VALSTYBĖS KONTROLĖ
BUDGET MONITORING

To the Seimas of the Republic of Lithuania

OPINION ON THE STRUCTURAL ADJUSTMENT TARGET

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Vilnius

THE PLANNED DEFICIT IN 2025 IS NOT IN LINE WITH NATIONAL FISCAL DISCIPLINE RULES AND RISKS BREACHING THE MAASTRICHT CRITERION

The National Audit Office implementing the function of a fiscal institution (NAO FI), submits to the Seimas its opinion on the Draft Law on Budget Approval of the Republic of Lithuania for the period 2025–2027[1] (DB2025).

The draft budget projects a general government deficit of 3% of GDP in 2025, with the risk of non-compliance with the surplus general government rule. This rule has not been applied since 2020, when exceptional circumstances were declared. From 2025 onwards, these circumstances will not apply. If the structural deficit in 2025 is higher than 1% of GDP, which is the medium-term objective adopted by the Parliament of the Republic of Lithuania, a structural adjustment target will have to be set for the period 2026–2027 in order to reach the structural deficit below 1% of GDP in 2027. The MoF forecasts a structural deficit of 2.4% of GDP in 2027. Thus, in order to comply with the Constitutional Law implementing the Fiscal Treaty, the general government deficit should decrease more than currently projected between 2026 and 2027.

Bringing the deficit back within the rules of fiscal discipline may require more effort than the draft budget would suggest, as it does not include routine decisions such as public sector salary increases for 2026–2027. In the context of rapidly rising expenditure, the Government has proposed to Parliament to add to the Constitutional Law implementing the Fiscal Treaty a provision to suspend the application of the articles defining the surplus general government rule and the structural adjustment targets for the 2025 budget. In the opinion of the NAO FI, this proposal poses risks to long-term fiscal sustainability and only postpones the fiscal adjustment into the future.

Key messages of the opinion:

- **According to the NAO FI's assessment, the planned deficit for 2025 does not comply with the requirements of the surplus general government rule.**
- **The Government's proposal to Seimas to suspend the surplus general government rule in 2025 poses risks to long-term fiscal sustainability.**
- **There is a risk that the general government deficit will be above 3% of GDP in 2025.**
- **Taking into account the annual decisions and the long-term commitments that are not foreseen in the draft budget for 2026–2027, the NAO FI projects the general government deficit to exceed the 3% of GDP threshold in 2026.**
- **With structural deficits on the rise, revenue and spending decisions are needed now to achieve sustainable public finances.**
- **Financing general government debt will become more expensive every year and, without the necessary decisions, the debt will increase and is expected to reach almost half of the country's GDP in 2027.**

[1] Available online: https://e-seimas.lrs.lt/portal/legalAct/lt/TAP/8747ce708bbb11efaf94d67dd8b48a7c.

SUMMARY

There are no significant differences between the projections of the general government (GG) deficit for 2024–2025 by the NAO FI and the Ministry of Finance. In the draft budget a general government deficit of 3% of GDP in 2025 is projected, higher than in 2024. According to the NAO FI's assessment, it is unlikely that the 2025 deficit would be better than 3% of GDP, due to past commitments and discretionary decisions that increase general government expenditure. There is little scope for general government revenues to be significantly higher than projected. Even if the execution of the revenue plan were to be better than projected, as in previous years, the resulting fiscal space would likely be used for additional spending. It cannot be excluded that various risks could push the deficit above the Maastricht criterion threshold in 2025.

The exceptional circumstances applied from 2020 will no longer apply in 2025. This means that not only the EU rules should be respected, but also the national rules laid down in the Constitutional Law on the Implementation of the Fiscal Treaty of the Republic of Lithuania (CL). As a preliminary assessment, the budgets of the State Social Insurance Fund (SSIF) and the Compulsory Health Insurance Fund (CHIF) for 2025 have been drawn up in accordance with the rules applicable to them. According to the NAO FI's assessment, the surplus GG rule would not be respected as the structural balance is below the medium-term objective, currently set by the Parliament at –1% of GDP. If the assessment is confirmed, a structural adjustment target should be set in accordance with the CL, which would allow a return to the medium-term objective within two years.

The Government has submitted a proposal to Parliament to amend the CL, which would mean that in 2025 the surplus GG rule would not be applied, and the structural adjustment target would not be set, in line with the aim of reviewing national legislation related to fiscal discipline rules. This change to the CL, in the view of the NAO FI, poses risks to long-term fiscal sustainability for two main reasons:

1) such single-purpose changes to the Constitutional Law create distrust in the stability of the fiscal governance;
2) tackling of the fiscal challenges is being postponed, while structural indicators already point to risks to the sustainability of public finances.

According to the NAO FI, the structural primary deficit will be around 1% of GDP in 2027. According to the technical information of the European Commission (EC) for 2024 provided in the DB2025, a structural primary surplus of 0.2% of GDP should be achieved in 2028. It is worth noting that some of the decisions that used to be foreseen for one year are now foreseen for three years in DB2025, but the task of realistic three-year budgets is still not met. DB2025 does not foresee decisions on additional indexation of pensions, on the tax-exempt amount of income, on salary increases for public sector workers in the period 2026–2027. According to the NAO FI's assessment, if decisions of this nature were taken without also providing for additional sources of revenue, the general government deficit in 2026 could exceed the Maastricht criterion threshold. In this case, the EC would have grounds to open an excessive deficit procedure for Lithuania.

According to the NAO FI's estimates, the debt would reach almost 43% of GDP in 2025 and approach 50% of GDP in 2027. It is important to note that financing general government debt is becoming increasingly expensive. This implies that in the future, more resources will be needed to service the debt, which could be used for other important public areas such as healthcare, etc. In the longer term, the need for spending will increase in the future not only because of commitments, possible discretionary decisions, but also because of an ageing population. Structural revenue and expenditure decisions are needed now to achieve sustainable public finances.

THE FISCAL DISCIPLINE RULES

The change in the European Union's fiscal discipline rules means that there is no longer a legal basis for applying exceptional circumstances in Lithuania in 2025. The exceptional circumstances in Lithuania have been applied from 2020, when the situation resulting from the COVID-19 pandemic was recognised as meeting the definition of exceptional circumstances. In 2022, the exceptional circumstances were based on the geopolitical situation resulting from the war in Ukraine. In the absence of a Government initiated waiver of the exceptional circumstances, the application of the national fiscal discipline rules (FDR) remains restricted in 2024. However, as a result of changes in the European Union legislation in 2024, to which the CL is linked, these circumstances will no longer apply in Lithuania from 2025.

According to the assessment of the NAO FI, the 2024 general government budgets will comply with the applicable requirements of the Constitutional Law, but there is a risk that the 2025 general government budget will not comply with the requirements of the surplus general government rule (Table 1)[2]. In the context of the ongoing exceptional circumstances in 2024, the GG expenditure growth limitation rule and surplus GG rule are not applicable. However, the full application of the rules from 2025 onwards would result in non-compliance with the surplus general government rule. Compliance with the rule would require that the structural balance is not below the medium-term objective (MTO), currently set by Parliament at –1% of GDP. The MoF estimates a structural deficit of 2.1 % of GDP in 2025 and the NAO FI 2.2 % of GDP. Thus, according to both institutions, the structural deficit of the GG will exceed the MTO in 2025. In this situation, the CL foresees that a structural adjustment target should be set in order to achieve the MTO within two years. The MoF forecasts a structural deficit of 2.4% of GDP in 2027. Thus, in order to comply with the CL, the GG deficit should decline more than currently projected between 2026 and 2027.

Table 1. Compliance with fiscal discipline rules 2024–2025

Fiscal discipline rules	2024	2025
Surplus GG rule	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 2025	

✓ – compliance, × – risk of non-compliance

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

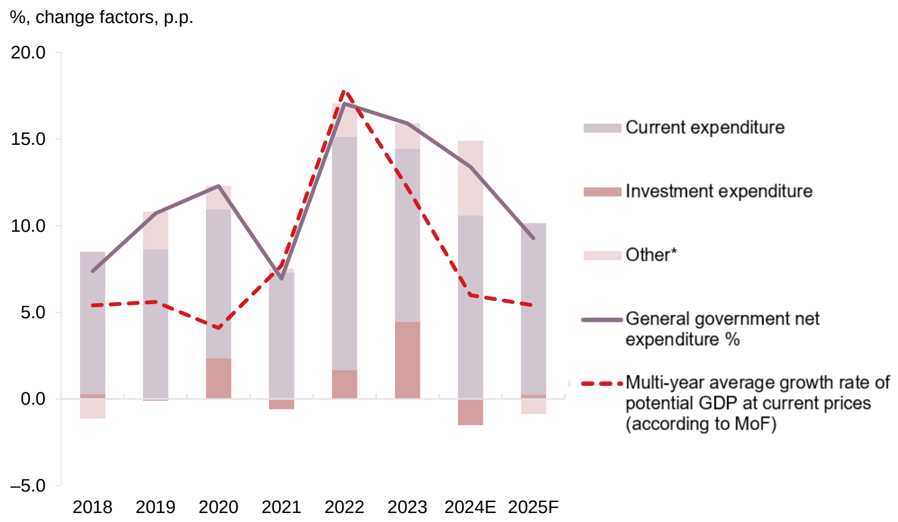
The exclusion of the GG growth limitation rule in 2025 is due to the following circumstances: slower GDP growth in Lithuania than the EU's multi-annual GDP growth rate, increased by 2 p.p., and a cyclical downturn. However, the rapid growth of net GG[3] expenditure, which exceeds the multiannual growth rate of potential GDP at current prices (Figure 1), points to a widening of the structural deficit in 2025. To reduce the structural deficit of the GG, these expenditures would need to increase more slowly than the multiannual rate of change in potential GDP at current prices, or they could increase more rapidly if they were financed by additional revenue measures. The EC has already pointed out the rapid growth of expenditure when assessing Lithuania's draft budget

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

[3] The net expenditure of the GG 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 COVID-19, the mitigation of the impact of the increase in energy prices, and support to Ukraine, and after the subsequent adjustment of this total expenditure by discretionary revenue measures.

for 2023. At the time, it was underlined that the increase in primary current expenditure financed by national resources is not in line with the Council recommendations[4].

Figure 1. Net expenditure in 2024–2025 is likely to exceed the rate of increase in multi-year potential GDP at current prices indicating sustainable growth



Based on DB2025 projections.

* Changes in inventories and acquisitions less disposals/transfers, acquisitions less disposals of non-financial assets not created, other current transfers, capital transfers.

E – expected, F – forecast

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

The rules for the budgets attributed to the SSIF and the CHIF are expected to be respected in the period 2024–2025. The structural balance of the SSIF budget in 2024 and 2025 is estimated by the NAO FI at 1.4% 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 of this sub-sector is expected. The estimated structural balance of the CHIF budget is estimated at 0.0% and 0.1% of GDP in 2024 and 2025 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, as judged by the structural balance indicator. The compliance of municipal budgets with fiscal discipline rules will be assessed in the first half of 2025.

Due to changes in EU fiscal discipline rules, changes in national legislation on fiscal discipline are foreseen in 2025. EU fiscal discipline rules have been substantially amended following the conclusion of the economic governance review in April 2024 and the adoption of the relevant EU legislation. The new rules are based on a debt sustainability analysis and an expenditure growth rule. These developments at EU level also entail, among other related changes to national legislation, an amendment to the Constitutional Law implementing the Fiscal Treaty to align national fiscal discipline rules with EU rules. The NAO FI welcomes the intention to revise the national fiscal discipline rules, not only to maintain their alignment with EU rules, but also to take into account Lithuania's fiscal and macro-economic situation and the challenges ahead.

The Government's proposal to Parliament to amend the CL, which would mean that in 2025 the surplus GG rule would not be applied, and the structural adjustment target would not be set, poses risks to long-term fiscal sustainability. Because there will be a transitional period until the end of 2025 during which part of the EU legislation will be transferred into national law, the Government proposes to exempt the draft budgets for the period 2025–2027 from the provisions of Articles 3 and

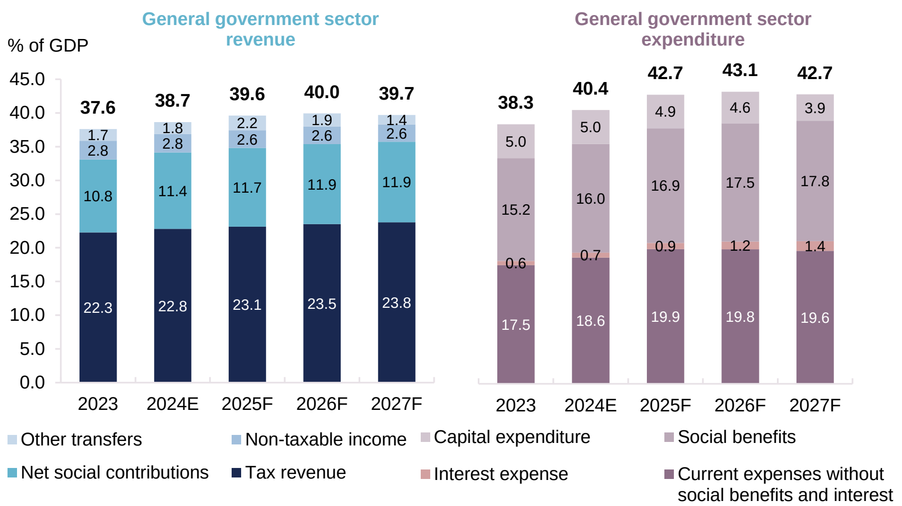
[4] Available online: https://economy-finance.ec.europa.eu/document/download/f90709fe-c921-4c8b-9a14-51127d8751fd_en?filename=c_2022_9513_1_lt.pdf.

6 of the CL. In this case, the surplus GG rule would not apply and there would be no obligation to set a structural adjustment target. However, according to the NAO FI's assessment, the proposed amendment to the CL in the draft budget to suspend the fiscal discipline rules in 2025 is a consequence of the projected strong expenditure growth without additional revenue sources. As noted by the European Fiscal Board (EFB)[5], in many euro area countries, general government expenditure has increased sharply over the past few years, well beyond the temporary measures taken in response to the COVID-19 crisis and the subsequent energy price spike. As Government needs have increased, the focus on sustainable public finances in Member States has declined significantly. A more prudent and balanced approach to fiscal policy would be appropriate for the euro area as a whole, as it would allow sustainable growth to be maintained. The NAO FI considers that these observations of the EFB are also relevant for Lithuania. The proposal to suspend some of the rules of the CL in one budgetary year only postpones the need for fiscal adjustment to later years and may pose risks to the application of fiscal discipline rules and the conduct of responsible fiscal policies in the future.

PROJECTIONS OF GENERAL GOVERNMENT FINANCES 2024–2025

The general government deficit in 2024 is projected by the NAO FI to be lower than in the draft budget. Taking into account the revenue and expenditure projected by the NAO FI, the general government deficit in 2024 will amount to 1.8% of GDP (Annex 1, Table 1). The draft budget is set at 2.2% of GDP. The main reason for the better NAO FI balance in 2024 is the higher projected revenue from corporate income and value added taxes than foreseen in DB2025. Based on the revenues received by the state budget in January–September, the NAO FI estimates that the revenue target approved in the 2024 Budget Law will be met for corporate income tax, but not for value added tax. It should be noted that the overall revenue plan foreseen in the 2024 Budget Law is likely to be achieved. This will be supported by higher projected personal income tax revenues due to faster than expected growth in average wages and the number of people in employment. NAO FI projected general government expenditure in 2024 is 0.2% of GDP lower than in DB2025, due to lower projected expenditure on interest and social benefits. The revenue and expenditure projections of the NAO FI are presented in Figure 2.

Figure 2. General government revenues are projected to grow insufficiently in the medium term to cover rising expenditure



* Totals may differ due to rounding.

E – expected, F – forecast

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

[5] "Assessment of the fiscal stance appropriate for the euro area in 2025". Available at: https://commission.europa.eu/publications/european-fiscal-board-assesses-appropriate-fiscal-stance-euro-area-2025_en.

EU support contributes to the overall level of expenditure and revenue, but in line with the principle of neutrality, it does not affect the budget deficit indicator. According to the assumptions of the NAO FI, EU support will peak in 2025 at more than 2% of GDP, before being halved in 2027.

The general government deficit of 3% of GDP in the draft budget for 2025 is plausible. The revenue projections in DB2025 are realistic and in line with macroeconomic developments. The NAO's FI projections are similar to those of DB2025. Given the projected level of revenue, the expenditure planned in the draft budget for 2025 grows at a pace that does not breach the Maastricht threshold. Compared to 2024, expenditure in 2025 rises by around 2% of GDP or €1.6 billion. The GG deficit projected for DB2025 is, in the assessment of the NAO FI, plausible given the nature of the expenditure projected for DB2025 in 2025:

- Most of the increase is due to previous commitments, including pension indexation, pay rises for targeted groups (e.g. teachers) and others. In most cases, this type of expenditure is implemented.
- There is no longer any provision for one-off expenditure, the non-spending of which, if no longer needed, could lead to a better GG balance, as was the case with COVID-19 or energy price mitigation measures.
- Borrowing is allowed within the 3% of GDP deficit and the statutory net borrowing limit, which would allow for additional spending if there were room for additional revenues. This would contribute to the keeping the GG deficit not decreasing.
- In the light of public debate, economic and social indicators and the geopolitical situation, the increased funding needs in different areas, with a view to improving security, social sustainability and the broader delivery of functions are highlighted. For example: defence, pensions, road infrastructure, etc.

To summarise, in the opinion of the NAO FI, it is unlikely that the 2025 deficit indicator would be better than 3% of GDP due to the commitments made in the past and discretionary decisions that increase GG expenditure. There is little scope for GG revenues to be significantly higher than projected, as one-off factors such as higher inflation are unlikely. Even if the revenue plan was to perform better than forecast, as in previous years, the resulting fiscal space would most likely be used for additional expenditure (Annex 2).

There is a risk that the general government deficit will be above 3% of GDP in 2025. If economic developments are more sluggish than projected in the September 2024 Economic Development Scenario (EDS), this could put pressure on additional spending and reduce general government revenues. The GG balance could also be affected by the ESA2010 accrual correction and revisions to the national accounts (see Box for more details).

Box. Revision of gross domestic product and its potential impact on projected fiscal indicators 2024–2027

A major revision of the national accounts was carried out in 2024, revising GDP data since 1995. Every year, the National Accounts are revised by the State Data Agency (SDA) to improve the accuracy and comparability of the indicators, and to ensure their quality and consistency at European Union level. This year, the five-yearly main revision of the national accounts indicators was carried out[6]. It affected all components of gross domestic product and affected the growth rates of the indicators. The time series for 1995–2022 were revised and the GDP figures for 2023

[6] The main reasons for the revision were the reservations received from Eurostat and recommendations and other improvements related to changes in methods and sources. Available online: https://osp.stat.gov.lt/informaciniai-pranesimai?eventId=335469.

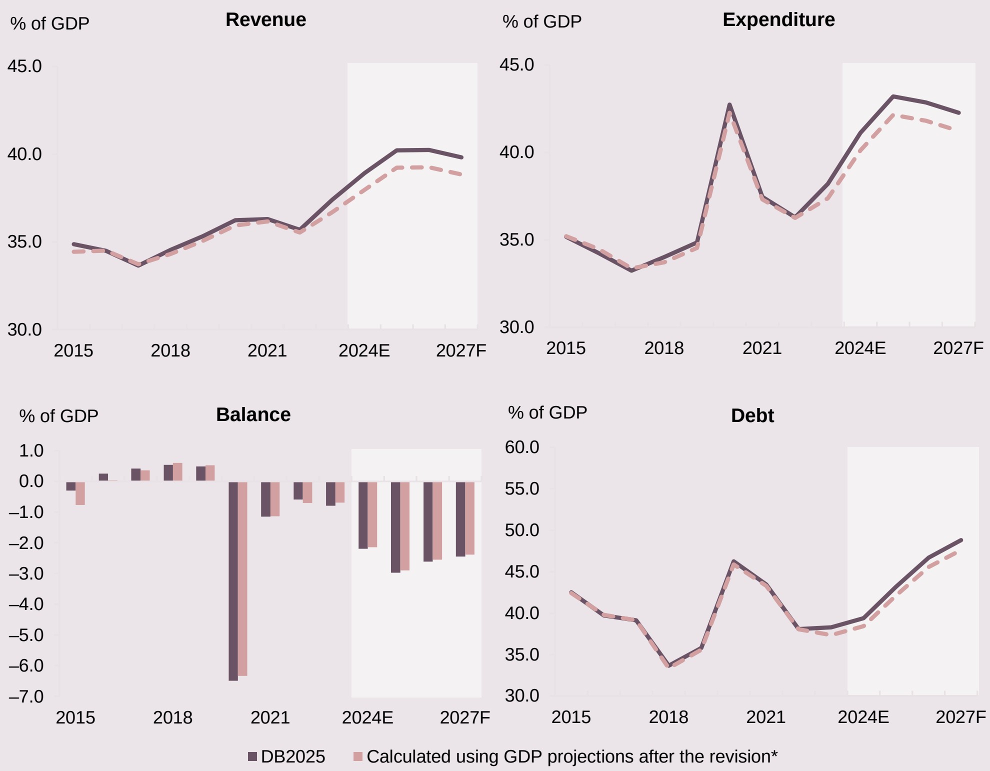
were revised. This data was published on 1 October, after the publication of the September Economic Development Scenario by the MoF and its endorsement by the NAO FI.

The revision significantly revises upwards the estimate of 2023 GDP at current prices. According to the revised data, GDP at current prices was €73.8 billion last year, compared to €72.0 billion previously. Real GDP changed by 0.3%, having been negative at −0.3% before the revision. The revised levels of nominal and real GDP also led to a revision of the deflator. In 2023, it grew by 9.0% compared to 2022 (previous estimate was 7.1%).

The NAO FI carried out an analysis to illustrate the impact that the revision of the national accounts could have on the ratio of the draft budget indicators to GDP in the period 2024-2027. To this end, the NAO FI produced a projection of GDP growth in current prices for the period 2024–2027 after the revision, based on the SDA's updated GDP estimate for 2023 and the September EDS growth rate for this indicator. According to the NAO FI's estimate, nominal GDP would be on average EUR 2.1 billion higher each year over the projection period than projected at the time of DB2025[7].

Box Figure 1 below shows the projections of the ratio of the DB2025 fiscal indicators (general government revenue, expenditure, balance and debt) to GDP for the period 2024–2027, and these projections calculated using the revised projections of nominal GDP of the NAO FI. It should be noted that in both cases the same values for fiscal indicators in billion euro were used as in DB2025.

Box. Figure 1. The ratio of general government indicators to GDP does not differ significantly from those projected in the draft budget, taking into account the revision of the national accounts



* The NAO FI has made a projection of GDP growth at current prices for the period 2024–2027, based on the SDA's updated GDP estimate for 2023 and the September EDS growth rate for this indicator.

E – expected F – forecast

Source: State Data Agency, DB2025, calculations by the National Audit Office implementing the function of a fiscal institution

[7] Based on the revised figures, nominal GDP could reach €77.9, €82.1, €86.8 and €91.6 billion in 2024-2027.

The ratio of general government indicators to GDP does not differ significantly from that projected in the draft budget, taking into account the revision of the national accounts. Due to higher nominal GDP, the average annual effect on general government revenue and expenditure could be 1% of GDP lower than projected in DB2025. Meanwhile, the projections for the GG balance are not significantly affected by the revised GDP data, so there are no material differences in the assessment of FDR compliance or the fiscal position in 2025.

According to the NAO FI's estimate, the debt of the GG[8] could be around 1.1% of GDP lower annually between 2024 and 2027 than in DB2025. However, it will increase by more than 10% of GDP in 2027 compared to 2023, similar to the draft budget, and approach 50% of GDP. According to the NAO FI's assessment, given the revision of the data, there is no further room for a significant increase in debt in the medium term.

Note that the forecasting exercise, using the revised time series of the national accounts, may lead to different forecasts for medium-term macroeconomic indicators than the September EDS.

PROJECTED GENERAL GOVERNMENT BALANCE 2026-2027

According to the assessment of the NAO FI, the fiscal indicators for 2026–2027 presented in the draft budget do not reflect the most likely scenario, as not all the decisions that would normally increase expenditure have been taken into account. According to the updated Law on Budgetary Structure[9], the indicators, ratios and other variables affecting the state budget should have been projected for a period of at least three years. The NAO FI welcomes the fact that the draft budget for the period 2026–2027 includes an increase in social expenditure due to the plans to increase the base rates for basic social benefits, state-supported income, the base of social assistance pensions and the base of targeted compensations. Until now, such rates have only been foreseen for one year instead of three. However, in the opinion of the NAO FI, the three-year budget plans should be more detailed, including other routinely variable rates that are subject to policy discretion. Such plans should be presented in the information accompanying the draft budget. Compliance with the plans should be independent of the political cycle once such decisions are adopted. The proper implementation of the concept of triennial budgets and the objective of increased transparency are expected to make budgetary plans increasingly accurate, to better assess and incorporate the impact of discretionary decisions on public finances and to identify risks to compliance with fiscal discipline rules.

For 2026–2027, the deficit is projected to remain below the 3% of GDP threshold in DB2025 and to decline compared to 2025. In the opinion of the NAO FI, this is unlikely, as decisions are taken each year that increase long-term GG expenditure, or the level of expenditure increases due to previous commitments. There are no decisions foreseen for the period 2026–2027, such as the tax-exempt amount of income rate, additional indexation of pensions or salary increases for public sector employees. In the absence of additional funding in the draft budget for 2026–2027, it is also unclear whether the commitment to keep teachers' and other educational staff salaries at 130% of the national average will be followed up. The NAO FI's projections are based on the assumption that such decisions to increase these indicators between 2026 and 2027 are highly probable and will be taken in the future, as has been the usual practice to date. The assumptions used by the NAO FI in projecting the 2026–2027 GG deficit are presented in Table 2.

[8] Based on the revised GDP figures, projected debt of the GG could reach 38.4%, 42.1%, 45.6% and 47.6% of GDP in 2024-2027.
[9] Law on budgetary structure. Available online: https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/TAIS.428/asr?.

Table 2. Assumptions used for the projection of the NAO FI 2026–2027 GG balance

Additional assumptions have been included that differ from the DB2025 2026–2027 indicators.

Given that discretionary decisions are taken every year, which normally reduce general government revenue and increase long-term GG expenditure, the assumptions used in the NAO FI are:

- Additional indexation coefficient for the individual part of the social security pension is 1.034 (3.4%), calculated on the basis of a 4-year average indexation.
- Increasing the rate of the tax-exempt amount of income.
- Increasing social assistance benefits not linked to basic amounts.
- Increasing salaries for public sector workers.
- Positive impact on GG revenues, assuming an increase in wage bill.
- The EU and international financial assistance plan is not fully implemented (does not affect the GG balance).

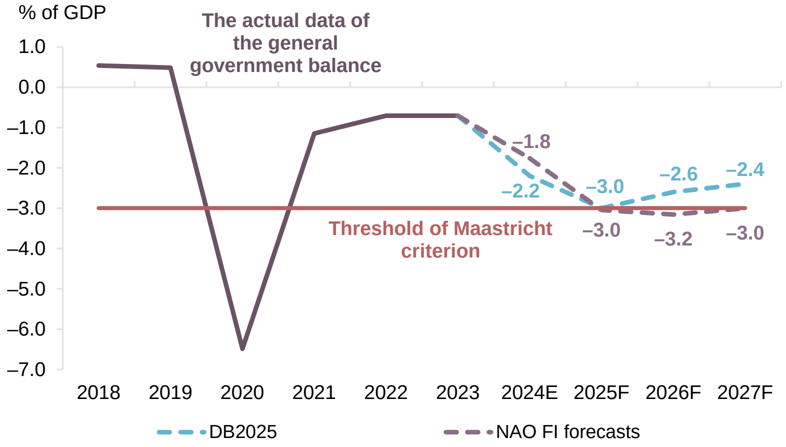
Other assumptions applied (no different from DB2025):

- Defence spending of 3% of GDP.
- The sub-sectoral budgets of the Local Government and Social Security Fund are drawn up in compliance with fiscal discipline rules.
- The projection of indicators is based on the September 2024 EDS.

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

Given the assumptions used, the general government deficit projected by the NAO FI will exceed 3% of GDP in 2026 (Figure 3). Projected general government expenditure is projected at around 43% of GDP, with the largest increases coming from social benefits, compensation of employees. Interest expenditure should be noted. It is projected to more than double in 2027 compared to 2023. The projected level of revenues will be around 40% of GDP. Compared to previous estimates, the increase in the level of tax revenue is due to additional decisions in the area of excise duties and to a wage bill projected to grow faster than nominal GDP. The NAO FI notes that decisions on additional revenue sources would help to reduce the gap between revenue and expenditure.

Figure 3. According to the NAO FI, the general government deficit is likely to exceed the threshold of Maastricht criterion in 2026



E – expected, F – forecast

Source: State Data Agency, DB2025, calculations by the National Audit Office implementing the function of a fiscal institution

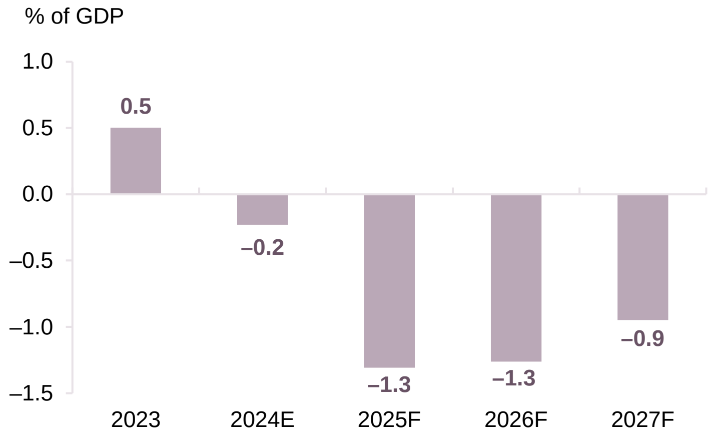
SUSTAINABILITY OF GENERAL GOVERNMENT FINANCES

A structural primary deficit is projected for the period 2024–2027, which calls for solutions to achieve sustainable public finances. Fiscal sustainability refers to the ability of the government to finance areas of public interest without worsening the future state of public finances. According to the European Commission's technical information for 2024, as presented in the DB2025[10], in order to maintain the long-term sustainability of general

[10] Annex 1 to the explanatory memorandum to the draft law on the approval of the budget for the period 2025–2027.

government finances, a structural general government primary surplus of 0.2% of GDP should be achieved in 2028. According to the NAO FI's assessment, a structural primary deficit of the GG remains between 2024 and 2027 (Figure 4). This suggests that, without additional revenue sources, general government expenditure is growing faster than macroeconomic developments allow.

Figure 4. The structural primary deficit of the GG remains between 2024 and 2027



E – expected, F – forecast

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

In Lithuania, the ratio of GG revenues from taxes and contributions to GDP in 2025 remains one of the lowest in the EA (Annex 3). Given the low level of incomes, Lithuania's general government expenditure-to-GDP ratio remains below the EU average[11]. The Council Recommendation[12] to Lithuania states that low tax revenues "constrain the availability of resources to finance public expenditure on health, social protection and general public services". The ratio of general public services expenditure to GDP is extremely low, less than half the EU average. The Council recommends "providing adequate funding for health, social protection and general public services". The underfunding is also reflected in the preparation of draft budgets, where the needs presented by the authorities managing appropriations are normally only partially met. For example, without assessing the validity of the needs, less than half of the needs declared by the authorities managing appropriations are planned to be met in 2025. Structural revenue and expenditure decisions are needed now in order to achieve sustainable public finances in the long term.

The NAO FI plans to publish its assessment of the sustainability of general government finances 2025–2050 in Q1 2025. Since 2017, the last time the NAO FI prepared this assessment, the country's economy has been hit by a number of severe shocks, including the COVID-19 pandemic, geopolitical uncertainties and the spike in energy prices following the war in Ukraine. Since 2020, exceptional circumstances have been in place where not all national fiscal discipline rules have been applied. In order to manage the impact of these shocks on the economy, various measures have been taken during this period, which have significantly increased GG expenditure or reduced revenues. Some of these measures (e.g. increases in social benefits or salaries of public sector employees) increased the long-term liabilities of the government. When assessing the sustainability of the GG finances for the period 2025–2050, the NAO FI will project the expenditure needs incorporating not only the commitments already made, but also the challenges of an ageing population, which will have a major impact on the areas of social protection, health and education. The assessment will be based on the latest demographic trends, with the long-term macroeconomic projections of the NAO FI updated accordingly.

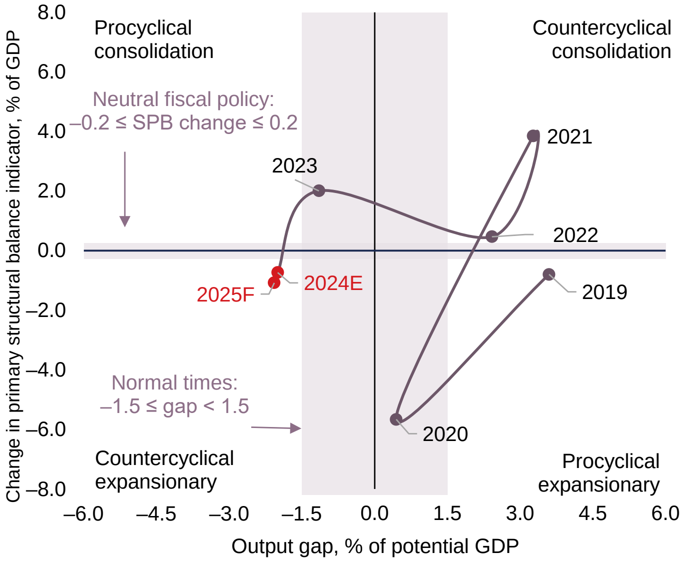
[11] In 2022, the share of GG expenditure in Lithuania was 36.4% of GDP, compared to the EU-27 average of 49.4% of GDP.

[12] Council Recommendation 2024 on economic, social, employment, structural and budgetary policies for Lithuania. Available online: https://eur-lex.europa.eu/legal-content/LT/TXT/HTML/?uri=CELEX:52024DC0615.

FISCAL STANCE FOR 2025

With the economy below its potential level, a stimulus is foreseen for 2025. Taking into account the projections for the general government balance of the NAO FI and the projected negative output gap in 2025, the annual change in the structural primary balance of the GG is projected at –1.1% of GDP (Annex 4). This suggests that fiscal policy is in the countercyclical stimulus area (Figure 5). It should be noted that the projected stimulus to the domestic economy is stronger in 2025 than in 2024. If the economy is below its potential level, a stimulus is possible, but it is important that it is also based on investment spending. This would help to increase the productivity and resilience of the economy by targeting spending on areas such as green and digital transformation.

Figure 5. Fiscal impulse remains stimulative in 2025



Based on projections of the general government balance and output gap by the NAO FI.

E – expected, F – forecast

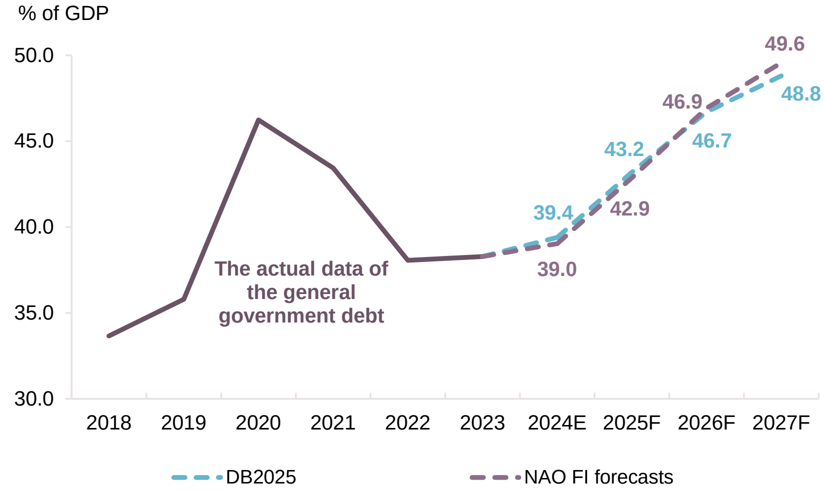
Source: State Data Agency, calculations by the National Audit Office implementing the function of a fiscal institution

PROJECTED GENERAL GOVERNMENT DEBT 2024–2027

With the general government deficit remaining close to the threshold of Maastricht criterion over the medium term, public debt is set to increase and is expected to reach almost half of the country's GDP by 2027. The NAO FI, based on the International Monetary Fund's methodology[13], projects this indicator to reach 39.0% and 42.9% of GDP between 2024 and 2025 respectively (Figure 6). Assuming a more favourable 2024 primary GG deficit, the debt level during this period may be slightly lower than indicated in DB2025. As a result of routine discretionary decisions (Table 2), debt is likely to grow faster than projected in the draft budget over the rest of the medium term, reaching 49.6% of GDP in 2027. This is 11.3 p.p. higher than in 2023. In DB2025, the debt of the GG is projected to increase to 48.8% of GDP in 2027.

[13] IMF 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 6. As a result of routine discretionary decisions, the debt of the GG is likely to grow faster than foreseen in DB2025 and approach the 50% of GDP level in 2026–2027

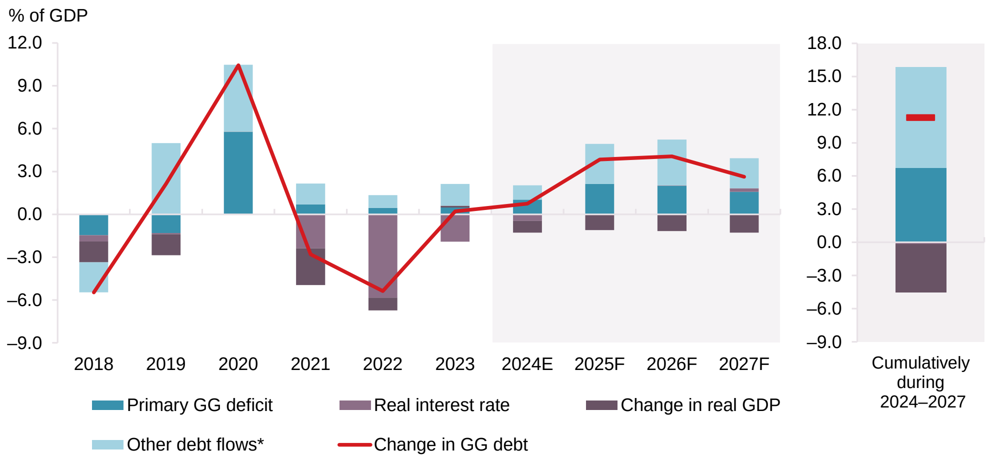


E – expected, F – forecast

Source: State Data Agency, DB2025, calculations by the National Audit Office implementing the function of a fiscal institution

Looking at the drivers of debt change, according to the NAO FI's assessment, it will be mainly driven by the primary deficit of the GG and other debt-creating flows (in line with the debt change adjustment foreseen in DB2025) (Figure 7). The primary deficit could average around 1.7% of GDP annually between 2024 and 2027. The projected expansion of real GDP will moderate the debt growth by an average of 1.1% 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 debt will diminish. It is projected to contribute to debt growth in 2027 (Annex 1, Table 3).

Figure 7. The main contributors to the general government debt-to-GDP ratio in 2024–2027 are the primary deficit and other debt-creating flows



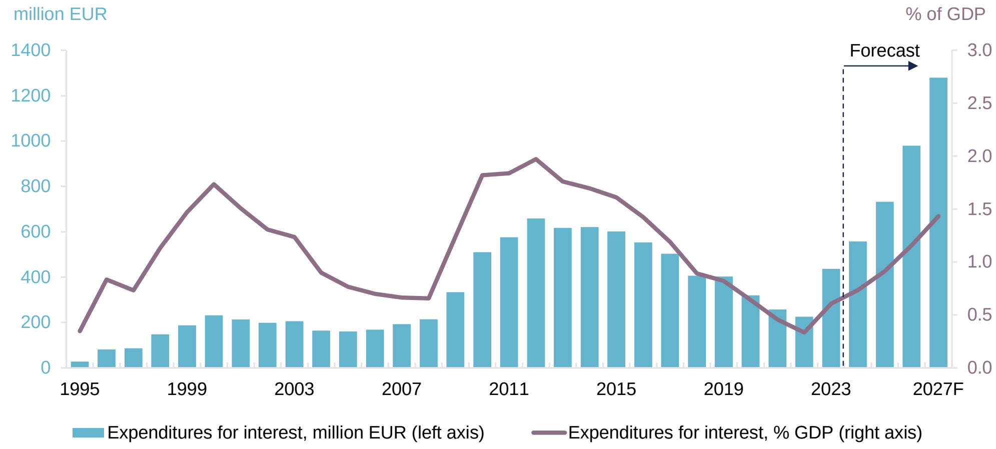
* Calculated as a residual until 2023, and incorporating the *stock-flow adjustment* for 2024–2027 as foreseen in DB2025.

E – expected, F – forecast

Source: State Data Agency, DB2025, calculations by the National Audit Office implementing the function of a fiscal institution

Financing GG debt is becoming increasingly expensive. The NAO FI projects the cost of interest payments on general government debt to be €557 million and €732 million (0.7% and 0.9% of GDP) in 2024–2025 (Figure 8). It is likely to exceed EUR 1.2 billion in 2027 (1.4% of GDP). 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.

Figure 8. Expenditure on interest payments on GG debt is projected to continue growing



Source: State Data Agency, 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, 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, carried out an assessment the Draft Law on Budget Approval of the Republic of Lithuania for the period 2025–2027 submitted by the Government to the Seimas on 14 October 2024 and prepared an opinion. In accordance with Article 4(1) of the Constitutional Law on the Implementation of the Fiscal Treaty of the Republic of Lithuania and Article 8(7)(2) of the Law on National Audit Office, it submits the opinion to the Parliament of the Republic of Lithuania.

Head of Budget Monitoring Department — Jurga Rukšėnaitė

ANNEXES

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NAO FI PROJECTIONS OF FISCAL INDICATORS

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

Indicator as % of GDP	ESA 2010	2022	2023	2024E	2025F	2026F	2027F
Total revenue	OTR	35.5	37.6	38.7	39.6	40.0	39.7
Tax revenue		21.6	22.3	22.8	23.1	23.5	23.8
Revenue from indirect taxes	D.2	11.6	11.5	11.7	12.0	12.2	12.3
Revenue from direct taxes	D.5	10.0	10.8	11.1	11.2	11.3	11.5
Net social contributions	D.61	10.2	10.8	11.4	11.7	11.9	11.9
Other income, of which:		3.8	4.5	4.5	4.8	4.6	4.0
Revenue from property	D.4	0.4	0.7	0.7	0.6	0.6	0.5
Total expenditure	OTE	36.2	38.3	40.4	42.7	43.1	42.7
Compensation of employees	D.1	10.1	10.7	11.1	11.5	11.5	11.5
Intermediate consumption	P.2	4.3	4.1	4.8	4.9	4.9	4.9
Subsidies	D.3	1.7	0.7	0.4	0.4	0.4	0.4
Interest costs	D.41	0.3	0.6	0.7	0.9	1.2	1.4
Social benefits	D.6M	14.0	15.2	16.0	16.9	17.5	17.8
Other expenditure, of which:		5.9	7.1	7.4	8.0	7.7	6.7
Gross fixed capital formation	P.5L	3.2	4.4	4.0	4.1	3.9	3.2
Capital transfers	D.9	0.7	0.6	1.0	0.9	0.7	0.7
Net lending (+) / net borrowing (-)	B9	−0.7	−0.7	−1.8	−3.0	−3.2	−3.0

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

Indicator as % of GDP	2022	2023	2024E	2025F	2026F	2027F
Central government subsector	−2.4	−2.2	−3.0	−4.1	−4.0	−3.6
Social insurance funds subsector	1.5	1.4	1.1	1.0	0.9	0.6
Local government sub-sector	0.2	0.2	0.1	0.0	0.0	0.0
General government	−0.7	−0.7	−1.8	−3.0	−3.2	−3.0

E – expected, F – forecast
Source: State Data Agency, calculations by the National Audit Office implementing the function of a fiscal institution

Table 3. Projected general government debt and its drivers of change in the NAO FI

No.	Indicator as % of GDP	2022	2023	2024E	2025F	2026F	2027F
1.	GG debt	38.1	38.3	39.0	42.9	46.9	49.6
2.	Change in GG debt (3+4+7)	−5.4	0.2	0.8	3.8	4.1	2.6
3.	Primary GG deficit	0.5	0.5	1.0	2.1	2.0	1.6
4.	Automatic debt dynamics (5+6)	−6.7	−1.8	−1.3	−1.1	−1.1	−1.0
5.	Real interest rate	−5.8	−1.9	−0.5	0.0	0.0	0.3
6.	Change in real GDP	−0.9	0.1	−0.8	−1.1	−1.2	−1.3
7.	Other flows affecting debt*	0.9	1.5	1.0	2.8	3.2	2.1

* Calculated as a residual until 2023 and incorporating the *stock-flow adjustment* for 2024–2027 in DB2025

E – expected, F – forecast

Source: State Data Agency, DB2025, calculations by the National Audit Office implementing the function of a fiscal institution

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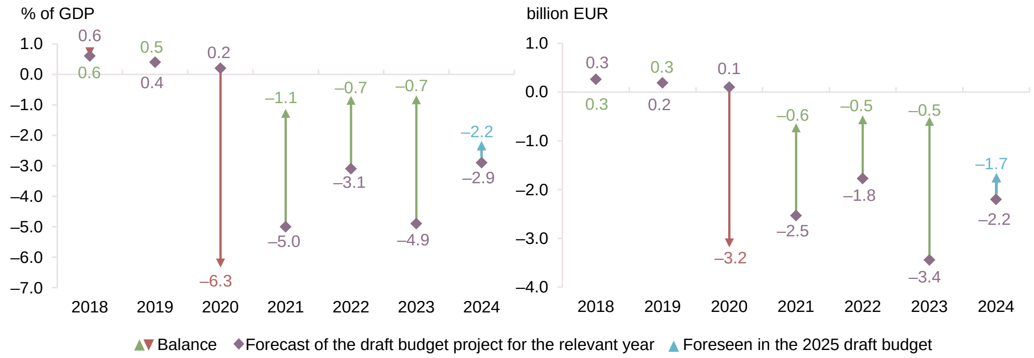
COMPARISON OF REVENUE, EXPENDITURE AND DEFICIT PROJECTIONS FOR DRAFT BUDGETS IN LITHUANIA

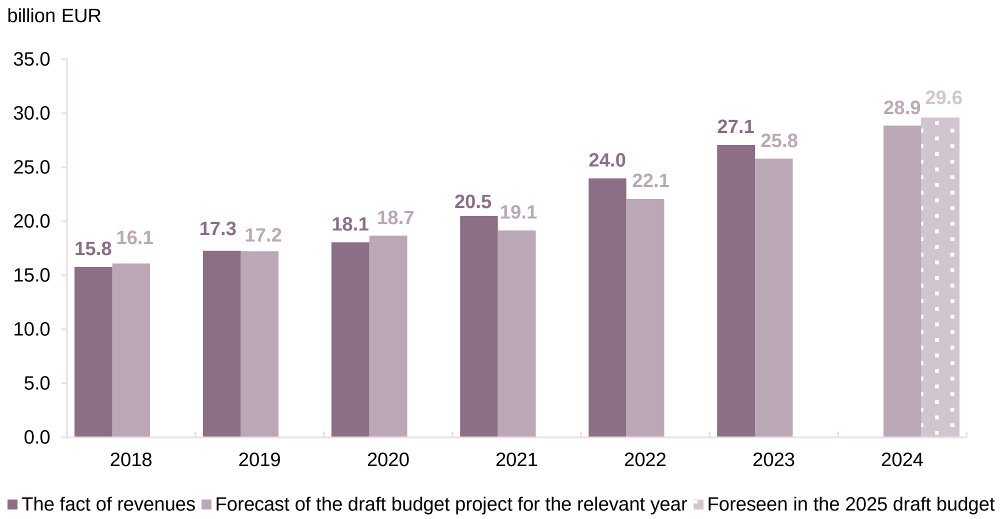
The general government deficit from 2021 onwards tends to be lower than projected in the draft budgets for those years, mainly due to higher revenues. The general government deficit from 2021 onwards has been lower than projected in the draft budgets of the respective years. This was supported by higher revenues. Better-than-expected revenue collection has typically been driven by more favourable macroeconomic indicators.

Figure 1. The general government deficit from 2021 onwards is actually lower than projected in the draft budgets for the respective years



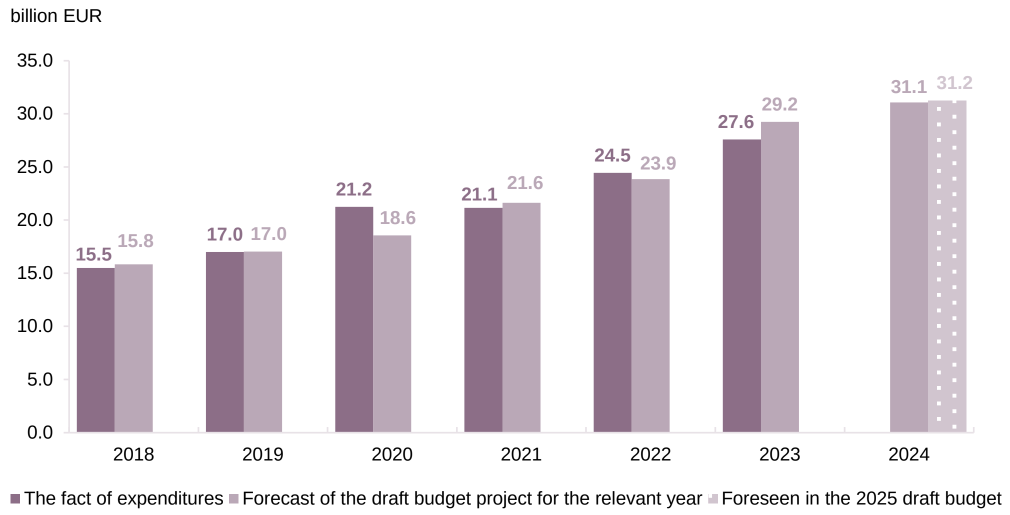
Source: Draft Lithuanian budget for the respective year, the National Audit Office, implementing the function of a fiscal institution, State Data Agency

Figure 2. The lower deficit is due to the usual higher-than-forecasted actual government revenue, as a result of faster growth in macroeconomic indicators



Source: Draft Lithuanian budget for the respective year, the National Audit Office, implementing the function of a fiscal institution, State Data Agency

Figure 3. When there is room for more revenue, general government expenditure is normally increased by a smaller amount, which puts the planned deficit below the target level



Source: Draft Lithuanian budget for the respective year, the National Audit Office, implementing the function of a fiscal institution, State Data Agency

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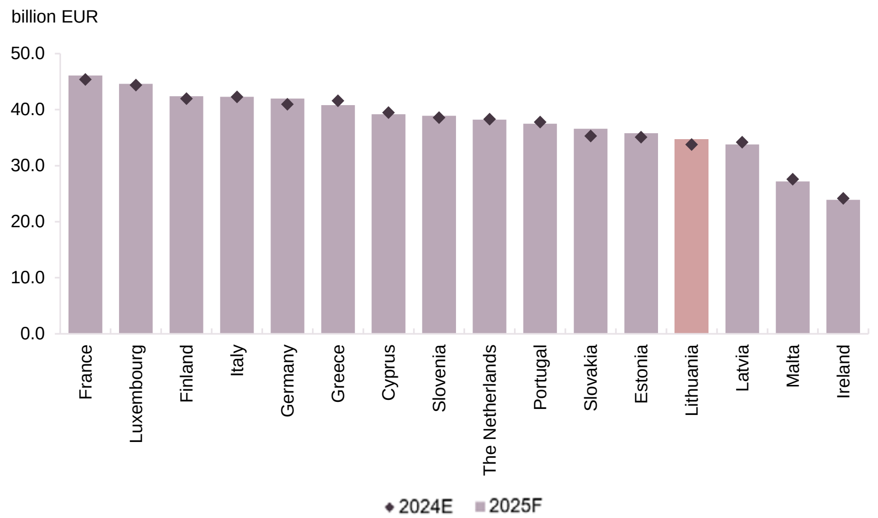
TAX REVENUE TO GDP RATIO IN EA COUNTRIES

The country's budget revenues from taxes and contributions remain among the lowest in the EA. As of 2020, it stood at around 32% of GDP, compared to an EA average of around 41% of GDP. The draft budget, due to tax changes in the form of excise duties, corporate tax increases and other measures, foresees a more significant increase in these revenues in 2024–2025 compared to the previous years, to 33.8% and 34.7% of GDP, respectively, with the indicator exceeding 35% of GDP at the end of the medium term. However, Lithuania remains one of the lowest tax and contribution revenue collectors among EA countries.

The country's tax and contribution revenues remain among the lowest in the EA



E – expected, F – forecast

Source: Draft budgets for 2025 submitted by EA countries to the EC by 25 October 2024.

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CYCLICAL SITUATION OF THE LITHUANIAN ECONOMY AND STRUCTURAL GENERAL GOVERNMENT BALANCE, 2020–2025, AS ASSESSED BY THE NAO FI

No.	Indicator as % of GDP	2020	2021	2022	2023	2024E	2025F
1.	General government net lending (+)/borrowing (-)	−6.4	−1.1	−0.7	−0.7	−1.8	−3.0
2.	One-off and other temporary measures*	0.0	0.0	0.2	−0.1	0.0	0.0
3.	Temporary measures**	−4.6	−2.4	−2.3	−0.8	−0.2	0.0
4.	Output gap, % of potential GDP	0.4	3.3	2.4	−1.1	−2.0	−2.1
5.	Cyclical budget component (0.399 × 4 series)	0.2	1.3	1.0	−0.5	−0.8	−0.8
6.	Structural GG balance (1 - 2 - 5)	−6.6	−2.4	−1.8	−0.1	−1.0	−2.2
7.	Structural GG balance excluding temporary measures (1 - 2 - 3 - 5)	−1.8	0.2	0.8	1.2	−0.8	−2.2
8.	Interest	0.6	0.5	0.3	0.6	0.7	0.9
9.	Structural GG primary balance (6 + 8)	−5.8	−2.0	−1.5	0.5	−0.2	−1.3
10.	Structural primary balance of the GG excluding temporary measures (7 + 8)	−1.2	0.7	1.1	1.8	0.0	−1.3
11.	Change in the structural GG primary balance	−5.7	3.9	0.5	2.0	−0.7	−1.1
12.	Change in the structural GG primary balance, excluding temporary measures	−0.9	1.9	0.4	0.6	−1.8	−1.3

E – expected, F – forecast

** 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