BOX 6

ADEQUACY AND EFFECTIVENESS OF GENERAL GOVERNMENT EXPENDITURE ALLOCATION IN LITHUANIA

Tax revenue and total general government expenditure in Lithuania are among the lowest in the EU. According to the data of 2017, they amounted to 29.6% and 33.1% of GDP respectively. However, the general government sector of Lithuania provides goods and services that are similar to those of other EU Member States, even though the revenue level and the revenue-generating mechanism, i.e. the tax system, differ. Thus, when comparing with other EU Member States, it is easier to understand what consequences Lithuania’s general government revenue level (one of the lowest in the EU) has on government-funded areas, i.e. to assess whether expenditure on general public services is adequate and its use is effective. This box discusses two of the three main government-provided functions, namely social security and healthcare.

In 2016, the ratio of Lithuania’s general government expenditure to GDP was lower than the EU and euro area average by about 12 percentage points and around 6 percentage points lower than the EU-13 average (see Chart A). A closer look at the areas of general government expenditure, showed that these differences are mostly attributed to significantly smaller share of Lithuania’s expenditure on social security (approximately 8 percentage points smaller than in the EU and euro area and 2 percentage points – than the EU-13 average), general public services16 (2 and 1 percentage points smaller respectively), general economic affairs17 (1 and 2 percentage points smaller respectively) and healthcare (1 percentage point smaller and 1 percentage point larger respectively). It is also worth noting that the ratio to GDP of funds earmarked for education in Lithuania is approximately 0.3-0.6 percentage point higher than the average share of GDP allocated to it in the EU, the euro area and EU-13.

The share of funds allocated to social security in Lithuania is lower than in other EU Member States, which is one of the root causes behind small old-age pensions (see Chart B). The analysis of funds allocated to social security shows that old-age and survivors’ pension expenditure in Lithuania is significantly lower than in other EU Member States. Fewer funds are also being allocated to children and family support and to reducing unemployment; however, these are smaller contributions to the gap. Furthermore, in 2016, funds for sickness and disability benefits in Lithuania were around 0.5 percentage point higher than the EU or euro area average and approximately 1.5 percentage points higher than in EU-13. The share of the total population who are pension beneficiaries is significantly higher than the EU average, which might suggest that the main reason behind small old-age pension replacement rate is the gap between the large number of beneficiaries and a relatively low share of GDP allocated to pensions. In 2016, the replacement rate amounted to 33% of the average gross wage making it a quarter less than the EU average (45%). Based on the analysis of the ratio of replacement rate to GDP share allocated, there is

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15 EU average – 39.8% and 45.8% of GDP respectively.
16 Under the Classification of the Functions of Government (COFOG), this area of expenditure includes expenditure on: administration, operation or support of executive and legislative organs (office of the chief executive at all levels of government); legislative bodies at all levels of government (parliaments, town councils, etc.); advisory, administrative and political staffs attached to these institutions and legislatures; financial and fiscal affairs and services at all levels of government (ministry of finance, the budget Office, the inland revenue agency and the customs authorities; the accounting and auditing services; production and dissemination of general information, technical documentation and statistics on financial and fiscal affairs and services). For more details, see Classification of the Functions of Government.
17 Under the Classification of the Functions of Government, this area of expenditure includes expenditure on: administration, operation or support of activities relating to general and sectoral economic affairs, e.g. implementation of general economic and commercial policies (general regulation of monopolies and other restraints on trade and market entry; supervision of the banking industry, etc.), administration of general labour affairs and services (e.g. operation of labour exchanges), administration of agricultural affairs and services (e.g. conservation of arable land, expansion of reclamation, etc.), administration of forestry affairs and services (e.g. conservation and rationalised exploitation of forest reserves; supervision and regulation of forest operations and issuance of tree-felling licences; operation of reforestation work, pest and disease control, forest fire-fighting and fire prevention services and extension services to forest operators, etc.), administration of fishing and hunting affairs and services, administration of solid mineral fuel affairs and services, etc. For more details, see Classification of the Functions of Government.
18 The ratio of average pensions of persons aged 65-74 to average labour income of persons aged 50-59.
some evidence to suggest that the funds allocated to old-age pensions in Lithuania are used quite efficiently. In 2016, the replacement rate of pensions paid via state’s pay-as-you-go system in Sweden, Denmark, Romania and Bulgaria was similar to Lithuania’s; however, these countries allocated significantly more funds for pensions. Bulgaria particularly stands out in this regard, since it allocated 9.3% of GDP for pensions in 2016, yet the average pension amounted to only 36% of gross wage. On the other hand, in many Western European countries, a significant share of old-age pensions is made up by benefits paid by private pension accumulation funds which are not included in the data provided in the chart.

**Lithuania allocates relatively less funds than most other EU Member States to social security and healthcare, general public services and economic affairs.**

Chart A. General government expenditure differences by areas in EU Member States and Lithuania in 2016

A relatively low share of pay-as-you-go funding allocated to social security is one of the root causes behind small old-age pensions.

Chart B. Old-age pension expenditure and pension replacement rate and beneficiaries in EU countries in 2016

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Sources: Eurostat and Bank of Lithuania calculations.

*EU-15 – EU Member States that joined the EU before 2004 (also referred to as ‘old’ Member States)
EU-19 – EU Member States that joined the EU in 2004 or later (also referred to as ‘new’ Member States).
Lithuania’s spending on wages of healthcare workers does not appear to be insufficient, therefore, the adequacy and effectiveness of other funds allocated to healthcare comes into question. Analysis of funds allocated to healthcare in Lithuania shows that the average EU and euro area funding is higher for outpatient services, hospital services and medical products, appliances and equipment. Having analysed the appropriation of these three categories by type of expenditure it is evident that, on average, other EU Member States spend more on intermediate consumption goods and products for healthcare institutions as well as on social transfers in kind, i.e. full or partial compensation by state funds for services provided to individuals. It is important to note that in 2016, Lithuania’s spending on wages of healthcare workers was slightly higher than, on average, in the old and the new EU member states (see chart C). Therefore, the relatively low average wage of Lithuanian medical personnel may be explained by a higher number of hospital and medical personnel per 100,000 inhabitants compared to the EU average.

**Lithuania is middling in terms of the share of GDP allocated to wages of healthcare workers, yet the relative number of medical personnel in the country is above the EU average.**

Chart C. Expenditure on wages and the total number of healthcare workers in the EU countries in 2016

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Amongst other factors, the relatively poor health outcomes of Lithuanians and relatively high mortality rates throughout all age groups are likely heavily influenced by lower accessibility to diagnostic services; this could be improved by optimising the number of beds in hospitals. As mentioned above, Lithuania allocates less funding for intermediate consumption goods and products for healthcare institutions, compared to the EU average. In all probability this could be directly linked to the number of diagnostic equipment available in Lithuanian hospitals, which is lower that the EU average and is quite far from the EU-15 average (see Chart D). Given higher economic development in the majority of the old EU Member States and their greater financial capacities to acquire diagnostic equipment, the lower availability of such equipment in Lithuania should come as no surprise. However, considering the number of hospital beds per 100,000 inhabitants, Lithuania has reserves to increase the effectiveness of healthcare funds’ use (e.g. by increasing the number of diagnostic equipment). In 2016, the number of beds per 100,000 inhabitants in Lithuanian hospitals was one of the highest in the EU. Furthermore, Lithuanian hospitals are also facing other problems19, including the surplus of hospital beds for active treatment (particularly outside the country’s largest cities), insufficient hospital bed occupancy (on an annual basis, 243 out of 1,000 Lithuanians are treated in hospitals, in Europe – 150 residents), excessive rates of

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19 Lithuania’s so-called hospital bed reform: some want to save money, others – ailing provincial hospitals (17 August 2015).
unnecessary hospital treatment or hospitalisation for social reasons. Bearing in mind that the maintenance costs for a hospital bed approximate €20,000 per year, one can assume that bringing the number of beds in Lithuanian hospitals (and, in turn, the effectiveness level of the whole hospital network) closer to the EU average could step up funding for medical diagnostic equipment and improve the accessibility of diagnostic services to Lithuanian residents.

In Lithuania, the number of hospital beds is much higher whereas the number of diagnostic equipment is lower than the EU average.

Chart D. Number of hospital beds and diagnostic equipment in the EU countries in 2016

In conclusion, it could be said that the consequences of one of the lowest in the EU Lithuania’s general government revenue levels on government-funded social security and healthcare are quite grave. A relatively large number of beneficiaries and a relatively low share of GDP allocated to pensions are the key reasons of changing the old-age pension replacement rate. There is quite a lot of room for improvement in more efficient usage of funds allotted to healthcare: if the Lithuanian hospital network and bed number reform was made in line with statistic EU standards, it would create real possibilities of increasing funding for medical diagnostic equipment and improving the accessibility of diagnostic services to Lithuanian residents.