



REPUBLIC OF LITHUANIA

SELECTED ISSUES

August 2026

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Approved By
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STRUCTURAL UNEMPLOYMENT IN LITHUANIA¹

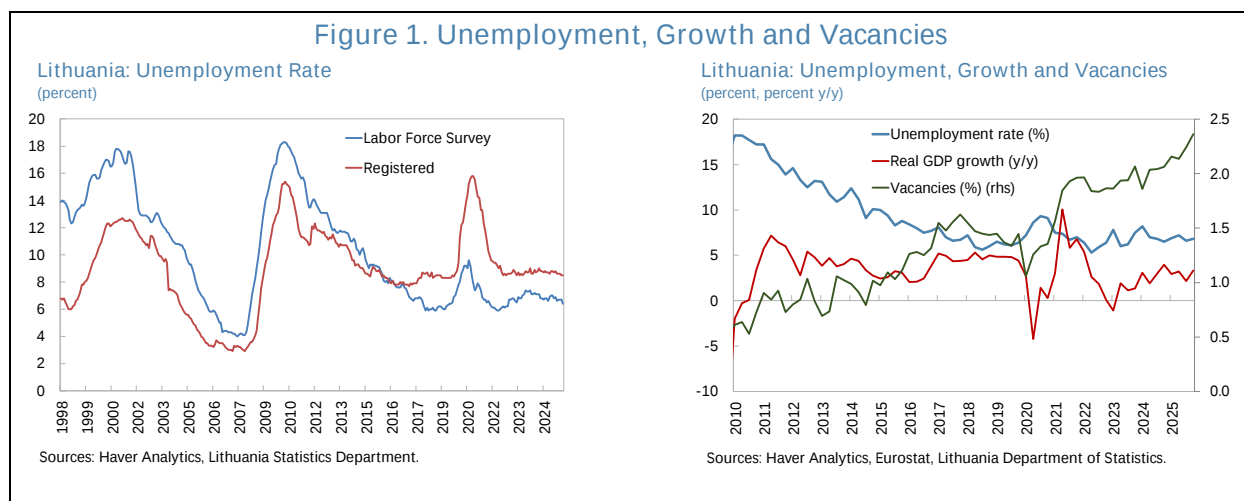
This paper investigates why Lithuania's unemployment rate has remained persistently high – at around 7 percent since 2018 – despite strong growth and rising job vacancies. A descriptive assessment of labor market outcomes shows that unemployment is concentrated among youth, older workers, the lower-educated, and residents outside major economic centers, while long-term unemployment remains sizable. The paper identifies three structural forces behind the muted response of unemployment to economic expansion: (i) skills mismatch and sectoral shortages amid a structural shift toward higher value-added activities; (ii) geographic mobility frictions linked to regional disparities, high homeownership rates, and a thin rental market; and (iii) a social benefit design with high effective marginal tax rates for second earners that can weaken work incentives at the margin. A cross-country panel exercise suggests that these frictions materially raise equilibrium unemployment. In an implied counterfactual where Lithuania's structural factors would adjust closer to the most efficient levels across EU countries, unemployment could fall by more than 2 percentage points. Policy priorities therefore include scaling up active labor market policies, improving access to labor-market-relevant training and education, easing housing and commuting constraints, and better targeting social benefits to strengthen work incentives while preserving adequacy.

A. Introduction

1. Lithuania's unemployment rate has remained elevated at around 7 percent since 2018 despite sustained growth and rising vacancies over several years. After gradually falling from a peak of 18 percent in 2010 to around 6 percent in 2018, the (survey-based) unemployment rate has broadly remained at this level—except for the Covid-19 crisis in 2020. The registered unemployment rate has fallen in tandem to a low point of around 8 percent in 2016 and remained sticky at around 8.5 percent since 2018 with a similar, albeit much larger spike in 2020.² This contrasts with the previous cycle when unemployment fell from a similar peak in 2001 to a low point of 3 to 4 percent in 2007. Vacancies have been on an upward trend since 2010, while growth has remained strong in 2018/19 and after the Covid-19 crisis. In contrast, the unemployment rate fluctuated sideways, decoupling from the level of vacancies and the evolution of economic growth. This indicates that unemployment is to a large part structural, with negative effects on potential growth.

¹ The authors thank Helge Berger, Kazuko Shirono, Linas Tarasonis and colleagues from the Bank of Lithuania and the Lithuanian Ministry of Social Security and Labor for helpful comments.

² While the survey-based unemployment rate is calculated as the share of unemployed actively seeking work in the total active labor force and based on a household survey interviewing approximately 0.5 percent of the population aged 15 and older every quarter, the registered unemployment rate is calculated as the share of persons registered with the Lithuanian Employment Services (LES) in the working age population. Differences between the two measures can be related to the different denominators (active labor force vs. working age population), different incentives underlying registration such as access to health insurance and social assistance when registered even if not actively searching for work, potential informal employment among registered unemployed, and the representativeness of the surveys.



2. The literature has identified several determinants of structural unemployment which could play a role in Lithuania. Both policy and institutional determinants can drive structural unemployment such as unemployment benefit generosity, labor taxes, trade union power, employment protection legislation, product market regulation, active labor market policies, minimum wages and housing policies. Bassanini and Duval (2006) use annual data for 21 OECD countries to show that unemployment rates are higher when unemployment benefits are higher and longer-lasting, tax wedges are higher, anti-competitive product market regulations are more stringent, and wage bargaining is less centralized. Orlandi (2012) and Heimberger (2019) build on this approach to show that similar relationships hold for structural rates of unemployment and that additional non-structural factors such as the real interest rate, investment and TFP growth play a role as well. Pesliakaite (2016) finds similar results for central and eastern European countries over the period 2002-2012. Specific to Lithuania, Lalé and Tarasonis (2020) show that prime-age men in Lithuania are relatively less employed than in the rest of Europe and are more likely to fall into unemployment than women. Moreover, older workers are less likely to find employment in Lithuania relative to EU peers. Garcia-Louzao and Jouvanceau (2023) find that wage growth outpacing productivity growth since 2013 was related to increasing wage bargaining power by workers that could reflect the shrinking labor force, several minimum wage increases and an increase in unemployment benefits in 2017. Garcia-Louzao and Tarasonis (2023) analyze the 2012 minimum wage increase—at 18 percent the largest historical increase in Lithuania—and find no negative effects on workers' prospects of retaining employment except for young workers in tradable sectors.

3. This paper examines characteristics of unemployment in Lithuania and the underlying factors that have prevented a further decline in unemployment despite economic expansion. The paper is structured in three parts. First, the paper provides a descriptive overview of the Lithuanian labor market and the structure of unemployment. Second, it discusses potential structural drivers such as i) skills mismatch and shortages, ii) insufficient active labor market policies, iii) mobility frictions, and iv) benefits and work incentives. Third, it uses a panel of European countries to estimate the relationship of unemployment to various structural and cyclical factors. Based on the results, a counterfactual analysis gauges to what extent unemployment in Lithuania could fall if

structural factors were adjusted to those levels in better performing EU peers. Relatedly, it discusses the potential fiscal savings from reducing unemployment to the counterfactual value. Finally, the paper concludes with implications for policy.

B. Lithuania's Unemployment Rate and the Labor Market

4. Unemployment in Lithuania is concentrated among specific demographic, skill and education groups. Young workers face a significantly higher risk of unemployment than the rest of the population, pointing to ongoing school-to-work transition challenges. At the same time, older workers account for a relatively large share of the unemployed compared with the EU average, reflecting difficulties in adapting to changing skill needs and re-entering employment once displaced. Lower educational attainment is also strongly associated with unemployment, underscoring persistent education and skill mismatches in the labor market. Long-term unemployment remains substantial, suggesting that joblessness tends to become entrenched, particularly for vulnerable groups. In addition, unemployment is more prevalent outside the main economic centers, highlighting the role of regional disparities and limited geographic mobility.

Figure 2. The Structure of Unemployment in Lithuania

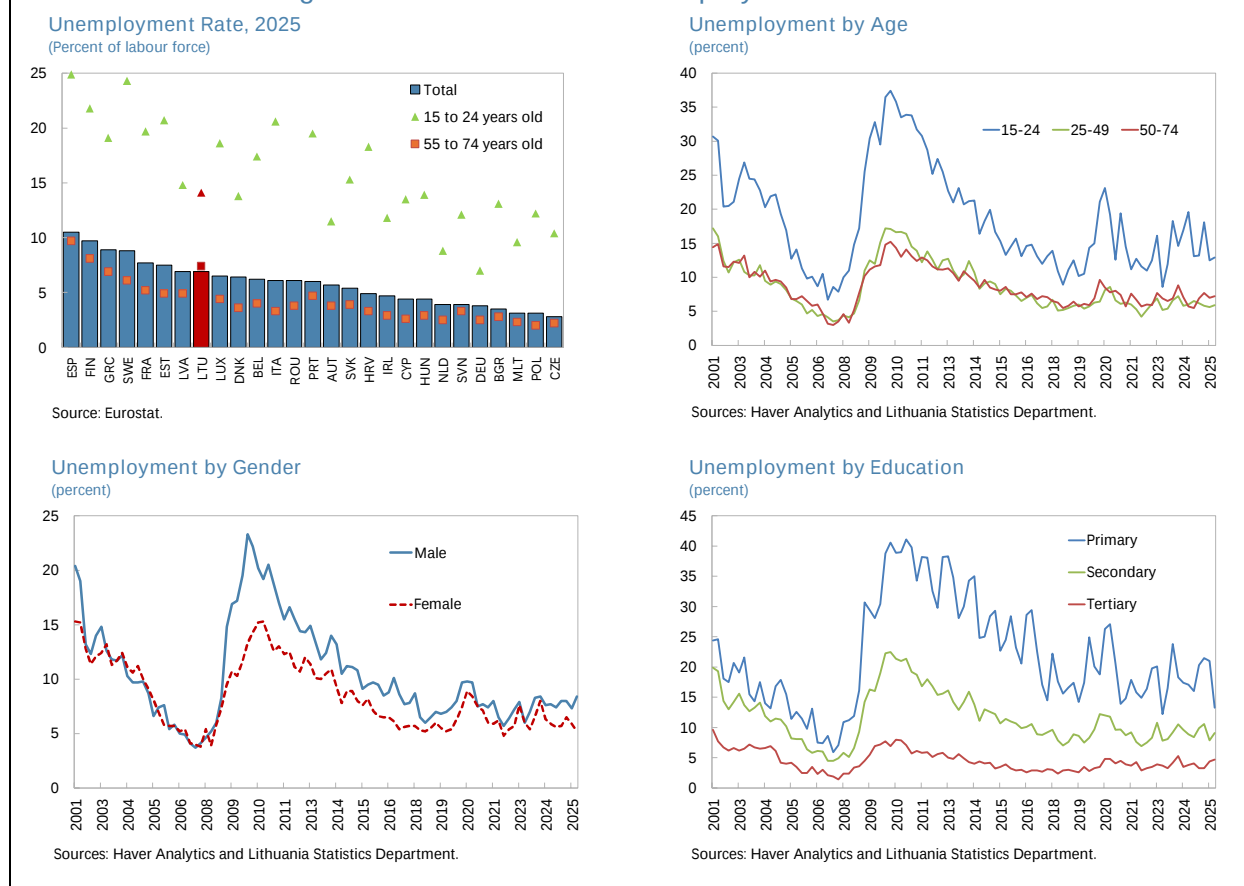
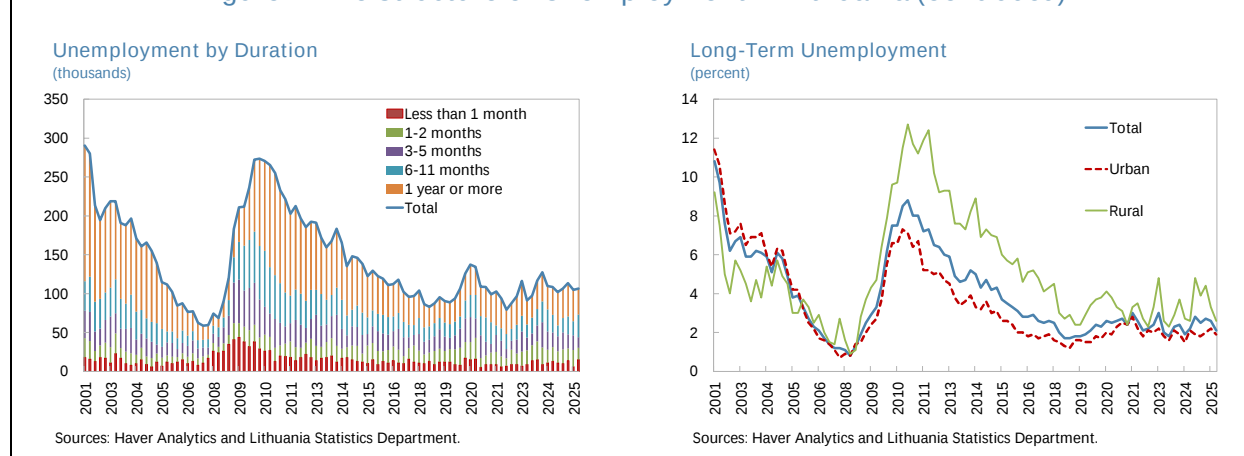
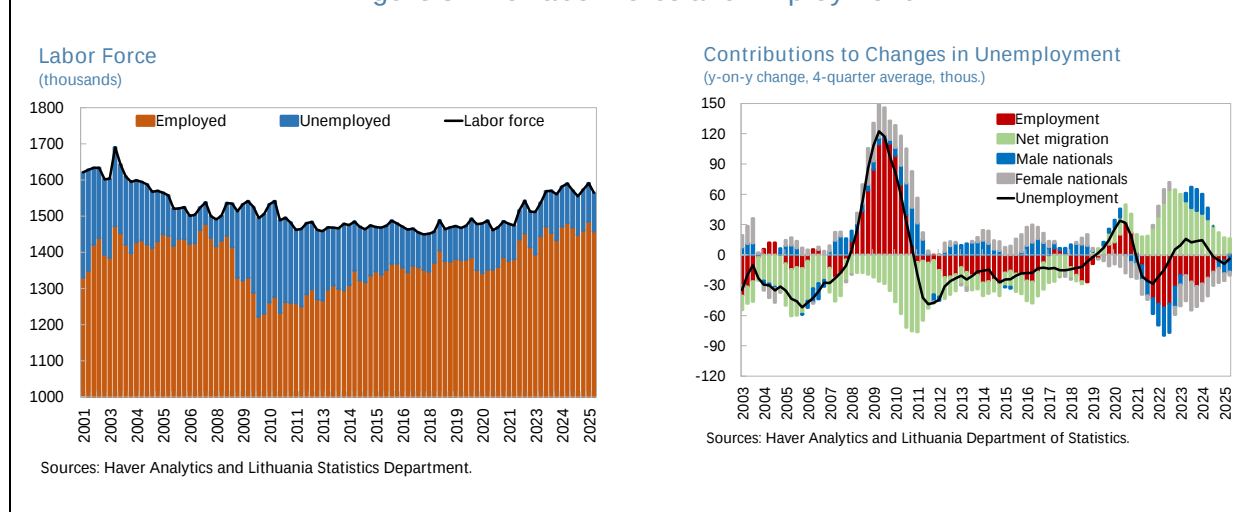


Figure 2. The Structure of Unemployment in Lithuania (Concluded)



5. The recent migration-driven increase in the labor force has translated into higher employment with limited effects on unemployment. Unemployment should be viewed in combination with the labor force and employment. An increase in the labor force without a similar increase in number of employed raises the number of unemployed. Given the broadly flat labor force during the 2010s and the continuous increase in the number of employed until 2018, unemployment has been falling during the 2010s. In 2022-23, both employment and the labor force have been increasing driven by strong positive net migration, mainly from Ukraine. As the recent migrant wave was quickly integrated into the labor market, the increase in the labor force did not result in an increase in the number of unemployed.

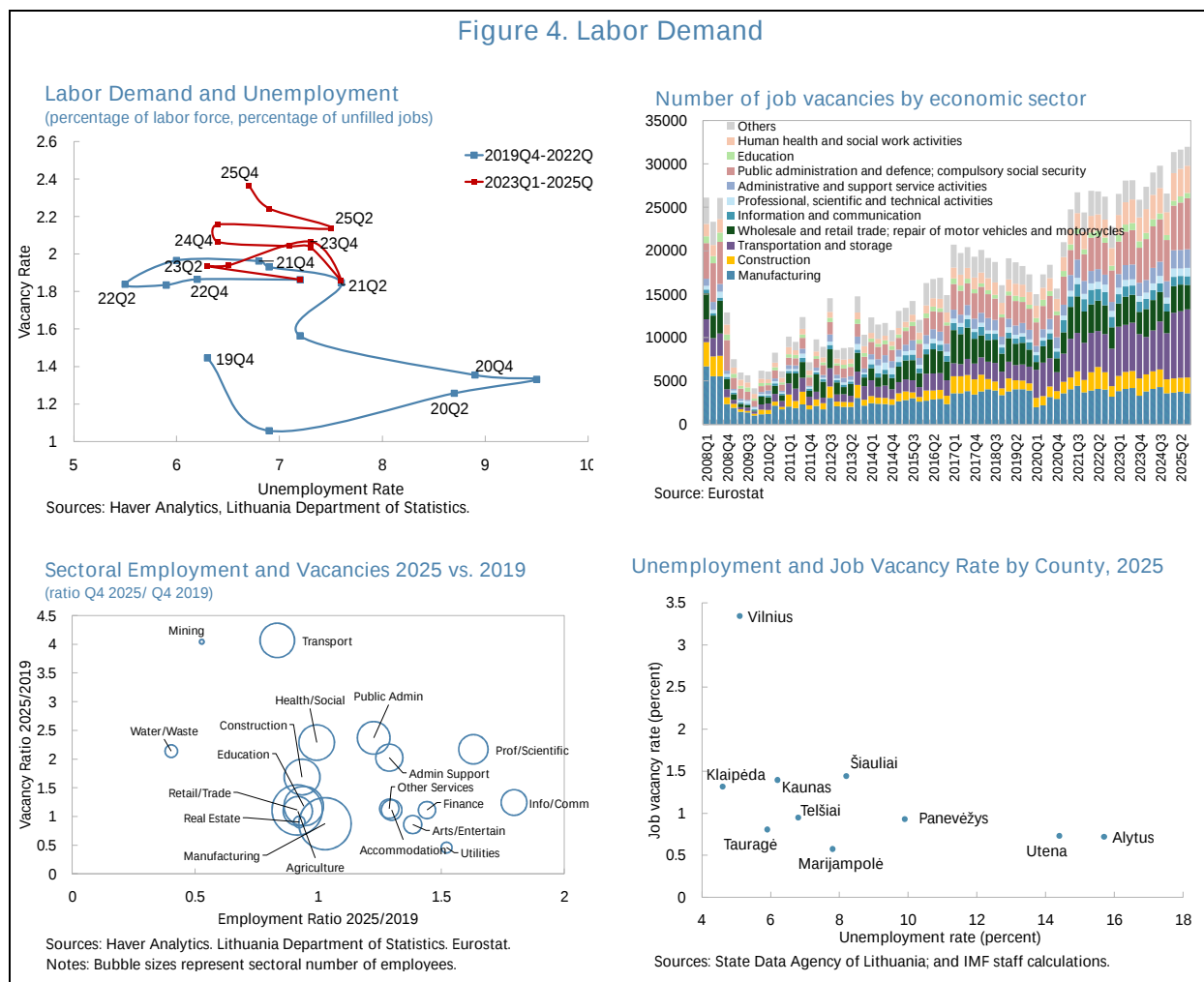
Figure 3. The Labor Force and Employment



6. Firms have continued posting more job openings while unemployment has not fallen further, indicating a mismatch between unfilled jobs and the unemployed. The text-book relationship of rising vacancies and lower unemployment during economic expansions was visible from 2020 to 2022; an upward movement along the so-called Beveridge curve, related to cyclical factors. After 2022, posted vacancies continued rising, peaking in 2025, while unemployment fluctuated around 7 percent without a clear relationship to posted vacancies. Hence, we observe

rather erratic movements in the curve, implying upward shifts of the underlying structural relation, which signals an increasing role of structural unemployment. The continuous increases in vacancies over the last years are concentrated across several sectors such as transport, public administration, health and professional, scientific and technical activities. Interestingly, sectors with stronger increases in vacancies over the last years display lower increases in employment. Some sectors such as the transport sector do not seem to find any additional labor, albeit offering larger wage increases than sectors with more muted increases in vacancies. Moreover, the share of vacancies and unemployed show a large variation across regions, where those regions with high unemployment rates display lower vacancy rates.

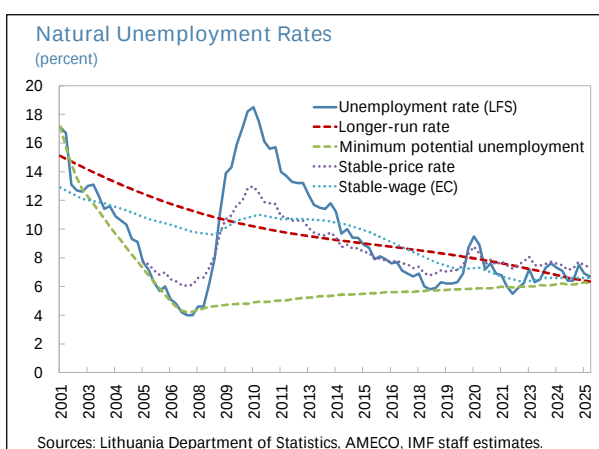
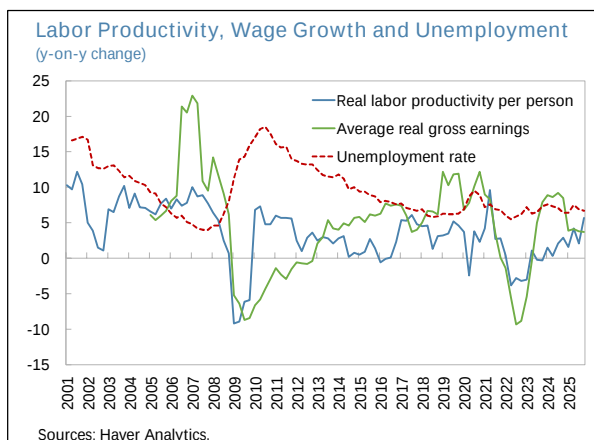
Figure 4. Labor Demand



7. The relationship between wage developments and unemployment has been muted recently. Historically, wage growth and unemployment have shown a negative correlation, indicating a flexible labor market. Since 2018 this relationship has been muted. High positive real wage growth from 2018-2021 and 2023-2025 has not led to further declines in the unemployment rate. Rather Covid-19 in 2020 and the terms-of-trade shock related to Russia's war in Ukraine in

2022-23 have been driving down labor productivity leading to periods of slightly rising unemployment rates.

8. Useful benchmarks for structural unemployment are natural rates of unemployment that have been close to actual unemployment in recent years. We estimate three measures of unemployment benchmarks: 1) an average longer-run unemployment rate, 2) a longer-run potential minimum rate and 3) a shorter-to-medium run rate, a so-called non-inflationary/stable-price rate of unemployment (see Bok et al., 2023), similar to the non-accelerating wage rate of unemployment (NAWRU) from the European Commission (EC).³ The longer-run rate has trended down continuously to a low point of around 6 percent in 2025 and now coincides with the longer-run potential minimum rate. The stable-price and stable wage rates have fluctuated around 7-8 percent since 2018. The measures indicate that the current unemployment rate is rather close to both its current potential minimum as well as its non-inflationary rate. As these natural rates are based solely on the historical evolution of the unemployment rate as well as cyclical inflation and wage dynamics, they do not explicitly model the underlying structural factors but provide a level of unemployment taking current structural determinants as given. However, countries can adjust their policies to address these underlying structural impediments to lower unemployment to which we turn next.



C. Structural Drivers of Unemployment

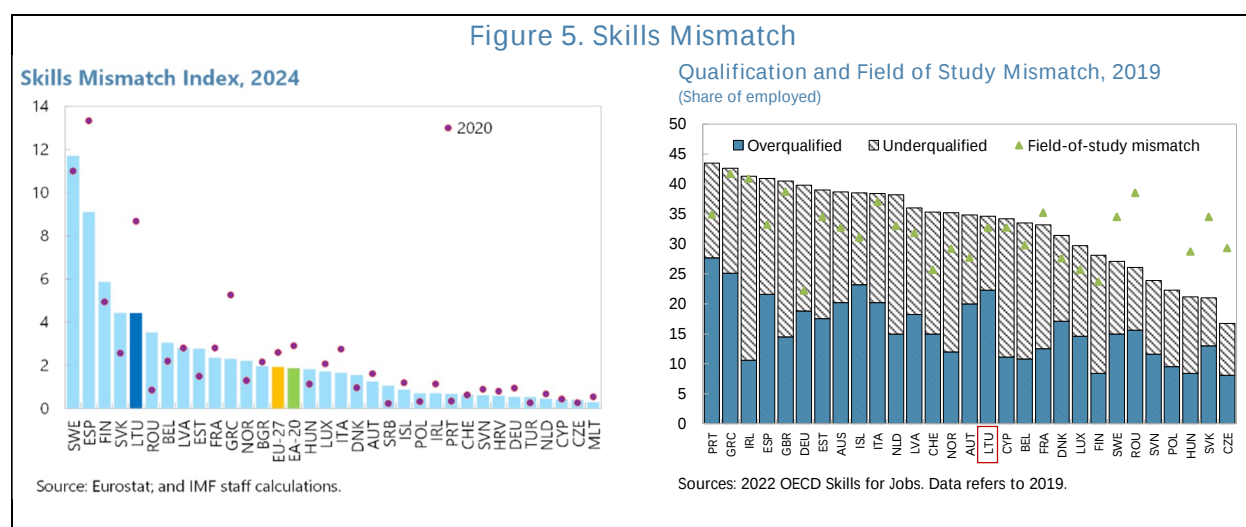
9. The labor market is characterized by pronounced skills mismatch and shortages. Lithuania's high skills mismatch has fallen in recent years but remains above most other European peers (Figure 5).⁴ This suggests that unemployment partly reflects imbalances between the desired

³ The first one extracts longer-run trends for disaggregated demographic groups (by age and gender) with statistical filters. The second infers a potential minimum rate of unemployment for different demographic groups based on business cycle peaks. The third one ('non-inflationary' or 'stable-price rate') is derived from the Philipps curve, an assumed relationship between inflation and the unemployment gap, the difference between actual unemployment and the equilibrium rate. This equilibrium rate helps to assess economic slack and inflationary pressures in the short to medium run. The NAWRU, retrieved from the EC, and similar in spirit, is based on a wage Philipps curve.

⁴ The index is measured as the gap between labor supply and demand by the level of education attainment for the economy as a whole based on Estevao and Tsounta (2011). See also IMF Country Report No. 19/253. The OECD Skills

(continued)

and actual profiles of job seekers. Rapid structural change toward higher value-added manufacturing, ICT, and business services like transportation and storage has increased demand for technical, digital, and managerial skills, while parts of the unemployed labor force would need to be retrained and relocate to be available for these jobs. At the same time, emigration and population aging have tightened labor supply, amplifying shortages in key sectors and slowing matching. To tackle those issues, Lithuania has enacted a broad range of measures over the last years, spanning active labor market policies (ALMPs)⁵ and vocational education and training (VET)⁶. However, partly due to the rather limited scope of those measures, key structural problems remain as skills mismatches, while decreasing, persist, VET employment outcomes lag the EU average, and regional disparities are pronounced. Policy should therefore focus on improving the efficiency of matching and the adaptability of workers: scaling up active labor market policies (ALMPs); modernizing and enhancing the work experience component of VET, training and tertiary curricula toward in-demand skills; expanding short, modular reskilling programs for mid-career workers and older jobseekers; and strengthening mobility through housing, transport, and regional job-matching services.



10. Lithuania spends relatively little on ALMPs and participation is low. Spending on ALMPs fluctuated around 0.2 percent of GDP, less than half the OECD average of more than 0.4 percent. It is also largely unresponsive to the number of unemployed—except for 2020—and heavily dependent

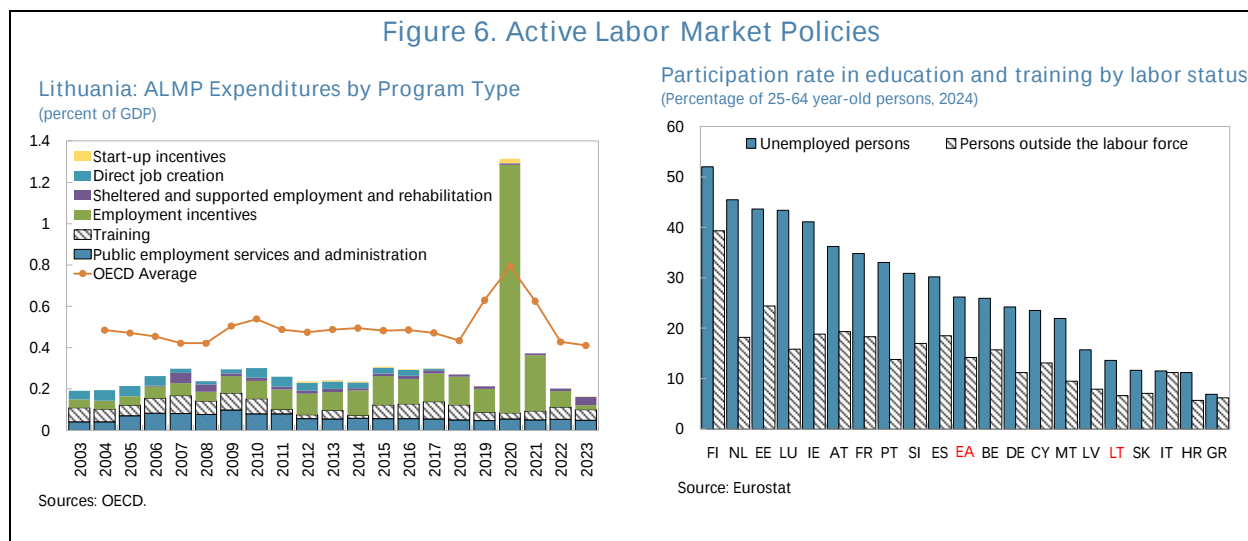
for Jobs Database is limited to 2019 data for Lithuania. The qualification mismatch index calculates the share of workers in each occupation that are under- or over-qualified to perform a certain job, comparing the level of educational attainment of individual workers to the modal level in that occupation for a given country and time. The field-of-study mismatch is a distinct indicator comparing the field of official training and education against the occupation of a worker.

⁵ Lithuania enhanced ALMPs by introducing internships, mobility support, recognition of self-education. Recent key projects include “Connections”, “KarjerON” and “Next step – work” targeting young, long-term, and migrant unemployed. A national lifelong learning platform has also been launched in 2024. An ex-post evaluation of ALMPs was launched in 2024.

⁶ Lithuania has pursued VET reforms under both the RRP and EU Cohesion funds, including updating curricula to better align with labor market needs, expanding apprenticeships and sectoral training centers, and launching the “Vocational Education – Accessible to All” project in 2024 to reduce dropout rates and improve transitions to employment for disadvantaged students.

on EU financing. Participation, at around 5-15 percent of people outside the labor force and in unemployment is significantly below that in European peers despite the relatively large number of registered unemployed in Lithuania. Survey responses show that low participation is related to scheduling and costs of programs. The 2017 labor market reform has modernized the setup of ALMP, establishing the Lithuanian Employment Service and strengthening the role of social partners in the Tripartite Council. More recent changes include the introduction of a digital jobseeker profiling tool in 2021, the expansion of regional career centers and more restrictive eligibility of unemployed for subsidized employment in 2024. In line with past IMF recommendations⁷ the share of spending on employment incentives decreased in 2023 while spending on training has risen, albeit remaining below levels during 2015-18. Current ALMP provision is insufficient in both scale and targeting, especially toward older workers and those outside the labor force.⁸

Figure 6. Active Labor Market Policies

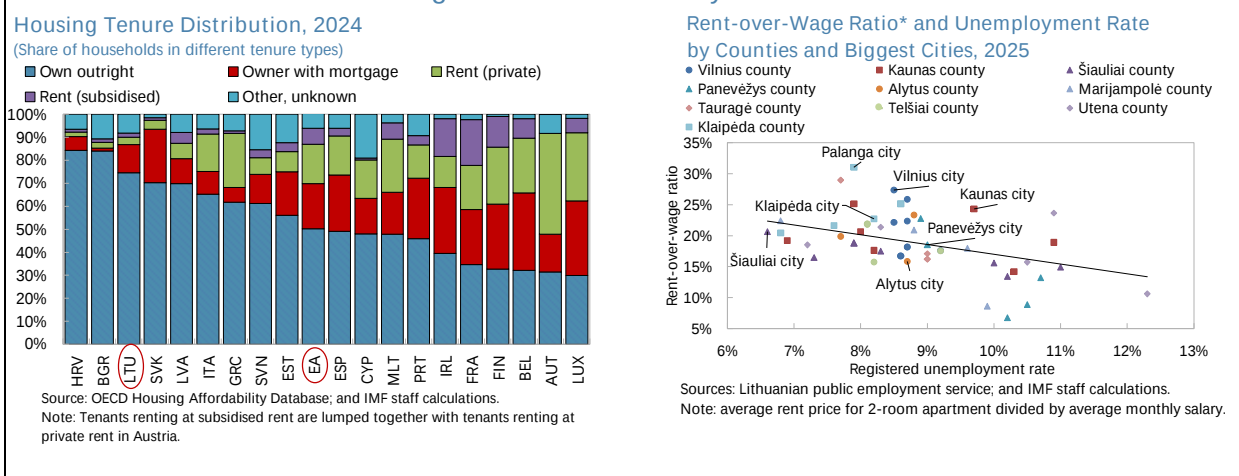


11. Labor mobility frictions prevent job creation. Lithuania's sticky unemployment is also explained by barriers preventing job seekers from moving to regions where new positions are being created. The most dynamic regions are characterized by high job vacancy rates and low unemployment rates while the lagging regions show the opposite pattern. This is consistent with limited spatial matching between labor supply and labor demand and suggests that unemployed workers in lagging areas are not relocating (or commuting) sufficiently toward tighter labor markets. These mobility constraints are reinforced by a large share of home ownership—close to 90 percent—and a shallow rental market, which reduce geographic mobility. Low housing affordability in big cities and in the regions with the lowest unemployment rate is also preventing job seekers from responding to employment opportunities, especially in the case of low-income households. Policy priorities should therefore focus on lowering barriers to relocation and commuting, including expanding affordable and rental housing supply, improving transport connectivity, and strengthening regional employment services and job matching.

⁷ See IMF Country Report No. 19/253.

⁸ See also OECD (2022).

Figure 7. Labor Mobility Frictions

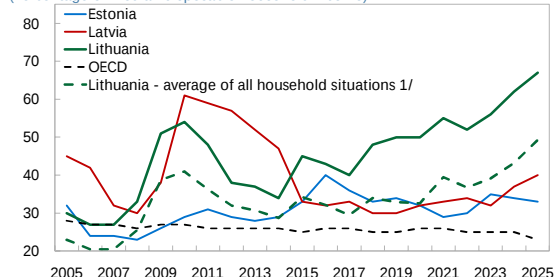


12. Social benefits have been rising and effective tax rates for unemployed are high. The substantial increase in minimum income benefits over time—now comparatively generous relative to the median disposable income—has improved social protection (Text Figure 8) and reduced poverty risks, but may have weakened work incentives at the margin, particularly for second earners. High effective marginal tax rates arising from benefit withdrawal, combined with childcare and transport costs, can reduce the net financial gain from taking up work and prolonging joblessness for some groups. Reforms should preserve adequacy while strengthening incentives: smoothing benefit tapering to lower effective marginal tax rates; expanding in-work benefits and earned income tax credits; improving access to affordable childcare; tightening conditionality by linking benefits more closely to job search and participation in ALMPs; making unemployment benefits accessible only for involuntary labor contract termination – and not in case of worker resignation as it is the case now; and further decreasing the labor tax wedge by making employee social security contributions and/or the personal income tax more progressive. While strengthening work incentives for job seekers, these measures would also support fiscal consolidation.

Figure 8. Social Benefits and Work Incentives

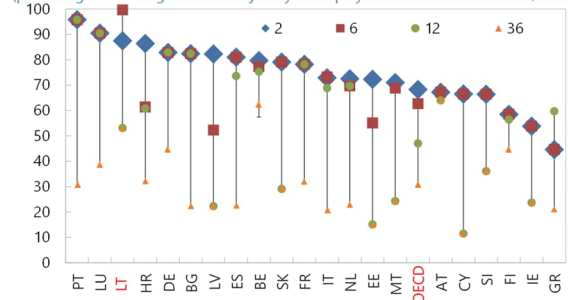
Net minimum income benefits (couple, two children, claiming rent supplements)

(Percentage of median disposable household income)



Sources: OECD, IMF staff calculations

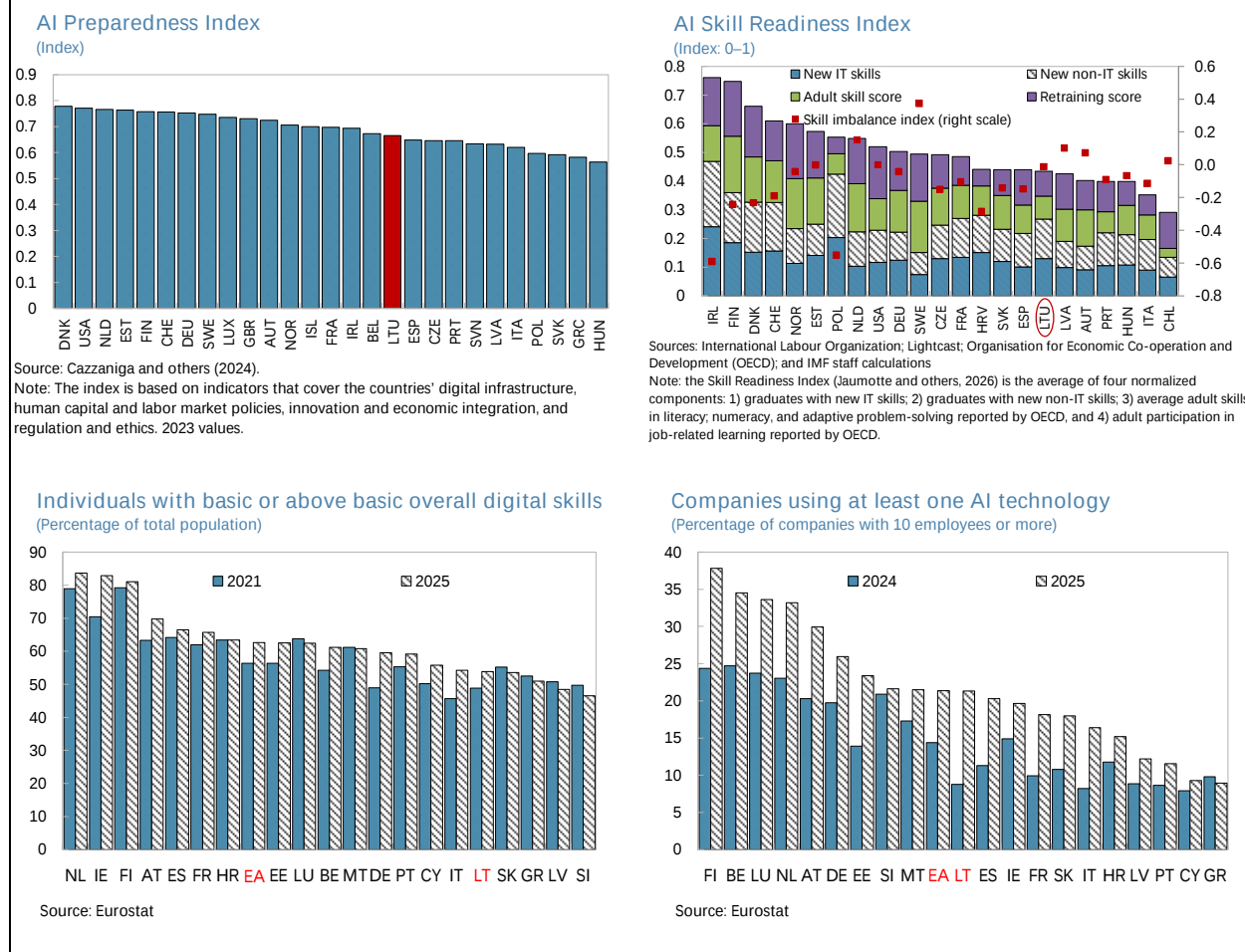
Effective tax rate on taking up work if unemployed 1/
(percentage of earnings in the new job by unemployment duration in months, 2025)



1\ Household type: couple, no children; earnings of the reference person: 67% of average wage; earnings of the spouse: 100% of average wage; claiming rent supplements and temporary into-work benefits when taking up work.
Source: OECD

13. AI could exacerbate some of the structural imbalances. Greater adoption of digital technologies and artificial intelligence (AI) has the potential to support productivity and labor market performance in Lithuania, but the associated gains are likely to be uneven and modest without complementary reforms. Over the recent years, Lithuania has made notable progress in digitalization and AI preparedness—emerging as a key fintech hub in Europe—but its population still has rather low digital skills.⁹ Even if AI may come as a complement rather than a substitute for most existing jobs (Gmyrek et al. 2023), it could, absent policy action, exacerbate skills mismatches and inequality through job displacement risks in certain occupations.

Figure 9. AI and Digital Skills Diffusion



⁹ See Cazzaniga and others (2024) and for the IMF AI preparedness Index and Jaumotte and others (2026) for the IMF Skill Readiness and Skill Imbalance Indexes. The AI Preparedness Index covers four areas: i) human capital, ii) labor market policies, iii) digital infrastructure, innovation and economic integration and iv) regulation and ethics. The Skill Readiness Index combines the share of recent graduates able to supply new IT and non-IT skills, indicators of retraining frequency, and workforce literacy and numeracy scores. The related skill imbalance index compares supply (via new graduates) and demand (via vacancy data and projections) of new skills.

D. A Counterfactual Analysis

14. We estimate the relationship between different structural factors and unemployment. Following Bassanini and Duval (2006), we use annual data for 22 EU countries over 2001–2023.¹⁰ We relate the unemployment rate to 1) active labor market policies, 2) the labor tax wedge, 3) unemployment benefits, 4) the minimum wage, 5) trade union density, 6) skills mismatch, and 7) other non-structural and cyclical factors.¹¹ These variables are affecting labor demand and supply and thus unemployment in equilibrium. Including other non-structural factors, such as the output gap, TFP and terms of trade growth, capital accumulation and the real interest rate is important to consider labor market rigidities that prevent wages from adjusting instantaneously. While these cyclical factors drive unemployment over the business cycle, they can also affect structural unemployment via hysteresis effects; a long period of unemployment makes the unemployed less attractive for employers.

15. A look at Lithuania's structural factors reveals major differences both across time and compared to other countries. First, the share of employees in trade unions in Lithuania is one of the lowest across European countries, fluctuating below 10 percent since 2006. Second, the minimum wage as a percentage of the median wage has fluctuated between 40 and 55 percent, a few percentage points below the average level of other countries. Third, the labor tax wedge¹²—the difference between the cost paid by employers and the net salary taken home by employees—has fallen from around 45 percent in 2000, the maximum across countries, to 32 percent in 2024, the average across countries. Fourth, the net replacement rate was among the lowest in the EU in 2005 (reaching 37.5 percent), but increased significantly since then (55.2 percent in 2024, slightly above the EU average). Fifth, spending on ALMPs is significantly lower in Lithuania than in EU peers—around half as much is spent—and has remained low over time, with the Covid period being a notable exception.

¹⁰ The included countries are Austria, Belgium, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, the Netherlands, Poland, Portugal, Slovak Republic, Slovenia, Spain and Sweden. The panel is unbalanced with 16 to 23 observations per country.

¹¹ We have also experimented with measures of strictness of employment protection legislation and different measures of labor mobility. Stricter employment protection legislation was positively associated with unemployment while the results for different measures of labor mobility were inconclusive. Employment protection was one of the most rigid among the OECD in the past but has become more flexible, in particular after the 2017 labor market reform

¹² Calculated as the average across different family constellations and earnings levels (Source: OECD).

Box 1. Panel Regression

The panel regression estimates

$$Unemployment_{it} = \beta X_{it} + \gamma Z_{it} + \alpha_i + \lambda_t + \varepsilon_{it},$$

where the unemployment rate (or the NAWRU) for country i at time t , is related to a set of structural explanatory variables X_{it} , a set of controls Z_{it} , country fixed effects α_i , and year fixed effects λ_t . ε_{it} are regression residuals. As the setup controls for the output gap and further cyclical economic drivers, it represents an econometric reduced-form model of structural unemployment. The baseline specification uses heteroskedasticity-robust standard errors that are clustered at the country level. To mitigate reverse causality between unemployment and the different regressors of interest, we implement several robustness exercises. First, we follow Orlandi (2012) by using a two-stage least squares approach where the structural variables are instrumented with their one-year lagged values. Second, we perform the same exercise but instrument the ALMP variable with the lagged first difference of the residual of the regression of the ALMP variable on current and lagged values of the output gap as in Bassanini and Duval (2006). Third, we use an Arellano-Bond estimator that includes the instrumented lagged unemployment rates. Fourth, we replace the unemployment rate with the NAWRU.

Expected effects:

- *A higher tax wedge, a higher minimum wage relative to the median wage, a larger replacement rate and larger unionization* are usually expected to raise unemployment as they would increase the bargaining position of workers, thereby raise wages and reduce the willingness to expect wage cuts, increasing labor market frictions. However, several studies have found opposite effects, noting that some of these labor market rigidities can help stabilize expectations of workers and thus promote labor productivity, technology growth and aggregate demand.
- *Higher ALMP spending* is expected to lower unemployment via reskilling and upskilling workers and increasing matching efficiency.
- *Higher skills mismatch* should increase unemployment as the profile of vacancies and unemployed potentially applying to these do not match.
- *A larger output gap*, as well as *stronger TFP growth*, is expected to lower unemployment. *Stronger terms of trade*, via lower import prices, should lower wage demand and thus lower unemployment. *A higher real rate* would lower investment and thus increase unemployment. Finally, *stronger capital accumulation* would increase the marginal product of labor and thus lower unemployment.

Table 1. Fixed-effects Regression: Unemployment Rate

	(1) Unemployment rate: OLS	(2) Unemployment rate: 2SLS	(3) Unemployment rate: 2SLS	(4) Unemployment rate: AB	(5) NAWRU: OLS
Lagged unemployment rate				0.353** (0.122)	
Labor tax wedge	0.043 (0.059)	0.008 (0.075)	-0.014 (0.095)	-0.041 (0.037)	0.085 (0.085)
Minimum wage	-0.064* (0.032)	-0.061* (0.037)	-0.050* (0.030)	0.001 (0.008)	-0.054** (0.022)
Replacement rate	0.035 (0.031)	0.041 (0.031)	0.029 (0.022)	-0.016 (0.021)	0.033 (0.033)
ALMP spending	-10.172** (4.220)	-10.190 (7.713)	-5.287 (3.628)	-10.865 (7.567)	-10.122** (4.095)
Trade union density	0.021 (0.058)	0.048 (0.067)	0.090 (0.093)	0.009 (0.011)	0.013 (0.062)

Box 1. Panel Regression (Concluded)

Skills mismatch	0.263*** (0.058)	0.274*** (0.065)	0.302*** (0.064)	0.215*** (0.045)	0.140** (0.061)
Output gap	-0.440*** (0.143)	-0.435*** (0.145)	-0.396*** (0.146)	-0.235*** (0.044)	0.104** (0.044)
Real rate	0.130* (0.069)	0.099 (0.064)	0.112* (0.059)	0.152*** (0.034)	0.088* (0.049)
Capital accumulation	-1.217** (0.512)	-1.152** (0.522)	-0.753 (0.471)	-0.339 (0.287)	-0.942* (0.467)
Country fixed effects	Yes	Yes	Yes	Yes	Yes
Time fixed effects	Yes	Yes	Yes	No	Yes
Add. cyclical controls	Yes	Yes	Yes	Yes	Yes
R-squared	0.832	0.815	0.830	0.836	0.576
Observations	459	459	381	433	459

Heteroskedasticity-robust country-clustered SEs in parentheses. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.
 2SLS is two-stage-least-squares estimation where the structural variables are instrumented with their lagged values. (3) additionally instruments ALMP spending with the residual from regressing ALMP spending on contemporaneous and three lags of the output gap. AB is Arellano-Bond.
 Additional cyclical controls include growth rates of total factor productivity and terms of trade.

16. Higher skills mismatch and lower spending on ALMPs are positively associated with higher structural unemployment. Most effects are in line with expectations (see Box 1). A higher labor tax wedge, a higher replacement rate and higher unionization are associated with higher unemployment. This is not the case for higher minimum-relative-to-median wages. This might be related to low levels of minimum wages disincentivizing labor supply or higher minimum wages pulling workers out of the shadow economy. Higher skills mismatches are positively associated with higher structural unemployment, while higher ALMP spending is associated with lower unemployment. Finally, investment is an important determinant of structural unemployment. Higher capital accumulation should raise the marginal product of labor, thereby reducing unemployment. In line with this a higher real interest rate, which would lower investment, is positively associated with unemployment.

- Structural reforms and policy changes could bring down the unemployment rate from its current sticky level around 7 percent to below 5 percent. In a counterfactual where skills mismatch, ALMP spending, the average replacement rate and the average labor tax wedge adjust, structural unemployment could decline significantly. The counterfactual sets these variables at the 25th percentile of other European countries in our sample (75th percentile for ALMP spending), meaning close to an efficient level according to the regression results.¹³ Under this counterfactual, Lithuania would exhibit lower skills mismatch, higher ALMP spending per unemployed, a lower

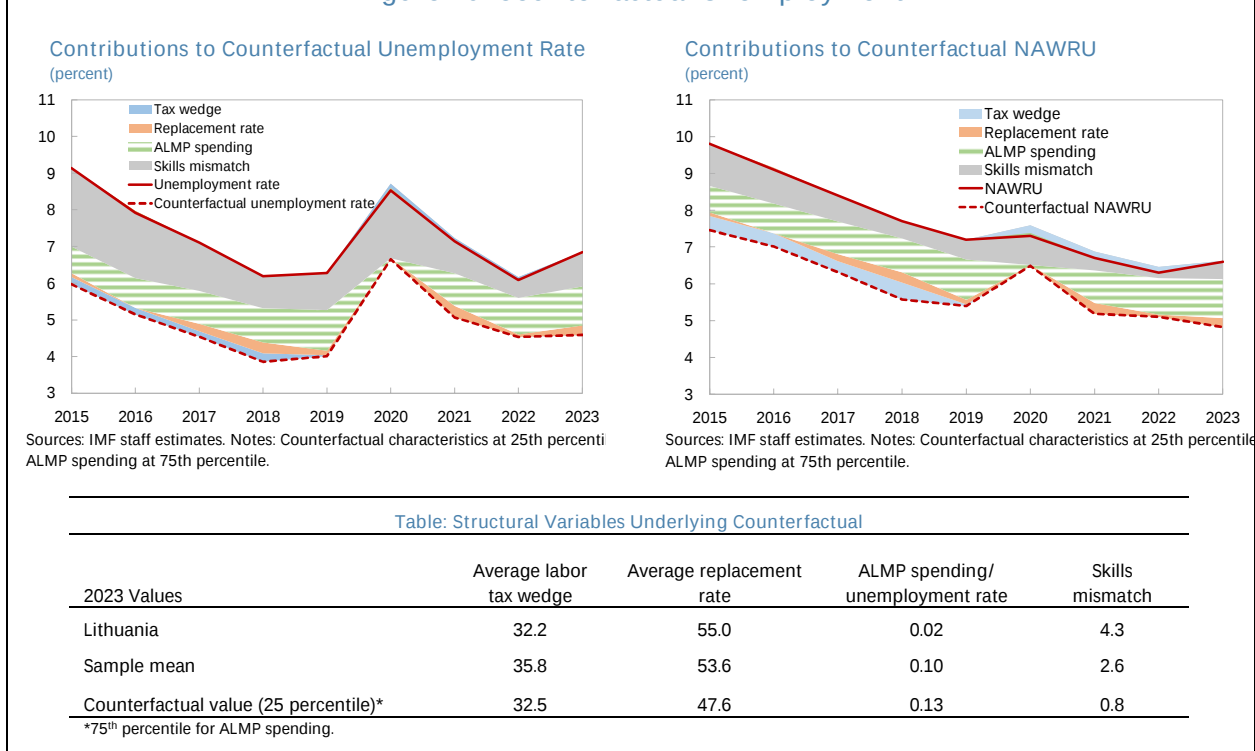
¹³ The counterfactual—which is constructed to quantify the potential decrease in unemployment—is implemented via an Oaxaca-Blinder decomposition

$$\widehat{Unemployment}_{counterfactual,t} = Unemployment_{LTU,t} - \sum_{i=1} \widehat{\beta}_i (X_{i,LTU,t} - \widehat{X_{i,peers,t}}),$$

where $\widehat{\beta}_i$ represents the estimated coefficient for structural variable i , $X_{i,LTU,t}$ the observed value of structural variable i for Lithuania in year t , and $\widehat{X_{i,peers,t}}$ the benchmark value for structural variable i , represented by the x^{th} percentile of the distribution of values for structural variable i among the other European countries in the sample at year t . We set x to the 25th percentile for each structural variable (75th percentile for ALMP spending).

replacement rate and a largely unchanged average labor tax wedge. Assuming these changes in structural factors and policies, the unemployment rate would fall by more than 2 percentage points to around 4.6 percent, mainly driven by stronger active labor market policies and reduced skills mismatch (Figure 10).

Figure 10. Counterfactual Unemployment



Box 2. Fiscal Effects of Reducing Unemployment

Reducing unemployment to the counterfactual value and tightening access to benefits for voluntary job separation could yield sizable fiscal savings. Lower unemployment would strengthen the fiscal position through both lower spending on unemployment-related benefits and higher revenues from labor taxes and social security contributions. A simple back-of-the-envelope calculation illustrates the potential magnitude of fiscal savings. In the counterfactual, the labor force survey-based unemployment rate declines by 2.3 percentage points. Assuming this translates one-for-one into a decline in registered unemployment, the number of registered unemployed would fall by around 34,000. Based on an average net wage of EUR 1,475 and an average replacement rate of 55 percent¹, this implies unemployment benefits of about EUR 815 EUR per beneficiary. At the same time, an employed worker earning the average gross wage of EUR 2,411 contributes about EUR 936 per month in taxes and social contributions. Under these assumptions, moving 34,000 unemployed persons into employment would improve the fiscal balance by around EUR 720 million per year.²

Another potential source of benefits spending is related to voluntary seasonal unemployment as unemployment benefits are paid for employees that deliberately end their labor contract. Registered unemployment exhibits a recurring seasonal pattern, with inflows rising at the start of the summer and reversing shortly thereafter. This seasonality is interpreted as capturing temporary separations and benefit

Box 2. Fiscal Effects of Reducing Unemployment (Concluded)

take-up followed by a return to work, providing a basis to estimate the fiscal costs of voluntary seasonal benefit recipients. This seasonal dynamic in registered unemployment is not apparent in labor force survey data. During 2019 and 2022-2025, registered unemployment exceeded its May-October trend by about 13,000 persons on average during the summer months June to September. With a replacement rate of 82 percent in the first three months of unemployment³, monthly benefits for a worker earning the average wage amount to about EUR 1,204, compared with monthly tax and social contribution revenues of EUR 936 when employed. On this basis, the annual fiscal cost could amount to roughly EUR 30 million. These losses could be reduced by tightening eligibility or imposing stronger sanctions in cases of voluntary job separation. Hence, reducing unemployment to the counterfactual value and tightening access to benefits for voluntary job separation could yield around EUR 750 million of fiscal savings or 0.9 percent of GDP annually.

¹ This replacement rate is a lower bound as it is calculated as the average replacement rate for different income and family situations at 12, 24, 36 and 48 months of unemployment based on OECD data, while unemployment benefits are highest during the first 3 months of unemployment.

² It should also be noted that a decrease in the unemployment rate to the counterfactual would imply higher spending on ALMPs, which would decrease in the medium-term once unemployment falls, and a decrease in social benefits spending given the lower replacement rate in the counterfactual.

³ After the reform to unemployment benefits in July 2026, the replacement rate during the first 3 of months of unemployment will increase to 85 percent for an employee that has worked for more than 12 months and is earning the average wage.

E. Conclusion and Policy Implications

17. To reduce structural unemployment and lift potential growth, Lithuania has reform potential in areas related to training, reskilling and upskilling, social benefit design, labor mobility and digitalization. Lithuania's unemployment rate has remained sticky at around 7 percent since 2018 despite strong growth and rising vacancies, reflecting an upward shift in the Beveridge curve and a growing role for structural frictions. Unemployment is concentrated among youth, older workers, the lower-educated, and residents in rural areas with long-term unemployment still sizable. The analysis points to several mutually reinforcing structural constraints that prevent unemployment from falling further—skills mismatch amid structural transformation, insufficient ALMP spending and targeting, limited geographic mobility of workers, and social benefit designs that can weaken incentives at the margin. A counterfactual in which Lithuania's structural factors converge toward better-performing EU peers indicates that unemployment could decline by around 2 percentage points, underscoring sizeable gains from targeted reforms. Policy priorities are therefore to (i) scale up and better target ALMPs—especially training and job-matching for older and low-skilled workers—, (ii) strengthen vocational and tertiary curricula and digital skills to ease mismatch and support AI-enabled productivity gains, (iii) lower mobility frictions through expanded affordable and rental housing and improved transport connectivity, and (iv) recalibrate social benefits to preserve adequacy while reducing effective marginal tax rates and strengthening activation and conditionality. Finally, deepening capital markets and ensuring certainty in the corporate tax environment is crucial to fostering continued expansion in private investment. Implemented as a coherent package, these measures would improve matching efficiency, broaden labor supply where shortages are most acute, and support inclusive growth while also helping to contain fiscal pressures.

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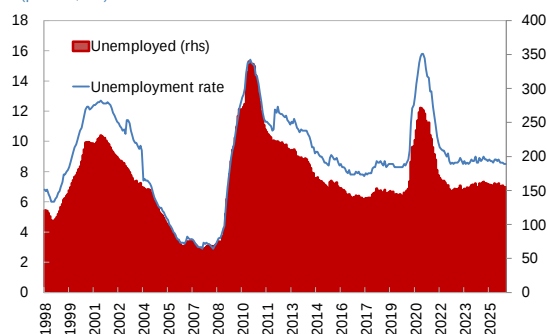
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Appendix I. Supplementary Information

Appendix I. Figure 1. Lithuania: Further Charts

Registered Unemployment Rate and Unemployed

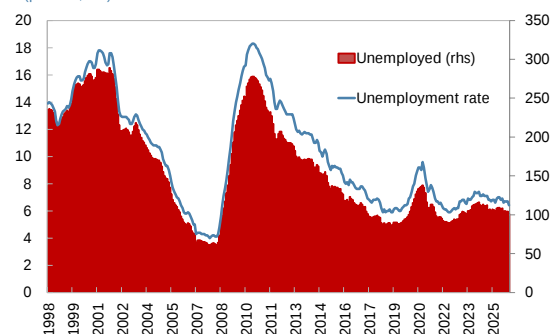
(percent, ths)



Sources: Haver Analytics and Lithuania Statistics Department. Registered.

Unemployment Rate and Unemployed

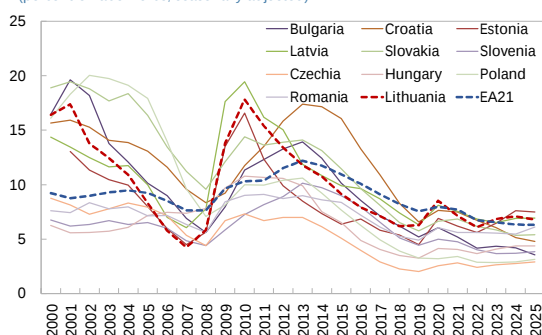
(percent, ths)



Sources: Haver Analytics and Lithuania Statistics Department. Labor Force Survey.

Unemployment Rate

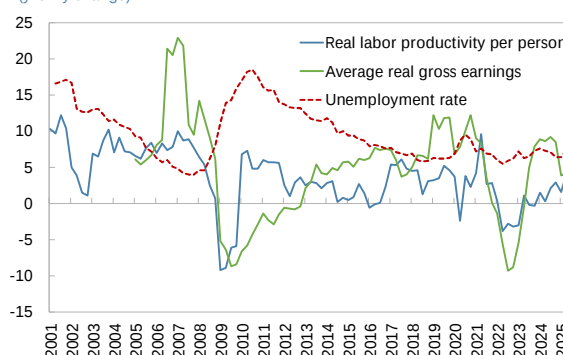
(percent of labor force, seasonally adjusted)



Sources: European Commission.

Labor Productivity, Wage Growth and Unemployment

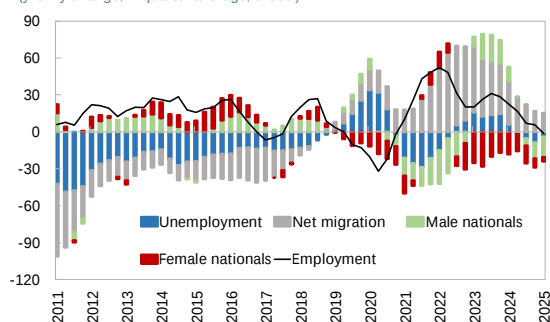
(y-on-y change)



Sources: Haver Analytics.

Contributions to Changes in Employment

(y-on-y change, 4-quarter average, thous.)



Sources: Haver Analytics and Lithuania Department of Statistics.

Notes: Lower unemployment (negative blue bars) raises employment.

Appendix I. Table 1. Lithuania: Data Sources

Variable	Data description	LTU Coverage	Data source
Unemployment rate	Harmonized rate, labor force survey based	1998-2025	EC, Haver Analytics
Labor tax wedge	Average tax wedge between the labor cost to the employer and the corresponding net take-home pay of the employee, calculated as the average across different family constellations and earnings levels. Expressed as percentage of labor costs.	2000-2024	OECD
Minimum wage	Minimum wage: Minimum relative to median wages of full-time workers.	1997-2024	OECD
Net replacement rate	Net replacement rate: average unemployment benefit replacement rate across two income situations (100% and 67% of average earnings), three family situations (single, with dependent spouse, with spouse in work earning 100 of average earnings) and three different unemployment durations (1 st year, 2 nd and 3 rd years, and 4 th and 5 th years of unemployment).	2005-2025	OECD
ALMP spending / Unemployment rate	Total spending on active labor market policies as a percentage of GDP (public employment services and administration, training, employment incentives, sheltered and supported employment and rehabilitation, direct job creation), divided by unemployment rate.	2003-2023	OECD
Employment protection stringency	Stringency of employment protection legislation (EPL): indicators of the strictness of regulation on dismissals and the use of temporary contracts.	2014-2019	OECD
Trade union density	Trade union density (percentage of employees)	1995-2022 with breaks	OECD/AIAS ICTWSS database
Product market regulation stringency	Stringency of product market regulation	2013, 2018, 2023	OECD PMR
Skills mismatch	based on employment and labor force by education attainment (see IMF: Republic of Lithuania, Selected Issues 2019) $AggregateSkillsMismatch = \sqrt{\sum_{j=1}^3 (S_{j,t} - M_{j,t})^2}$ where j is the skill level; $S_{j,t}$ is the percentage of the population with skill level j at time t (skills supplied) and $M_{j,t}$ is the percentage of employees with skill level j at time t (skills demanded). The skill level is measured by data on education attainment from European Labor Force Survey	1998-2024 for LTU	Eurostat

Appendix I. Table 1. Lithuania: Data Sources (Concluded)

Variable	Data description	LTU Coverage	Data source
	(EULFS), and categorized as low skilled (less than primary, primary and lower secondary education), medium-skilled (upper secondary and post-secondary non-tertiary education), and high-skilled (tertiary education).		
Home ownership rate	Home ownership rate	2005-2024 for LTU	Eurostat
Real interest rate	Short-term real interest rate (GDP deflator based)		AMECO
Output gap	Output gap	1995-2025	AMECO
Total factor productivity	Total factor productivity growth	1995-2025	AMECO
Terms of trade	Export prices/import prices growth	1995-2025	AMECO
Capital accumulation	Gross fixed capital accumulation/net capital stock	1995-2025	AMECO

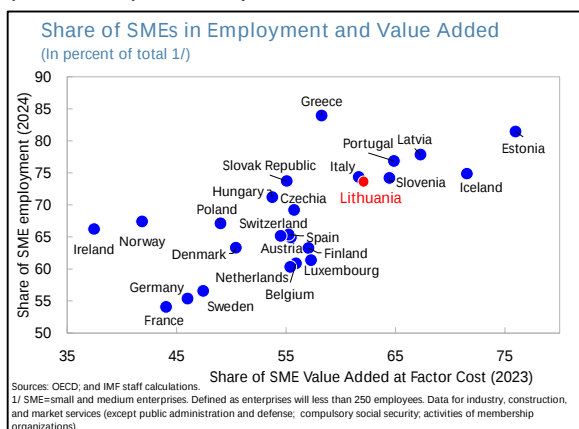
FINANCING CONSTRAINTS AND GROWTH CHALLENGES OF LITHUANIAN SMEs¹

Small and medium-sized enterprises (SMEs)² play a central role in Lithuania's economy but face persistent challenges that constrain investment, productivity, and firm growth. Limited access to finance, alongside labor and skills shortages, weighs on SMEs' ability to scale up. This paper reviews these challenges using firm-level survey evidence and examines both demand-side and supply-side factors that limit SME financing and expansion. The analysis points to the need for a holistic reform agenda that deepens SME financing – by mobilizing long-term savings, expanding non-bank financing channels, and strengthening EU capital market integration – complemented by policies to ease labor and skills constraints.

A. Introduction

1. The prominence of SMEs in Lithuania underscores the macroeconomic importance of creating an enabling environment for healthy firm growth. SMEs play a central role in Lithuania's economy, accounting for over 99 percent of firms, with most being micro-enterprises, 74 percent of employment, 62 percent of value added (text chart) and 63 percent of the turnover, and 53 percent of employee wages and salaries³.

While access to finance has remained a critical constraint over the last few years, firm performance is also increasingly shaped by other challenges, including labor and skills shortages, competitive pressures, and production costs. Financing conditions interact with these constraints by influencing firms' capacity to invest, innovate, and scale up, and persistent frictions across these dimensions can weigh on productivity growth, slow income convergence, and limit Lithuania's medium-term growth potential.



2. Difficulties in accessing finance have long been a challenge for SMEs in Lithuania, reflecting a bank-dominated highly concentrated financial system with limited alternative financing options. Studies suggest that SME debt financing gap could be around EUR 1 bn in Lithuania (Raab, 2025)⁴. Corporate financing is largely provided by a few large, predominantly

¹ The authors would like to thank Kazuko Shirono and Helge Berger for their guidance and the Lithuanian authorities for their useful comments.

² SMEs are defined as non-financial enterprises with less than 250 employees.

³ 2024 OECD data for industry, construction and market services (except public administration and defense; compulsory social security; activities of membership organizations) for most series. 2023 data for value added at factor costs and wages and salaries. Wages and salaries for industry excluding construction.

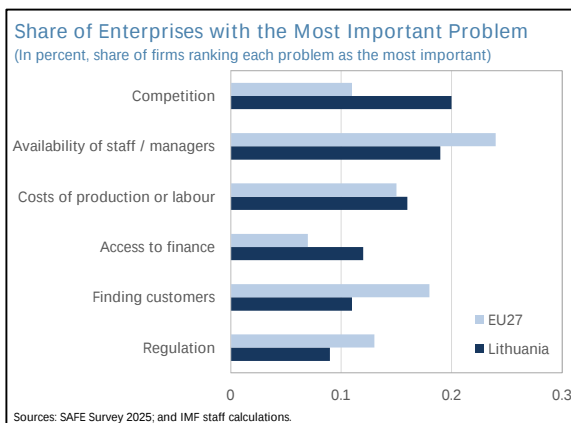
⁴ Estimate for 2023. For details, see "Debt Financing Gap for SMEs in Europe".

foreign-owned banks, and while the banking sector remains liquid, resilient, and well capitalized, access to credit for smaller firms is often constrained by high collateral requirements and weak confidence in loan approval prospects. At the same time, prevalence of micro enterprises and shallow capital markets limit the demand and availability of equity and bond financing, as well as other market-based instruments that could complement bank lending and support risk-taking and firm scale-up. Policy initiatives in recent years – including the expansion of specialized banks, public guarantees, development-bank support, and efforts to expand the capital markets – have helped ease some constraints, but significant gaps remain.

3. Building on these considerations, the paper examines SME challenges, the structure and constraints of SME financing, and draws broader policy implications. This paper first reviews firm-level challenges using survey evidence and assesses the structure, availability, demand, and constraints of SME financing in Lithuania. It then analyzes bank-based financing, including the role of banks and the barriers SMEs face in accessing credit. It reviews alternative financing channels—including capital markets, non-bank financial institutions, and risk capital—and identifies key structural impediments to their development. Addressing these challenges calls for a holistic reform agenda that deepens SME financing by mobilizing long-term savings and advancing EU capital market integration, while also tackling complementary constraints, notably labor and skills shortages, through workforce upskilling and active labor market policies.

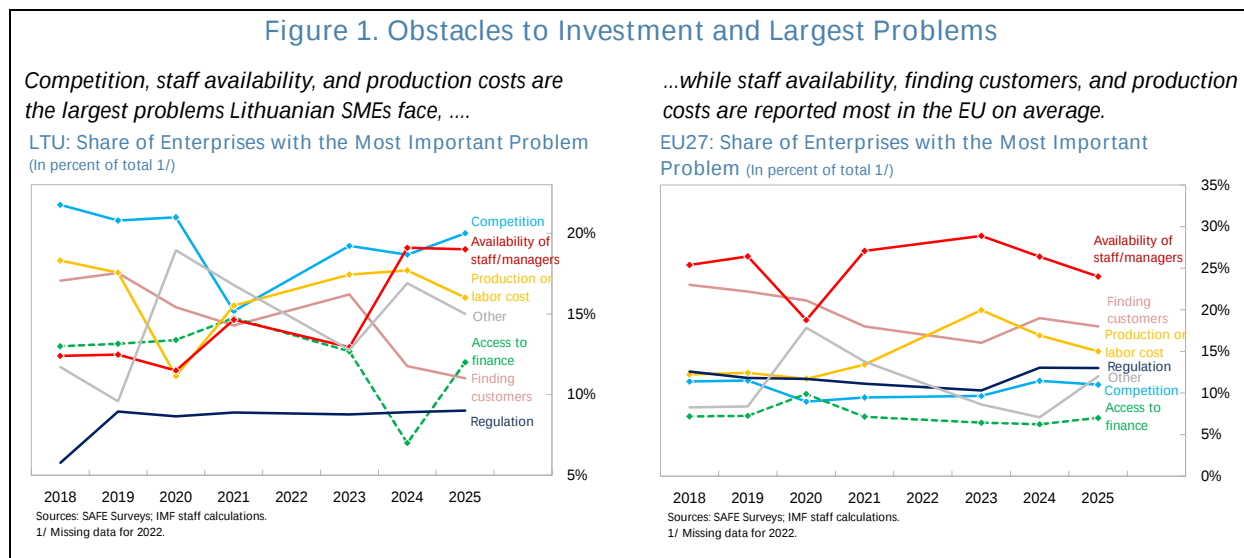
B. Challenges of SMEs

4. SMEs report facing significant challenges, including competition, labor shortages, rising costs, and access to finance. (Figure 1). In Lithuania, many SMEs name competition, the availability of staff and managers, production costs, and access to finance as their primary concerns (EC and ECB, Survey on the Access to Finance of Enterprises (SAFE), 2025)⁵. Furthermore, uncertainty about the future, the availability of skilled workers, product demand, business regulation, availability of finance and energy costs are identified as major long-term barriers to investment by micro and small enterprises (European Investment Bank, Investment Survey, 2025). Surveys show that an increasing number of Lithuanian businesses are struggling to recruit qualified staff, which reflects the tighter labor market and ongoing labor shortages. Competition is reported as a challenge by Lithuanian SMEs more frequently than by SMEs across the European Union on average (Figure 1). More broadly, real-sector bottlenecks, notably a limited pipeline of investable projects,



⁵ EC ECB SAFE survey (2025) sample includes companies with 1 to 249 employees. For details, see [Survey on the Access to Finance of Enterprises \(SAFE\)](#) commissioned by the European Central Bank and the European Commission.

also play a major role in constraining firm growth across Europe—including in Lithuania (Brandao-Marques et al., 2026).



5. These obstacles appear to hinder investment, innovation, digitalization and AI adoption, and productivity in SMEs more than in large enterprises. Despite some advancement in recent years, SMEs face greater challenges adopting digital and AI technologies than large enterprises (Figure 2). Skills shortages – such as data scientists, AI engineers, and ICT specialists, for instance – are a major barrier.

Without specialized talent, integrating AI tools is difficult. Large firms can attract and train experts more easily and are better equipped with human capital for AI adoption. SMEs struggle with high upfront and ongoing costs, limited revenues and data, and more limited access to collateral. Meanwhile, large companies benefit from more internal data, established governance, and stronger legal resources, making AI adoption less risky and more accessible.

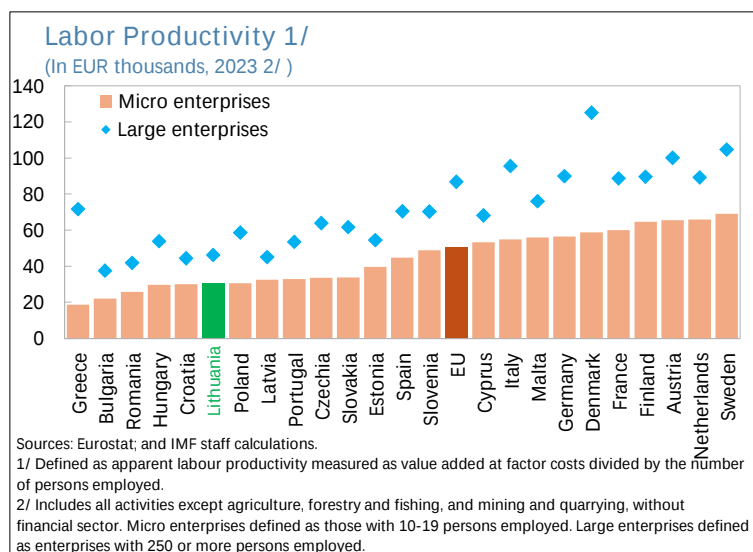
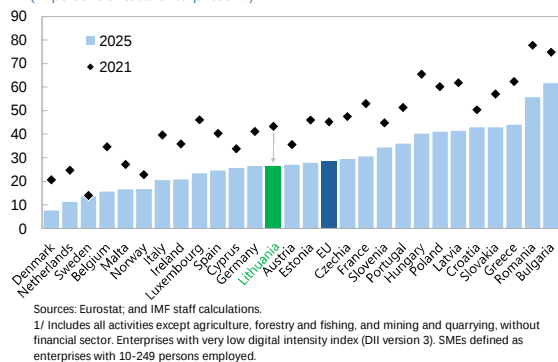


Figure 2. Use of Digital and AI Technologies by SMEs and Large Enterprises

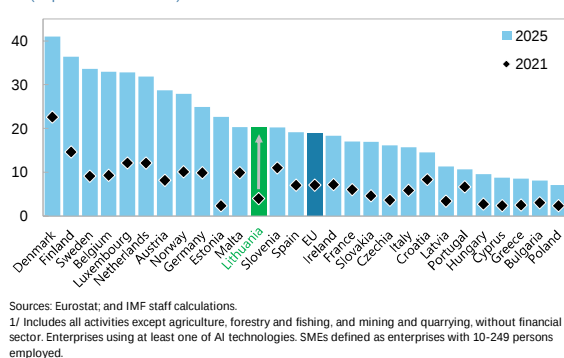
The prevalence of low digital intensity among SMEs has declined substantially during 2021-25, ...

Share of SMEs with Low Digital Intensity
(In percent of total enterprises 1/)



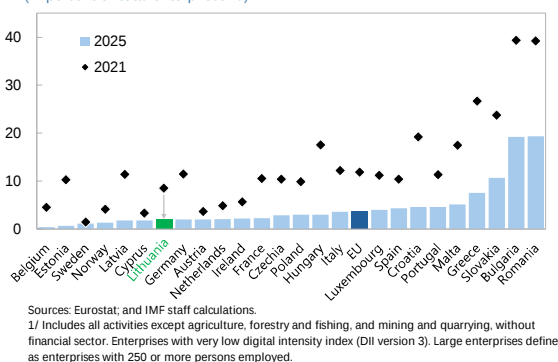
Adoption of AI technologies is also faster among large enterprises...

SMEs Using AI Technologies
(In percent of total 1/)



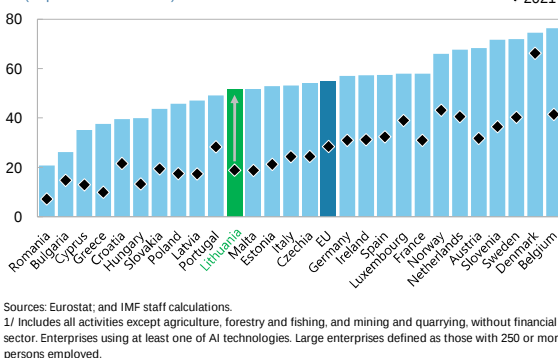
... but low digital intensity remains more prevalent among the SMEs than large enterprises.

Share of Large Enterprises with Low Digital Intensity
(In percent of total enterprises 1/)



...than SMEs.

Large Enterprises Using AI Technologies
(In percent of total 1/)

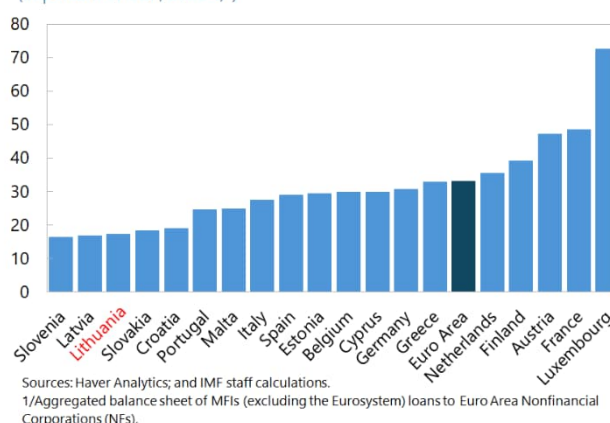


C. Access to Bank Financing

6. Despite Lithuania's financial system being heavily bank-centered, the volume of bank loans remains low. Lithuanian SMEs are less reliant on bank loans than the EU average, even though banks are the dominant players within the country's financial sector. Lithuania's banking system is highly concentrated, with lending dominated by foreign banks, which reportedly operate under conservative, risk-based business models that emphasize strong collateral and prudent underwriting, supporting financial stability but limiting risk-taking. In an environment of shallow capital markets, this has contributed to relatively subdued credit provision – particularly for smaller and younger firms with limited collateral – despite a sound and

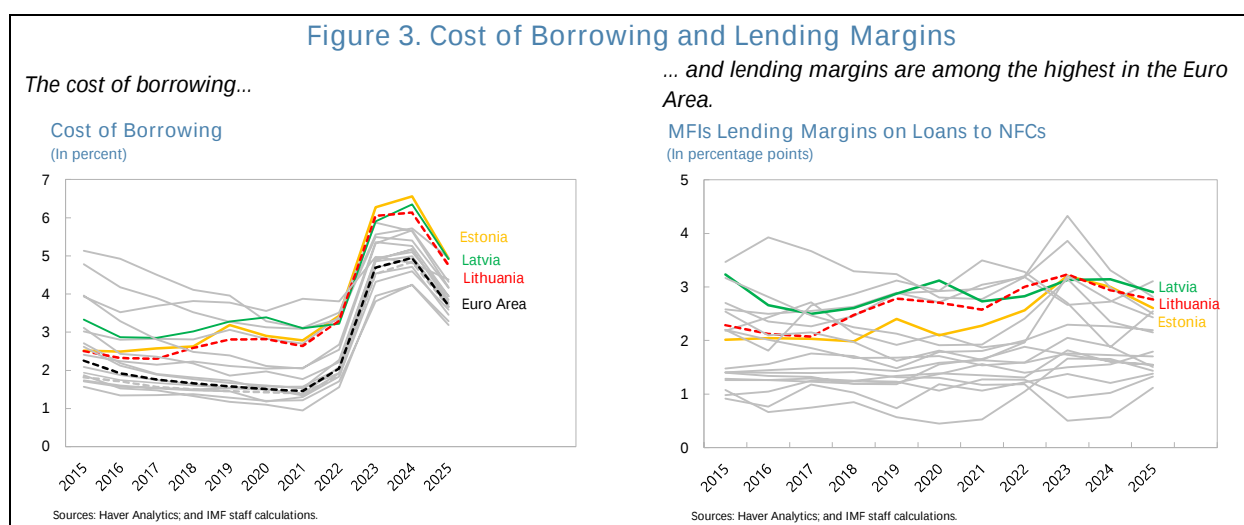
Bank Loans to NFCs

(In percent of GDP, 2025 1/)



profitable banking sector. This is consistent with broader EU trends, where limited cross-border lending leaves firms heavily reliant on domestic banks, reflecting persistent home bias and fragmented banking markets (Brandao-Marques et al., 2026). Moreover, with a large share of corporate lending provided at variable interest rates, borrowing costs in Lithuania adjust rapidly to monetary policy changes. This heightened interest-rate sensitivity may add to firms' caution in taking on debt – particularly for smaller and highly leveraged companies – during periods of policy tightening. Thus, corporate bank lending – as a share of GDP – is noticeably lower than in other euro area nations (text figure). At less than 10 percent of GDP, the volume of outstanding SME loans was well below many other European countries in 2024 (OECD 2026b). Both the cost of borrowing and lending margins are among the highest in the Euro Area, likely at least in part reflecting banking system concentration, small market size, and higher perceived risk premia, among others (Figure 3).

7. Specialized banks complement large universal banks in helping to address persistent credit access gaps. Since the introduction of the specialized bank license in 2017 – supervised by the Bank of Lithuania within the ECB's Single Supervisory Mechanism – these institutions have been able to collect deposits and provide lending under a narrower business scope and lower entry barriers than traditional banks⁶. Several specialized banks focus on SMEs, particularly through working-capital, investment, and asset-based lending, helping diversify financing channels.



8. Many Lithuanian firms have long faced financing constraints, with collateral requirements frequently cited as a key limiting factor. In the SAFE survey (SAFE survey, 2025) about 12 percent of respondents identified access to financing as their most significant issue in Lithuania, just below Greece at 14 percent, and significantly above the EU average at 7 percent (Figure 4). Responders indicated that their most recent loan requests were primarily meant for fixed investments (42 percent in Lithuania compared to 36 percent in the EU) and for inventory purchases (48 percent versus 35 percent). A key factor limiting access to financing was insufficient collateral,

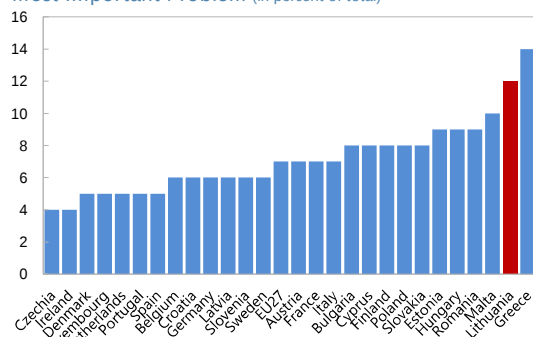
⁶ Specialized banks are defined as credit institutions established in Lithuania, which have the right to receive deposits, lend funds, provide transfer of funds and other usual banking services. A specialized bank cannot provide investment and other similar financial services. For details, see <https://www.lb.lt/en/fs-banks>.

which affected 27 percent of those surveyed, well above the EU average of 9 percent. More than 90 percent of SMEs required collateral in 2024, one of the highest rates in OECD (OECD, 2026b). Lithuania stands out for its share of loans secured by real estate collateral as one of the highest in Europe. Looking ahead, Lithuanian SMEs remain among the least confident in Europe regarding their ability to secure bank financing and achieve the desired outcome – only 35 percent expressed confidence, compared to 56 percent the EU average.

Figure 4. Access to Finance and Rejection Rates

A larger share of Lithuanian companies name 'access to finance' as the largest problem, then in most other countries.

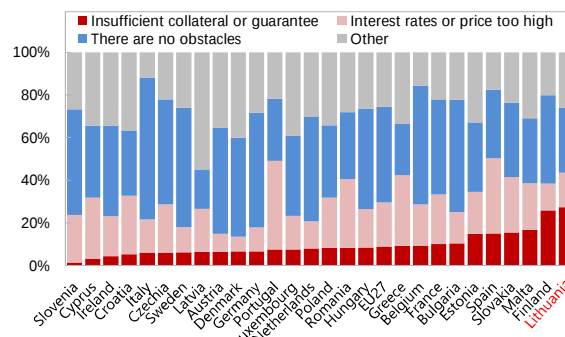
Share of Enterprises Ranking Access to Finance as Most Important Problem (In percent of total)



Sources: SAFE Enterprise Survey 2025, and IMF staff calculations.

Naming collateral and insufficient guarantees as the main limiting factor to obtaining financing.

Most Important Factor Limiting Financing (In percent of total)



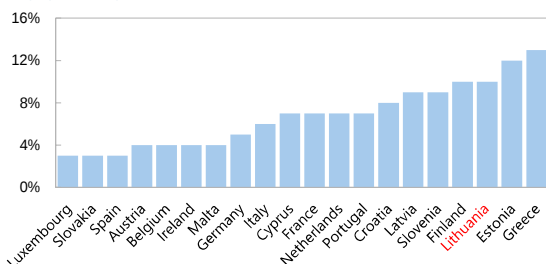
Sources: ECB SAFE Survey 2025, and IMF staff calculations.

9. Lithuanian companies report higher loan rejection rates compared to many other countries. The EIB Investment Survey (2025) indicates a significantly elevated rejection rate among the Lithuanian companies (Figure 5). While the 2025 SAFE survey reports a lower rejection rate, a considerable percentage (31 percent) of respondents still had pending applications. Additionally, the share of applicants who received the full amount requested was below the EU average. This suggests that, even when rejection rates seem low, access to the desired level of bank financing is still more limited for Lithuanian respondents than for their European counterparts.

Figure 5. Bank Loan Rejection Rates

About 10 percent of companies report being financially constrained in the EIB Investment Survey (2025).

Proportion of Firms that are Finance Constrained (In percent 1/)

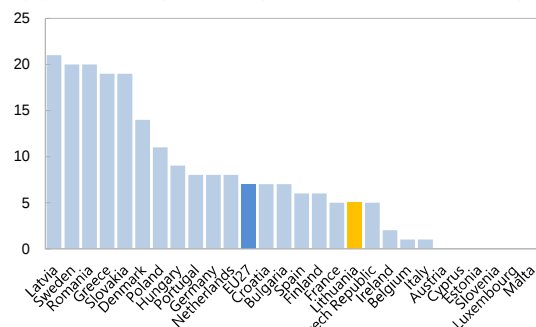


Sources: EIB Investment Survey 2025, and IMF staff calculations.

1/ Includes all firms of all sizes. Credit constrained firms include those dissatisfied with the amount of finance obtained (received less), firms that sought external finance but did not receive it (rejected) and those who did not seek external finance because they thought borrowing costs would be too high (too expensive) or they would be turned down (discouraged).

While loan rejection rates appear low in the SAFE Survey (2025), a large share of respondents still had pending applications.

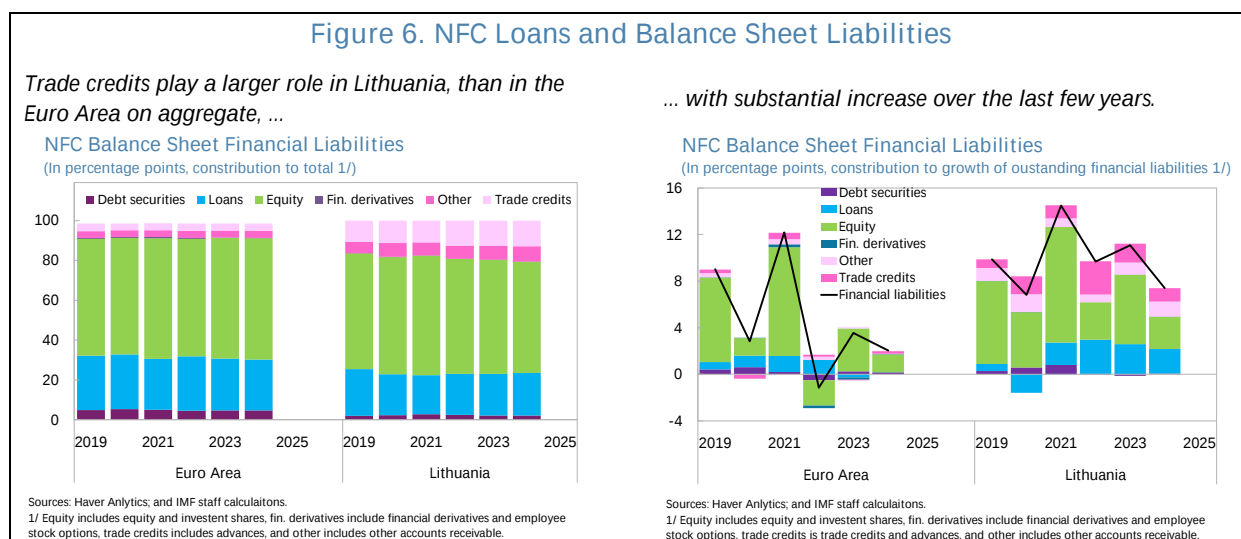
Reported Bank Loan Rejection Rates (In percent, those responding that applied for a bank loan but got rejected)



Sources: SAFE Survey 2025, and IMF staff calculations.

D. Alternative Non-Bank Sources of Financing

10. Due to challenges in accessing bank loans, businesses in Lithuania often rely on trade credit and their own internal resources. The two surveys reveal that, although bank loans are still the preferred financing option for businesses, a smaller percentage of Lithuanian companies utilize bank financing compared to their European Union counterparts. Instead, they often favor internal funds and trade credit. While debt financing remains important, a lower proportion of Lithuanian companies use bank loans, leasing agreements, hire-purchase agreements, grants, and subsidized loans compared to the EU average. Additionally, the usage of equity capital is reportedly among the lowest in the region. Overall, Lithuanian businesses show a greater dependence on trade credit and internal resources for funding their operations than their peers in Europe. This trend is supported by non-financial corporations' (NFC) balance sheets, which indicate a higher reliance on trade credits and advances compared to the Euro Area (Figure 6).



11. Due to shallow capital markets, alternative financing options beyond banks and trade credits remain limited in Lithuania. The country's capital markets are shallow, with low activity and limited liquidity, reflecting both constrained demand and a narrow supply of market-based funding. Domestic firms continue to rely predominantly on bank intermediation rather than equity or bond issuance. This bank-centric financing model limits the pipeline of investable securities, dampening participation by both institutional and retail investors and reinforcing shallow capital-market depth (European Commission, 2025). Specifically, the Lithuanian stock exchange market capitalization is only 6.7 percent of GDP with 32 companies listed; these figures pale in comparison with larger countries like France, with 130 percent of GDP in market capitalization and 795 listed companies⁷.

12. Progress on the Baltic Capital Market Initiative has materially improved integration outcomes, but limited market scale continues to cap liquidity and prevent the emergence of fully self-sustaining capital markets. The Baltic initiative has helped reduce regional

⁷ For details on the Lithuanian capital market, see Bank of Lithuania's [Capital Market Review 2025](#). For the number of listed companies and market capitalization for France, see [SSE Stock Exchange Database](#).

fragmentation and support progress toward EU-wide CMU. However, the small scale of the combined Baltic market continues to limit liquidity and depth, constraining its ability to generate fully self-sustaining capital market activity. Thus, continued policy efforts are required to secure lasting gains in liquidity, investor depth, and risk capital availability. (Box 1).

Box 1. The Baltic Regional Capital Market Initiative

The Baltic Regional Capital Market Initiative emerged as a policy response to long standing fragmentation and firms' limited access to market-based finance in small open economies. The Baltic Regional Capital Market Initiative was launched in 2017, when the Ministries of Finance of Estonia, Latvia, and Lithuania signed a Memorandum of Understanding to jointly develop a single pan-Baltic capital market, with support from the European Commission (EC) and the European Bank for Reconstruction and Development (EBRD) (Mirbabaeva, 2023). The initiative was motivated by the small size and fragmentation of local capital markets, which limited liquidity, investor participation, and firms' access to market-based finance. Its core objectives were to achieve scale and visibility through regional integration, reduce reliance on bank lending, improve access to financing – particularly for SMEs and mid-caps – and align regional market development with the EU's broader Capital Markets Union (CMU) agenda (Ministry of Finance of the Republic of Lithuania, 2025).

The Baltic authorities have made substantial progress in integrating market infrastructure and strengthening the Baltic regional capital market functioning. Several key elements of market integration predated the 2017 initiative, including the launch of the Baltic List, harmonization of trading rules and market practices, a common trading system and a single membership framework. Since the 2017 Memorandum of Understanding, further progress has been made, including legal and regulatory harmonization, new regional instruments, and more efficient post-trade infrastructure. For instance, the national exchanges have been unified under Nasdaq Baltic, featuring harmonized listing standards and a single trading platform. Companies from all three countries now list their shares together on the Nasdaq Baltic stock exchange, making cross-border investment easier and more efficient. The establishment of a single regional central securities depository (Nasdaq CSD) further streamlined operations, and in 2024, full connectivity to TARGET2-Securities via Clearstream significantly reduced cross-border settlement costs (Nasdaq, 2024). Market visibility also improved with the introduction of the MSCI Baltic Index in 2023 (Mirbabaeva, 2023). These advancements have led to increased issuance and are widely regarded as exemplary steps in regional market integration that align with the Capital Markets Union (CMU) objectives.

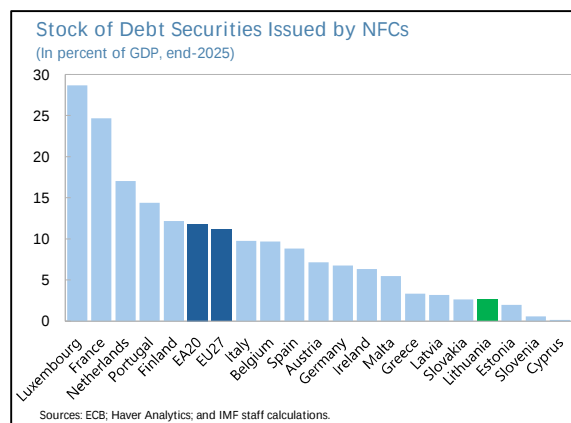
Regional integration has been further advanced through the harmonization of disclosure requirements for smaller public securities offerings across the Baltic states. In December 2023, the Bank of Lithuania, together with the Latvian and Estonian authorities, agreed on a common information document for public securities offerings that do not require a prospectus. Since 2024, issuers have been able to use a single English-language document for offerings across one or more Baltic countries, replacing separate national submissions and reducing administrative burdens and issuance costs (Bank of Lithuania, 2023). The framework initially covered offerings of EUR 1–8 million over a 12-month period and was intended to facilitate capital market access for SMEs and mid-sized firms. Building on this initiative, Lithuania increased the threshold for non-prospectus public offerings from EUR 8 million to EUR 12 million in 2026, while maintaining alignment with the common Baltic disclosure framework (Bank of Lithuania, 2026d).

While the initiative has delivered tangible integration gains, liquidity, investor participation, and market depth remain limited. Despite tangible progress, key challenges remain, including thin secondary market liquidity, small equity markets relative to GDP, and still limited participation by domestic institutional investors. SME use of equity markets remains modest, reflecting structural constraints beyond market infrastructure, including firm size, ownership structures, and disclosure capacity. As a result, while the initiative has succeeded in creating an effective enabling platform, it has not yet delivered deep, self-sustaining capital markets. Future efforts need to focus on strengthening market and post-trade

Box 1. The Baltic Regional Capital Market Initiative (Concluded)

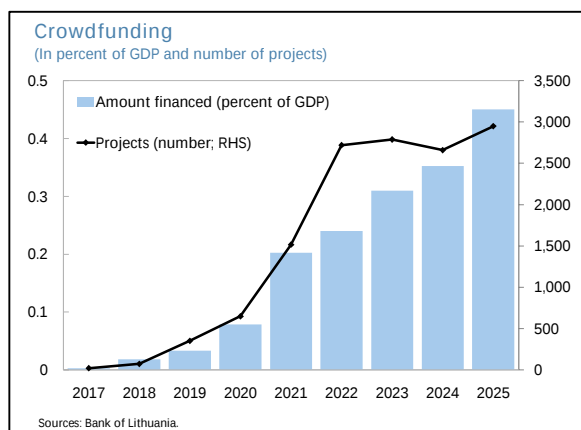
infrastructure to attract more issuers to Baltic trading venues, while broadening institutional investor participation and expanding the range of available financial instruments (Ministry of Finance of the Republic of Lithuania, 2025). The Baltic capital markets will have difficulty further expanding and increasing liquidity unless institutional investors become more actively involved (Skrutkowski, 2025). Overall, the Baltic project reduces fragmentation at the regional level and facilitates progress toward EU-wide CMU, but continued policy efforts are needed to translate integration into durable gains in liquidity, investor depth, and risk capital availability.

13. Corporate bond issuance increased substantially in 2025, although it remains small by international standards. Non-financial corporate bond issuance is low by international standards, representing only 2.6 percent of GDP at end-2025, compared to the Euro Area average of 11.8 percent (text chart). However, corporate bond issuances on First North – a trading venue alternative to the regulated Nasdaq Vilnius – increased in 2025, driven by various supply- and demand-enhancing factors (Box 2).



14. Other market-based financing for SMEs remains small, despite substantial growth in the fintech sector over the last few years.

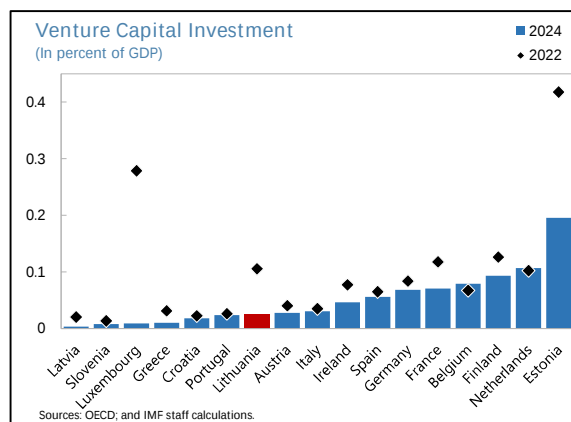
- Crowdfunding.** Crowdfunding, largely loan-based, has been expanding in Lithuania, offering alternative financing options primarily for small firms, startups, and project-based ventures, mostly in the real estate industry, that have limited access to traditional bank credit. In 2025, 16 crowdfunding service providers were operational in Lithuania, providing about EUR 379 million (0.5 percent of GDP) in financing.⁸ The number of funded projects continued to increase, pointing to growing demand for alternative financing, rising confidence in crowdfunding platforms, and investors' greater willingness to diversify portfolios toward loan-based instruments. Lithuania was also in the top five European countries in terms of capital raised and had the largest number of projects in 2024 (European Securities and Markets Authority, 2025). Nevertheless, crowdfunding remains small relative to GDP and continues to



⁸ For details, see Bank of Lithuania's [Review of the Activities of Crowdfunding Service Providers \(2025\)](#).

play a complementary – rather than systemic – role in SME financing, largely providing financing to real estate companies.

- *Venture capital (VC)* has been expanding (text chart) amid a growing start-up ecosystem and shows potential, but its overall role in SME financing remains modest, serving mainly as a complement to the dominant, bank-centered financial system. Over the past decade, venture capital has gained some traction, but its adoption is mostly focused on innovative tech firms rather than being a widely accessible funding source for most SMEs. Consequently, the insufficient scale and depth of Lithuania's domestic venture capital market continue to constrain opportunities for SME scale-up financing and broader capital deepening. Studies find that the EU's underdeveloped VC market is an important factor holding back productivity and innovation (Brandao-Marques et al., 2026).



15. The Lithuanian government also supports SMEs through a range of public financing instruments aimed at easing collateral and cost constraints. Through the national promotional bank ILTE, firms can access loan guarantees, factoring, leasing, export credit guarantees, and preferential loans, including via alternative financing and venture-capital-linked schemes. However, despite being the principal public instrument for supporting SMEs—especially those excluded from bank lending—ILTE guarantees do not always materially reduce collateral requirements, as substantial additional collateral is often still required (Baliukonis and Buteikis, 2024). Additional support is provided by municipalities through start-up grants and interest subsidies, while targeted direct lending was introduced to support firms affected by the economic impact of Russia's war against Ukraine (OECD, 2026).

16. EU-level programs play an important role in supporting SME access to finance in Lithuania, primarily through risk-sharing, guarantees, and co-investment mechanisms. The InvestEU program plays an important role in expanding access to finance for Lithuanian SMEs by providing EU budget guarantees implemented mainly by the European Investment Fund (EIF), which reduce lender risk and improve loan terms for smaller and higher-risk firms. In Lithuania, InvestEU guarantees have supported lending through local banks and alternative finance providers, enabling lower collateral requirements, longer maturities, and better pricing for SMEs, microenterprises, and small mid-caps—particularly for projects related to innovation, digitalisation, sustainability, and microfinance. These facilities have enabled Lithuanian intermediaries to extend financing on more favorable terms, while public risk-sharing helps crowd in private capital and partially offset the limitations of small domestic capital markets (European Investment Fund, 2023).

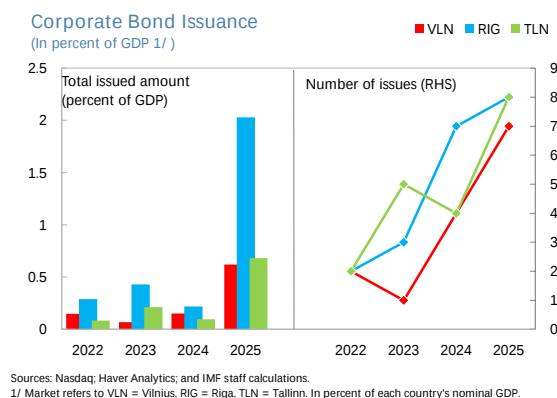
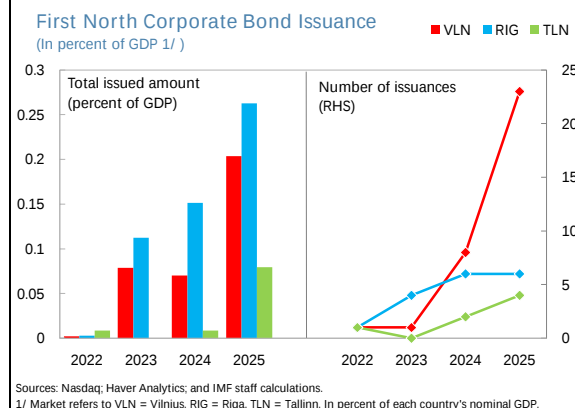
Box 2. Lithuania's First North Market

Nasdaq Vilnius offers both traditional regulated and streamlined trading venues for companies. Nasdaq Vilnius stands as Lithuania's primary stock exchange and the nation's sole regulated securities market. Together with Nasdaq Riga and Nasdaq Tallinn, it forms the backbone of the Nasdaq Baltic market infrastructure. Through Nasdaq Vilnius, issuers can access both the regulated market and the First North alternative market, which operates as a multilateral trading facility (MTF) under the Markets in Financial Instruments Directive (MiFID II). The regulated market is licensed and overseen by the Bank of Lithuania, while First North, in place since 2009, is governed by its own rulebook and offers a streamlined admission process compared to the full requirements of the regulated market.

First North is a growth market tailored for smaller fast-growing companies, offering public listing benefits with simpler, lighter regulatory requirements. To join, firms must engage a Certified Adviser for ongoing compliance, as set out in the Lithuanian First North rulebook. Listing not only provides access to capital but also offers a stock exchange quality mark to companies, making it an appealing and straightforward steppingstone for businesses aiming to graduate to the regulated market.

Lithuania has emerged as the most active Baltic First North bond market in terms of number of issuances in 2025. An increasing number of Lithuanian SMEs and mid-caps are now leveraging Nasdaq Baltic First North as meaningful – though still niche – complement to bank finance, although the number of issuances and total amounts remain small by international standards. On average, First North corporate bonds feature higher coupons, shorter maturities, and smaller issue sizes than corporate bonds issued on the regulated market. This, however, aligns with the platform's focus on firms that often fall outside the conventional large-cap segment of the regulated market. Real estate leads among First North corporate issues, followed by energy.

Several key factors have driven the activation of Lithuania's bond market, boosting both the supply and demand for corporate bonds on First North. The tightening of bank credit, following decades of heavy reliance on bank financing, made the need for alternative funding options—such as bonds—more pressing. While IPO activity remained subdued and equity markets continued to be shallow, bond financing became more prominent as a source of corporate funding. The increased engagement of domestic banks as arrangers has lowered transaction costs, and, together with the lighter disclosure requirements and reduced issuance expenses at First North compared to the regulated market, this has made the platform more attractive to SMEs and repeat issuers. Efforts to expand the local Certified Adviser base in 2024 strengthened the market infrastructure, while the rapidly growing retail investor base has enhanced absorption capacity for smaller bond issues. Finally, policy initiatives – such as widening First North's foreign securities list to include bonds and admitting 18 Lithuanian government Eurobonds listed in Luxembourg in 2025 – have broadened investor access and further supported market development. Going forward, First North could play a larger role as a complementary financing venue for Lithuanian SMEs and mid-caps, particularly for bond issuance and repeated market access.



E. Constraints to Accessing Finance

17. The main constraint on the development of Lithuanian capital markets – and on SMEs' access to market-based finance – is scale. As a small economy, Lithuania lacks the critical mass needed to sustain liquid markets and a sufficiently diversified investor base for corporate securities. This reflects a combination of demand-side constraints, including a limited pipeline of market-ready firms and low appetite for issuance, and supply-side constraints, such as a small domestic institutional investor base and shallow secondary-market liquidity. Together, these factors prevent capital markets from reaching minimum efficient scale and from playing a more systemic role in SME financing. Fundamentally, this reflects the incomplete nature of the EU single market across products, labor, and financing. IMF (2025) underscore that closing these integration gaps would yield substantial gains by expanding market scale, while Brandao-Marques et al. (2026) highlight that persistent fragmentation and home bias in financial markets constrain cross-border capital allocation and limit the depth of funding sources.

18. The supply-side constraints limit SME access to non-bank market finance, reflecting a shallow domestic investor base, limited institutional scale, and policies affecting long-term risk capital. Specifically:

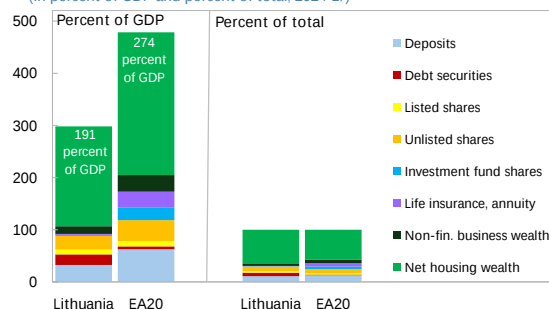
- *Retail investor participation in capital markets remains low, with household wealth predominantly allocated to housing and deposits rather than financial instruments.* While the composition of household wealth across asset classes is broadly comparable to that of the euro area households, Lithuanian households hold a larger share of their wealth in housing, and both total and financial assets of households – relative to GDP – are significantly smaller than in the euro area (Figure 7), constraining the pool of domestic risk capital available to firms. Accordingly, Lithuanian households are not only less wealthy but also save less than many European peers (Skrutkowski, 2025). Although overall financial literacy is broadly in line with the EU average, confidence in investment advice from banks and financial advisors is comparatively weak in Lithuania (Skrutkowski, 2025).

Figure 7. Household Saving Rate and Assets

A larger share of Lithuanian households' assets is allocated toward housing wealth than the EA average.

Assets of Households

(In percent of GDP and percent of total, 2024 1/)

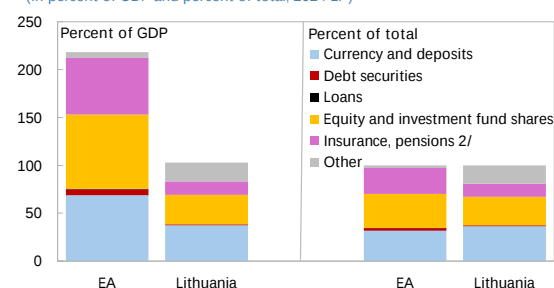


Sources: Haver Analytics; and IMF staff calculations.
1/ Estimates based on the Distributional Wealth Accounts (DWA) are experimental statistics produced by the European System of Central Banks (ESCB).

Lithuanian households also hold less wealth relative to GDP, on average, than in the EA.

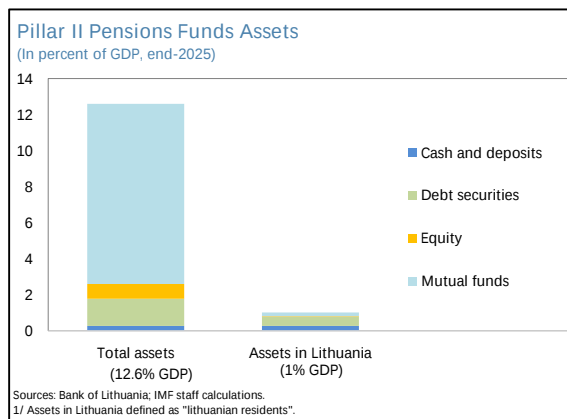
Financial Assets of Households

(In percent of GDP and percent of total, 2024 1/)

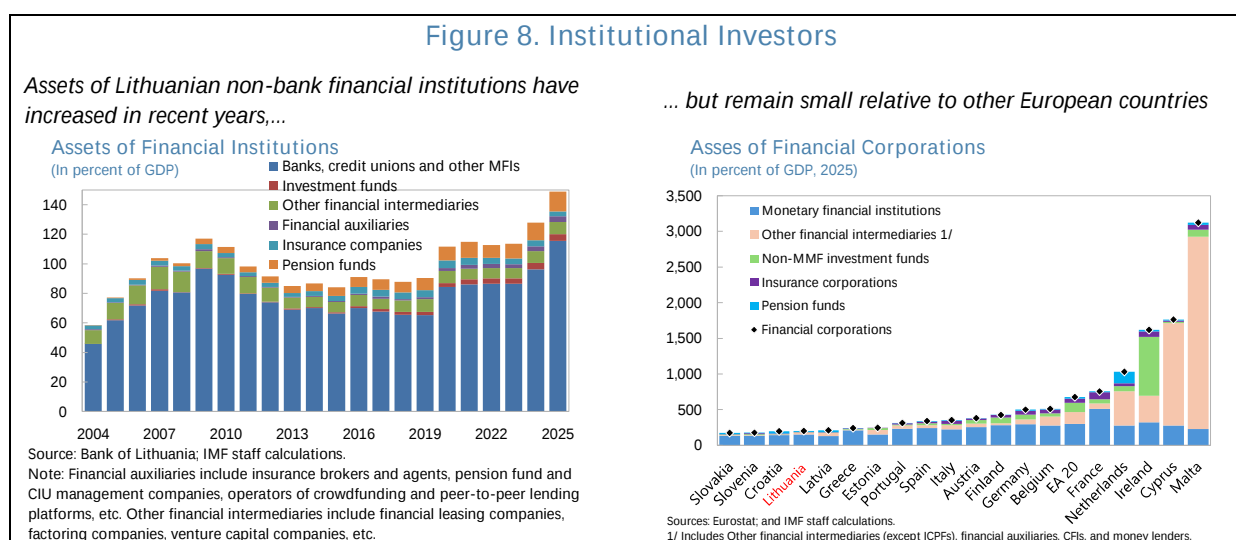


Sources: Eurostat; and IMF staff calculations.
1/ Consolidated financial balance sheet of households. Other includes financial derivatives and employee stock options and other accounts receivable.
2/ Includes insurance, pensions, and standardized guarantees.

- A small domestic institutional investor base restricts the amount of capital available to firms in capital markets. Pension funds, insurers, and investment funds typically function as anchor investors, providing buy-and-hold demand, supporting longer maturities, and compressing issuance premia in capital markets. In Lithuania, however, the asset base of non-bank financial institutions remains relatively small (Figure 8). Pension fund assets are modest and, where accumulated, are invested predominantly abroad (text chart), reflecting both the limited availability of domestic investable opportunities on a scale and regulatory and risk-management constraints. These scale limitations, in turn, restrict their capacity to allocate meaningfully to SME equity or alternative financing instruments.
- The second-pillar pension amendment, and the resulting withdrawals of assets, have reduced the size of the pension system further, dampening the prospective supply of patient domestic capital. Pillar II pension withdrawals in the first quarter of 2026 reduced assets from about EUR 11 bn to EUR 7 bn (Bank of Lithuania, 2026c).



Taken together, these factors contribute to thin local capital markets and constrain the availability of patient, risk-bearing finance for SMEs, reinforcing reliance on bank lending.

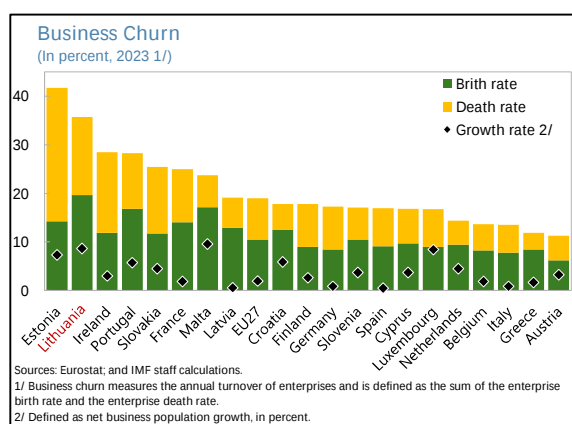


19. The demand-side constraints further restrict the effective SME uptake of finance, reflecting a structurally thin pipeline of firms suited for long-term risk capital. Specifically:

- A weak pipeline of investable projects in the EU constrains the uptake of market-based financing. Structural barriers—ranging from domestic policy gaps that hinder business

dynamism and innovation (including tax systems, business environment regulations, and insufficient investment in R&D and tertiary education) to cross-border frictions affecting the mobility of labor, capital, and goods—limit the availability of market-ready firms and reduce demand for external financing, keeping financial markets shallow and underdeveloped in many countries (Brandao-Marques et al., 2026; Budina et. Al, 2025). In this context, expanding the pool of investable Lithuanian projects would help support not only the issuance activity but also investor participation in the domestic capital market.

- *Lithuania's SME sector is dominated by very small businesses*, as micro enterprises with fewer than 10 employees account for about 95.8 percent of all firms.⁹ This landscape leads to a limited willingness among small business owners to dilute their ownership, which reinforces a prevailing low equity culture.
- *Elevated business churn rate reflects a high turnover of predominantly small firms, limiting firm longevity and scale* (text chart). While higher business churn can support economic dynamism through productivity-enhancing reallocation of resources and innovation, it can also reduce the demand for long-term finance, as fewer SMEs reach the maturity and growth profile typically required for bank lending, equity, or capital-market financing.
- *Fewer small firms operate in innovation-intensive or high-growth segments, where risk capital is typically demanded, than in many other countries*. While the share of high-growth firms is slightly above the EU average, this performance lags many other countries, and small firms tend to be less innovative than the EU average, in contrast to relatively strong innovation among the Lithuanian medium and large enterprises.
- *Many SMEs remain regionally focused and non-scalable, limiting the prevalence of business models suitable for capital market or venture capital financing*, despite Lithuania being well integrated into the EU single market.¹⁰ A significant share of SME activity is concentrated in non-tradable sectors with limited scalability, such as retail, construction and real estate activities, and local services, at a higher share than the EU average (Figure 9).
- *Relatively limited financial reporting sophistication and lack of financial literacy* (Bank of Lithuania, 2021) may also deter engagement with more complex financing instruments.



⁹ Based on Eurostat data on enterprise statistics by size class and NACE Rev. 2 activity. Data for 2024.

¹⁰ The trade integration of the economy reaches 51.5% of GDP, and 12.4% of SMEs export online (vs 8.7% in average in the EU). Source: European Commission Lithuania [2023 SME Country Fact Sheet](#). Lithuanian firms are also equally integrated into global trade compared to EU firms (European Investment Bank, 2025).

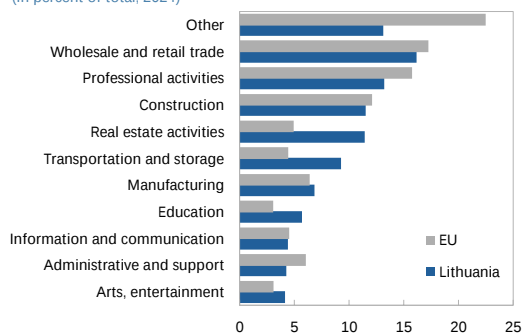
Many firms also continue to have limited knowledge of sources of financing alternative to bank lending and some lack the skills to correctly complete loan application forms.

Taken together – a weak pipeline of investable projects, prevalence of micro enterprises, limited scalability, high business churn, combined with the average share of high-growth firms and the below-average share of innovative firms among small companies – imply a structurally limited demand for market-based long-term finance even under well-functioning markets, reinforcing heavy reliance on internal funds. This behavior delays or suppresses the effective demand for both bank-based and capital-market financing.

Figure 9. High-Growth and Innovation-Active Enterprises

A significant share of SMEs is involved in non-scalable activities.

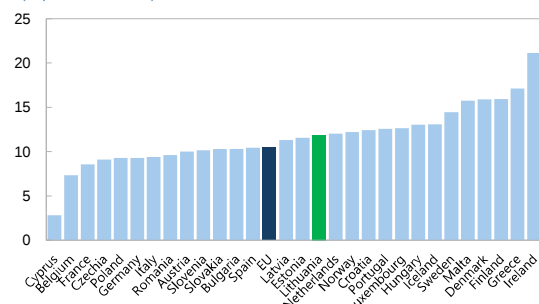
Share of SMEs by Sector
(In percent of total, 2024)



Sources: Eurostat; and IMF staff calculations.

The share of high-growth enterprises in Lithuania is broadly comparable to the EU average.

Share of High-Growth Enterprises
(In percent, 2023 1/)

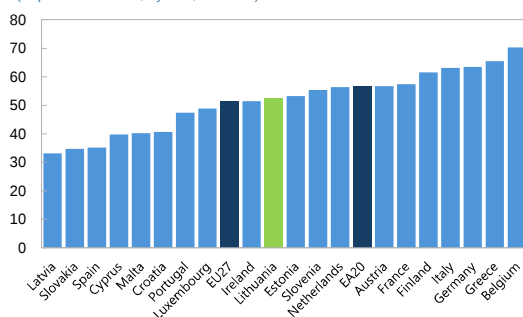


Sources: Eurostat; and IMF staff calculations.

1/ Defined as share of high growth enterprises measured in employment - high growth enterprises divided by active enterprises with at least 10 employees, in percent.

While the share of innovation-active enterprises in Lithuania is largely similar to the EU average overall, ...

Share of Innovation-Active Enterprises: Total
(In percent of total, by size, 2022 1/)

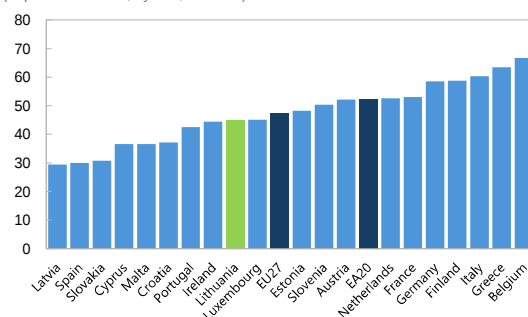


Sources: Eurostat; and IMF staff calculations.

1/ Enterprises by innovation status; Community Innovation Survey (2022).

... it is relatively small among the small enterprises...

Share of Innovation-Active Enterprises: Small Enterprises
(In percent of total, by size, 2022 1/)



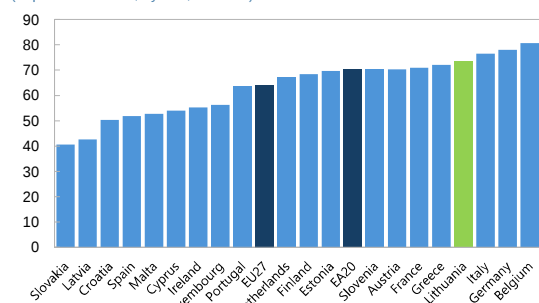
Sources: Eurostat; and IMF staff calculations.

1/ Enterprises by innovation status; Community Innovation Survey (2022). Small defines as enterprises with 10 to 49 employees.

Figure 9. High-Growth and Innovation-Active Enterprises (Concluded)

... in contrast to the high share of innovation-active enterprises among the medium and...

Share of Innovation-Active Enterprises: Medium Enterprises
(In percent of total, by size, 2022 1/)

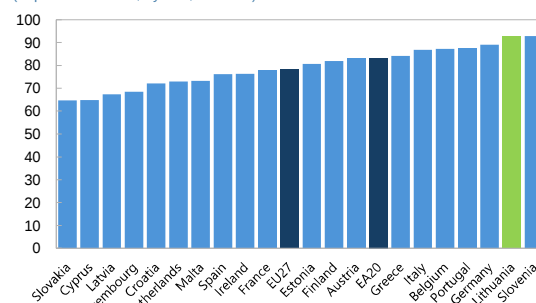


Sources: Eurostat; and IMF staff calculations.

1/ Enterprises by innovation status; Community Innovation Survey (2022). Medium defined as enterprises with 50 to 249 employees.

... large enterprises in Lithuania.

Share of Innovation-Active Enterprises: Large Enterprises
(In percent of total, by size, 2022 1/)



Sources: Eurostat; and IMF staff calculations.

1/ Enterprises by innovation status; Community Innovation Survey (2022). Large defined as enterprises with 250 or more employees.

20. Market size and liquidity constraints constitute structural impediments to SME capital-market financing in Lithuania, with the minimum efficient scale being the main challenge. As a small economy, Lithuania naturally has a limited pool of potential SME issuers, resulting in few listings and a thin pipeline of marketable securities. The narrow issuer base translates into low secondary-market liquidity, raising trading costs and liquidity risk and, in turn, requiring investors to demand higher risk premia. At the same time, the fixed costs of issuing, listing, and disclosure – legal, regulatory, and compliance-related – are high relative to typical SME balance-sheet size, discouraging market entry even for viable firms. These features interact to create a self-reinforcing equilibrium: a small market constrains liquidity, which dampens institutional investor interest, further limiting issuance and market depth. In this context, Lithuania's core challenge is not weak performance of existing markets, but the difficulty of achieving minimum efficient scale needed to sustain liquid, self-standing capital markets.

F. Conclusions and Policy Implications

21. A holistic approach is needed to expand financing options and support sustainable growth of Lithuania's SMEs. SMEs in Lithuania face a range of persistent challenges, including competition, labor and skills shortages, rising costs, and limited access to finance. These issues highlight the need for comprehensive solutions that address multiple fronts – such as implementing active labor market policies to improve workforce availability and strengthening access to financing to support investment and growth. Deepening SME finance also hinges on healthy firm dynamics, as high turnover and limited scale-up reduce the pool of firms able to productively absorb long-term finance. Tackling these problems holistically is essential for enhancing the resilience and productivity of SMEs and ensuring their continued contribution to the economy. Policy options include the following:

- *Mobilize domestic institutional investors to deepen capital markets.* A pension system reform that ensures long-term pension adequacy and sustainability would help mobilize long-term domestic savings, encourage continued voluntary participation, and reduce incentives for

early withdrawals. Together with improved financial education for retail investors and greater trust in investment advice, this could support a shift from deposits toward diversified capital-market investments, expand the pool of long-term funding for firms, including SMEs, and better align household savings with productive investment and long-term retirement needs.

- *Deepen Lithuania's domestic non-bank financing market.* To improve SME access to finance, Lithuania should continue to expand non-bank market-based financing channels – including venture capital, private equity, securitization, and SME bond markets. This would help reduce SMEs' heavy reliance on bank lending, aligning with the objectives of the EU Single Market.
- *Harmonize EU Capital Markets.* The main challenge for Lithuania is scale – national capital markets are simply too small to provide sufficient liquidity and a diversified investor base for corporate securities. EU single market integration can help alleviate these limitations by providing greater scale, diversifying the investor base, strengthening risk sharing, reducing transaction costs, and enhancing liquidity. For Lithuanian SMEs, this approach is crucial for gaining access to broader markets and attracting investors who are ready to support their growth. The Savings and Investment Union will make it easier for startups to raise equity and list IPOs, thus supporting innovation and growth. Model-based simulations suggest that reforms addressing financial policy barriers could raise EU GDP by around 3 percent in the long run, with the gains accruing disproportionately to smaller EU economies and younger firms (Brandao-Marques et al., 2026). The Baltic regional capital market harmonization initiative should also support the EU single market. Additionally, the 28th corporate regime will introduce a unified EU framework for governance, accounting, and taxation, simplifying cross-border expansion for businesses.
- *Leverage public instruments.* Programs such as InvestEU and EIF guarantees can attract private investors, reduce risk, and help develop local equity and debt markets that are accessible to smaller firms.
- *Scale up ILTE lending, while strengthening governance and operational transparency and ensuring prudent underwriting standards and adequate risk controls to preserve financial sustainability.* ILTE should act as a catalytic public development institution, crowding in private finance for Lithuanian SMEs by sharing risk through guarantees and co-lending while avoiding direct competition with banks. As ILTE's role expands, efforts should remain focused on addressing well-identified market failures while preserving financial discipline, prioritizing instruments such as guarantees and risk-sharing tools that target specific frictions and complement—rather than substitute for—private financial intermediation. Strengthening the insolvency framework and improving the use of ILTE guarantees could help ease collateral constraints. Weaker insolvency regimes lower recovery values, prompting lenders to demand higher collateral. Better calibration of ILTE's guarantees to the needs of constrained but viable firms could help support broader credit provision. At present, their effectiveness could be strengthened further, as lenders continue to require substantial additional collateral (Bank of Lithuania, 2026c).

- *Strengthen financial reporting and financial literacy of SMEs.* Strengthening financial reporting and financial literacy among SMEs would reduce information asymmetries and improve access to finance. More standardized and transparent financial reporting, together with better understanding of financing options and disclosure requirements, would help broaden the pool of SMEs able to engage with banks and capital markets.

Collectively, these measures – combining the EU Single Market implementation and domestic market development – will broaden financing options for SMEs, promote capital deepening, and reduce vulnerability to banking credit cycles.

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