VALSTYBĖS KONTROLĖ
BUDGET MONITORING

To the Seimas of the Republic of Lithuania

THE ASSESSMENT OF GENERAL GOVERNMENT FINANCES FOR 2024–2027

22 May 2024 No. VRE–2

Vilnius

ADDITIONAL REVENUE SOURCES ARE NEEDED TO ENSURE QUALITY PUBLIC SERVICES AND THE SUSTAINABILITY OF PUBLIC FINANCES

The National Audit Office implementing the function of a fiscal institution (hereinafter – NAO FI), has carried out an assessment of Lithuania's general government finances for 2024–2027. The NAO FI used to assess the general government finances situation in the spring, taking into account the Stability Programmes of Lithuania submitted to the European Commission for the respective years and the National Audit Office's law to deliver an opinion on these programmes. In May 2024, amendments to the European Union's Stability and Growth Pact regulations entered into force. In view of this, the Ministry of Finance did not prepare a Stability Programme for Lithuania for 2024. In order to contribute to enhancing fiscal transparency through regular analyses, the NAO FI is providing an own-initiative assessment of the general government financial position for the period 2024–2027. With the start of the 2025-2027 budget planning cycle, it is intended to help policymakers make more informed decisions.

This assessment presents projections for the general government balance and debt for the period 2024–2027. It assesses the fiscal stance and *ex-post* compliance with fiscal discipline rules in 2023. An overview of the changes in the EU's economic governance review is provided.

Key messages from the assessment:

- **In 2023, general government budgets were in line with the fiscal discipline rules, and the NAO FI expects a return to full application of the rules in 2025.**
- **The general government deficit in 2024 is likely to be lower than foreseen in the 2024 Budget Law.**
- **The economic stimulus path for 2024 is maintained, as the economy grows more slowly than it could potentially do.**
- **Additional revenue sources for defence would result in a slower growth of general government deficits and debt between 2025 and 2027. However, even with such decisions, without offsetting the usual annual increases in long-term expenditure with additional revenue sources, the deficit could exceed the 3% of Maastricht criterion threshold in 2027.**
- **Changes to the tax system are necessary to achieve a fairer, simpler tax system and to meet growing financing needs.**
- **Changes to the EU's fiscal discipline rules adopted this year will focus on medium-term planning.**

SUMMARY OF GENERAL GOVERNMENT SECTOR FINANCE REVIEW

In 2023, general government budgets were in line with the fiscal discipline rules, and the NAO FI expects a return to full application of the rules in 2025. During the period of exceptional circumstances, the surplus general government (GG) and the GG expenditure growth limitation rules are not applied. The budgets of the State Social Insurance Fund (SSIF) and the Compulsory Health Insurance Fund (CHIF) have complied with the fiscal discipline requirements for their budgets. The assessment of compliance of municipal budgets with fiscal discipline rules will be presented in June 2024. With the general escape clause of the Stability and Growth Pact no longer applied in the European Union as of 2024, and the absence of evidence available to the NAO FI that there are grounds for further application of exceptional circumstances, the institution expects that these circumstances will no longer apply in Lithuania from 2025. In that case, all national fiscal discipline rules would apply from 2025.

The general government deficit in 2024 may be lower than foreseen in the 2024 Budget Law. According to the NAO FI's estimates, the 2024 deficit could be around 2% of GDP. This is due to the March update of macroeconomic development projections and a lower deficit in 2023 than projected in the 2024 Budget Law. The NAO FI's projected revenue collection from corporate income and value added taxes in 2024 is close to that foreseen in the Budget Law. Given the results of the revenue sensitivity analysis, it is likely that personal income tax collections will be higher in 2024, but uncertainty remains.

With the economy growing more slowly than it could potentially do, the stimulus path for 2024 is maintained. According to the assessment of NAO FI, the fiscal impulse in 2024 remains expansionary. With the economy below its potential level, stimulus is warranted. Importantly, the stimulus should also be based on investment spending. Between 2016 and 2023, general government investment financed by national resources represented a higher share of GDP than that financed by EU support flows. The level of nationally financed investment has been maintained in line with European Commission recommendations.

Additional revenue sources for defence would lead to a slower growth of general government deficit and debt between 2025 and 2027. However, even with such decisions, without offsetting the usual annual increases in long-term expenditure with additional revenue sources, the deficit could exceed the 3% of GDP Maastricht criterion threshold in 2027. The NAO FI has prepared two scenarios for 2025–2027: with and without additional revenue sources for defence. Both scenarios include higher defence expenditure up to 3% of GDP and annual decisions that increase long-term general government expenditure (public sector salary increases, increases in the tax-exempt amount of income, etc.). According to the NAO FI's assessment, even if decisions on additional revenue sources for defence financing were taken, the general government deficit would increase and exceed the Maastricht criterion threshold 3% of GDP in 2027, while debt would reach 44.1% of GDP. If 3% of GDP were allocated to defence from 2025 onwards, but no decisions were taken on additional revenue sources, the debt would rise even further to 45.5% of GDP. This result is due to the fact that the NAO FI’s projected non-defence expenditure is likely to grow faster than the growth of general government revenue.

As inflation slows and GG debt is refinanced with more expensive securities issues, the favourable impact of real interest rates on GG debt will diminish. Increasingly expensive general government debt financing implies that more resources will be needed in the future to service debt when they could be used for other important public areas. Additional revenues are needed to ensure sufficient financing of public sector activities. One of the areas where underfunding is felt is health care. With the ratio of general government revenue to GDP remaining one of the lowest in the EU, health financing is low compared to the EU, and households' *out-of-pocket* expenditure share is twice the EU average.

Changes to the tax system are necessary to contribute to a fairer, simpler tax system and to meet growing financing needs. International organisations have made recommendations to improve Lithuania's tax system. Currently, Lithuania does not ensure horizontal equity, as people with similar incomes pay different levels of tax depending on the type of income received or the form of activity carried out. Vertical equity is also not ensured, as the average PIT burden decreases once a certain level of high income is reached and continues to increase. This is because the income structure of high-income earners is dominated by individual activity and capital income, which is taxed at a lower rate. They also recommend extending environmental and property taxes and adjusting the tax system by reviewing exemptions and removing some of them. Improving the fairness and efficiency of the system is an important objective, but more ambitious changes are needed to increase the ratio of general government revenue to GDP.

Changes to the EU's fiscal discipline rules adopted this year will focus on medium-term planning. From 2024, countries will start preparing fiscal-structural plans with a time horizon of 4-7 years instead of Stability and Convergence Programmes and National Reform Programmes. In these documents countries' fiscal plans will need to be set out and explanations provided on how the Member State will ensure that reforms and investments that are in line with the Member State's and the EU's priorities will be implemented. This is a step towards medium-term planning.

ASSESSMENT OF THE FISCAL DISCIPLINE RULES IN 2023

The application of fiscal discipline rules has been temporarily narrowed from 2020. Exceptional circumstances were first declared in Lithuania in March 2020, with the onset of the COVID-19 pandemic. In 2022, as the impact of the pandemic diminished, the geopolitical situation became the basis for exceptional circumstances. From 2024, the general escape clause of the Stability and Growth Pact (SGP) is no longer applied in the EU, but the change in economic governance means that there was no return to the old rules. However, the European Commission (EC) has announced that it will apply the Excessive Deficit Procedure (EDP) to countries that exceed the 3% of GDP deficit threshold[1]. With the re-application of the fiscal discipline rules in the EU from 2024 and the absence of evidence available to the NAO FI that there are grounds for further application of exceptional circumstances in Lithuania, the institution expects that from 2025 these circumstances will no longer apply in Lithuania. In that case, all national fiscal discipline rules would apply from 2025.

Given the narrower application of the fiscal discipline rules, the 2023 general government budgets were in line with the requirements of the Constitutional Law (Table 1)[2]. During the period of exceptional circumstances, the GG expenditure growth limitation rule and surplus GG rule are not applied. However, even if the rules were applied, they would not be breached. The general government surplus rule would be respected because the estimated structural balance of the general government is positive, and the expenditure growth limitation rule would not be applied because of the negative output gap. The structural balance of the SSIF budget estimated by the NAO FI was at 1.3% of GDP in 2023. As the structural balance was positive, the SSIF budget complied with the requirements of Article 4(3) of the Constitutional Law. The estimated structural balance of the CHIF budget in 2023 was 0.3% of GDP. The budget of this fund complied with the requirements of Article 4(2) of the CL, as it was in surplus according to the structural balance indicator. An assessment of the compliance of municipal budgets with fiscal discipline rules will be presented in June 2024.

Table 1. Compliance with fiscal discipline rules in 2023

Fiscal discipline rules	Opinion
Surplus GG rule	Not applicable
GG expenditure growth limitation rule	Not applicable
Rules for the Budgets Attributable to GG, including:	
State Social Insurance Fund	✓
Compulsory Health Insurance Fund	✓
Local Government sub-sector	The evaluation will be presented in June 2024.

✓ – the rule was complied with, × – the rule was not complied with

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

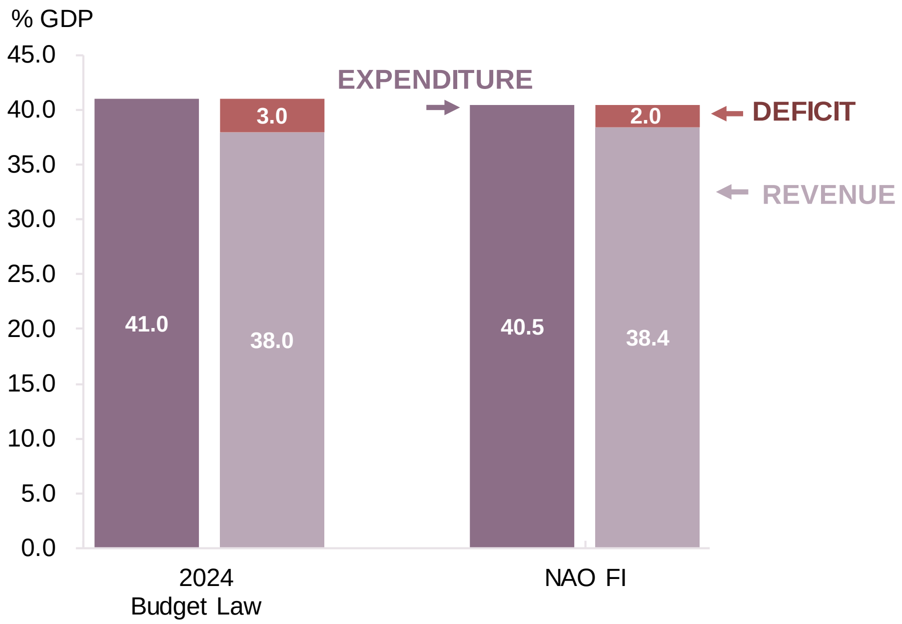
[1] Available online: https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/fiscal-policy-guidance_en.

[2] A detailed assessment of compliance with the rules can be found in the *MS Excel* workbook accompanying this assessment on the website. Available via the Internet: https://www.valstybeskontrole.lt/EN/BudgetMonitoring.

PROJECTIONS FOR GENERAL GOVERNMENT FINANCES IN 2024

According to the NAO FI, the 2024 deficit could be lower than the one foreseen in the 2024 Budget Law, reaching 2% of GDP (Figure 1). This is mainly due to higher general government revenues and lower expenditure in 2023 than foreseen in the law and the March 2024 update of macroeconomic development projections[3]. Given the results of the revenue sensitivity analysis, the impact of the revised macroeconomic developments on general government revenue could be positive, but uncertainties remain.

Figure 1. The general government deficit in 2024 is projected by the NAO FI to be lower than in the 2024 Budget Law

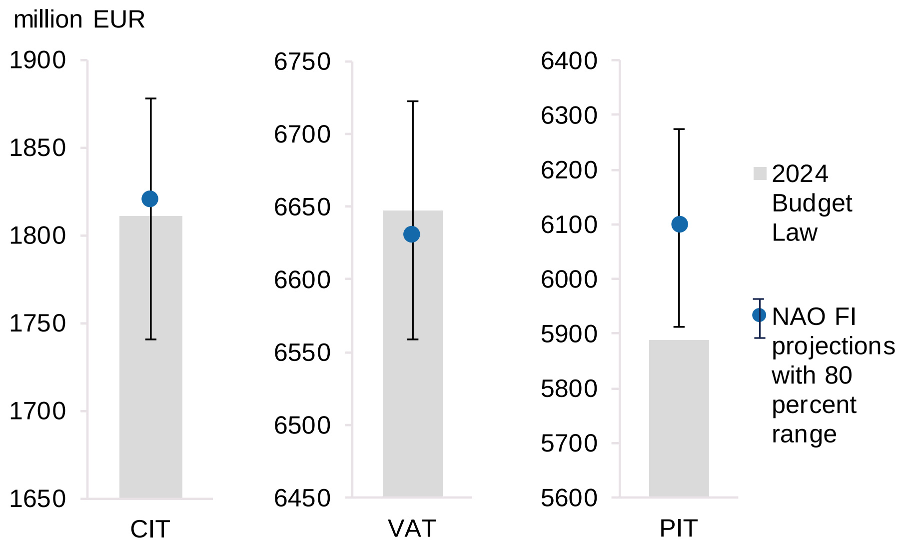


Source: 2024 Budget Law, calculations by the National Audit Office implementing the function of a fiscal institution

Taking into account the uncertainty involved, the projected 2024 revenue collection from corporate income and value added taxes by the NAO FI is close to that foreseen in the Budget Law. In 2024, revenue collection from personal income tax is likely to be higher. Both Lithuanian and international institutions project rapidly decelerating inflation and moderate economic growth in 2024. In order to assess the impact of macroeconomic uncertainty on the collection of revenue from the main taxes, the NAO FI carried out a sensitivity analysis of the budget revenue projections. On the basis of the March 2024 Economic Development Scenario (EDS) macroeconomic indicator endorsement ranges, the collection ranges for corporate income tax (CIT), VAT and PIT were calculated (indicated by the vertical lines in Figure 2). They show the interval in which the collection of the respective tax is likely to fall with a probability of 80%. The wider these intervals, the greater the uncertainty. Note that the ranges constructed are based on historical errors and therefore may not necessarily be fully indicative of future uncertainty.

[3] On 27 March 2024, the NAO FI issued an opinion on the endorsement of the Economic Development Scenario, which was the basis for its fiscal projections. Available online: https://www.valstybeskontrole.lt/EN/Product/24226/opinion-on-the-endorsement-of-the-economic-development-scenario.

Figure 2. Given the current uncertainty, personal income tax revenue in 2024 is likely to be higher than projected in the Budget Law



The blue dots indicate the projected 2024 revenues of the NAO FI for CIT, VAT and PIT. Next to these dots are the estimated vertical ranges: there is an 80% probability that the actual collection of the tax in question may fall within this range. The lower bounds of these intervals represent the 10th percentile of the distribution and the upper bounds the 90th percentile. The further apart these ranges are, the greater the uncertainty. These bands are based on the March 2024 EDS endorsement ranges for key macroeconomic indicators. The grey bars indicate the revenue plan in the 2024 Budget Law.

Source: State Data Agency, 2024 Budget Law, calculations by the National Audit Office implementing the function of a fiscal institution

The NAO FI projects that revenue from corporate income tax may be slightly higher than foreseen in the 2024 Budget Law, while VAT may be lower. However, taking into account the current macroeconomic uncertainty, the projections of the NAO FI for these revenues are similar to those of the Budget Law. It should be noted that there are both upside and downside risks to revenue collection. In the case of the PIT, this year's revenue collection is likely to be higher than projected in the 2024 Budget Law. The level of revenue in the law is based on the September 2023 EDS. The scenario assumes that the wage bill, which is used for the PIT revenue projections, will increase by 6.8% in 2024. In the March 2024 EDS, the wage bill growth projections for this year have been revised upwards to 9.1%. The NAO FI projects that in 2024, revenues from the CIT, the VAT and the PIT may be higher by around EUR 200 million than the Budget law.

In 2023, all general government sub-sectors performed better than expected, resulting in a general government deficit of 0.8% of GDP in 2023, instead of the projected 1.9% of GDP[4]. The surplus of the social security funds sub-sector (1.4% of GDP) was 0.4% of GDP higher than projected in the 2024 Draft Budget. This is mainly due to higher revenues from social contributions as a result of faster-than-projected growth in employment and wages. The improved labour market situation has also led to higher-than-expected personal income tax revenues. They contributed to a surplus in the local government sub-sector (0.2% of GDP), although under the fiscal discipline rules applicable to municipalities, they could have also run budget deficits given the negative output gap. The deficit of the central government sub-sector was lower than planned, due to higher tax revenues and lower current expenditure.

[4] The 2023 Budget law adopted a deficit of 4.9% of GDP and the 2024 Draft Budget revised the estimate to 1.9% of GDP.

PROJECTED GENERAL GOVERNMENT BALANCE 2025–2027

In the preparation of the projections of fiscal indicators, the NAO FI prepared two scenarios for the period 2025–2027: with and without additional revenue sources to increase the defence expenditure up to 3% of GDP (Table 2). Both scenarios include an increase in defence expenditure up to 3% of GDP and usual decisions that increase long-term general government expenditure. In the period 2018–2023, long-term expenditure averaged 1.3% of GDP. In the period 2025–2027, no decisions have yet been taken, such as increases in in the tax-exempt amount of income (TEA), social benefits or public sector salaries, and the NAO's FI is based on the assumption that such increases will be adopted. Other assumptions, such as additional indexation of pensions, are also included in the projections. The projection of the CHIF, SSIF and municipal budget indicators was based on the assumption that they are made in compliance with fiscal discipline rules.

Table 2. NAO FI scenarios for 2025–2027

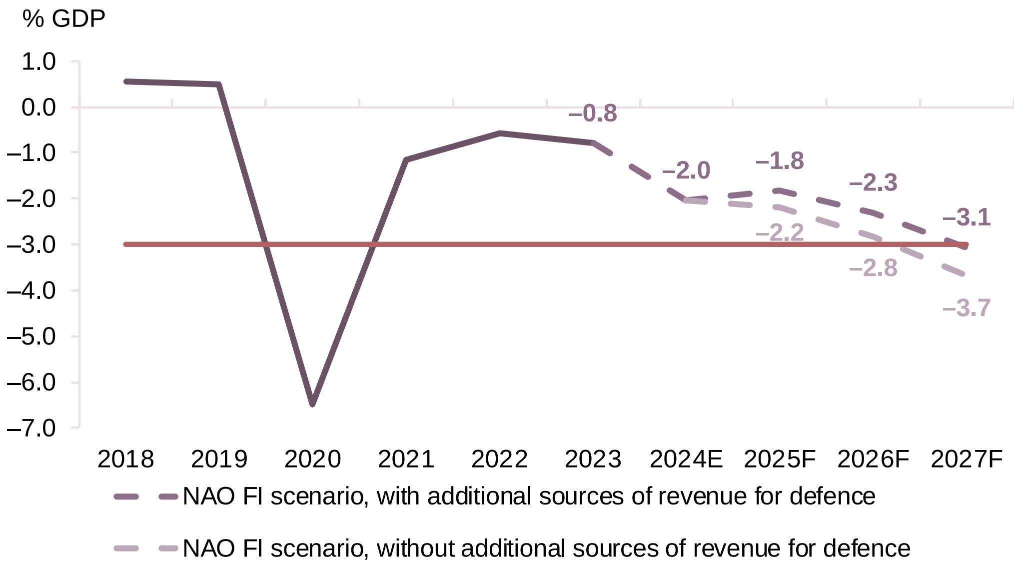
Baseline scenario, with additional sources of revenue for defence	Alternative scenario without additional sources of revenue for defence
Includes revenue from additional sources to finance defence[5]. In the absence of decisions, for simplicity they are included under other revenue, which in the NAO FI projections falls under the category of tax revenue from indirect taxation.	No revenue from additional sources for defence is foreseen.
Other assumptions are included: ➢ Defence spending is set at 3% of GDP from 2025. ➢ Additional indexation coefficient for the individual part of the social security pension is 1.02 (2%). ➢ The sub-sectoral budgets of the Local Government and Social Security Fund are drawn up in compliance with fiscal discipline rules.	
Includes discretionary decisions (on average €320 million annually) which normally reduce general government revenue and increase long-term GG expenditure on an annual basis: ➢ Bringing the rate of the tax-exempt amount of income closer to the minimum monthly wage. ➢ Increases in social assistance benefits and other basic amounts. ➢ Increasing salaries for public sector workers.	
The expenditure and revenue projections are based on the March 2024 Economic Development Scenario.	

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

The general government deficit would increase between 2025 and 2027 even if decisions on additional defence revenues were taken. According to the NAO FI's assessment, the general government deficit would then exceed the Maastricht criterion threshold of 3% of GDP in 2027 (Figure 3). This result is due to the fact that the NAO FI projections for non-defence expenditure are likely to grow faster than general government revenue growth. Additional sources of revenue would be needed to reduce the general government deficit.

[5] According to the Resolution of the Council of Ministers of the Republic of Lithuania No XIV-2505 of 21 March 2024 "On Approval of the Programme for Strengthening and Development of the National Defence System". Available online: https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/e3acb430e78f11ee9fdedfc979ae62a9.

Figure 3. Even if defence was financed by additional revenues, the usual annual increases in long-term expenditure would lead to a widening of the general government deficit between 2025 and 2027.



E – expected, F – forecast

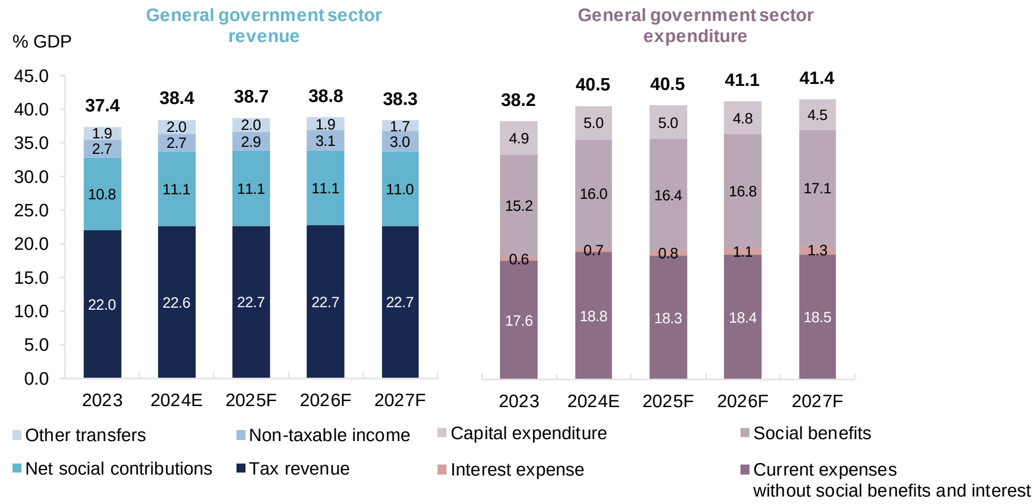
Source: State Data Agency, calculations by the National Audit Office implementing the function of a fiscal institution

The general government revenue level projected by the NAO FI for 2025–2027 will remain below the EU average at around 38.6% of GDP. Assuming that decisions are taken on additional sources of tax revenue to finance defence, the revenue level remains stable (Figure 4). Tax revenue consists of direct taxes (PIT, CIT) and indirect taxes (VAT, excise duties). The assumption of an increase in the TEA projects a decreasing level of direct taxes. The increase in the level of revenue from indirect taxes is mainly due to the inclusion of the assumption of additional sources of revenue for defence[6]. Revenues from social contributions remain stable (Annex 1, Table 1). The level of general government expenditure projected by the NAO FI will also remain below the EU-27 average[7] at around 41% of GDP. The main increase in general government expenditure will be driven by social benefits. Current expenditure, excluding interest and social benefit expenditure, will remain stable. Capital expenditure will grow on the back of defence expenditure. The overall level of expenditure and revenue is boosted by EU support, but, in line with the neutrality principle, it has no impact on the budget deficit indicator. According to the NAO FI's assessment, the peak level of EU support is likely to be around 2% of GDP in 2025. Interest expenditure should be noted. In 2027, it is projected to be more than twice as high as in 2023.

[6] According to the Resolution of the LRG "On Approval of the Programme for Strengthening and Development of the National Defence System", the revenue projection for 2025–2027 includes 0.3%, 0.4%, 0.5% of GDP respectively.

[7] In 2023, the average general government expenditure in EU countries was 49.4% of GDP.

Figure 4. General government revenue growth is projected to be insufficient to cover rising expenditure



In the NAO FI scenario, with additional revenue for defence.

E – expected, F – forecast

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

As demand for social and health services grows, surpluses in the social security sub-sector may be replaced by deficits in the near future. The surplus of the social security sub-sector is projected by the NAO FI to fall to 0.5% of GDP in 2027, from 1.4% of GDP in 2023 (Annex 1, Table 2). The NAO FI projects the surplus of the SSIF in 2027 to be more than double that in 2023. This is due to demographic projections, which show a declining working age population and an increasing retirement age population. [8] Also included is the assumption of an additional indexation of the individual part of the social security pension in order to increase the pension replacement rate. The NAO FI projects that the CHIF budget deficit will be the size of the cyclical component for the period 2025–2027[9], taking into account the negative output gap. It is important to mention that, given the average growth of health expenditure over the last 5 years and if the CHIF budget deficit is not constrained by fiscal discipline rules, it could reach a deficit of up to 1% of GDP in 2027. Such expenditure growth is likely to cover only part of the needs.

Financing of health care is low and the share paid by households is twice the EU average. Lithuania spends 2.5% p.p. of GDP less on health than the EU average (Figure 5). Households make up part of this difference by paying for healthcare *out of pocket'*, with 30.2% of total healthcare spending in 2021, more than double the EU average (14.5%). The European Commission has pointed out that most of the challenges in Lithuania's health system are due to structural underfunding of the health sector and insufficient resources at the primary care level. Based on the CHIF estimates provided with the draft budget for the year concerned, the NAO FI has observed that the indicated expenditure needs are often higher. For example, the CHIF's draft budget for 2024[10] indicates a spending requirement of EUR 3.9 billion, while the approved expenditure is EUR 3.5 billion. Expenditure is likely to

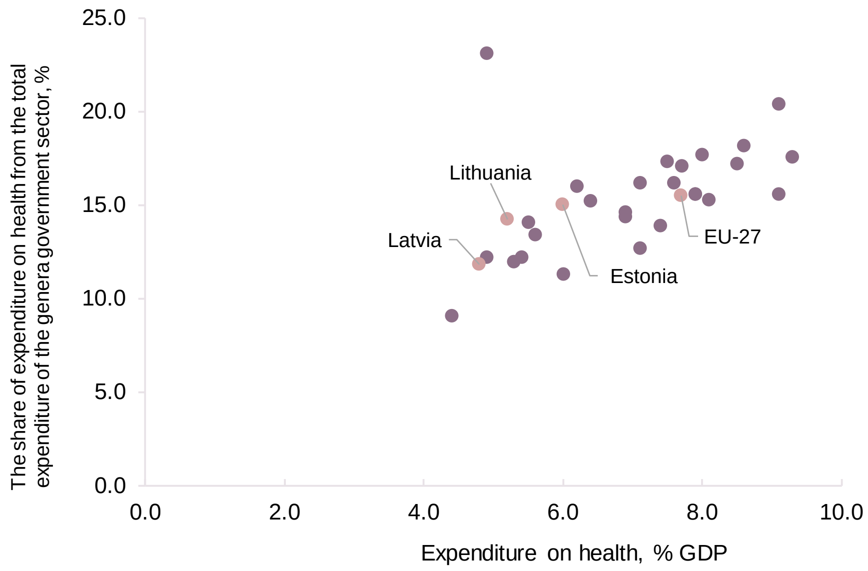
[8] As already mentioned by the NAO FI, the updated EUROPOP2023 projections foresee a slower decline in the working-age population compared to the EUROPOP2019 baseline scenario, but a faster growth of the population aged over 65.

[9] Cyclical components of municipal, SSIF, CHIF budgets. Available online: https://finmin.lrv.lt/media/viesa/saugykla/2024/4/OPuaeTviD18.pdf.

[10] Annex 5 "Detailed table of expenditure" to the draft law on the approval of the Budget Indicators of the Compulsory Health Insurance Fund for 2024. Available online: https://e-seimas.lrs.lt/portal/legalAct/lt/TAP/a491dd40638f11eea182def3ac5c11d6.

increase in the future in view of the commitments made to increase the salaries of health care staff, the ageing population and the development of related services.

Figure 5. Lithuania spends less on health than the EU average, although the share of health expenditure in total general government expenditure is similar to the EU average



2022 general government expenditure data by function (COFOG).

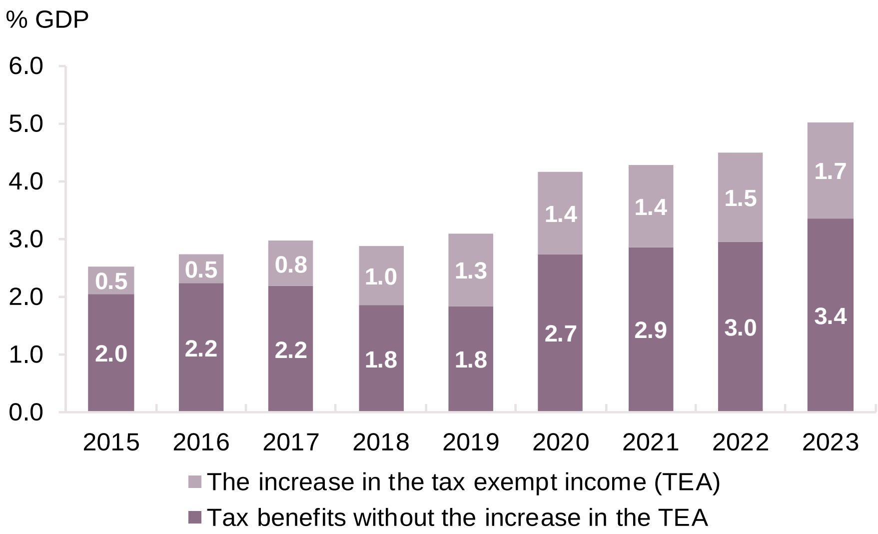
Source: Eurostat

Changes to the tax system are necessary to contribute to a fairer, simpler tax system and to meet growing financing needs. International organisations have made recommendations to improve Lithuania's tax system to make it fairer, simpler, and more neutral. Currently, Lithuania does not ensure horizontal equity, as people with similar incomes pay different levels of tax. Vertical equity has also been observed to be lacking, as the average PIT burden decreases once a certain level of high income is reached and continues to increase. This is because the income structure of high-income earners is dominated by individual activity and capital income, which are taxed at a lower rate. The tax system is also highly fragmented. According to World Bank estimates, there are as many as 72 taxable income codes in Lithuania. In the light of the World Bank's analysis[11], it is proposed to tax income as a whole, rather than by form of activity or type of income.

International organisations also recommend expanding environmental and property taxes and adjusting the tax system by reviewing exemptions and eliminating some of them. For example, a World Bank analysis revealed that the corporate tax break for small businesses in Lithuania are holding back the development of companies at the €300,000 threshold, because once the threshold is reached, the break ceases to apply, making the break harmful. If the exemptions for PIT, CIT, VAT and excise duties (excluding TEA) were not applied, the state budget revenues could be around 2.0% of GDP higher in 2015 and 3.4% of GDP higher in 2023 (Figure 6).

[11] World Bank. Analyzing the Size and Effects of Tax Optimization and Bunching with a Microsimulation Tool. Report and recommendations. December 2022.

Figure 6. The 4 main tax exemptions in place deprive the State budget of a significant share of revenue each year



Source: Budget Revenue Outlook 2015–2022, Explanatory Notes to the State Budget Implementation Accounts 2023, calculations by the National Audit Office implementing the function of a fiscal institution

Ambitious changes to the tax system are needed to ensure sufficient and stable funding for important areas of society. In 2023, the Government has proposed tax changes. Some of these were based on recommendations from international organisations[12], but did not sufficiently address the need for more redistribution. Improving the fairness and efficiency of the system is an important objective, but more ambitious changes are needed to increase the ratio of general government revenue to GDP. This is needed to address important societal challenges.

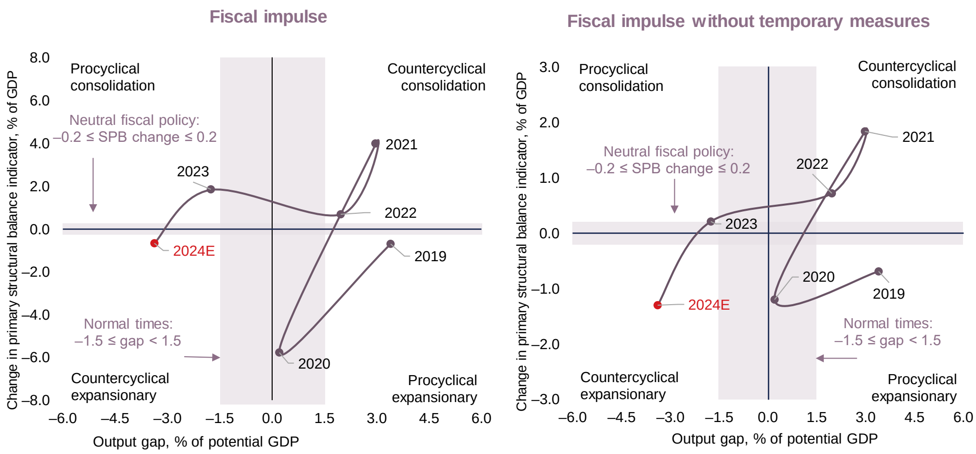
FISCAL POLICY STANCE FOR 2024

With the economy below its potential level, a stimulus is foreseen in 2024. The NAO FI projects a negative output gap in 2024, resulting in a projected annual change of –0.7% of GDP in the structural primary balance of the GG primary balance (Annex 2). This suggests that fiscal policy is in the countercyclical stimulus area. If temporary measures (i.e. support to Ukraine, mitigating the impact of the increase in energy prices, etc.[13]) are added to the one-off factors and removed from the structural balance assessment, the fiscal impulse in 2024 remains stimulative (Figure 7). With the economy below its potential level, stimulus is warranted. Importantly, the stimulus should also be based on investment spending.

[12] Assessment of Lithuania's Stability Programme 2023, 8 May 2023. Available at: https://www.valstybeskontrole.lt/EN/Product/24172/assessment-of-the-stability-programme-of-lithuania-for-2023.

[13] COVID-19 related measures, installation of a physical barrier and security systems on the Lithuanian-Belarusian border, maintenance of Lithuanian railway infrastructure.

Figure 7. The fiscal impulse in 2024 is stimulative, both including and excluding temporary factors

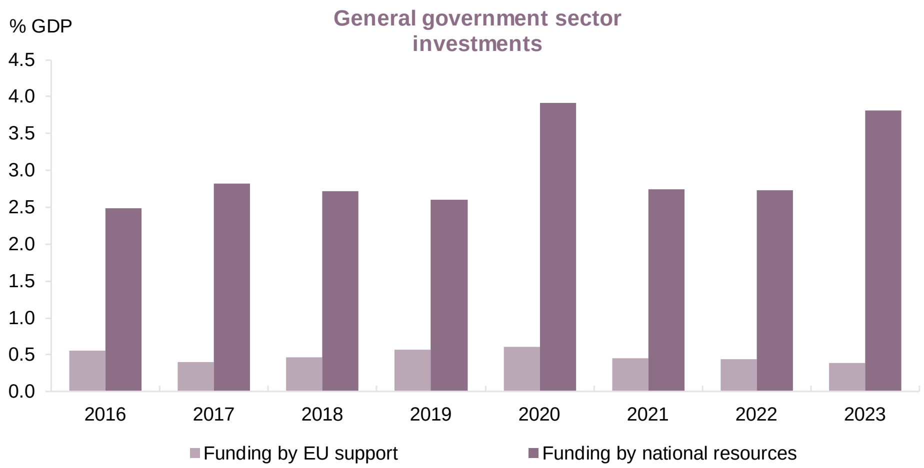


E – expected

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

It is important for Lithuania not only to maintain, but also to continue to promote nationally funded public investment. The dynamics of general government gross fixed capital formation (investment) by source of financing over the period 2016–2023 show that investment financed from national resources represented a larger share of GDP than that financed by EU support flows. The level of national investment has generally remained stable at around 3% of GDP on average each year (Figure 8). The role of national investment has been particularly pronounced during periods of economic hardship (2020 and 2023), when it has been necessary to absorb the negative effects of the business cycle and stimulate economic activity. The European Commission's Communication on the Fiscal Policy Guidelines 2024[14] notes that all Member States should preserve nationally financed investment in the future. There is also a need to ensure the effective use of the Recovery and Resilience Facility and other EU funds, in particular in the context of the green and digital transformation and resilience objectives.

Figure 8. Between 2016 and 2023, general government investment financed by national resources represented a higher share of GDP than that financed by EU support flows and has been kept at a generally stable level



Source: State Data Agency, State Budget Accounting and Payment System, calculations by the National Audit Office implementing the function of a fiscal institution

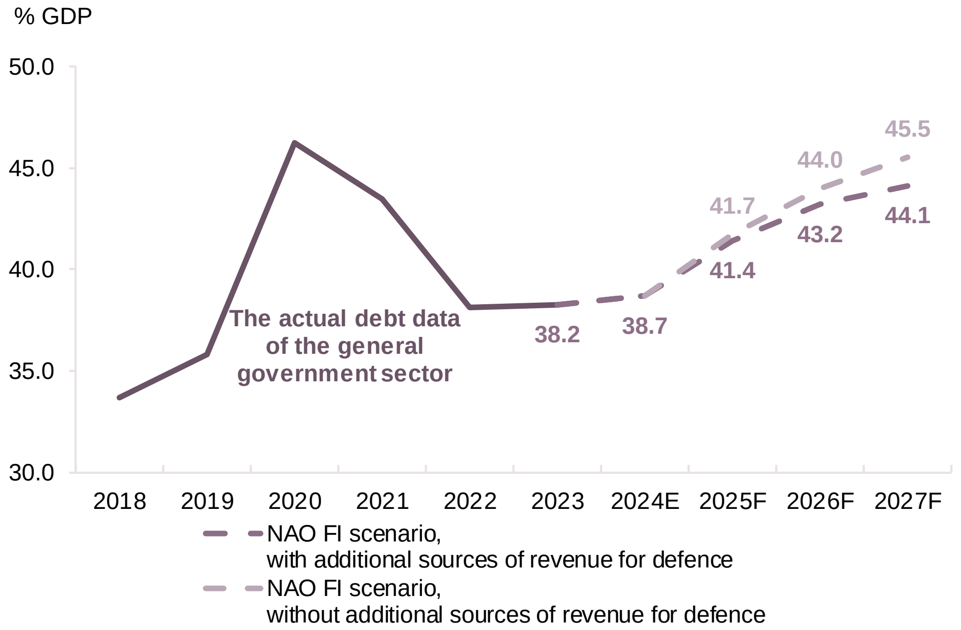
[14] Communication from the European Commission to the Council on the Fiscal Policy Guidelines 2024, 8 March 2023. Available online: https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/fiscal-policy-guidance_en.

According to the International Monetary Fund (IMF) [15], the need for spending to address structural challenges, including demographic and climate change pressures, is becoming more pressing, while slowing growth prospects in the medium term and rising real interest rates are likely to further constrain fiscal space in most countries.

PROJECTED GENERAL GOVERNMENT DEBT 2024–2027

Even if additional revenue sources for defence financing are foreseen, general government debt is likely to increase in the medium term. The NAO FI, based on the International Monetary Fund's methodology[16], projects this indicator to reach 38.7% and 41.4% of GDP in 2024–2025 (Figure 9). Normal discretionary decisions will lead to a further increase in GG debt over the rest of the medium term, reaching 44.1% of GDP in 2027. Without additional sources of revenue for defence financing, the growth of the debt would be even faster and could reach 45.5% of GDP in 2027.

Figure 9. Without additional sources of revenue for defence financing, general government debt would grow faster



E – expected, F – forecast

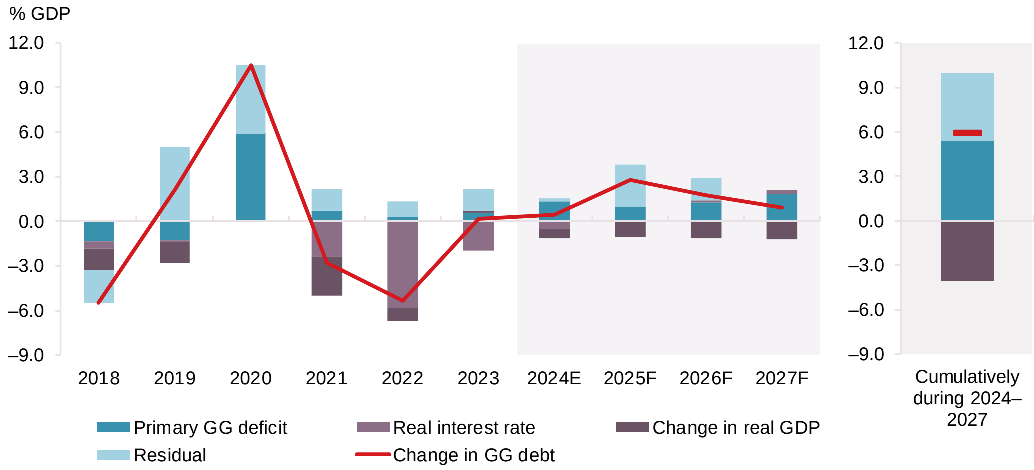
Source: State Data Agency, calculations by the National Audit Office implementing the function of a fiscal institution

Looking at the drivers of debt dynamics, the main contributor to debt change will be the primary deficit of the GG, which could average around 1.4% of GDP annually between 2024 and 2027 (Figure 10). The projected expansion of real GDP will moderate the debt growth by an average of 1% of GDP annually. As inflation slows down and GG debt is refinanced with more expensive issues of securities, the favourable impact of real interest rates on GG debt will diminish. It is projected to contribute to debt growth between 2026 and 2027 (Annex 1, Table 3).

[15] International Monetary Fund "Why Our World Needs Fiscal Restraint in Biggest-Ever Election Year". Available online: https://www.imf.org/en/Blogs/Articles/2024/04/17/why-our-world-needs-fiscal-restraint-in-biggest-ever-election-year.

[16] International Monetary Fund, Staff Guidance Note for Public Debt Sustainability Analysis in Market-Access Countries, 9 May 2013. Available online: https://www.imf.org/external/np/pp/eng/2013/050913.pdf.

Figure 10. The main contributor to the general government debt-to-GDP ratio in 2024–2027 is likely to be the primary deficit



* The balance for 2025–2026 includes the *stock-flow adjustment* in the 2024 Draft Budget (DB2024)

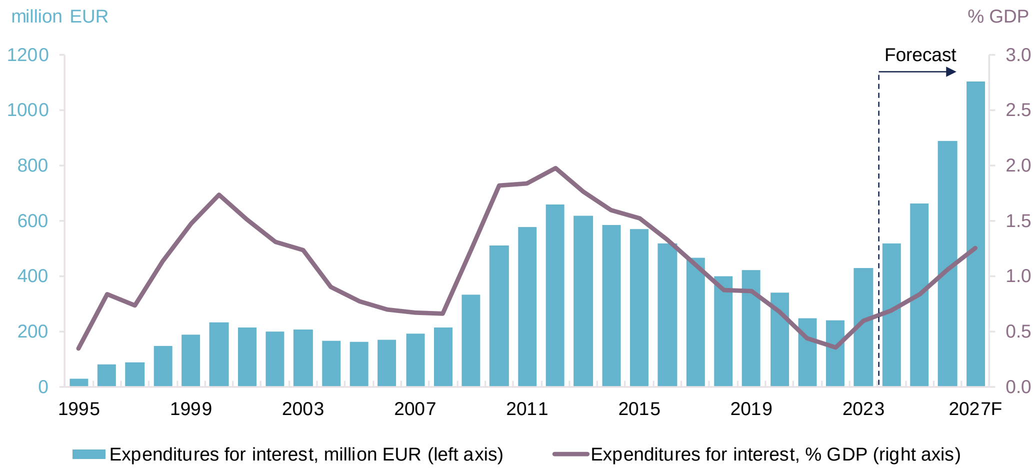
In the NAO FI scenario, with additional revenue for defence.

E – expected, F – forecast

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

Financing public sector debt is becoming increasingly expensive. The NAO FI projects the cost of interest payments on general government debt to amount to EUR 518 million (0.7% of GDP) in 2024, with an annual increase (Figure 11). It is likely to exceed EUR 1 billion (1.3% of GDP) in 2027. This higher expenditure implies that more resources will need to be devoted to debt servicing in the future, when they could be used for other important public areas such as health, etc. Although the projected ratio of interest expenditure to GDP is rising over the medium term, it is not exceptionally high given the data since 1995. For example, interest expenditure amounted to more than 1.4% of GDP in 2010–2015.

Figure 11. Expenditure on interest payments* on GG debt is projected to continue to grow



* Estimated on the basis of information from the Ministry of Finance on debt repayments and interest payments based on commitments made on 29.02.2024 and information on planned debt commitments for the assessment of the Draft Budget 2024.

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

REVIEW OF THE ECONOMIC GOVERNANCE OF THE EUROPEAN UNION

On 29 April 2024, the Council of the European Union approved legal changes[17], which define fiscal discipline at EU level. The economic governance process is changing: from 2024, countries will start preparing fiscal-structural plans with a 4-7 year horizon instead of Stability and Convergence Programmes and National Reform Programmes. This is a shift towards medium-term planning. These documents will need to set out the countries' fiscal plans and explain how the Member State will ensure that reforms and investments reflecting the Member State's and the EU's priorities (e.g. green transformation, strengthening of defence capabilities) are implemented. The plans will be approved by the Council and each spring Member States will submit annual progress reports to the EC.

The updated rules will be based on the expenditure growth rule and debt sustainability analysis. Compliance with the rules will depend on how well countries manage to stay within the net expenditure growth path set in the Council-approved plan. Net expenditure is calculated taking into account interest expenditure, discretionary revenue measures, EU funds, national expenditure on co-financing of EU programmes, cyclical unemployment benefits and one-off and temporary measures. The allowed growth rate of these expenditures will be determined on the basis of a debt sustainability analysis and debt and deficit safeguards. For countries with debt below 60% of GDP and deficits below 3% of GDP, the EC can provide technical information at the country's request to ensure that the 3% of GDP deficit criterion is not breached. This means that for countries like Lithuania, the EU's fiscal discipline rules will be looser than before. In addition, the new changes adopted in the EU's review of economic governance strengthen governments' ability to invest. The European Commission will now have to take into account the investments being made before a Member State can be subject to an excessive deficit procedure[18]. Also, by removing from net expenditure all national expenditure related to the co-financing of EU programmes, it will be able to grow faster over the period of the fiscal plan.

When a country's debt exceeds 60% of GDP or its deficit exceeds 3% of GDP, the EC provides the Member State concerned with a reference trajectory of net expenditure, which includes a four-year adjustment period and a possible extension of up to three years due to an investment and reform clause. The reference trajectory proposed by the EC will need to ensure that the public debt-to-GDP ratio declines or remains below 60% of GDP after the adjustment period and that the 3% of GDP deficit criterion is not breached. It must also take into account debt and deficit safeguards - i.e. ensuring at least a minimum debt reduction over the adjustment period and a distance from the 3% of GDP deficit (a structural deficit of no more than 1.5% of GDP must be ensured).

The new rules clarify the circumstances under which the general escape clause to the fiscal discipline rules applies. In exceptional circumstances, the Council may apply the general escape clause, but it should be limited to one year. If the exceptional circumstances persist, an extension of the clause is possible. In such a case, they shall be extended for a period of one year, but the number of extensions shall not be limited. The European Fiscal Board shall deliver an opinion on the extension of the general escape clause. The duration of the national escape clause shall also be fixed in advance and approved by the Council.

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[17] Available online: https://www.consilium.europa.eu/en/press/press-releases/2024/04/29/economic-governance-review-council-adopts-reform-of-fiscal-rules/?utm_source=brevo&utm_campaign=AUTOMATED%20-%20Alert%20-%20Newsletter&utm_medium=email&utm_id=320.

[18] New EU fiscal rules approved by MEPs. Available at: https://www.europarl.europa.eu/news/en/press-room/20240419IPR20583/new-eu-fiscal-rules-approved-by-meps.

The role of independent fiscal institutions is maintained. As before, the fiscal institutions will have to prepare, assess or approve macroeconomic forecasts. They will also have to assess the coherence, consistency and effectiveness of the national budgetary framework. A role is also envisaged in the context of the preparation of fiscal-structural plans, whereby a Member State may request the opinion of an independent fiscal institution on the macroeconomic forecasts and the assumptions underlying the net expenditure path.

The National Audit Office of the Republic of Lithuania, in its capacity as the budget policy monitoring authority, is responsible for monitoring compliance with the rules of fiscal discipline and the fulfilment of tasks set out in the Constitutional Law on the Implementation of the Fiscal Treaty of the Republic of Lithuania, and is empowered to prepare and submit to the Seimas of the Republic of Lithuania independent opinions related to compliance with the rules of fiscal discipline and macroeconomic developments. The NAO FI, on its own initiative, has carried out an assessment of general government finances for the period 2024–2027 and is submitting it to the Seimas of the Republic of Lithuania.

Head of Budget Monitoring Department Jurga Rukšėnaitė

ANNEXES

General government finance assessment
2024–2027
Annex 1

NAO FI PROJECTIONS OF FISCAL INDICATORS

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

Indicator, % of GDP	ESA 2010 code	2022	2023	2024E	2025F	2026F	2027F
Total revenue	OTR	35.7	37.4	38.4	38.7	38.8	38.3
Tax revenue		21.4	22.0	22.6	22.7	22.7	22.7
Revenue from indirect taxes	D.2	11.4	11.3	11.8	12.2	12.4	12.6
Revenue from direct taxes	D.5	10.0	10.7	10.8	10.5	10.3	10.1
Net social contributions	D.61	10.2	10.8	11.1	11.1	11.1	11.0
Other revenue, of which:		4.1	4.6	4.7	4.9	5.0	4.7
Revenue from property	D.4	0.4	0.7	0.7	0.9	1.1	1.0
Total expenditure	OTE	36.3	38.2	40.5	40.5	41.1	41.4
Compensation of employees	D.1	10.1	10.7	11.1	11.1	11.2	11.3
Intermediate consumption	P.2	4.3	4.1	4.5	4.5	4.5	4.5
Subsidies	D.3	1.7	0.7	0.6	0.4	0.3	0.4
Interest costs	D.41	0.4	0.6	0.7	0.8	1.1	1.3
Social benefits	D.6M	14.0	15.2	16.0	16.4	16.8	17.1
Other expenditure, of which:		5.9	6.9	7.6	7.4	7.1	6.8
Gross fixed capital formation	P.5L	3.2	4.3	4.3	4.4	4.3	4.0
Capital transfers	D.9	0.7	0.6	0.6	0.6	0.5	0.5
Net lending (+) / net borrowing (-)	B9	−0.6	−0.8	−2.0	−1.8	−2.3	−3.1

In the NAO FI scenario, with additional sources of revenue for defence.
E – expected, F – 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, % of GDP	2022	2023	2024E	2025F	2026F	2027F
1.	Central government sub-sector	−2.2	−2.3	−3.0	−2.7	−3.0	−3.6
2.	Social insurance funds sub-sector	1.5	1.4	1.0	0.8	0.7	0.5
3.	Local government sub-sector	0.2	0.2	−0.1	0.0	0.0	−0.0
4.	General government	−0.6	−0.8	−2.0	−1.8	−2.3	−3.1

Figures may vary due to rounding.
In the NAO FI scenario, with additional sources of revenue for defence.
E – expected, F – 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, % of GDP	2022	2023	2024E	2025F	2026F	2027F
1.	GG debt	38.1	38.2	38.7	41.4	43.2	44.1
2.	Change in GG debt (3+4+7)	–5.4	0.2	0.4	2.7	1.8	0.9
3.	Primary GG deficit	0.3	0.6	1.4	1.0	1.2	1.8
4.	Automatic debt dynamics (5+6)	–6.7	–1.9	–1.1	–1.1	–1.0	–0.9
5.	Real interest rate	–5.8	–2.0	–0.5	–0.0	0.2	0.3
6.	Change in real GDP	–0.9	0.1	–0.6	–1.1	–1.1	–1.2
7.	Residual*	1.0	1.4	0.2	2.8	1.5	0.0

* The residual for 2025–2026 includes the *stock-flow adjustment* in DB2024

In the NAO FI scenario, with additional sources of revenue for defence.

E – expected, F – forecast

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

General government finance assessment
2024–2027
Annex 2

CYCLICAL SITUATION OF THE LITHUANIAN ECONOMY AND STRUCTURAL GENERAL GOVERNMENT BALANCE, 2020–2024, AS ASSESSED BY THE NAO FI

No.	Indicator, % of GDP	2020	2021	2022	2023	2024E
1.	General government net lending (+) / borrowing (-)	−6.5	−1.1	−0.6	−0.8	−2.0
2.	One-off and other temporary measures*	0.0	0.0	0.2	−0.1	0.0
3.	Temporary measures**	−4.6	−2.4	−2.5	−0.8	−0.2
4.	Output gap, % of potential GDP	0.2	3.0	2.0	−1.8	−3.4
5.	Cyclical budget component (0.399 × 4 lines)	0.1	1.2	0.8	−0.7	−1.3
6.	Structural GG balance (1 – 2 – 5)	−6.6	−2.3	−1.5	0.1	−0.7
7.	Structural GG balance, excluding temporary measures (1 – 2 – 3 – 5)	−2.0	0.1	0.9	0.9	−0.5
8.	Interest	0.7	0.4	0.4	0.6	0.7
9.	Structural GG primary balance (6 + 8)	−5.9	−1.9	−1.2	0.6	0.0
10.	Structural GG primary balance, excluding temporary measures (7 + 8)	−1.3	0.6	1.3	1.5	0.2
11.	Change in the structural GG primary balance	−5.8	4.0	0.7	1.8	−0.7
12.	Change in the structural GG primary balance, excluding temporary measures	−1.2	1.8	0.7	0.2	−1.3

E – expected,

** COVID-19-related measures include 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