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COMMISSION OF THE EUROPEAN COMMUNITIES

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**COMMISSION OPINION**

**on the existence of an excessive deficit in Lithuania**

**Application of Article 104(5) of the Treaty establishing the European Community**

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#### Application of Article 104(5) of the Treaty establishing the European Community

#### THE APPLICATION OF THE STABILITY AND GROWTH PACT IN THE CURRENT CRISIS SITUATION

1. Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty. The often strong deterioration in the deficit as well as the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn. Several factors are at play. First, the economic downturn brings about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP), endorsed by the European Council in December. The Plan explicated that the stimulus should be timely, targeted and temporary and differentiated across Member States, with more room for manoeuvre for those Member States that have achieved sustainable public finance positions and improved their competitive positions. It also called for structural reforms that support demand and promote resilience in the short term, while paying special attention to actions in the four priority areas of the Lisbon strategy. Finally, several countries have taken measures to stabilise the financial sector, some of which impact on the debt position or constitute a risk of higher deficits and debt in the future, although some of the costs of the government support could be recouped in the future.
2. The Stability and Growth Pact requires the Commission to initiate the excessive deficit procedure (EDP) whenever the deficit of a Member State exceeds the 3% of GDP reference value. The amendments to the Stability and Growth Pact in 2005 aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation, and thereby ensuring long-term sustainability of public finances.

#### LEGAL BACKGROUND

3. Article 104 of the Treaty lays down an excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 “on speeding up and clarifying the implementation of the excessive deficit procedure”<sup>1</sup>, which is part of the Stability and Growth Pact.

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<sup>1</sup> OJ L 209, 2.8.1997, p. 6. Account is also taken of the Opinion of the Economic and Financial Committee on the “Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes”, endorsed by the

4. According to Article 104(2) of the Treaty, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b) whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).
5. Article 104(3) stipulates that, if a Member State does not fulfil the requirements under one or both of these criteria, the Commission has to prepare a report. This report also has to “take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State”.
6. On the basis of the data notified by the Lithuanian authorities in April 2009<sup>2</sup> and subsequently validated by Eurostat<sup>3</sup> and taking into account the Commission services’ spring 2009 forecast, the Commission adopted a report under Article 104(3) for Lithuania on 13 May 2009<sup>4</sup>.
7. Subsequently, and in accordance with Article 104(4), the Economic and Financial Committee formulated an opinion on the Commission report on [28 May 2009].
8. Article 104(5) of the Treaty requires the Commission to address an opinion to the Council if the Commission considers that an excessive deficit in a Member State exists or may occur. In order to reach a conclusion on whether an excessive deficit exists or may occur, the Commission considers that account should be taken of: (i) the conclusions of its report under Article 104(3) and (ii) the opinion of the Economic and Financial Committee on this report. On the basis of these elements, the Commission has established a number of considerations for Lithuania.

#### CONSIDERATIONS CONCERNING LITHUANIA

9. According to the April 2009 EDP notification, the general government deficit in Lithuania reached 3.2% of GDP in 2008, thus exceeding the 3% of GDP reference value. The Commission report under Article 104(3) considered that the deficit was close to the 3% of GDP reference value but that the excess over the reference value cannot be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact. In particular, it did not result from a severe economic downturn in

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ECOFIN Council of 11 October 2005, available at:

[http://ec.europa.eu/economy\\_finance/other\\_pages/other\\_pages12638\\_en.htm](http://ec.europa.eu/economy_finance/other_pages/other_pages12638_en.htm) .

<sup>2</sup> According to Council Regulation (EC) No 3605/93, Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notification of Lithuania can be found at:

[http://epp.eurostat.ec.europa.eu/portal/page/portal/government\\_finance\\_statistics/procedure/edp\\_notification\\_tables](http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/procedure/edp_notification_tables)

<sup>3</sup> Eurostat news release No 56/2009 of 22 April 2009.

<sup>4</sup> All EDP-related documents for Lithuania can be found at the following website:

[http://ec.europa.eu/economy\\_finance/netstartsearch/pdfsearch/pdf.cfm?mode=\\_m2](http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2)

2008, when GDP growth declined to 3.0% in 2008 from 8.9% in 2007. This annual average growth figure does not allow by itself to qualify the 2008 deficit as exceptional. Furthermore, the excess over the reference value cannot be considered temporary. According to the Commission services' spring 2009 forecast, taking into account measures for the current year in the budget for 2009 and in the supplementary budget adopted by Parliament in May, the deficit would widen to 5.4% of GDP in 2009, and on a no-policy-change basis worsen further to 8.0% of GDP in 2010. Therefore, the deficit criterion in the Treaty is not fulfilled.

10. General government gross debt remains well below the 60% of GDP reference value and stood at 15.6% of GDP in 2008. It is nevertheless, according to the Commission services' spring 2009 forecast, projected to rise rapidly to 22.6% of GDP in 2009 and to 31.9% in 2010 mainly due to expected high primary deficits.
11. In line with the provisions in the Stability and Growth Pact, the Commission in its report gave due consideration to systemic pension reforms introducing a multi-pillar system that includes a mandatory, fully funded pillar. While the implementation of these reforms leads to a temporary deterioration of the budgetary position, the long-term sustainability of public finances clearly improves. Based on the estimates of the Lithuanian authorities, the net costs of this reform amount to 1.0% of GDP in 2008 and, due to the temporary reduction of contributions from 5.5% to 2%, 0.5% in 2009 and 0.4% in 2010. According to the Stability and Growth Pact, these can be taken into account on a linear degressive basis for a transitory period and only in case where the deficit remains close to the reference value. For 2008 (which is the only year in which the deficit can be considered close to the reference value), taking into account the net cost of the reform would produce an adjusted deficit of 2.6% of GDP. For 2009 and 2010, on the other hand, the deficit forecast by the Commission services is no longer close to the reference value and therefore the cost of the pension reform cannot be taken into account.
12. In line with the provisions in the Treaty and the Stability and Growth Pact, the Commission also analysed in its report "relevant factors". According to the Stability and Growth Pact, these can only be taken into account in the steps leading to the decision on the existence of an excessive deficit if the deficit satisfies the double condition of closeness and temporariness. In the case of Lithuania, the double condition is not met. Considered on their own merit, the relevant factors in the current case present on balance a mixed picture.
13. The opinion of the Economic and Financial Committee in accordance with Article 104(4) of the Treaty is consistent with the assessment in the Commission report under Article 104(3).

## CONCLUSION

14. The monitoring of the budgetary situation in Lithuania and, in particular, the examination of the compliance with the criteria laid down in Article 104(2) has led the Commission to prepare a report in accordance with Article 104(3) of the Treaty. The Commission, having taken into account its report and the opinion of the Economic and Financial Committee, is of the opinion that an excessive deficit exists in Lithuania.