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COMMISSION OPINION

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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 updated Draft Budgetary Plan for 2017 submitted on 15 December 2016, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. The updated Draft Budgetary Plan was submitted by the new government that took office on 13 December 2016 following the general elections on 9 and 23 October. It updates the no-policy-change Draft Budgetary Plan that was submitted by the outgoing Lithuanian government on 17 October 2016.

   The submission of the updated Draft Budgetary Plan did not take place in time for the Commission to adopt its opinion before the budget law was adopted by the Parliament, which is not in line with Section A.2 of the Code of Conduct of the Two-Pack. However, the situation for Lithuania is specific in view of the interplay between the timing of the recent elections and the applicable national timeline and legal requirements for the approval of the budget.

5. 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 supports the ongoing recovery, while ensuring the long-term sustainability of national public finances.

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. According to the country-specific recommendations of 12 July 2016, 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 updated 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 a surge of nominal wages combined with a continued increase in employment. The scenario is the same

as the one underpinning the no-policy-change Draft Budgetary Plan for 2017 as submitted in October. Compared to the scenario underlying the latest Stability Programme, the growth forecast for 2016 has been revised downwards by 0.2 percentage points. That revision mainly reflects the slower GDP growth during the first half of 2016 resulting from weaker than expected investment, as a result of a slowdown due to the end of the 2007-2013 EU programming period and the delayed start of the 2014-2020 EU programming period. For 2017, the forecast has been revised downwards by 0.5 percentage points, as the increased economic uncertainty as a result of the United Kingdom's vote on EU membership is expected to weaken demand. Overall, the updated Draft Budgetary Plan's macroeconomic projections, in particular real GDP growth for 2016 are somewhat more positive compared to those of the updated Commission forecast which updated the Commission 2016 autumn forecast with the draft 2017 budget measures. The updated Commission 2016 autumn forecast projects real GDP growth of 2.0% and 2.7% for 2016 and 2017 respectively. Nevertheless, when looking at the growth composition, growth rates of the tax bases are broadly in line with those contained in the updated Commission 2016 autumn forecast. The updated forecast is similar to the Commission 2016 autumn forecast, since most of the planned fiscal measures now included in the updated Draft Budgetary Plan were already taken into account.

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 updated 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 a 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 updated Draft Budgetary Plan expects a slightly lower general government deficit of 0.6% of GDP in 2016, compared to the 0.7% contained in the no-policy-change Draft Budgetary Plan. That 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 0.7% of GDP, which is 0.4% of GDP higher than in the no-policy-change Draft Budgetary Plan. That increase results from the new discretionary fiscal revenue measures introduced by the new government. The updated Draft Budgetary Plan projects general government debt at 40.8% of GDP in 2016 and 43.5% of GDP for 2017, while over the medium term the debt-to-GDP ratio is expected to decline. The advancement of the pre-financing of forthcoming bond redemptions and the higher 2017 planned general government deficit explain the higher debt level in 2017, compared to the no-policy-change Draft Budgetary Plan.

The fall in interest rates led to estimated interest expenditure savings of 0.1% of GDP in 2016 and in 2017 based on the updated Draft Budgetary Plan, compared to the forecast in the 2014 Convergence Programme, and around 0.6% of GDP compared to the peak in 2012. Those estimates are in line with the updated 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.

10. The updated 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 (the request for 0.5% of GDP is 0.1% of GDP lower than in the no-policy-change DBP due to the postponement of a part of the reform package). The complete assessment of Lithuania's eligibility for flexibility will be taken into account within the normal European Semester cycle in the context of the assessment of the 2017 Stability Programme. At present, it suffices to note that it appears that, on the basis of the updated Commission 2016 autumn forecast, Lithuania has sufficient fiscal space to benefit from a temporary deviation in 2017, subject to the constraint of the minimum benchmark. If implemented fully and on time, those reforms appear to have a positive impact on the sustainability of public finances.

11. The updated Draft Budgetary Plan for 2017 includes discretionary revenue and expenditure measures adopted by the new government, with a net negative budgetary impact of around 0.5% of GDP in 2017. The public salary increases, additional social spending and costs of legislated structural reform are only partially covered by a range of multiannual tax increases and by the expected revenues from a set of tax compliance measures.

12. The measures included in the updated Draft Budgetary Plan have been included in the updated Commission 2016 autumn forecast. The updated Commission 2016 autumn forecast expects the same general government deficit (0.6% of GDP) in 2016 as in the updated Draft Budgetary Plan and a 0.1% of GDP higher deficit (0.8% of GDP) in 2017. The difference mostly reflects the Commission's more conservative estimates of expected revenues from a set of tax compliance measures. In structural terms, the updated Draft Budgetary Plan projects a structural balance of -1.1% of GDP in 2016 and -1.3% of GDP in 2017, compared to the updated Commission 2016 autumn forecasts projections of -1.0% of GDP in 2016 and -1.4% of GDP in 2017. According to the Commission, risks to the public finance forecast are low due to expectations of robust growth in the tax base. The debt projections for 2016 are similar in the updated Draft Budgetary Plan and the updated Commission 2016 autumn forecast. For 2017, the debt projections are also close when adjusted for the forecast differences in the expected deficit and in the estimates of stock flow adjustments. Risks to the debt projections are balanced.

13. In 2016, Lithuania benefited from a temporary deviation of 0.1% of GDP from the required adjustment path towards the MTO linked to the pension reform clause. According to the updated Draft Budgetary Plan the (recalculated) structural balance is expected to deteriorate in 2016 by 0.4% of GDP, which is 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 assessment of the (recalculated) updated 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 updated Commission 2016 autumn forecast.

For 2017, the (recalculated) projections of the updated Draft Budgetary Plan indicate that both the structural deficit and the expenditure benchmark pillars point to a risk of some deviation over one year. Therefore the overall assessment points to a risk of some deviation. If a temporary deviation from the required adjustment path towards the MTO in 2017 linked to the implementation of structural reforms is taken into account, the planned structural adjustment would point to compliance in 2017. According to the updated Commission 2016 autumn forecast, the structural balance is set to deteriorate by 0.4% of GDP to -1.4% in 2017, thus deviating by 0.2% from the required adjustment and pointing to a risk of some deviation. Net expenditure growth in 2017 is expected to exceed the applicable benchmark rate (2.2%), leading to a deviation of 0.7% of GDP and pointing to a risk of a significant deviation. That situation calls for an overall assessment. The structural balance in 2017 is improved by temporary revenue windfalls (0.2% of GDP), mostly reflecting strong wage growth. Moreover, developments in government investment lead to a more positive reading of the fiscal effort based on the structural balance compared to the expenditure benchmark pillar. 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 the updated Commission 2016 autumn forecast. If the temporary deviation from the required adjustment path towards the MTO in 2017 linked to the implementation of the structural reform package is taken into account, the overall assessment based on the updated Commission 2016 autumn forecast would point to a risk of some deviation in 2017.

14. Overall, the Commission is of the opinion that the updated Draft Budgetary Plan of Lithuania, which is currently under the preventive arm, is at risk of non-compliance with the provisions of the SGP. According to the updated Commission 2016 autumn forecast, there is a risk of a significant deviation from the MTO in 2017. The Commission will continue to monitor closely 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 considerations set out in point 10 on Lithuania's possible eligibility for flexibility under the SGP. Particular attention will be paid to actual progress made with the structural reform agenda, taking into account the country-specific recommendations adopted by the Council on 12 July 2016. 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 SGP.

The Commission is also of the opinion that Lithuania has made limited progress in responding to the specific Council recommendations related to fiscal structural reforms. While the authorities have reduced the tax wedge by increasing the tax free income threshold, limited progress has been made on shifting the tax burden to other sources less detrimental to growth. The Commission therefore invites the authorities to accelerate progress. A comprehensive assessment of progress made in the implementation of the country-specific recommendations will be made in the 2017 Country Reports and in the context of the country-specific recommendations to be adopted by the Council in 2017.

Done at Brussels, 17.1.2017

For the Commission
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Member of the Commission