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REPORT FROM THE COMMISSION

Lithuania

Report prepared in accordance with Article 126(3) of the Treaty

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1. LEGAL BACKGROUND

Article 126 of the Treaty on the Functioning of the European Union (TFEU) lays down the 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"[1], which is part of the Stability and Growth Pact (SGP).

According to Article 126(2) TFEU, 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).

Article 126(3) TFEU stipulates that, if a Member State does not fulfil the requirements under one or both of the above 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".

This report, which represents the first step in the EDP, analyses whether Lithuania is non-compliant with the deficit criterion of the Treaty, with due regard to the economic background and other relevant factors.

Data notified by the authorities on 30 September 2013[2] and subsequently validated by Eurostat[3] show that the general government deficit in Lithuania reached 3.2% of GDP in 2012, thus exceeding the 3% of GDP reference, while the debt was at 40.5% of GDP, below the 60% of GDP reference value.

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1 OJ L 209, 2.8.1997, p. 6. The report also takes into account 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 ECOFIN Council of 3 September 2012, available at: http://ec.europa.eu/economy_finance/economic_governance/sgp/legal_texts/index_en.htm.

2 According to Council Regulation (EC) No 479/2009, 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/excessive_deficit/edp_notification_tables.

3 Eurostat news release No 152/2013 of 21 October 2013

Table 1. General government deficit (% of GDP)

		2010	2011	2012	2013		2014		2015	
					COM	National authorities	COM	National authorities	COM	National authorities
Deficit criterion	General government balance	-7,2	-5.5	-3.2	-3.0	-2.9	-2.5	-1.9	-1.9	-0.9

Source: Eurostat and Commission 2013 autumn forecasts.

The figure for the 2012 deficit provide *prima facie* evidence on the existence of an excessive deficit in Lithuania in the sense of the Treaty and the SGP. The Commission has therefore prepared the following report in order to comprehensively assess the excess over the reference value, in order to conclude whether the breach of the deficit criterion merits the launch of an EDP. Section 2 of the report examines the deficit criterion. Section 3 deals with medium-term economic and budgetary positions and systemic pension reform. The report takes into account the Commission 2013 autumn forecast, released on 5 November 2013.

2. DEFICIT CRITERION

In 2012, the general government deficit reached 3.2% of GDP, down from 5.5% of GDP in 2011.

Although in excess of 3% of GDP, the deficit is close to the Treaty reference value.

The excess over the 3% of GDP reference value is not exceptional. In particular:

- it does not result from an unusual event in the sense of the Treaty and the SGP;
- it does not result from a severe economic downturn in the sense of the Treaty and the SGP. Economic growth has been strong over the past years, reaching 6.0% in 2011 and 3.7% in 2012. Real GDP growth is expected to remain robust going forward. The latest Commission forecast sees GDP growth at 3.4% for 2013 and 3.6% in 2014 respectively and a further pick-up in growth to 3.9% in 2015. Commission estimates that potential GDP growth is set to increase gradually from 2.8% in 2013 to 3.2% in 2015, while the output gap is estimated to close in 2013.

Table 2: Macroeconomic and budgetary developments [a]

	2010	2011	2012	2013		2014		2015	
	COM	COM	COM	COM	National authorities	COM	National authorities	COM	National authorities
Real GDP (% change)	1.6	6.0	3.7	3.4	3.7	3.6	3.4	3.9	4.3
Potential GDP (% change)	-1.0	-0.5	2.2	2.8		3.0		3.2	
Output gap (% of potential GDP)	-8.1	-2.1	-0.7	0.0		0.5		1.2	
General government balance	-7.2	-5.5	-3.2	-3.0	-2,9	-2.5	-1.9	-1.9	-0.9
Primary balance	-5.4	-3.7	-1.4	-1.2		-0.8		-0.2	
One-off and other temporary measures	0.0	0.0	0.1	0.0		-0.1		0.0	
Government gross fixed capital formation	4.4	4.7	4.2	4.2		4.4		4.6	
Cyclically-adjusted balance	-4.7	-4.8	-3.0	-3.0		-2.7		-2.2	
Cyclically-adjusted primary balance	-2.9	-3.1	-1.2	-1.2		-1.0		-0.6	
Structural balance [b]	-4.7	-4.8	-3.1	-3.0		-2.6		-2.2	
Structural primary balance	-2.9	-3.1	-1.3	-1.2		-0.9		-0.6	

Notes:

[a] In percent of GDP unless specified otherwise.

[b] Cyclically-adjusted balance excluding one-off and other temporary measures.

Source: Eurostat and Commission 2013 autumn forecasts

The excess over the 3% of GDP reference value is temporary in the sense of the Treaty and the SGP. In particular, the budgetary forecasts as provided by the Commission forecast indicate that the deficit will not exceed the 3% of GDP threshold over the forecast horizon.

Having peaked at 9.4% of GDP in 2009 the general government deficit in Lithuania has been brought down to 7.2% of GDP in 2010, to 5.5% of GDP in 2011 and to 3.2% of GDP in 2012. This improvement was driven by consolidation measures on the expenditure side, in particular a continued restriction of expenditure growth in accordance with Lithuania's Law on Fiscal Discipline, and favourable cyclical conditions. As robust economic growth is forecast to continue the general government deficit is set to decline to 3% of GDP in 2013, 2.5% in 2014 and 1.9% in 2015.

In sum, the deficit is close to the 3% of GDP reference value but the excess over the reference value is not exceptional while it is temporary in the sense of the Treaty and the SGP. At the same time, the Commission services' 2013 autum forecast project the general government gross debt to stay around 40% of GDP (39.9% in 2013, 40.2% in 2014 and 39.6% in 2015), well below the 60% of GDP reference value. This warrants an analysis of relevant factors, including systemic pension reform, in deciding whether an excessive deficit exists, according to Art. 2(4) and 2(5) of Council Regulation (EC) No 1467/97.

3. RELEVANT FACTORS

Article 126(3) of the TFEU provides that the Commission report "shall also take into account whether the government deficit exceeds government investment expenditure and take into account other relevant factors, including the medium-term economic and budgetary position of the Member State". These factors are further clarified in Article 2(3) of Council Regulation (EC) No 1467/97, which also specifies that "any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess in qualitative terms the excess over the reference value and which the Member State has put forward to the Commission and to the Council" need to be given due consideration. Finally, Article 2(5) of the Regulation provides that the implementation of pension reforms introducing a multi-pillar system that includes a mandatory, fully funded pillar should be considered in all assessments in the framework of the excessive deficit procedure.

In view of the above provisions, the following subsections consider in turn (1) the medium-term economic position; (2) the medium-term budgetary position (including public investment); and (3) pension reforms as mentioned above.

3.1. Medium-term economic position

The Lithuanian economy is set to grow at a robust pace going forward. The Commission forecasts GDP growth at 3.6% in 2014 and 3.9% in 2015 respectively. Following a number of years with strong growth, the output gap is estimated to close in 2013 and become positive thereafter, underlining a strong economic outlook for Lithuania. While wage pressures are likely to increase and could undo some of the recent competitiveness gains, no major economic slowdown is expected. Growth risks stem mainly from the external economic environment and are tilted to the downside although their likelihood has slightly decreased.

3.2. Medium-term budgetary position

Having peaked at 9.4% of GDP in 2009 the general government deficit in Lithuania has been brought down to 7.2% of GDP in 2010, then to 5.5% of GDP in 2011 and to 3.2% of GDP in 2012. This improvement was driven by consolidation measures on the expenditure side, in particular a continued restriction of expenditure growth in accordance with Lithuania’s Law on Fiscal Discipline, and favourable cyclical conditions. Lithuanian authorities project the general government deficit to continue falling to 2.9% of GDP in 2013, 1.9% of GDP in 2014 and 0.9% in 2015, while the Commission services’ 2013 autumn forecast projects a slower improvement of the general government deficit to 3.0% of GDP in 2013 and to 2.5% of GDP in 2014 and 1.9% of GDP in 2015. The deficit is thus set to remain below the reference value of 3% of GDP over the forecast horizon.

3.3. Systemic pension reform

Since the deficit of 3.2% of GDP can be considered to be close to the reference value and Lithuania's debt-to-GDP ratio is below the 60% of GDP reference value in a sustained manner, Lithuania is eligible to Articles 2(5) and 2(7) of Regulation 1467/97 regarding systemic pension reforms. Thus, the direct net cost of the pension reform should be taken into account when assessing the correction of the excessive deficit. The net costs of Lithuania's systemic pension reform were confirmed at 0.2% of GDP in 2012 by the Commission (Eurostat), and are thus sufficient to explain the excess over the 3 % of GDP Treaty reference value in 2012.

3.4. Other factors put forward by the Member State

By the letter No (25.11-01)-GK-1309257 sent on 8 November 2013, Lithuania argued that the excess over the 3% of the Treaty reference value in 2012 was explained by the net costs of Lithuania's systemic pension reform, and that the Council took the decision that the excessive deficit had been corrected, abrogating Decision 2009/588/EC. This fact has already been considered by the Commission as a relevant factor.

Moreover, the authorities informed of a revision in the general government deficit projected for 2013 from 2.5% of GDP in the 2013 Convergence Programme to 2.9% currently and explained the reasons for such revision. Furthermore, they confirmed their commitment, supported by the draft Budget Law, to improve the deficit by 1 pp. of GDP annually and reach the budget surplus in 2016. The mentioned facts have been taken into consideration in the Commission 2013 Autumn Forecast.

4. CONCLUSIONS

The general government deficit in Lithuania reached 3.2% of GDP in 2012, above but close to the 3% of GDP reference value. The excess over the reference value cannot be qualified as exceptional within the meaning of the Treaty and the SGP, while it can be considered temporary. Since Lithuania's debt-to-GDP ratio is below the 60% of GDP reference value in a sustained manner, Lithuania is eligible to the SGP provisions in the Regulation (EC) No 1467/97 regarding systemic pension reforms. Thus, the direct net cost of the pension reform should be taken into account when assessing the correction of the excessive deficit. As the net costs of Lithuania's systemic pension reform have been 0.2% of GDP in 2012, as confirmed by the Commission (Eurostat), they explain the excess over the 3 % of GDP Treaty reference value in 2012.

This suggests that the deficit criterion in the Treaty is fulfilled.