EUROPEAN
COMMISSION

Brussels, 16.11.2016
C(2016) 8010 final

COMMISSION OPINION

of 16.11.2016

on the Draft Budgetary Plan of Lithuania

COMMISSION OPINION

of 16.11.2016

on the Draft Budgetary Plan of Lithuania

GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING LITHUANIA

3. On the basis of the Draft Budgetary Plan for 2017 submitted on 17 October 2016 by Lithuania, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. The Commission opinion is to be seen in light of the latest economic and budgetary data. In this context, as indicated in the Commission recommendation for a Council Recommendation on the economic policy of the euro area as well as in the Commission Communication 'Towards a positive fiscal stance for the euro area', it is important that the aggregate fiscal stance of the euro area is positive and supports the ongoing recovery, while ensuring the long-term sustainability of national public finances.

5. The Draft Budgetary Plan was submitted by the outgoing government on the basis of unchanged policies in view of the ongoing election process.

6. Lithuania is subject to the preventive arm of the SGP and should preserve a sound fiscal position which ensures compliance with the medium-term budgetary objective (MTO), a structural deficit of 1% of GDP. Lithuania should ensure that the deviation from the medium-term budgetary objective is limited to the allowance linked to the systemic pension reform in 2016 and in 2017.

7. The macroeconomic scenario underlying the Draft Budgetary Plan appears plausible for both 2016 and 2017. It foresees an increase to 2.3% real GDP growth in 2016 followed by a further increase to 2.7% in 2017. The scenario projects that domestic demand would continue to drive growth on the back of robust growth of nominal wages combined with continued employment growth. Compared to the scenario underlying the latest Stability Programme, the growth forecast for 2016 has been revised downwards by 0.2 percentage points. This revision mainly reflects the slower GDP growth during the first half of 2016 resulting from the weaker than expected investment, which was negatively impacted from a slowdown due to the end of the 2007-2013 EU programming period and the delayed start of the 2014-2020 one. For 2017 the forecast has been revised downwards by 0.5 percentage points, as the increased economic uncertainty as a result of the UK's vote on EU membership is

expected to weaken external as well as domestic demand. Overall, the Draft Budgetary Plan macroeconomic projections, in particular real GDP growth for 2016 are somewhat more positive compared to those of the Commission, which projects real GDP growth of 2.0% and 2.7% for 2016 and 2017 respectively. When looking at the growth composition though, growth rates of the tax bases are broadly in line with those contained in the Commission 2016 autumn forecast.

8. Lithuania complies with the requirement of Regulation (EU) No 473/2013 that the draft budget has to be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecast underlying the Draft Budgetary Plan has been endorsed by the National Audit Office of Lithuania which carries out the function of a budget policy monitoring institution via its Budget Policy Monitoring Department. In its endorsement of the forecasts, the National Audit Office nevertheless flagged the uncertainty in assessing the phase of the business cycle calling for safety margin in setting structural targets. The National Audit Office works under a legal framework which ensures its independence and has a long standing reputation as a body which is independent from the government.

9. The Draft Budgetary Plan expects a slightly lower general government deficit of 0.7% of GDP in 2016 compared to the 0.8% in the latest Stability Programme, despite the marginal slowdown in real GDP. This improvement is due to better-than-expected budgetary execution with revenue collection helped by a solid increase in tax rich components of GDP growth such as employment and wages. For 2017, the Draft Budgetary Plan indicates a general government deficit of 0.3% of GDP, which is 0.3% of GDP higher than in the latest Stability Programme. This increase results from the inclusion of the costs of a structural reform which was adopted after the submission of the Stability Programme. A number of new discretionary fiscal measures envisaged by the outgoing government, in particular an increase in the non-taxable income threshold and in public wages, are not included in the no-policy-change scenario.

   The Draft Budgetary Plan projects general government debt at 40.9% of GDP in 2016 and 42.9% of GDP for 2017. The advancement of the pre-financing of forthcoming bond redemptions and the slightly higher 2017 planned general government deficit explain the higher debt level in 2017 compared to the latest Stability Programme. The debt level projected by the Commission is close to the Draft Budgetary Plan in 2016, while it is higher in 2017 due to a projected higher fiscal deficit. Risks to the debt projections are balanced.

10. The fall in interest rates led to estimated interest expenditure savings of 0.1% of GDP in 2016 and in 2017 based on the no-policy-change Draft Budgetary Plan compared to the forecast in the 2014 Convergence Programme and around 0.6% of GDP compared to the peak in 2012. These estimates are in line with the Commission 2016 autumn forecast. A modest fall in interest expenditure, in part helped by a fall in market spreads as a result of prudent fiscal policy, only had a marginal impact on structural primary effort.

11. The Draft Budgetary Plan is accompanied by a formal request to avail of the flexibility under the preventive arm for 2017 pursuant to the "Commonly agreed position on Flexibility within the Stability and Growth Pact" endorsed by the ECOFIN Council in February 2016 in view of the planned implementation of major structural labour market and pension reforms with a positive impact on the long-term sustainability of public finances (request for 0.6% of GDP). It appears that, on the

basis of the Commission 2016 autumn forecast Lithuania has sufficient fiscal space to benefit from a temporary deviation. The complete assessment of Lithuania's possible eligibility for flexibility can be taken into account within the normal European Semester cycle in the context of the assessment of the 2017 Stability Programme.

12. The Draft Budgetary Plan for 2017 only includes the discretionary revenue and expenditure measures, which were adopted before the submission of the Draft Budgetary Plan. The net effect of these measures taken at face value adds around 0.2% of GDP to the general government deficit. The costs of the legislated structural labour market and pension reform are only partially compensated by the adopted multiannual tax increases and by the expected revenues from a set of tax compliance measures.

    Most measures included in the Draft Budgetary Plan have been included in the Commission 2016 autumn forecast. The Commission 2016 autumn forecast expects the general government deficit in 2017 to be 0.5% of GDP higher than set in the Draft Budgetary Plan. The difference mostly reflects the impact of discretionary fiscal measures foreseen by the outgoing government, but not included in the Draft Budgetary Plan, such as increases in the non-taxable income threshold and in public wages. According to the Commission, risks to the public finance forecast are tilted to the upside linked to expectations of robust growth in the tax base, but only if expenditure growth is contained after the 2016 electoral cycle.

13. In 2016, Lithuania benefits from a temporary deviation of 0.1% of GDP from the required adjustment path towards the medium term objective linked to the pension reform clause. According to the Draft Budgetary Plan the (recalculated) structural balance is expected to deteriorate in 2016 by 0.5% of GDP, which is slightly less than the allowed deterioration of 0.7% of GDP. The growth rate of government expenditure, net of discretionary revenue measures, in 2016 is expected not to exceed the applicable expenditure benchmark rate (4.1%) Therefore, the overall assessment of the (recalculated) Draft Budgetary Plan points to compliance with the provisions of the SGP in 2016. The conclusion that Lithuania is compliant with the provisions of the SGP in 2016 is confirmed by the Commission 2016 autumn forecast.

    For 2017, the (recalculated) projections of the Draft Budgetary Plan indicate that both the structural deficit and the expenditure benchmark pillars are set to be compliant with the requirements of the SGP. According to the Commission 2016 autumn forecast, the structural balance is set to deteriorate by 0.4% of GDP to -1.4% in 2017, thus deviating by 0.3% of GDP from the required adjustment of -0.2% of GDP and pointing to a risk of some deviation. Net expenditure growth in 2017 is expected to exceed the applicable benchmark rate, leading to a risk of significant deviation (gap of 0.8% of GDP). This calls for an overall assessment. The structural balance in 2017 is positively impacted by temporary revenue windfalls (0.3% of GDP) mostly reflecting strong wage growth. Moreover, the development of public investment is increasing the effort indicated by the structural balance. The expenditure benchmark is thus a better indicator of the underlying budgetary position. Therefore, the overall assessment points to a risk of significant deviation from the adjustment path towards the MTO in 2017, based on Commission 2016 autumn forecast.

14. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Lithuania, which is currently under the preventive arm, is at risk of non-compliance with the

provisions of the Stability and Growth Pact. According to the Commission 2016 autumn forecast, a significant deviation from the MTO is to be expected in 2017. The Commission will continue to closely monitor Lithuania's compliance with the obligations under the SGP, notably in connection with the assessment of the next Stability Programme. In the context of the overall assessment of a possible deviation from the adjustment path towards the MTO in 2017, the Commission will take into account the above considerations on Lithuania's possible eligibility for flexibility under the SGP. Particular attention will be paid to an actual progress made with the structural reform agenda, taking into account the country-specific recommendations adopted by the Council on 12 July 2016. In line with the Commission Communication 'Towards a positive fiscal stance for the euro area', the Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2017 budget will be compliant with the Stability and Growth Pact.

As soon as a new government takes office and as a rule at least one month before the draft budget law is planned to be adopted by the national parliament, the authorities are invited to submit to the Commission and the Eurogroup an updated Draft Budgetary Plan.

Done at Brussels, 16.11.2016

For the Commission
Pierre MOSCOVICI
Member of the Commission