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REPORT FROM THE COMMISSION

Lithuania

Report prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union

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1. INTRODUCTION

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact. The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn. In its Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the current conditions permit activation of the clause. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. For the corrective arm, the Council may also decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

Data notified by the Lithuanian authorities on 31 March 2020 and subsequently validated by Eurostat[1] show that the general government surplus in Lithuania reached 0.3% of GDP in 2019, while general government gross debt stood at 36.3% of GDP. According to the 2020 Stability Programme, Lithuania plans a deficit of 11.4% of GDP in 2020, while debt is planned at 50.6% of GDP.

The planned deficit for 2020 provides *prima facie* evidence of the existence of an excessive deficit as defined by the Stability and Growth Pact.

Against this background, the Commission has therefore prepared this report, which analyses Lithuania's compliance with the deficit criterion of the Treaty. The debt criterion can be considered to be met as the debt ratio in 2019 is below the Treaty reference value of 60% of GDP. It takes into account all relevant factors and gives due consideration to the major economic shock linked to the COVID-19 pandemic.

Table 1. General government deficit and debt (% of GDP)

		2016	2017	2018	2019	2020	2021
Deficit criterion	General government balance	0.2	0.5	0.6	0.3	-6.9	-2.7

1 https://ec.europa.eu/eurostat/documents/2995521/10294648/2-22042020-AP-EN.pdf/6c8f0ef4-6221-1094-fef7-a07764b0369f

Debt criterion	General government gross debt	39.7	39.1	33.8	36.3	48.5	48.4

Source: Eurostat, Commission 2020 spring forecast

2. DEFICIT CRITERION

Based on the 2020 Stability Programme, Lithuania's general government deficit in 2020 is expected to reach 11.4%, above and not close to the Treaty reference value of 3% of GDP.

The planned excess over the Treaty reference value in 2020 is exceptional, as it results from a severe economic downturn. Taking into account the impact of the COVID-19 pandemic, the Commission 2020 spring forecast projects a contraction of real GDP growth in 2020 by 7.9%.

The planned excess over the 3% of GDP reference value would be temporary, based on the Commission 2020 spring forecast, which projects the general government deficit to fall under 3% of GDP in 2021. However, those projections are surrounded by an exceptionally high degree of uncertainty.

In sum, the planned deficit for 2020 is above and not close to the 3% of GDP Treaty reference value. The planned excess is considered to be exceptional as defined by the Treaty and the Stability and Growth Pact, while the nature of the excess is currently considered temporary. Hence, the analysis suggests that *prima facie* the deficit criterion as defined by the Treaty and Regulation (EC) No 1467/97 is not fulfilled.

3. RELEVANT FACTORS

Article 126(3) of the Treaty provides that, if a Member State does not fulfil the requirements under one or both of those criteria, the Commission has to prepare a report. That report must also "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".

Those factors are further clarified in Article 2(3) of Regulation (EC) No 1467/97, which also provides that "any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess compliance with the deficit and debt criteria and which the Member State has put forward to the Council and to the Commission" need to be given due consideration.

In the current situation, a key additional factor to take into consideration regarding is the economic impact of the COVID-19 pandemic, which has a very substantial impact on the budgetary situation and results in a highly uncertain outlook. The pandemic has also led to the activation of the general escape clause.

3.1. COVID-19 pandemic

The COVID-19 pandemic has led to a major economic shock that is having a significant negative impact throughout the European Union. The consequences for GDP growth will depend on the duration of both the pandemic and of the measures taken by national authorities and at European and global level to slow its spread, protect production capacities and support aggregate demand. Member States have already adopted or are adopting budgetary measures to increase the capacity of health systems and provide relief to those individuals and sectors that are particularly affected. Significant liquidity support measures and other guarantees have also been adopted. Subject to more detailed information, the competent statistical authorities are to examine whether those measures entail an immediate impact on the general government balance or not. Together with the fall in economic activity, those measures will contribute to substantially higher government deficit and debt positions.

3.2 Medium-term economic position

In 2019, economic growth reached 3.9% and was broad-based. In its Spring 2020 forecast, the Commission assumes a strong shock to the Lithuanian economy in 2020 due to the COVID-19 pandemic. This a mitigating factor in the assessment of Lithuania's compliance with the deficit criterion in 2020. The largest negative contribution to growth is projected to come from the decline in domestic demand and much less from net exports. Despite a projected strong rebound in 2021, GDP will remain below the level of 2019.

The downturn is projected take a toll on employment. The unemployment rate is expected to climb above 9% in 2020 then go below 8% in 2021. Reduced pressures in the labour market and lower energy prices will put inflation below 2% in the near term. However, it should be noted that the Commission forecast is marked by an exceptional degree of uncertainty on the duration of the pandemic and its economic impact.

3.3 Medium-term budgetary position

Based on outturn data and Commission calculations, Lithuania's structural deficit in 2019 stood at 1.6% of GDP and was close to the medium term budgetary objective (MTO) of -1.0% of GDP, taking into account the allowance linked to structural reforms of 0.5% of GDP in 2019 (gap of 0.1% of GDP). The overall assessment points to compliance with the requirements of the Stability and Growth Pact in 2019 as Lithuania's structural balance is assessed to be close to the MTO, taking into account the allowance linked to structural reforms.

Lithuania's 2020 Stability Programme assumes the deficit of 11.4% of GDP in 2020 which is set to decline to 3.9% of GDP in 2021. The expected deficit levels are higher than those projected in the Commission 2020 forecast. The difference stems from the fact that the Lithuanian authorities have factored in larger amounts of State spending on measures to stimulate the economy and mitigate the consequences of the COVID-19 pandemic. Overall, the government measures aim to ensure sufficient funding of the healthcare sector, secure disposable income, suppor firm's liquidity and stimulate the economy.

According to the Commission spring forecast, Lithuania's headline deficit is expected to stand at -6.9% of GDP in 2020. The COVID-19 pandemic is forecast to result in a notable decline of general government revenues which are set to recover in line with an expected strong rebound of the economy in 2021. At the same time, higher-than-planned spending on healthcare and the government's measures to support household disposable income and help businesses to retain their liquidity are projected to boost government expenditure. For 2021, expenditure is projected to decline as most measures related to COVID-19 are expected to expire in 2020. In addition, as funding for some areas is linked to GDP and the overall economic situation, updated spending projections are lower than envisaged before. Therefore, Lithuania's general government deficit is projected to fall to 2.7% in 2021.

3.4 Other factors put forward by the Member State

On 11 May 2020, the Lithuanian authorities transmitted a letter with relevant factors in accordance with Article 2(3) of Regulation (EC) No 1467/97. The analysis presented in the previous sections already broadly covers the key factors put forward by the authorities.

4. CONCLUSIONS

According to the plans in the Stability Programme Lithuania's general government deficit in 2020 is planned to reach 11.4% of GDP, above and not close to the 3% of GDP Treaty reference value. The planned excess over the reference value is considered to be exceptional and currently considered to be temporary.

In line with the Treaty and the Stability and Growth Pact, this report also examined relevant factors.

Overall, since the planned deficit is well above 3% of GDP and taking into account all relevant factors, the analysis suggests that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is not fulfilled.