	0.1	-0.6	-1.1	-1.2	-1.1	-1.2
7.	Residual*	1.0	0.6	0.7	2.8	1.5	2.8	1.5

* The residual for 2023-2026 includes the stock-flow adjustment envisaged in DB2024.

N – expected, P – forecast

Source: State Data Agency, DB2024, calculations by the National Audit Office implementing the function of a fiscal institution

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**CYCLICAL SITUATION OF THE LITHUANIAN ECONOMY AND STRUCTURAL
 GENERAL GOVERNMENT BALANCE, 2020–2026, AS ASSESSED BY THE NAO FI**

No.	Indicator, % GDP	2020	2021	2022	2023N	2024P	2025P	2026P
1.	General government net lending (+) / borrowing (-)	-6.5	-1.2	-0.7	-1.5	-2.5	-2.9	-3.6
2.	One-off and other temporary measures*	0.0	0.0	0.2	-0.1	0.0	0.0	0.0
3.	Temporary measures**	-4.6	-2.5	-2.5	-0.9	-0.4	0.0	0.0
4.	Output gap, % of potential GDP	0.4	2.9	1.3	-2.5	-4.1	-4.6	-4.9
5.	Cyclical budget component (0.399 × 4 lines)	0.2	1.1	0.5	-1.0	-1.7	-1.8	-2.0
6.	Structural GG balance (1 – 2 – 5)	-6.7	-2.3	-1.3	-0.3	-0.9	-1.1	-1.7
7.	Structural GG balance, excluding temporary measures (1 – 2 – 3 – 5)	-2.0	0.2	1.2	0.5	-0.5	-1.1	-1.7
8.	Interest	0.7	0.4	0.4	0.5	0.7	0.9	1.1
9.	Structural GG primary balance (6 + 8)	-5.8	-1.8	-1.0	0.1	-0.2	-0.2	-0.5
10.	Structural GG primary balance, excluding temporary measures (7 + 8)	-1.4	0.6	1.5	1.0	0.2	-0.2	-0.5
11.	Change in the structural GG primary balance	-5.7	4.0	0.9	1.1	-0.4	0.0	-0.3
12.	Change in the structural GG primary balance, excluding temporary measures	-1.2	2.0	0.9	-0.5	-0.8	-0.4	-0.3

Under the hypothetical scenario of the NAO FI.

N – expected, P – forecast

** Measures related to COVID-19 and measures to mitigate the impact of rising energy prices, assistance to the Ukrainian people fleeing Russian military action and other support to Ukraine, the installation of a physical barrier and security systems on the Lithuanian-Belarusian border, and support for Lithuania’s railway infrastructure.

Source: Ministry of Finance*, State Data Agency, calculations by the National Audit Office implementing the function of a fiscal institution

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Indicator, % GDP		2023N	2024P	2025P	2026P
MF's estimate of the output gap		-1.9	-2.3	-1.3	-0.3
Structural balance	DB2024	-1.0	-2.0	-1.9	-2.0
	NAO FI's no-policy-change scenario	-0.6	-1.7	-1.6	-2.2
	NAO FI's hypothetical scenario	-0.6	-1.7	-2.4	-3.5
Structural balance excluding the impact of support to Ukraine	DB2024	-0.8	-1.6	-1.9	-2.0
	NAO FI's no-policy-change scenario	-0.4	-1.3	-1.6	-2.2
	NAO FI's hypothetical scenario	-0.4	-1.3	-2.4	-3.5
NAO FI's estimate of the output gap		-2.5	-4.1	-4.6	-4.9
Structural balance	DB2024	-0.8	-1.2	-0.6	-0.2
	NAO FI's no-policy-change scenario	-0.3	-0.9	-0.3	-0.4
	NAO FI's hypothetical scenario	-0.3	-0.9	-1.1	-1.7
Structural balance excluding the impact of support to Ukraine	DB2024	-0.6	-0.9	-0.6	-0.2
	NAO FI's no-policy-change scenario	-0.1	-0.6	-0.3	-0.4
	NAO FI's hypothetical scenario	-0.1	-0.6	-1.1	-1.7

N – expected, P – forecast

■ below the MTO ■ above the MTO

Lithuania's MTO is -1% of GDP.

Source: DB2024, calculations by the National Audit Office implementing the function of a fiscal institution