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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 Draft Budgetary Plan for 2016 submitted on 15 October 2015 by Lithuania, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.
4. Lithuania is subject to the preventive arm of the Pact and should avoid deviating from the medium-term budgetary objective (MTO) in 2015 and ensure that the deviation in 2016 is limited to the allowance linked to the systemic pension reform.
5. The macroeconomic scenario underlying the Draft Budgetary Plan foresees a slowdown of real GDP growth in 2015 followed by a recovery in 2016. The scenario assumes that domestic demand will be the main growth engine on the back of robust employment growth and higher nominal wages. Compared to the scenario underlying the Stability Programme, the growth forecast for 2015 has been revised downwards from 2.5% to 1.9%. This revision mainly reflects the weaker GDP growth during the first half of 2015 resulting from stronger than expected decline in exports to Russia. For 2016, the growth forecast of 3.2% remains broadly unchanged compared to the Stability Programme since an upward revision of private consumption compensates for somewhat slower export growth. Overall, the Draft Budgetary Plan's macroeconomic projections are similar to those of the Commission, which forecasts 1.7% and 2.9% real GDP growth for 2015 and 2016 respectively. The Draft Budgetary Plan forecasts inflation at -0.4% in 2015 and 1.4% in 2016, above the projections included in the Commission 2015 autumn forecast (-0.8% and 0.6% respectively). At the same time, the growth rates of the most important tax bases (private consumption and wages and salaries) projected in the Draft Budgetary Plan for 2016 are broadly in line with those in the Commission forecast. Overall, in the Commission's view, the Draft Budgetary Plan is based on plausible macroeconomic assumptions.
6. Regulation (EU) No 473/2013 requires the draft budget 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. In its endorsement of the forecasts the National Audit Office nevertheless flagged

that the forecast is subject to downside risks and recommended a prudent planning of budget revenues in 2016. The National Audit Office works under a legal framework which ensures its independence and has long standing reputation as a body independent from the government.

7. The Draft Budgetary Plan expects a slightly lower general government deficit of 0.9% of GDP in 2015 compared to the 1.2% in the Stability Programme, despite the slowdown in real GDP. This improvement is due to better budgetary outcomes of local governments and additional one-off revenues. In addition, the first half of 2015 saw a solid increase in tax rich components of GDP growth such as private consumption, employment and wages, supporting revenue collection, which the Draft Budgetary Plan takes into account. On the expenditure side, the Draft Budgetary Plan foresees higher investment spending compared to the Stability Programme. In 2016, the Draft Budgetary Plan targets the general government deficit at 1.3% of GDP, 0.2% of GDP above the one of the Stability Programme. This slight increase results from a number of new expansionary discretionary fiscal measures contained in the Draft Budgetary Plan, in particular an increase in the non-taxable income threshold, higher pensions and public wages, which are only partially offset by a number of smaller tax increases.

The fall in interest rates led to estimated interest expenditure savings of 0.5% of GDP in 2015 compared to the forecast in the 2013 Convergence Programme. The structural primary effort observed over the period 2012-2015 is smaller than initially planned in 2013, while interest savings, in part helped by a fall in market spreads as a result of past prudent fiscal policy, increased, suggesting that the latter substituted structural primary effort. Based on the Draft Budgetary Plan, interest expenditure is set to decrease by another 0.1% of GDP in 2016.

8. The Commission 2015 autumn forecast projects a general government deficit of 1.1% of GDP in 2015 and 1.3% of GDP for 2016. The projected deficit for 2015 is 0.2% of GDP higher than planned in the Draft Budgetary Plan as the Commission forecast is more cautious on the positive impact of tax enforcement measures and the budgetary outcome of local governments. For 2016, the Commission's projection is in line with the one of the Draft Budgetary Plan.
9. The Draft Budgetary Plan foresees general government debt at 42.9% of GDP in 2015 and 40.8% of GDP for 2016, similar to the Commission forecast. The debt increase in 2015 compared to the Stability Programme can be mostly explained by a higher-than-usual pre-financing of EU funded expenditures. The increase in 2016 is explained by a shift in timing of pre-financing of forthcoming bond redemptions and a slightly higher 2016 general government deficit. Risks to the debt projections are balanced.
10. The Draft Budgetary Plan for 2016 puts forward several discretionary measures on the revenue and expenditure side. The net effect of these measures taken at face value is to increase the general government deficit by slightly less than 0.5% of GDP. The increase of the non-taxable income thresholds, higher pensions and social benefits as well as public wage increases in some categories is only partially compensated by several small tax increases envisaged in the Draft Budgetary Plan. All measures as planned in the Draft Budgetary Plan have been included in the Commission autumn forecast for 2016.
11. The (recalculated) structural balance of the Draft Budgetary Plan is expected to improve by 0.1% of GDP in 2015, slightly below the required improvement of 0.2%

of GDP. On the other hand, the growth rate of government expenditure, net of discretionary revenue measures, will not exceed the applicable expenditure benchmark rate in 2015, pointing to compliance. This warrants an overall assessment. The structural balance in 2015 is negatively affected by a temporary increase in investments, which is smoothened when calculating the expenditure benchmark. Therefore, the latter is considered to be a more relevant indicator of the underlying budgetary position. The overall assessment thus points to compliance of the DBP with the adjustment path towards the MTO in 2015. In the Commission 2015 autumn forecast, the structural balance is projected to improve by 0.2% of GDP, in line with the required adjustment, reaching – a structural deficit of 1.2% of GDP. As a result, Lithuania is assessed to be at its MTO (set at -1% of GDP) due to the 0.25% GDP margin of tolerance. In addition, the net growth rate of expenditure is expected to be in line with the expenditure benchmark. Lithuania is thus considered to be compliant with the requirements in 2015.

In 2016, the (recalculated) structural deficit of the Draft Budgetary Plan points to a risk of a significant deviation (gap of 0.6% of GDP) from the required adjustment of 0.1% of GDP. The growth rate of government expenditure, net of discretionary revenue measures, points to a risk of some deviation (gap of 0.4% in 2016). This warrants an overall assessment. As the structural balance is affected by sizeable revenue shortfalls, the expenditure benchmark is the more appropriate indicator of the underlying budgetary position. On this basis, the overall assessment points to a risk of some deviation from the adjustment path towards the MTO in 2016 based on the Draft Budgetary Plan. According to the Commission 2015 autumn forecast, the structural balance is set to deteriorate by 0.2% of GDP, pointing to a risk of some deviation (gap of 0.3% of GDP). The expenditure benchmark points to a risk of a significant deviation in 2016 (gap of 1.2% of GDP). This warrants an overall assessment. First, the structural balance is positively affected by revenue windfalls (whereas shortfalls are expected in the Draft Budgetary Plan as the plan forecasts a larger positive output gap for 2016). Correcting for these windfalls, the projected deviation based on the structural balance pillar would become significant. Second, while the deviation from the expenditure benchmark is partly the result of deficit-increasing one-offs and fluctuations in public investment, it would remain significant when corrected for these elements. Therefore, the overall assessment points to a risk of significant deviation from the MTO in 2016. This conclusion is reached before taking into account the full effect of the tax administration reform.

12. The Draft Budgetary Plan contains the objective to reduce the tax burden on labour. It foresees an increase in the thresholds for non-taxable income, mostly targeted to low income individuals and families seeking to increase real disposable income for low wage earners, with an additional positive effect on household consumption and employment. Only part of this planned reduction is set to be covered by tax shift towards taxes less detrimental to growth. In addition, the Draft Budgetary Plan contains measures to improve tax compliance and address challenges identified in the labour market and social security systems.
13. 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 2015 autumn forecast, the required adjustment towards the MTO is not projected to be delivered and a significant deviation from the MTO is to be expected in 2016. The Commission therefore invites the authorities to take the necessary measures within

the national budgetary process to ensure that the 2016 budget will be compliant with the Stability and Growth Pact.

The Commission is also of the opinion that Lithuania has made limited progress with regard to the country-specific recommendations issued by the Council in the context of the 2015 European Semester relating to fiscal governance and thus invites the authorities to accelerate progress. A comprehensive assessment of progress made with the implementation of the CSRs will be made in the 2016 Country Reports and in the context of the Country Specific Recommendations adopted by the Commission in May.

Done at Brussels, 16.11.2015

*For the Commission
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Member of the Commission*