



**EUROPEAN COMMISSION**  
DIRECTORATE GENERAL  
ECONOMIC AND FINANCIAL AFFAIRS

Brussels, 02.03.2005  
ECFIN/50408/05-EN

**JANUARY 2005 UPDATE**  
**OF THE CONVERGENCE PROGRAMME OF LITHUANIA**  
**(2004-2007)**  
**AN ASSESSMENT**

---

## Table of contents

SUMMARY AND CONCLUSIONS .....	3
1. INTRODUCTION .....	6
2. MACROECONOMIC DEVELOPMENTS .....	6
3. MEDIUM-TERM MONETARY POLICY OBJECTIVES AND THEIR RELATIONSHIP TO PRICE AND EXCHANGE RATE STABILITY .....	8
4. BUDGETARY IMPLEMENTATION IN 2004 .....	9
5. BUDGETARY TARGETS AND THE MEDIUM-TERM PATH OF THE PUBLIC FINANCES .....	9
5.1. Evolution of budgetary targets in successive programmes .....	9
5.2. Budgetary targets in the updated programme.....	10
5.3. Sensitivity analysis .....	14
6. EVOLUTION OF THE DEBT RATIO .....	14
7. STRUCTURAL REFORM AND THE QUALITY OF PUBLIC FINANCES .....	15
8. THE SUSTAINABILITY OF THE PUBLIC FINANCES.....	16
Annex 1: Summary tables from the January 2005 convergence programme.....	19
Annex 2: Indicators of long-term sustainability.....	24

## SUMMARY AND CONCLUSIONS<sup>1</sup>

The first update of the Lithuanian convergence programme was submitted on 14 January 2005. The programme broadly complies with the data requirements of the revised “code of conduct on the content and format of stability and convergence programmes”<sup>2</sup>.

The macroeconomic scenario expects real GDP growth to reach 6.5% in 2004 and 2005 and to decelerate progressively thereafter to 6.0% in 2007. Compared to the May 2004 programme, growth has been revised downwards for the whole programme’s period. Output growth in 2004 is estimated to have been lower than expected by the Commission services autumn 2004 forecast. The growth rates foreseen for 2005 and 2006 are somewhat higher than the Commission services autumn 2004 forecast. For the year 2007, the programme’s estimate of potential output growth is below the Commission services estimate. On the basis of currently available information, the scenario in the programme can be considered as plausible.

CPI inflation has been revised upwards throughout the programme horizon. It reached 1.2% in 2004 and is expected to be 2.9% in 2005, 2.5% in 2006 and 2.9% in 2007. The Lithuanian litas joined the ERM II in June 2004, with a unilateral commitment to maintaining the currency board regime. The litas has not deviated from its central rate vis-à-vis the euro. Medium-term interest rates have been trending down in 2004, fluctuating within 0.65 percentage points above the euro area level, including periods of significantly lower spreads. Lithuania intends to be ready for the introduction of the euro in early 2007.

The key objective of the medium-term fiscal strategy defined in the programme is the approximation to a cyclically balanced general government budget. The programme foresees the general government deficit to remain at 2.5% of GDP in 2005 but to decline gradually thereafter to 1.5% in 2007. The time profile of the primary deficit is very similar, improving gradually from 1.5% of GDP in 2004 to 0.5% in 2007. Consolidation is planned to be achieved mainly by an increase of revenues from a low base and, after 2005, also the expenditure side contributes. Revenues are expected to increase from 33% of GDP in 2004 to 34.5% in 2007, primarily due to higher EU financial transfers, the introduction of new taxes and better tax enforcement. Public expenditure is foreseen to increase by 0.5% of GDP over the same period, primarily owing to a significant increase in capital expenditure related to EU projects and “other” expenditures where the largest part corresponds to transfers to the EU budget and the costs of the pension reform<sup>3</sup>. Such

---

<sup>1</sup> This technical analysis, which is based on information available up to 9 February 2005, accompanies the recommendation by the Commission for a Council opinion on the update of the convergence programme, which the College adopted on 16 February 2005. It has been carried out by the staff of and under the responsibility of the Directorate-General for Economic and Financial Affairs of the European Commission. Comments should be sent to Luis Fau (luis.fau@cec.eu.int).

<sup>2</sup> Revised Opinion of the Economic and Financial Committee on the content and format of stability and convergence programmes, document EFC/ECFIN/404/01 - REV 1 of 27.06.2001 endorsed by the ECOFIN Council of 10.07.2001.

<sup>3</sup> A second-pillar pension system was introduced in 2004. Employees participating in the second pillar do not make direct contributions to the second pillar. The state collects all contributions from the employees to the first and second pillars and transfers the corresponding share to the second pillar (as a capital transfer). Therefore, the costs of the pension reform reflect in the expenditure side in the programme’s government figures.

increases will be partly compensated by a decrease in consumption and transfers and interest payments. A significant programme of public investment is being implemented, which lifts public investment from 3.4% of GDP in 2004 to 5% in 2007, resulting in an average public investment ratio over the programme period of about 4.6% of GDP. When compared to the May 2004 programme, the deficit outcome for 2004 is estimated to have been lower than budgeted, thanks to better-than-expected revenues. The targets for 2005-2007 are maintained, despite a considerable downward revision of GDP growth.

The risks to the budgetary projections in the programme appear broadly balanced. The government has shown a good track in meeting the fiscal targets in recent years. The new growth assumptions are more cautious than those provided in the May programme and downside macro-economic risks seem more limited. The main risk to the fiscal projections stems from the uncertainty about the application of detailed measures envisaged in the programme. In particular, the tax revenue target for 2005 might be difficult to achieve if compensatory measures for the abolition of the turnover tax were not introduced. The execution of the foreseen use of better-than-projected revenues and unused co-financing funds for deficit reduction would be crucial to limit additional spending at the end of the year, which has been a frequent budgetary practice in the past that prevented a faster fiscal consolidation. Other risks stem from the relatively uncertain costs of the pension reform, the high outstanding contingent liabilities, budget arrears, liabilities related to the savings and real estate restitution obligations and spending related to the decommissioning of the Ignalina nuclear power plant.

In view of this risk assessment, the budgetary stance in the programme may not provide a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations throughout the programme's period, particularly in 2005, nor to achieve a budgetary position of close-to-balance in the medium term. Against the background of the strong economic performance and the large current account deficit, the budgetary targets do not appear ambitious, also in view of preventing potential risks of overheating.

The programme projects an initial increase of the debt to GDP ratio in 2004 by 0.8 percentage points, mostly due to the increase of the general government deficit in the same year. The ratio is expected to decrease throughout the remainder of the programme horizon and reach 20.1% in 2007. The government plans to decrease the stock of government-guaranteed loans from 2% of GDP to 1.2% over the medium-term. No guarantees on new loans have been issued since 2003.

The programme reviews the government's structural reforms which focus on pension and healthcare, labour market, agriculture and product markets. The pension and healthcare reforms are expected to improve the efficiency of the system and the sustainability of public finances in the long run, but some uncertainty about their medium-term costs remains. Measures are proposed to strike a better balance between capital and labour taxes (decreasing the tax pressure on the latter) and to improve the control and efficiency of expenditure.

Lithuania appears to be in a relatively favourable position with regard to long-term sustainability of public finances, of which the projected budgetary costs of an ageing population is an important element. The relatively low debt ratio, the pension reform measures enacted, including the introduction of the funded pillars will contribute to limit the budgetary impact of ageing. The strategy outlined in the programme is based on a contained budgetary deficit over the medium term and the long-term impact of the

pension reform. Nevertheless, risks related to the costs of the pension reform and to the outstanding contingent liabilities should be monitored. In addition, reform measures in the field of health-care could involve higher expenditures. Lithuania has a relatively low tax ratio: the sustainability gap that arises in the long-run could be addressed by raising it.

Overall, the economic policies outlined in the update are broadly consistent with the country-specific broad economic policy guidelines in the area of public finances. There are measures to use better-than-projected revenues and savings in budgeted EU co-financing allocations for deficit reduction and limit expenditure overruns. The announced measures are not extended to savings made in items unrelated to EU co-financing.

In view of the above assessment it would be appropriate for Lithuania to:

- i) make further progress towards a close-to-balance budgetary position, particularly in view of its current account deficit and domestic demand pressures, fuelled by strong credit growth,
- ii) implement strictly the budget for 2005 in order to reduce the risk of breaching the 3% reference value,
- iii) use better-than-projected or additional revenues and unused expenditure items for deficit reduction.

## **1. INTRODUCTION**

The first update of the Lithuanian convergence programme was submitted to the European Commission on 14 January 2005. It covers the period 2004-2007. The programme was approved by the Council of Ministers, and thus constitutes a firm political commitment as the official medium-term macroeconomic framework programme of the Lithuanian government. Overall, the programme is based on the same macroeconomic scenario stated in the budget for 2005, but foresees a set of new measures adopted after the publication of the budget.

The programme broadly complies with the data requirements of the revised “code of conduct on the content and format of stability and convergence programmes”. The data are generally in line with the ESA95 standards. The programme broadly follows the model structure of Annex 2 of the “code of conduct on the content and format of stability and convergence programmes”<sup>4</sup>.

## **2. MACROECONOMIC DEVELOPMENTS**

The macroeconomic scenario expects real GDP growth to reach 6.5% in 2004. In 2005, growth is forecast to be maintained at 6.5% and to decelerate progressively thereafter to 6.0% in 2007. GDP growth has been revised downwards for all the years covered in the programme. In view of recently released GDP figures for the third quarter of 2004 growth in 2004 is estimated to have been lower than expected by the Commission services autumn 2004 forecast. The growth rates foreseen for 2005 and 2006 are slightly higher than the Commission services autumn 2004 forecast. The growth projection for 2007 is below the Commission services estimate of potential output growth. Overall, the new projections can be considered plausible.

The programme’s external assumptions correspond to those of the Commission services autumn 2004 forecast.

The CPI inflation projections have been revised upwards throughout the programme horizon. After reaching 1.2% in 2004, inflation is expected to be 2.9% in 2005, 2.5% in 2006 and 2.9% in 2007. The projections are broadly in line with those in the Commission services autumn 2004 forecast for the years 2004 and 2005. The inflation projection for 2006 appears on the low side.

---

<sup>4</sup> As for table 11 of the programme, within external assumptions, the compulsory projections for ‘growth of relevant foreign markets’ and ‘world import prices’ are not included. The assumption on ‘world GDP growth, excluding EU-25’ is not in the table of external assumptions but is in the text. Optional foreign assumptions data on nominal effective exchange rates, USD interest rates and non-oil commodity prices are missing but the text clearly states that they correspond to the Commission services autumn forecasts assumptions. Forecast inflation is reported on the basis of the national definition of the consumer price index (CPI), and the optional HICP inflation is only available for the past. None of these minor deviations would make more difficult the programme’s evaluation. A new version of the programme, updating some data in tables 11, 12 and 15 was submitted on 25 January 2005.

**Table 1: Comparison of macroeconomic developments and forecasts**

	2004		2005		2006		2007
	COM	CP	COM	CP	COM	CP	CP
Real GDP (% change)	7.1	6.5	6.4	6.5	5.9	6.2	6.0
<i>Contributions:</i>							
- Final domestic demand	10.2	9.5	7.8	9.0	6.8	8.2	6.6
- Change in inventories	-0.1	-0.2	0.4	0.3	0.0	0.0	-0.3
- External balance on g&s	-3.0	-2.8	-1.8	-2.7	-0.8	-2.0	-0.3
Employment (% change)	1.6	1.5	1.1	0.5	0.9	0.5	0.6
Unemployment rate (%)	11.4	11.3	10.6	10.8	9.9	10.3	9.7
HICP inflation (%) <sup>1</sup>	1.2	1.2	2.9	2.9	2.8	2.5	2.9
GDP deflator (% change)	1.7	2.0	2.9	2.3	3.3	2.5	2.5
Current account (% of GDP)	-8.7	-8.4	-8.5	n.a.	-7.9	n.a.	n.a.
<i>Note:</i>							
<sup>1</sup> CPI inflation for convergence programme data							
<i>Sources:</i>							
Commission services autumn 2004 economic forecasts (COM); convergence programme update (CP)							

The estimate of potential output growth based on the Commission services calculations according to the commonly agreed methodology and consistent with the programme's macro-economic scenario is for 2004 slightly below, for 2005 identical and for 2006 somewhat above the estimate of potential output growth of the Commission services autumn 2004 forecast. According to the autumn forecast, the output gap follows a declining trend but remains positive along the period 2004-2006, whereas the Commission services calculations based on the commonly agreed methodology applied to the programme's data also suggests a positive output gap on a declining trend, becoming negative in 2007. This supports the view that the programme's macroeconomic scenario is plausible.

**Table 2: Sources of potential output growth**

	2004		2005		2006		2007
	COM	CP <sup>3</sup>	COM	CP <sup>3</sup>	COM	CP <sup>3</sup>	CP <sup>3</sup>
Potential GDP growth <sup>1</sup>	6.7	6.5	6.8	6.8	7.0	7.1	6.6
<i>Contributions:</i>							
- Labour	0.5	0.5	0.6	0.5	0.7	0.6	0.3
- Capital accumulation	3.0	2.9	3.1	3.2	3.1	3.4	3.2
- TFP	3.1	3.0	3.0	3.0	3.0	3.0	3.0
Output gap <sup>1,2</sup>	2.1	1.6	1.7	1.3	0.7	0.5	-0.1
<i>Notes:</i>							
<sup>1</sup> based on the production function method for calculating potential output growth							
<sup>2</sup> in percent of potential GDP							
<sup>3</sup> Commission services calculations on the basis of the information in the convergence programme update							
<i>Sources:</i>							
Commission services autumn 2004 economic forecasts (COM); Commission services calculations							

The current account deficit has been widening since 2001, reaching 6.9% of GDP in 2003. The deterioration was mostly the result of a decrease in gross savings, which decreased from 16% of GDP in January 2002 to 14.3% at the end of 2003. During the first half of 2004, the current account deficit deteriorated further to nearly 10% of GDP. This was the result of a deterioration of all subcomponents of the balance of current transactions. One-off factors related to EU accession (i.e. tax changes and contributions to the EU budget) and more structural factors such as robust domestic demand fuelled by surging credit growth are underlying the deficit deterioration. Domestic demand is

expected to continue putting pressure in the current account in the medium term. Since 2001, a significant share of the deficit has been financed by FDI, with the only exception of 2003. Lithuania's foreign debt as a percentage of GDP accounted for 43% of GDP in June 2004. Though the dynamics of foreign debt at the total economy level do not raise concerns, the increasing exposure to foreign currency of the private sector deserves close supervision.

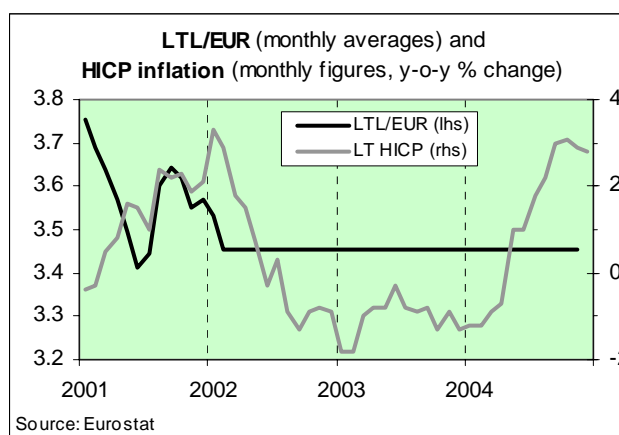
The current account deficit is expected to remain high over the medium term. The reasons respond to domestic demand pressures rather than to competitiveness losses. High growth of capital goods imports, fuelled by the absorption of EU structural funds, is expected to be a major factor leading to a persisting high trade imbalance. The fast pace of credit growth, whereby credit to consumption is surging, adds pressure to the external balance. Under Lithuania's currency board arrangement, the use of monetary policy to counteract excessive domestic demand pressures is constrained. In consequence, fiscal policy has a more important role in containing excessive domestic pressures and higher external imbalances. In this regard, it is noteworthy that the programme outlines measures for preventing a potential overheating (e.g. expenditure cuts in 2005 if additional co-financing of EU funds is necessary, reduction of shadow economy, new real estate taxes).

### 3. MEDIUM-TERM MONETARY POLICY OBJECTIVES AND THEIR RELATIONSHIP TO PRICE AND EXCHANGE RATE STABILITY

The main objective of the Bank of Lithuania's monetary policy is price stability, which is implemented by pursuing a fixed exchange rate policy under a currency board arrangement (CBA). Lithuania has been operating its currency board regime for more than a decade. It has served as a nominal anchor for monetary policy and contributed to the disinflation process in Lithuania over the past years.

Lithuania joined ERM II in June 2004 with a unilateral commitment to maintaining its previous fixed exchange rate regime. Within ERM II, there have been no signs of tensions and the litas has not deviated from its central rate vis-à-vis the euro. The convergence programme update points out that Lithuania intends to be ready for the introduction of the euro in early 2007.

Annual HICP inflation rates increased markedly in May 2004, ending almost two years of deflation, and continued to rise in subsequent months. HICP inflation rose from a negative 0.7% in April to 2.8% in December, reflecting a mix of rising energy, food, transport and health care prices, some of which were linked to tax alignments coupled with EU accession. Annual average inflation for 2004 as a whole was 1.1%, one of the lowest annual averages among Member States. The convergence programme update now projects CPI inflation to be in the range 2.5-2.9% during the period 2005-2007.





Money market rates in Lithuania have been stable in the course of 2004 and have moved in line with money market rates in the euro area. Since June, the 3-month VILIBOR traded within a range of 0.45-0.60 percentage points above the 3-month EURIBOR. The level of the long-term interest rate has been trending downward in the course of 2004 and has been fluctuating within 0.65 percentage points above the euro area level, including periods of a very low spread towards mid-2004. In the second half of 2004, the long-term interest rate spread vis-à-vis the euro area increased slightly and stood at 0.3 percentage points in December.

#### **4. BUDGETARY IMPLEMENTATION IN 2004**

The May 2004 programme targeted a 2.7% of GDP general government deficit for 2004, based on a 7% output growth assumption. In the current update, the estimated deficit for 2004 is 2.5%, while growth has been revised down to 6.5%. The Commission services autumn 2004 forecast projected a 2.6% deficit with 7.1% growth. Taking account of the latest fiscal and GDP growth developments, the programme's estimate is more realistic, indeed preliminary data on revenues and expenditure outcomes for 2004 suggest that the final deficit outcome could be lower than the 2.5% of GDP estimated in the programme.

The main factor underlying the better-than-projected budget deficit in 2004 is the cautious forecasting of several categories of budget revenue in Lithuania. As in recent years, revenues (excluding EU funds) were higher than expected, while expenditure related to co-financing of EU funds turned out lower than budgeted. It is worth noting that revenue and expenditure ratios in 2005 are not fully comparable with 2004 due to methodological improvements and data revisions. The deficit was lower as compared to the May programme's target in spite of a budgetary amendment that allocated some 0.3% additional spending in June, increasing mostly social benefits, civil servant salaries, transfers to municipalities and savings restitutions (see Box 2). An expenditure overrun accounting for some 0.7% of GDP to repay savings restitution obligations (in addition to the payments made in June) was also carried out at the end of the year, when it had become clear that the fiscal target would be outperformed. This additional expenditure did not require a budgetary amendment.

#### **5. BUDGETARY TARGETS AND THE MEDIUM-TERM PATH OF THE PUBLIC FINANCES**

##### **5.1. Evolution of budgetary targets in successive programmes**

The updated programme foresees the general government deficit to remain unchanged (as a percentage of GDP) at 2.5% in 2005 and to decrease gradually thereafter to 1.5% in 2007. When compared to the May 2004 programme, the deficit targets for 2005-2007 are maintained, despite a considerable downward revision of GDP growth. The deficit reduction path in the update is broadly in line with that in the pre-accession economic programme of August 2003.

**Table 3: Evolution of budgetary targets in successive programmes**

		2003	2004	2005	2006	2007
General government balance (% of GDP)	<b>CP January 2005</b>	<b>-1.9</b>	<b>-2.5</b>	<b>-2.5</b>	<b>-1.8</b>	<b>-1.5</b>
	CP May 2004	-1.7	-2.7	-2.5	-1.8	-1.5
	PEP August 2003	-2.4	-2.9	-2.5	-1.8	<i>n.a.</i>
General government expenditure (% of GDP)	<b>CP January 2005</b>	<b>34.1</b>	<b>35.5</b>	<b>36.9</b>	<b>36.5</b>	<b>36.0</b>
	CP May 2004	34.1	37.6	37.8	36.7	35.9
	PEP August 2003	35.8	38.1	38.3	37.4	<i>n.a.</i>
General government revenues (% of GDP)	<b>CP January 2005</b>	<b>32.3</b>	<b>33.0</b>	<b>34.4</b>	<b>34.7</b>	<b>34.5</b>
	CP May 2004	32.4	34.9	35.3	35.0	34.4
	PEP August 2003	33.4	35.2	35.8	35.6	<i>n.a.</i>
Real GDP (% change)	<b>CP January 2005</b>	<b>9.7</b>	<b>6.5</b>	<b>6.5</b>	<b>6.2</b>	<b>6.0</b>
	CP May 2004	9.0	7.0	7.3	6.6	6.3
	PEP August 2003	6.7	6.8	6.2	6.5	6.0
<i>Sources:</i>						
<i>Convergence programmes (CP); pre-accession economic programme (PEP)</i>						

## 5.2. Budgetary targets in the updated programme

The key objective of the medium-term fiscal strategy defined in the programme is *"the approximation to a cyclically balanced general government budget"*. While the general government deficit targets are below the 3% of GDP reference value in each year, they are not consistent with a position of close-to-balance throughout the programme period.

The update foresees the general government deficit to remain at 2.5% of GDP in 2005 but to decline gradually thereafter, to 1.5% in 2007. The time profile of the primary deficit is very similar, with a marginal improvement from 1.5% of GDP in 2004 to 1.4% in 2005 and a gradual decrease afterwards to 0.5% in 2007.

Consolidation is planned to be achieved mainly by an increase in revenues over the period 2004-2007. Revenues are expected to increase from 33% of GDP in 2004 to 34.5% in 2007, primarily due to an increase in financial transfers from the EU (by about 1% of GDP). Improvements in tax enforcement and several new taxes are expected to contribute further. The programme assumes the introduction of new tax measures not included in the budget for 2005, e.g. real estate and vehicle taxes. Those measures are expected to increase revenues by some 0.6% of GDP in the medium term. The abolition of the turnover tax in July 2005 is estimated to cause a 0.4% of GDP yearly loss of revenue. The programme highlights detailed proposals to replace this tax by alternative sources of financing, but remains vague about the time for their implementation, which generates uncertainty about the revenue target in 2005. In addition, plans to decrease the personal income tax are estimated to lead to a 0.4% of GDP loss of revenue in the medium-term, which calls for a timely application of compensating measures foreseen in the programme.

Public expenditure is foreseen to increase by 1.4% of GDP in 2005 and to decline afterwards, leading to a 0.5% of GDP increase over the whole programme's period. A significant increase in capital expenditure (related to EU-cofinanced projects) and other expenditures that include transfers to the EU budget, savings and property rights restitutions and the costs of the pension reform are budgeted. Such increases will be only partly offset by a decrease in consumption, transfers and interest payments. It is worth noting that a significant programme of public investment is being implemented, which lifts public investment from 3.4% of GDP in 2004 to 5% in 2007, resulting in an average public investment ratio over the programme period of about 4.6% of GDP against an EU average of 2.4% in 2004.

**Table 4: Composition of the budgetary adjustment**

(% of GDP)	2003	2004	2005	2006	2007	Change: 2007-2004
<b>Revenues</b>	32.3	33.0	34.4	34.7	34.5	<b>1.5</b>
<i>of which:</i>						
- Taxes & social security contributions	28.6	28.5	29.0	28.9	28.9	<b>0.4</b>
- Other (residual)	3.7	4.4	5.4	5.8	5.6	<b>1.2</b>
<b>Expenditure</b>	34.1	35.5	36.9	36.5	36.0	<b>0.5</b>
<i>of which:</i>						
- Primary expenditure	32.8	34.4	35.8	35.5	34.8	<b>0.6</b>
<i>of which:</i>						
Gross fixed capital formation	3.0	3.4	4.9	5.2	5.0	<b>1.6</b>
Consumption	18.7	17.9	17.9	16.9	16.2	<b>-1.7</b>
Transfers other than in kind+subsidies	10.0	10.2	10.1	10.1	9.9	<b>-0.3</b>
Other (residual)	1.1	2.9	2.9	3.4	3.9	<b>1.0</b>
- Interest payments	1.3	1.1	1.1	1.0	1.0	<b>-0.1</b>
<b>Budget balance</b>	<b>-1.9</b>	<b>-2.5</b>	<b>-2.5</b>	<b>-1.8</b>	<b>-1.5</b>	<b>1.0</b>
<b>Primary balance</b>	<b>-0.6</b>	<b>-1.5</b>	<b>-1.4</b>	<b>-0.8</b>	<b>-0.5</b>	<b>1.0</b>
<i>Sources:</i>						
<i>Convergence programme update; Commission services calculations</i>						

### **Box 1: The budget for 2005**

The budget for 2005 was approved on 9 November 2004, short before the end of the previous parliament's term. The deficit target was set at 2.5% of GDP in ESA 95 terms (2.7% according to the national methodology).

The budget did not contain significant tax changes, apart from the planned abolition of the turnover tax in July 2005, which so far has not been replaced by compensating measures. Revenues are to be supported by strong economic growth, EU-related financial assistance, a pick up of inflation and further improvements in tax enforcement.

Outlays related to EU co-financed projects account for the largest increase in expenditure. Several categories of expenditures are increased substantially compared to the previous year's budgetary allocations. The growth in allocations for agriculture and defence is particularly high, (29% and 17.5% respectively). Allocations for education and healthcare (largely corresponding to increasing salaries of professors and medical personnel) also increased significantly, although their share in total expenditure remains relatively low. Social security expenditure is set to increase notably, mostly due to the costs of the pension reform. Public investment is set to increase by about 20%, supported by EU-related financial aid.

Several measures to limit expenditure and to use better-than-budgeted revenues for deficit reduction were announced by the new government after the budget for 2005 and have been included in the updated convergence programme. The government proposes to amend the budget law to allow for cutting expenditure if additional funds for co-financing were necessary in 2005. The intention to replace the turnover tax with other taxes is also stated, though no decision has been taken yet.

The risks to the budgetary projections in the programme appear broadly balanced. On the one hand, the government has shown a good track in meeting the fiscal targets in the last years and has often outperformed the planned budgetary deficits. Revenue forecasting, particularly corporate and personal income taxes, has been prudent but VAT revenues have been overestimated in 2004 (to an extent due to structural changes in the collection system). In addition, the growth assumptions envisaged in the programme update are more cautious than those provided in the May 2004 programme. On the other hand, a risk to the fiscal projections stems from the uncertainty about the application of envisaged measures related to the introduction of new taxes and the use of higher-than-budgeted revenues and unused EU-related expenditures to decrease the deficit. In particular, the tax revenue target for 2005 might be difficult to achieve if compensatory measures for the abolition of the turnover tax were not introduced. The execution of the planned measures would be crucial to limit additional spending, which has been a frequent budgetary practice that prevented a faster fiscal consolidation in previous years. Other risks stem from the relatively uncertain costs of the pension reform, the high outstanding contingent liabilities, budget arrears, liabilities related to the savings and real estate restitution obligations and spending related to the decommissioning of the Ignalina nuclear power plant. The contingent liabilities and other fiscal risks mentioned in the programme pertain to the insurance of deposits (25.6% of GDP), guaranteed loans (about 2% of GDP), the restitution of lost savings and confiscated real estate assets (see Box 2) and municipalities' arrears (0.4% of GDP). As an additional risk factor there also exist arrears of VAT refunds from the state to enterprises, which are not mentioned in the programme (about 1% of GDP).

It is worth noting that the sharp increase expected in the revenue ratio in 2005 (1.4 percentage points higher than in 2004) is to a great extent explained by increasing EU funds, and a shortfall of those revenues would also entail lower expenditure than planned.

### **Box 2: The restitution of savings and property rights**

In the aftermath of independence, the Lithuanian economy endured a process of hyperinflation, shortages in consumer goods and administrative restrictions in the form of freezing of deposits. A vast amount of deposits denominated in roubles (and the surrogate currency talonas) depreciated rapidly. Following the introduction of the litas in 1993, the government decided to compensate for the losses of savings held in state banks by Lithuanian citizens. There was no formal requirement on the schedule of repayments. A first wave of compensations started in 1993 and, after some interruptions, continues under the 1997 Law on the Restoration of Savings of the Population. Privatisation receipts were set as the main source of financing. As of December 2004, the amounts of compensations pending to be yet paid were estimated at some 2.5% of GDP.

Short after the restoration of independence, the government also decided to restore real estate assets confiscated during the Soviet times. In 1991 a law regulating the procedure and conditions for restoration of property was published. An amendment to the law in 1996 established that liabilities related to residential houses should be fully paid by 2011 (2016 for agricultural land). Restoration of property has been made in actual or equivalent property, or by financial compensation. The amount of compensations to be paid was estimated at 1.7% of GDP in December 2004.

Compensation in both cases takes place according to a schedule decided each year by the government, and the repaid amounts have often differed from the budgeted amounts. In Lithuania's first convergence programme in May 2004, the government presented a medium-term plan for the payment of part of the compensation in an effort to increase transparency.

Cash compensation for lost savings and confiscated real estate are recorded in the government accounts as government expenditure, increasing the general government deficit in the year when they are paid. The amounts yet to be paid are not included in the government debt. Classification changes in the future cannot be excluded.

In view of this risk assessment, the budgetary stance in the programme does not seem to provide a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations throughout the programme period, particularly in 2005, nor to achieve a budgetary position of close to balance in the medium term. Against the background of the strong economic performance and the large current account deficit, the budgetary targets do not appear ambitious, also in view of preventing potential risks of overheating.

Overall, the economic policies outlined in the update are broadly consistent with the country-specific broad economic policy guidelines in the area of public finances. The outlined measures to use better-than-projected revenues for deficit reduction and limit expenditure overruns are consistent with the guidelines. The announced measures do not seem to prevent expenditure overruns that stem from savings unrelated with EU co-financing. The extension of such measures to other kind of savings would assure a stricter consistency with the guidelines.

**Table 5: Budgetary targets and output gaps**

	2003		2004		2005		2006		2007	Change: 2007-2004
	COM	CP <sup>1</sup>	COM	CP <sup>1</sup>	COM	CP <sup>1</sup>	COM	CP <sup>1</sup>	CP <sup>1</sup>	CP <sup>1</sup>
Budget balance <sup>2</sup>	-1.9	-1.9	-2.6	-2.5	-2.5	-2.5	-1.9	-1.8	-1.5	1.0
Output gap <sup>1,3</sup>	1.7	1.6	2.1	1.6	1.7	1.3	0.7	0.5	-0.1	-1.7
Notes:										
<sup>1</sup> Commission services calculations on the basis of the information in the convergence programme (CP)										
<sup>2</sup> in percent of GDP										
<sup>3</sup> in percent of potential GDP										
<i>Sources:</i>										
<i>Commission services autumn 2004 economic forecasts (COM); Commission services calculations</i>										

### 5.3. Sensitivity analysis

The sensitivity of the general government budget deficit to GDP fluctuations is estimated to be low. According to the programme, this is explained by a low elasticity of revenues to GDP fluctuations and low expenditure associated with unemployment in Lithuania. A sensitivity analysis on interest rates and absorption of EU funds is briefly presented. It assumes that an increase in interest rates by 1 percentage point would entail a 0.1 percentage point of GDP annual increase in interest payments and therefore the general government deficit on public debt over the programme's period.

## 6. EVOLUTION OF THE DEBT RATIO

Lithuania's debt ratio is estimated at 21.1 % of GDP in 2004, well below the Treaty reference level. The programme projects an initial increase of the debt to GDP ratio in 2004 by 0.8 percentage points, mostly due to the increase of the general government deficit in the same year. The ratio is expected to decrease throughout the remainder of the programme horizon reaching 20% in 2007. The government plans to decrease the stock of government-guaranteed loans from 2% of GDP to 1.2% over the medium-term, thereby contributing to decreasing fiscal risks and increase confidence about the budgetary targets. No guarantees on new loans have been issued since 2003.

**Table 6: Debt dynamics**

	average 2000-2003	2004		2005		2006		2007
	COM	COM	CP	COM	CP	COM	CP	CP
<b>Government gross debt ratio</b>	22.7	21.1	20.1	21.7	20.9	21.3	20.3	20.1
Change in debt ratio (1 = 2+3+4)	-0.3	-0.5	-1.5	0.6	0.8	-0.4	-0.6	-0.2
<i>Contributions:</i>								
- <b>Primary balance</b> (2)	0.5	1.4	1.4	1.4	1.4	0.9	0.8	0.5
- <b>“Snow-ball” effect</b> (3)	0.1	-0.6	-0.8	-0.7	-0.6	-0.9	-0.7	-0.6
- Interest expenditure	1.5	1.2	1.1	1.1	1.1	1.0	1.0	1.0
- Real GDP growth	-1.4	-1.4	-1.3	-1.2	-1.2	-1.2	-1.2	-1.1
- Inflation (GDP deflator)	0.0	-0.3	-0.6	-0.6	-0.5	-0.7	-0.5	-0.5
- <b>Stock-flow adjustment</b> (4)	-0.9	-1.3	-2.1	-0.1	0.0	-0.4	-0.7	-0.1
- Cash/accruals	0.5							
- Accumulation of financial assets	-0.7							
<i>of which: Privatisation proceeds</i>	-1.3		-0.7		-0.8		-0.2	-0.2
- Valuation effects & residual adj.	-0.7							
<u>Note:</u>								
The change in the gross debt ratio can be decomposed as follows:								
$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left( \frac{D_{t-1}}{Y_{t-1}} * \frac{i_t - y_t}{1 + y_t} \right) + \frac{SF_t}{Y_t}$								
where $t$ is a time subscript; $D$ , $PD$ , $Y$ and $SF$ are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and $i$ and $y$ represent the average cost of debt and nominal GDP growth. The term in parentheses represents the “snow-ball” effect.								
<u>Sources:</u>								
<i>Convergence programme update (CP); Commission services autumn 2004 economic forecasts (COM); Commission services calculations</i>								

## 7. STRUCTURAL REFORM AND THE QUALITY OF PUBLIC FINANCES

The programme reviews new important measures which would contribute to improve the quality of public finances.

Several tax measures are announced in the programme. A better balance between capital and labour taxes is planned to be implemented, through higher taxes on real estate and lower personal income tax rates. The programme makes the plans to introduce several of these revenue enhancing measures (i.e. real-estate tax conditional on residents) conditional on future macroeconomic and housing prices developments. The pension reform (i.e. introduction of second and third pillars and extension of retirement age) is well under way and should improve the quality of the public finances in the long run, particularly if plans to further extend the retirement age from 2010 proceed. A vast public investment programme is also under way and modernising equipment and infrastructure in the healthcare sector is part of the programme.

New measures are also announced that introduce clear improvements in the control and efficiency of expenditure. Unused funds for co-financing EU-related projects and better-than-expected revenues are assigned for deficit reduction. Furthermore, should additional co-financing needs arise, expenditure would be cut in order to meet the deficit target in 2005. Plans to develop the reserve fund, complete the privatisation programme and the transposition to a programme-based budgeting, together with improving the finances of municipalities, are also commendable. These measures do not prevent expenditure overruns stemming from savings in expenditure items other than co-financing funds for EU-related projects.

## **8. THE SUSTAINABILITY OF THE PUBLIC FINANCES**

The assessment of the sustainability of Lithuanian public finances is based on an overall judgement of the results of quantitative indicators and qualitative features. The quantitative indicators project debt development according to two different scenarios, to take into account different budgetary developments over the medium term. The “programme” scenario (baseline) assumes that the medium-term objective set up in the programme is actually achieved, while the “2004” scenario assumes that the underlying primary balance remains throughout the programme period at the 2004 level.

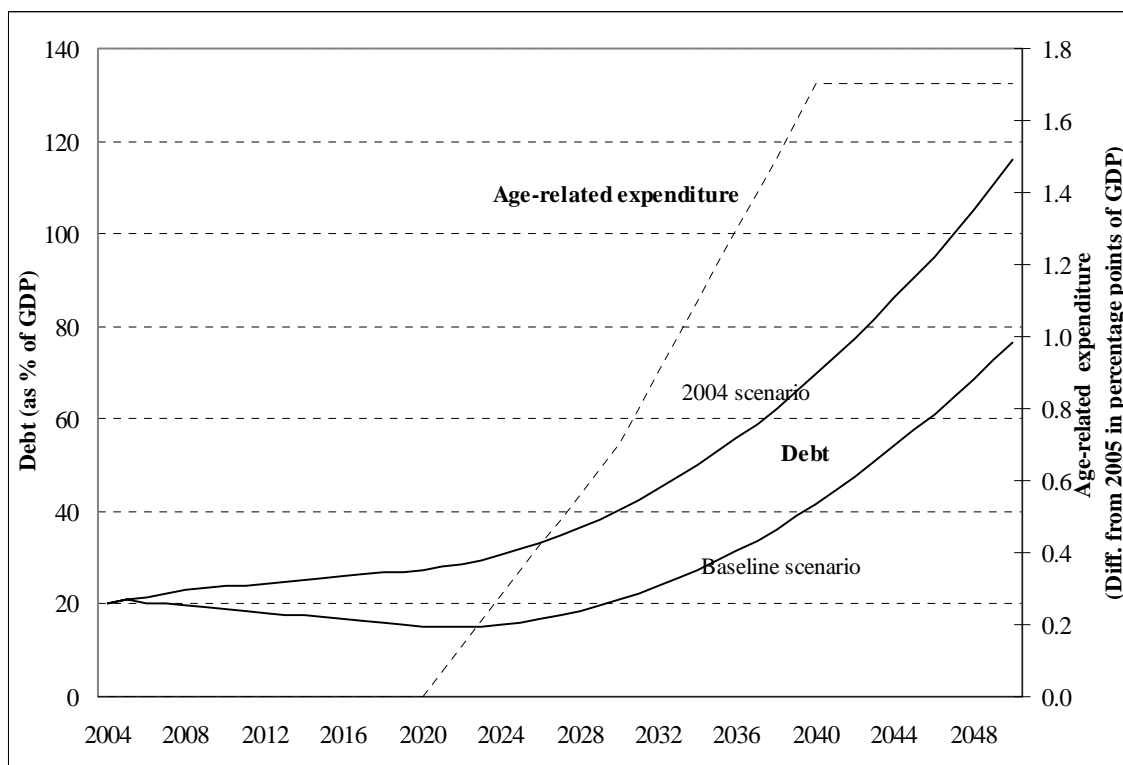
The graph below presents the gross debt development according to the two different scenarios. On the basis of the programme, age-related expenditure is foreseen to increase by 1.7% of GDP between 2008 and 2050 (see Annex 2 for a breakdown of different age-related expenditures). This trend includes the assumptions on an increase in the replacement rate to 60% by 2010 and on a progressive increase of the retirement age to 65 years, starting in 2010. Gross debt is projected to slightly fall over the next 25 years and increase sharply thereafter to reach values around 75% of GDP in 2050, reflecting the impact of ageing population on the PAYG pension system<sup>5</sup>. The debt dynamic would significantly worsen if the expected consolidation path in the programme period does not materialise.

---

<sup>5</sup> It should be recalled that, being a mechanical, partial equilibrium analysis, projections are in some cases bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels is not a forecast of likely outcomes and should not be taken at face value.



## Long-term sustainability: summary results



### Sustainability indicators

	S1*	S2**	RPB***
<b>Baseline scenario</b>	0.4	2.7	2.6
<b>2004 scenario</b>	1.4	3.6	2.6

#### Notes:

\* It indicates the required change in tax revenues as a share of GDP over the projection period that guarantees to reach debt to GDP ratio of 60% of GDP in 2050.

\*\* It indicates the required change in tax revenues as a share of GDP that guarantees the respect of the intertemporal budget constraint of the government, i.e., that equates the actualized flow of revenues and expenses over an infinite horizon to the debt as existing at the outset of the projection period; p.m. debt to GDP ratio in 2050: -34.9%

\*\*\* Based on S2, the Required Primary Balance (RPB) indicates the average minimum required cyclically adjusted primary balance as a share of GDP over the first five years of the projection period that guarantees the respect of the intertemporal budget constraint of the government.

On the basis of the debt projections, it is possible to calculate a set of sustainability indicators to measure the gap between the current policies and a sustainable one. The S1 indicator shows the permanent change in the primary balance in order to have a debt to GDP ratio in line with the Maastricht Treaty reference value in the very long run (year 2050).<sup>6</sup> S2 shows the gap between the current tax policies and those that would ensure respect of the intertemporal budget constraint given the future impact of ageing on public expenditure, namely the change in the tax ratio that would equate the present discounted value of future primary balances to the current stock of gross debt. According to the latter, in order to tackle the cost of ageing entirely through a budgetary strategy, Lithuania should increase its tax ratio permanently by at least 2.7 percentage points

<sup>6</sup> The respect of the underlying debt path does not ensure sustainability over an infinite horizon, but only that debt remains below 60% up to 2050. In most cases, this would imply an increasing trend and possible unbalances after the end of the projection period.

compared with the projected one at the end of the programme period. This would lead to a negative debt ratio by the middle of this century<sup>7</sup>. The budgetary effort over the first 5 years of projections (i.e. after the end of the programme period) to respect the intertemporal budget constraint requires a primary surplus of about 2.6% of GDP on average, compared with a primary deficit of 0.5% of GDP targeted for the last year of the programme period.

In interpreting these results, several factors must be taken into account. The introduction of the 2nd and 3rd pillar should alleviate the impact of ageing on public finances, create better retirement conditions for future pensioners and promote private savings and the capital market. Increase in pension expenditure resulting from a re-direction of a part of social security contributions to the 2nd pillar is to be financed by privatisation revenues and state budget. In this context, it is crucial to monitor the implementation of the pension reform and to ensure sufficient financing to cover the above-mentioned losses as it could affect the planned budgetary consolidation over the medium term.

Concerning the health-care, the expenditure in this area is assumed to remain constant over the entire projection period. In addition to a number of measures aiming at reforming the health-care sector, depicted in the updated programme, the expected salary increases of professionals in the sector and the budgetary pressure resulting from population ageing should entail significant costs, thus making the assumption of unchanged health-care expenditures highly unlikely.

Lithuania appears to be in a relatively favourable position with regard to long-term sustainability of the public finances, of which the projected budgetary costs of an ageing population is an important element. The relatively low debt ratio, the pension reform measures enacted, including the introduction of the funded pillars will contribute to limit the budgetary impact of ageing.

The strategy outlined in the programme is based on a contained budgetary deficit over the medium term and the long-term budgetary impact of the pension reform. Nevertheless, risks related to the costs of the pension reform and to the outstanding contingent liabilities should be monitored. In addition, reform measures in the field of health-care could involve higher expenditures. However, Lithuania has a relatively low tax ratio: the sustainability gap that arises in the long-run could be addressed by raising it.

---

<sup>7</sup> The debt ratio of around -35% in 2050 according to the S2 indicator illustrates that the sustainability gap is higher in order to ensure a sustainable evolution of gross debt beyond 2050, compared with the S1 indicator, which illustrates that a lower budgetary strengthening is compatible with the 60% reference value in 2050.

## Annex 1: Summary tables from the January 2005 convergence programme

**Table 1. Growth and associated factors**

	2003	2004	2005	2006	2007
<b>GDP growth at constant market prices (7+8+9)</b>	9.7	6.5	6.5	6.2	6.0
<b>GDP level at current market prices, SKK bn.</b>	56,179	61,027	66,526	72,424	78,686
<b>GDP deflator</b>	-0.83	2.02	2.31	2.51	2.50
HICP change	-1.2	1.2	2.9	2.5	2.9
<b>Employment growth</b>	2.2	1.5	0.5	0.5	0.6
Labour productivity growth	9.8	6.1	6.1	6.3	6.0
<b>Sources of growth: percentage changes at constant prices</b>					
<b>1. Private consumption expenditure</b>	12.4	8.5	6.9	6.6	6.7
<b>2. Government consumption expenditure</b>	4.0	9.4	3.7	3.0	2.5
<b>3. Gross fixed capital formation</b>	14.0	10.5	16.7	13.2	6.5
<b>4. Changes in inventories and net acquisition of valuables as a % of GDP</b>	1.0	1.9	0.9	0.0	0.0
<b>5. Exports of goods and services</b>	6.9	9.8	8.8	8.6	7.5
<b>6. Imports of goods and services</b>	10.2	13.2	11.6	10.0	6.7
<b>Contribution to GDP growth</b>					
<b>7. Final domestic demand (1+2+3)</b>	11.5	9.5	9.0	8.2	6.6
<b>8. Change in inventories and net acquisition of valuables (=4)</b>	0.6	-0.2	0.3	0.0	-0.3
<b>9. External balance of goods and services (5-6)</b>	-2.40	-2.79	-2.69	-1.97	-0.30

**Table 2. General government budgetary developments**

% of GDP	2003	2004	2005	2006	2007
<b>Net lending by sub-sectors</b>					
<b>1. General government</b>	-1.9	-2.5	-2.5	-1.8	-1.5
<b>2. Central government</b>	-2.38	-2.69	-2.55	-1.82	-1.51
<b>3. State government</b>	--	--	--	--	--
<b>4. Local government</b>	0.03	0.05	0.02	0.02	0.02
<b>5. Social security funds</b>	0.50	0.11	0.03	0.00	0.00
<b>General government</b>					
<b>6. Total receipts</b>	32.3	32.9	34.4	34.8	34.5
<b>7. Total expenditures</b>	34.1	35.5	36.9	36.6	36.0
<b>8. Budget balance</b>	-1.9	-2.5	-2.5	-1.8	-1.5
<b>9. Net interest payments</b>	0.4	0.5	0.6	0.6	0.6
<b>10. Primary balance</b>	-0.6	-1.5	-1.4	-0.8	-0.5
<b>Components of revenues</b>					
11. Taxes	19.9	19.8	20.4	20.4	20.5
12. Social contributions	8.7	8.7	8.6	8.5	8.4
13. Interest income	0.9	0.6	0.5	0.4	0.4
14. Other	2.8	3.8	4.9	5.4	5.2
15. Total receipts	32.3	32.9	34.4	34.7	34.5
<b>Components of expenditures</b>					
16. Collective consumption	7.9	7.1	7.1	6.6	6.3
17. Social transfers in kind	10.8	10.8	10.8	10.3	9.9
18. Social transfers other than in kind	9.2	9.3	9.2	9.2	9.0
19. Interest payments	1.3	1.1	1.1	1.0	1.0
20. Subsidies	0.8	0.9	0.9	0.9	0.8
21. Gross fixed capital formation	3.0	3.4	4.9	5.2	5.0
22. Other	1.1	2.9	2.9	3.4	3.8
23. Total expenditures	34.1	35.5	36.9	36.5	36.0

**Table 3. General government debt developments**

% of GDP	2003	2004	2005	2006	2007
<b>Gross debt level</b>	21.4	20.1	20.9	20.3	20.1
<b>Change in gross debt</b>	-1.0	-1.3	0.8	-0.6	-0.2
<b>Contributions to change in gross debt</b>					
<b>Primary balance</b>	0.6	1.5	1.4	0.8	0.5
<b>Interest payments</b>	1.3	1.1	1.1	1.0	1.0
<b>Nominal GDP growth</b>	-1.9	-1.9	-2.0	-1.9	-1.8
<i>Other factors influencing the debt ratio</i>	-1.0	-2.0	0.3	-0.5	0.1
<i>Of which: Privatisation receipts</i>	-1.5	-0.7	-0.8	-0.2	-0.2
<i>p.m. implicit interest rate on debt</i>	5.5	5.4	5.2	5.1	5.1

**Table 4. Cyclical developments**

% of GDP	2003	2004	2005	2006	2007
<b>1. GDP growth at constant prices</b>	9.7	6.5	6.5	6.2	6.0
<b>2. Actual balance</b>	-1.9	-2.5	-2.5	-1.8	-1.5
<b>3. Interest payments</b>	1.3	1.1	1.1	1.0	1.0
4. Potential GDP growth	6.3	6.4	6.4	6.2	6.0
5. Output gap	1.75	1.86	1.94	1.94	2.00
6. Cyclical budgetary component	0.51	0.55	0.59	0.59	0.61
7. Cyclically-adjusted balance (2-6)	-2.36	-3.09	-3.09	-2.39	-2.11
8. Cyclically-adjusted primary balance (7-3)	-1.06	-1.99	-1.99	-1.39	-1.11

**Table 5. Divergence from previous update**

% of GDP	2003	2004	2005	2006	2007
<b>GDP growth</b>					
<b>Previous update</b>	9.0	7.0	7.3	6.6	6.3
<b>Latest update</b>	9.7	6.5	6.5	6.2	6.0
<b>Difference</b>	0.7	-0.5	-0.8	-0.4	-0.3
<b>Actual budget balance</b>					
<b>Previous update</b>	-2.4	-2.7	-2.5	-1.8	-1.5
<b>Latest update</b>	-1.9	-2.5	-2.5	-1.8	-1.5
<b>Difference</b>	-0.5	-0.2	0.0	0.0	0.0
<b>Gross debt levels</b>					
<b>Previous update</b>	21.5	22.4	22.2	21.4	21.0
<b>Latest update</b>	21.4	20.1	20.9	20.3	20.1
<b>Difference</b>	-0.1	-2.3	-1.3	-1.1	-0.9

**Table 6. Long-term sustainability of public finances**

% of GDP	2004	2005	2010	2020	2030	2050
Total expenditure		37.0	37.4	37.4	37.4	37.4
Old age pensions <sup>1</sup>		5.3	5.3	5.3	6.0	7.0
Health care (including care for the elderly)		4.6	4.6	4.6	4.6	4.6
Interest payments		1.1	1.1	0.9	0.7	0.5
Total revenues		34.5	37.4	37.4	37.4	37.4
<i>Of which: from pension contributions</i>		5.3	6.1	6.2	5.4	4.4
National pension fund assets (if any)		0.8	N/A	N/A	N/A	N/A
<b>Assumptions</b>						
Labour productivity growth		6.1	5.2	5.0	4.8	3.7
Real GDP growth		6.5	5.2	4.6	3.9	2.4
Participation rate males (aged 20-64)		83.3	88.2	89.0	90.0	90.2
Participation rates females (aged 20-64)		74.5	76.7	79.0	79.5	80.0
Total participation rates (aged 20-64)		78.4	82.0	83.9	84.6	85.0
Unemployment rate		11.4	8.6	6.9	6.9	6.9

(1) On the assumption that the increase of the pension age to 65 years will start in 2010.

**Table 7. Basic assumptions**

	2003	2004	2005	2006	2007
<b>Short-term interest rate</b> (annual average)	2.4	2.3	2.5	3.2	3.6
<b>Long-term interest rate</b> (annual average)	5.3	4.6	5.1	5.7	6.0
United States: short-term (three-month money market)					
United States: long term (10-year government bonds)					
<b>USD/€exchange rate</b> (annual average) <sup>1</sup>	1.13	1.23	1.24	1.24	1.24
Nominal effective exchange rate (euro area)					
Nominal effective exchange rate (EU)					
<b>LTL/€exchange rate</b> (annual average)	3.45	3.45	3.45	3.45	3.45
<b>World GDP growth, excluding EU</b>		5.7	4.8	4.6	
United States, GDP growth					
Japan, GDP growth					
<b>EU-25 GDP growth</b>	1.0	2.5	2.3	2.4	2.4
<b>Growth of relevant foreign markets</b>					
<b>World import volumes, excluding EU</b>	4.2	5.7	4.8	4.6	4.6
<b>World import prices</b> (goods, in USD)					
<b>Oil prices</b> (Brent, USD/barrel) <sup>2</sup>	28.5	39.3	45.1	40.1	40.1
Non-oil commodity prices (in USD)					

(1) Technical assumption.

(2) The upper limit of OPEC's price corridor.



<b>Main assumptions - baseline scenario (as % GDP)</b>	<b>2008</b>	<b>2010</b>	<b>2020</b>	<b>2030</b>	<b>2040</b>	<b>2050</b>	<b>changes</b>
Total age-related spending	9.9	9.9	9.9	10.6	11.6	11.6	1.7
Pensions	5.3	5.3	5.3	6.0	7.0	7.0	1.7
Health care	4.6	4.6	4.6	4.6	4.6	4.6	0.0
Total primary non age-related spending*	25.1						
Total revenues	34.8	35.0	35.1	34.3	34.0	33.3	-1.5

\*constant

<b>Results (as % GDP)</b>	<b>2008</b>	<b>2010</b>	<b>2020</b>	<b>2030</b>	<b>2040</b>	<b>2050</b>	<b>changes</b>
<b>Baseline scenario</b>							
Gross debt	19.9	19.1	15.3	20.9	41.7	76.7	56.8
<b>i + 0.5*</b>	19.9	19.3	16.2	22.5	44.7	82.9	63.1
<b>2004 scenario</b>							
Gross debt	22.9	23.8	27.5	40.3	69.6	115.9	92.9
<b>i + 0.5*</b>	22.9	24.0	28.8	43.0	74.9	126.2	103.3

\* i + 0.5 represents the evolution of debt under the assumption of the nominal interest rate being 50 basis points higher throughout the projection period.

