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Assessment of the 2019 Stability Programme for

Lithuania

(Note prepared by DG ECFIN staff)

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EXECUTIVE SUMMARY

Lithuania is subject to the preventive arm of the Stability and Growth Pact. With a gross public debt below 60% of GDP, Lithuania is compliant with the debt criterion. According to the Commission 2019 spring forecast, after solid economic performance in 2018, Lithuania's GDP growth is set to moderate to 2.7% in 2019 and 2.4% in 2020. Private consumption and investment are projected to be the main growth drivers. Solid wage growth and increasing employment are expected to support consumption. After moderating in 2018, inflation is projected to stand at around 2% in 2019 and 2020. The macro-economic scenario included in the Stability Programme is plausible and close to the Commission spring 2019 forecast.

In 2018, the general government balance stood at 0.7% of GDP. In structural terms, the deficit amounted to 0.8% of GDP, i.e. Lithuania maintained the structural balance above its medium-term budgetary objective set at -1% of GDP and complied with the requirements of the preventive arm of the Stability and Growth Pact.

According to the Stability Programme, the general government budget balance is set to decrease to 0.4% of GDP in 2019 and 0.2% in 2020, before falling further to 0.1% in 2021. The recalculated structural balance[1] is expected to improve from -0.8% of GDP in 2019 to 0.1% of GDP in 2022 due to closing output gap.

Based on the Commission 2019 spring forecast, the structural balance is projected to respect the medium-term budgetary objective in 2019 and 2020. Therefore, Lithuania is expected to be compliant with the provisions of the Stability and Growth Pact in both 2019 and in 2020. Based on the assessment of the structural primary balance, the fiscal stance is slightly expansionary. Risks to the short-term fiscal outlook mainly come from the reliance on measures with an uncertain yield, such as an improved tax administration, and implementation in view of upcoming elections in 2020.

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[1] Recalculated by the Commission on the basis of the information in the programme according to the commonly agreed methodology

1. INTRODUCTION

On 30 April 2019, Lithuania submitted its 2019 Stability Programme (hereafter called Stability Programme), covering the period 2018-2022. The government approved the programme on 24 April and it was submitted to the Parliament on 15 May.

Lithuania is currently subject to the preventive arm of the Stability and Growth Pact (SGP) and should preserve a sound fiscal position which ensures compliance with the medium-term budgetary objective (MTO).

This document complements the Country Report published on 27 February 2019 and updates it with the information included in the Stability Programme.

Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2019 spring forecast. The following section presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it includes an overview on the medium term budgetary plans, an assessment of the measures underpinning the Stability Programme and a risk analysis of the budgetary plans based on Commission forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview on long-term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

According to the macroeconomic scenario underlying the Stability Programme, after solid economic growth of 3.5% in 2018, Lithuania's GDP growth is set to moderate to 2.6% in 2019 and 2.4% in 2020. GDP growth is expected to stand at 2⅓% for the years 2021-2022. Robust domestic demand is projected to remain the main growth driver in the near term. Having increased by 3.9% in 2018, private consumption growth is expected to remain at similar levels in 2019 and 2020 on the back of increasing household earnings. Due to the favourable situation in the labour market, wage growth is projected to remain solid, though a bit lower compared to 2018. A greater use of EU funds and pressure on businesses to invest in automation due to labour shortages are expected to keep investment growth around 5% in coming years. By contrast, the contribution of net exports is forecast to be negative in 2019 and 2020 due to decelerating foreign demand. Inflation is projected to remain slightly above 2% in 2019 and 2020.

The macroeconomic scenario underpinning the 2019 Stability Programme is slightly more cautious compared to the one published in September 2018 underpinning 2019 Draft Budgetary Plan. The forecast of real GDP growth was revised downwards by 0.2 and 0.1 percentage points for 2019 and 2020, respectively. These revisions reflect lower export growth projections.

The positive output gap as recalculated by the Commission based on the information in the programme, following the commonly agreed methodology, peaked in 2018 (at 3.7%), and is set to decrease gradually before closing in 2022. According to the Commission forecast, the estimates of the output gap in 2019 and 2020 are slightly higher. The most recent available data on capacity utilisation, used in Commission estimations, point to lower potential GDP growth and, consequently, wider output gap.

The macroeconomic scenario of the Stability Programme is broadly in line with the Commission 2019 spring forecast. The Commission projects real GDP growth to be only

marginally higher in 2019 compared to the Stability Programme, while growth forecasts for 2020 are identical. According to the programme's underlying scenario, in 2019 and 2020, anticipated export and import growth is slightly higher compared to the Commission 2019 spring forecast; however, overall contributions of net exports to real GDP growth are set to be similar. The Commission projects a somewhat higher unemployment rate and slightly lower inflation than the Stability Programme in 2019 and 2020. To conclude, the Stability Programme is based on plausible macroeconomic assumptions.

Table 1: Comparison of macroeconomic developments and forecasts

	2018		2019		2020		2021	2022
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	3.4	3.4	2.7	2.6	2.4	2.4	2.3	2.3
Private consumption (% change)	3.9	3.9	3.8	3.9	3.3	3.8	3.5	3.5
Gross fixed capital formation (% change)	6.5	6.5	5.0	5.5	4.4	4.9	4.0	4.0
Exports of goods and services (% change)	4.9	4.9	3.6	4.1	3.6	4.4	4.3	4.3
Imports of goods and services (% change)	4.3	4.3	4.5	5.0	4.3	4.8	4.5	4.5
Contributions to real GDP growth:								
- Final domestic demand	3.8	3.9	3.4	3.8	3.0	3.6	3.2	3.2
- Change in inventories	-1.0		0.0		0.0			
- Net exports	0.6	0.6	-0.7	-0.6	-0.5	-0.2	-0.1	-0.1
Output gap[1]	3.6	3.7	3.1	2.7	2.1	1.4	0.5	0.0
Employment (% change)	1.1	1.0	0.4	0.5	0.1	0.2	-0.1	-0.2
Unemployment rate (%)	6.2	6.2	6.2	5.9	6.0	5.9	5.9	5.9
Labour productivity (% change)	2.4	2.4	2.4	2.1	2.3	2.3	2.4	2.5
HICP inflation (%)	2.5	2.5	2.1	2.2	2.1	2.2	2.1	2.0
GDP deflator (% change)	3.4	3.4	3.0	2.3	2.7	2.2	2.1	2.0
Comp. of employees (per head, % change)	7.7	7.7	7.0	8.0	5.9	6.4	5.8	5.5
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	1.3	1.2	1.4	1.8	1.2	1.1	0.9	0.6

Note:

[1]In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source :

Commission 2019 spring forecast (COM); Stability Programme (SP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS IN 2018 AND YEAR 2019

In 2018, Lithuania's general government surplus reached 0.7% of GDP, slightly above the 0.5% of GDP surplus in 2017. The 2018 outcome was somewhat higher than the 0.6% of GDP target set in the 2018 Stability Programme and the 2019 Draft Budgetary Plan.

Like in preceding years, notable differences between planned and actual government revenues and expenditure levels were registered in 2018: the recorded revenue amounted to 34.7% of GDP or 0.9 percentage points below planned levels; the gap between the planned and recorded expenditure side was 1.0 percentage point, with the nominal outturn level standing at

34.0% of GDP. One of the reasons for these lower outturns was the slower than planned take-up of EU funds.

In 2018, the central government registered a deficit of 8.4% of GDP while the surplus of social security funds was recorded at 8.8% of GDP. These results reflect the cancellation of debt of the State Social Insurance Fund of 8.2% of GDP and its internalisation by the central government. This was not reflected in the 2018 Stability Programme and in the 2019 Draft Budgetary Plan. The surplus of the local government came out at 0.2% of GDP, which is in line with the 2019 Draft Budgetary Plan and the 2018 Stability Programme.

According to the Stability Programme, the general government surplus is set to decline to 0.4% of GDP in 2019. This is in line with the 2019 Draft Budgetary Plan and is 0.2 percentage points lower than indicated in the 2018 Stability Programme. The envisaged decline in the general government balance is mostly linked to the revenue losses stemming from labour taxation reform legislated in the middle of 2018.

In 2019, the aforementioned reform brought a number of significant changes that resulted in a set of new discretionary measures that were not envisaged in the 2018 Stability Programme. The consolidation of social insurance contributions paid by employers and employees, the adjustment of contribution rates and an increase in the personal income tax rate are forecast to result in overall revenue losses amounting to 1% of GDP. These are partially to be offset by the termination of transfers from the State Social Insurance Fund to the second pillar of the pension system. Furthermore, the government plans to make additional efforts to improve tax administration and, consequently, to increase tax revenues.

3.2.   MEDIUM-TERM STRATEGY AND TARGETS

According to the 2019 Stability Programme, the headline surplus is set to decline from 0.4% of GDP in 2019 to 0.1% of GDP in 2021 and remain at this level in 2022. Due to the shrinking positive output gap, the structural balance at face value is projected to improve from -0.4% of GDP in 2019 to 0.1% of GDP in 2022. Compared to the 2018 Stability Programme, the structural balance at face value is lower by 0.2 and 0.4 percentage points in 2019 and 2020, respectively. The difference is mainly linked to a lower projected nominal surplus. In 2019 and 2020, the programme envisages staying above the MTO set at -1.0% of GDP, which reflects the objectives of the Pact.

According to the Commission 2019 spring forecast, the structural deficit is set to stay at the MTO in 2019 before improving slightly to 0.9% of GDP in 2020. For both 2019 and 2020, the structural deficit is 0.2 and 0.5 percentage point higher compared to the (recalculated) structural deficit in the programme. The differences are mainly due to a different forecast of the general government headline balance and different output gap calculations.

The deterioration of the general government balance over the programme period is driven by a significantly faster growth of expenditures compared to revenues. The main negative impact on government revenues stems from a decrease in the projected receipts of social insurance contributions due to the above-mentioned labour taxation reform. At the same time, higher social payments push up expenditures. These two factors also determine the projected decline in surplus of social security funds over the programme period.

While the Stability Programme foresees an increase of 1.5 percentage points in the expenditure ratio and 0.9 percentage points in the revenue ratio over the programme horizon, the Commission 2019 spring forecast assumes smaller changes of those ratios in the coming

years due to a more cautious revenue forecast and the historical track record of budget execution.

The Stability Programme contains information on the discretionary revenue and expenditure measures for 2019. However, measures from 2020 onwards are not sufficiently specified, especially taking into account reservations expressed in an explanatory note[2] which was submitted to the Parliament before adoption of the 2019 budgetary plans.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2018	2019		2020		2021	2022	Change: 2018-2022
	COM	COM	SP	COM	SP	SP	SP	SP
Revenue	**34.7**	**34.7**	**36.0**	**34.9**	**36.0**	**35.9**	**35.6**	**0.9**
of which:								
- Taxes on production and imports	11.6	11.6	11.8	11.6	12.0	12.3	12.4	0.8
- Current taxes on income, wealth, etc.	5.7	8.3	8.5	8.3	8.6	8.6	8.9	3.2
- Social contributions	13.1	10.1	10.4	10.3	10.6	10.6	10.6	-2.5
- Other (residual)	4.3	4.8	5.3	4.7	4.8	4.4	3.7	-0.6
Expenditure	**34.0**	**34.4**	**35.5**	**34.9**	**35.9**	**35.9**	**35.5**	**1.5**
of which:								
- Primary expenditure	33.1	33.6	34.6	34.2	35.2	35.4	35.2	2.1
of which:								
Compensation of employees	9.8	9.4	9.6	9.5	9.6	9.6	9.6	-0.2
Intermediate consumption	4.4	4.9	5.0	4.8	4.8	4.6	4.5	0.1
Social payments	13.5	14.0	14.1	14.5	14.7	15.1	15.4	1.9
Subsidies	0.4	0.4	0.3	0.4	0.3	0.3	0.2	-0.2
Gross fixed capital formation	3.2	3.0	3.7	3.3	3.7	3.7	3.2	0.0
Other (residual)	1.8	1.8	2.0	1.8	2.0	2.1	2.3	0.5
- Interest expenditure	0.9	0.8	0.9	0.7	0.7	0.5	0.3	-0.6
General government balance (GGB)	**0.7**	**0.3**	**0.4**	**0.0**	**0.2**	**0.1**	**0.1**	**-0.6**
Primary balance	**1.5**	**1.1**	**1.3**	**0.7**	**0.8**	**0.6**	**0.3**	**-1.2**
One-off and other temporary	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
GGB excl. one-offs	**0.7**	**0.2**	**0.3**	**0.0**	**0.2**	**0.1**	**0.1**	**-0.6**
Output gap[1]	3.6	3.1	2.7	2.1	1.4	0.5	0.0	-3.7
Cyclically-adjusted balance[1]	-0.8	-0.9	-0.7	-0.8	-0.4	-0.1	0.1	1.0
Structural balance[2]	**-0.8**	**-1.0**	**-0.8**	**-0.9**	**-0.4**	**-0.1**	**0.1**	**1.0**
Structural primary balance[2]	0.1	-0.1	0.1	-0.2	0.3	0.4	0.4	0.4

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Stability Programme (SP); Commission 2019 spring forecasts (COM); Commission calculations.

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[2] According to the Annex 1 of the Explanatory Note Regarding Draft Project of the Law on Indicators of the State and Municipal Budgets of 2019, additional measures amounting to EUR 258 million (0.5% of GDP) will have to be considered in order to achieve projected general government surplus in 2020. Retrieved from https://www.e-tar.lt/rs/lasupplement/c05c12f0d13d11e8bea9885f77677ec1/35676c90d14111e8bea9885f77677ec1/

The general pattern of stability programmes was to envisage a slight worsening of the general government balance for the next year, followed by an upward trend for the remaining years of the programmes. The 2018 Stability Programme projected a somewhat higher nominal surplus for 2019 and 2020 as it did not yet incorporate the negative effects of the labour taxation reform on tax revenues. Lithuania has overachieved its budgetary balance targets for the last five years.

Figure 1: Government balance projections in successive programmes (% of GDP)

Source: Commission 2019 Spring Forecast. Stability programmes
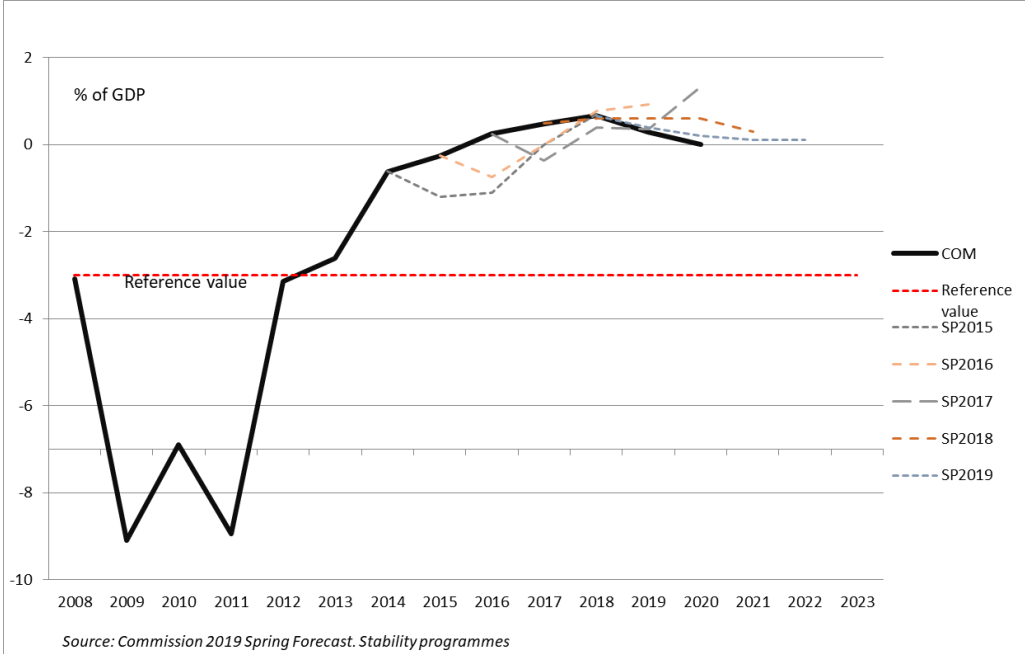
3.3. MEASURES UNDERPINNING THE PROGRAMME

According to the Stability Programme, the total positive impact of discretionary revenue measures amounts to 0.1% in 2019 and 0.4% in 2020. The biggest effects stem from labour taxation and pension system reforms. In 2019, the overhaul of labour taxation is projected to result in lower receipts of social insurance contributions of 3.8% of GDP, while revenues from personal income tax, taking into account an increase in tax-free allowance, should be higher by 2.8% of GDP. The gap between losses and additional revenues is set to be partially offset by better tax collection, thanks to new administrative measures as well as the termination of transfers from the State Social Insurance Fund to the second pillar of the pension system. This measure should have an incremental impact beyond 2019 since under previous legislation, the state fund's obligations to the private pension funds would have increased in 2020 and 2021.

On the expenditure side, in 2019, government's decision to finance a share of pensions from the state budget, instead of the State Social Insurance Fund, results in two notable discretionary measures that compensate each other.

As in previous stability programmes, the fiscal indicators rely on additional revenues from measures targeted at improving tax collection. The Commission forecasts a lower positive effect from these measures since it is difficult to disentangle their impact from a notable increase in tax-rich components of GDP growth.

The difference between the discretionary revenue measures indicated in the DBP and the Stability Programme is negligible.

Main budgetary measures included in the Programme

Revenue	Expenditure
2018	
• Increase in non-taxable allowance (-0.2% of GDP) • Measures to improve collection of social insurance contributions (+0.1% of GDP) • Measures to improve VAT collection (+0.2% of GDP) • Abolishment of the additional tax-free income allowance for children (+0.3% of GDP)	• Financial support to young families and families with children (+0.5% of GDP) • Increase in wages for specific groups of public employees (+0.2% of GDP)
2019	
• Adjustments to the base of social security contributions and their rate following the labour taxation reform (-3.8% of GDP) • Increase in non-taxable allowance (-0.4% of GDP) • Measures to improve collection of social insurance contributions (+0.1% of GDP) • Measures to improve VAT collection (+0.2% of GDP) • Termination of transfers from the State Social Insurance Fund to the second pillar of the pension system (+0.4% of GDP) • Adjustments to the base of personal income tax and its rate following the labour taxation reform (+3.2% of GDP)	• Reduction in expenses of the State Social Insurance Fund due transferred obligation to pay a share of pensions to the state budget (-3.6% of GDP) • Increase in wages for public employees in the education sector (+0.2% of GDP) • Increase in wages for public employees in the healthcare sector and other related expenses (+0.2% of GDP) • Increase of wages for civil servants (+0.2% of GDP) • Financial support to young families and families with children as well as other social welfare related expenses (+0.3% of GDP) • Increase in expenses of the state budget due transferred obligation to pay a share pensions (+3.6% of GDP)
2020	
• Increase in non-taxable allowance (-0.3% of GDP) • Measures to improve VAT collection (+0.2% of GDP) • Termination of transfers from the State Social Insurance Fund to the second pillar of the pension system (+0.4% of GDP)	
<u>Note</u>: The table refers to the main measures included in the 2019 Stability Programme that have an incremental budgetary impact over the programme period. The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.	

3.4. DEBT DEVELOPMENTS

In 2018, Lithuania's gross government debt stood at 34.2% of GDP. The state will have to secure pre-financing for upcoming bond redemptions, which are to take place between 2020 and 2022. This is reflected in substantial stock-flow adjustments during this period. Consequently, in 2019, the debt-to-GDP ratio is projected to increase to 37.0% of GDP. Following this hike, the Stability Programme envisages a gradual decline in gross government debt to 32.9% of GDP by 2022. Refinancing is also set to decrease amounts of payable interests over the programme period.

The short-term future debt dynamics presented in the programme are similar to the one provided by the Commission 2019 spring forecast, although for 2020 the Commission projects a somewhat higher debt level. This is based on a no-policy-change assumption, leading to a slightly lower surplus compared to the indications provided in the 2019 Stability Programme.

Table 3: Debt developments

| (% of GDP)	Average 2013-2017	2018	2019		2020		2021	2022
			COM	SP	COM	SP	SP	SP
Gross debt ratio[1]	**40.3**	**34.2**	**37.0**	**37.0**	**36.4**	**36.2**	**35.4**	**32.9**
Change in the ratio	-0.1	-5.2	2.8	2.8	-0.6	-0.8	-0.8	-2.5
Contributions[2]:								
1. Primary balance	**-0.9**	**-1.5**	**-1.1**	**-1.3**	**-0.7**	**-0.8**	**-0.6**	**-0.3**
2. "Snow-ball" effect	**-0.4**	**-1.6**	**-1.0**	**-0.7**	**-1.1**	**-1.0**	**-1.0**	**-1.3**
Of which:								
Interest expenditure	1.5	0.9	0.8	0.9	0.7	0.7	0.5	0.3
Growth effect	-1.2	-1.3	-0.9	-0.8	-0.9	-0.8	-0.8	-0.8
Inflation effect	-0.6	-1.3	-1.0	-0.8	-0.9	-0.8	-0.7	-0.7
3. Stock-flow adjustment	**1.2**	**-2.0**	**5.0**	**4.9**	**1.2**	**1.1**	**0.9**	**-0.9**
Of which:								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :

Commission 2019 spring forecast (COM); Stability Programme (SP), Commission calculations.

Lithuania's previous stability programmes predicted the short-term debt dynamics quite closely. According to the 2018 Stability Programme, the medium-term debt levels were projected to be somewhat higher than the Commission 2019 spring forecast estimates (Figure 2). All the projections and the outcomes always remained substantially below the 60% of GDP reference value of the Treaty.

Figure 2: Government debt projections in successive programmes (% of GDP)

Source: Commission 2019 Spring Forecast. Stability and Covergence programmes
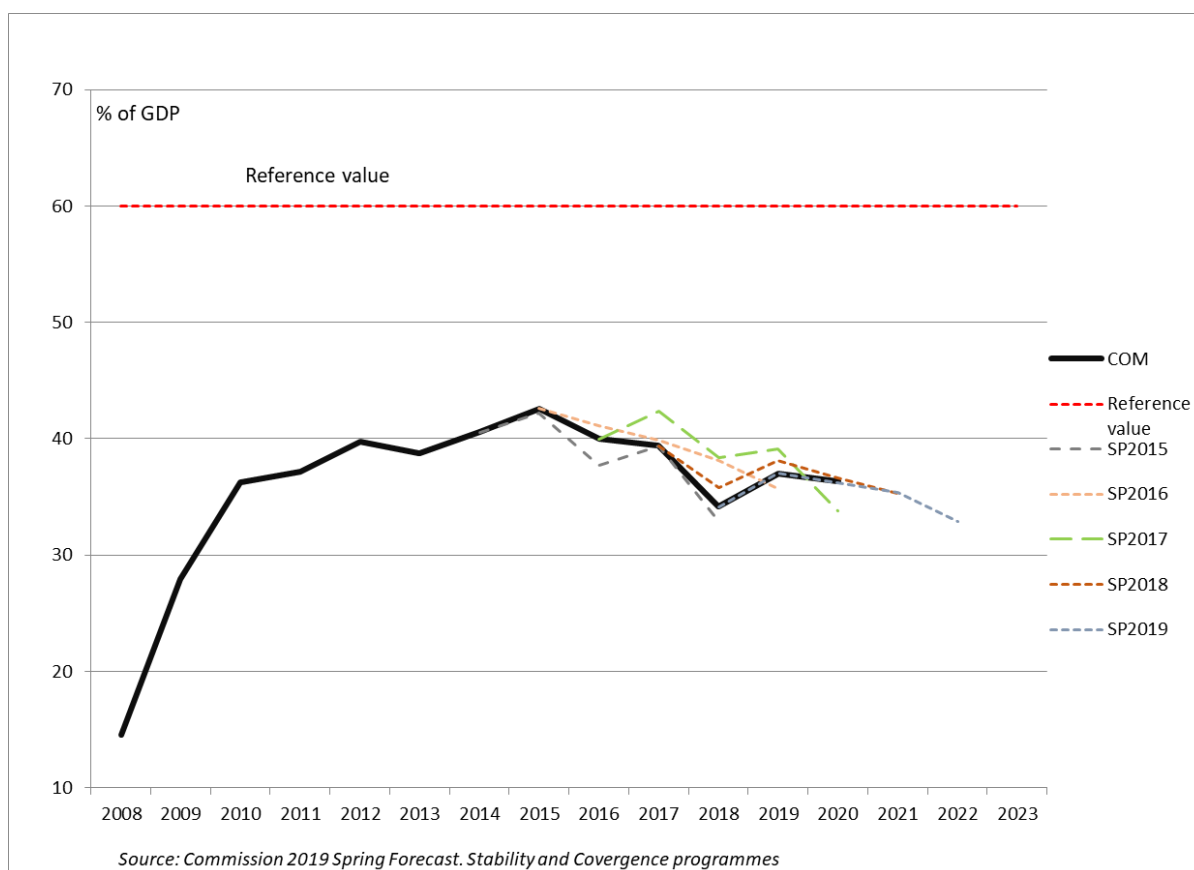
3.5.   RISK ASSESSMENT

For the last couple of years, Lithuania has achieved its planned targets for the general government balance. The economic growth and fiscal projections of the Stability Programme are broadly in line with the Commission 2019 spring forecast. However, the projected consolidation path for the general government and structural balances are subject to some risks on the revenue as well as the expenditure side.

The Stability Programme projects a notable increase in the revenue ratio of 1.3 percentage points in 2019. A similar increase was already targeted in previous stability programmes; however, the actual results were more modest. Heavy reliance on measures with an uncertain yield, such as an improved tax administration, poses a downward risk to revenues over the programme period.

On the expenditure side, as also indicated in the Stability Programme, there are risks linked to the acquisitions of military equipment. Following the rules of accrual accounting, the recording of some purchases that took place in 2018 and amounted to 0.4% of GDP will have to be completed in the coming years. This led to an improvement in the government's nominal balance by 0.4 percentage points in 2018. Over the programme period, differences between planned and factual spending on equipment, assessed following the principles of accrual accounting, might again reduce expenditure level or increase it above those planned.

Furthermore, there are implementation risks in view of the upcoming elections. In March 2019, the government released a draft Strategy on the long-term sustainable funding of wages

of employees in the public sector until 2025[3]. If adopted and implemented, this measure could notably increase government expenditure in 2020.

4.   COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Lithuania is subject to the preventive arm of the Stability and Growth Pact and should ensure compliance with its MTO. Under the European Semester in July 2018 the Council considered that Lithuania complied with the Stability and Growth Pact.

For 2018, Lithuania benefitted from a temporary deviation of 0.5% of GDP from the MTO (set at -1.0% of GDP) linked to the carry forward of the flexibility granted under the pension reform and structural reform clauses. As the temporary deviations are carried forward for a period of three years, the allowed temporary deviation amounting to 0.5% of GDP is still applicable in 2019. There are no allowances granted from 2020 onwards.

In 2018, Lithuania's structural balance stood at -0.8% of GDP, i.e. Lithuania remained above its MTO. For 2019, the Stability Programme plans to remain above the MTO as the recalculated structural deficit is projected to be at 0.8% of GDP. The Commission 2019 spring forecast projects a structural deficit to remain at the MTO, i.e. at -1.0% of GDP.

For 2020, the recalculated structural balance based on the Stability Programme is set to improve to -0.4% of GDP, while the 2019 Commission forecast expects the structural balance to stand at -0.9% of GDP. Therefore, both assessments point to the overachievement of the MTO. At the same time, expenditure developments should be monitored carefully, especially in light of possible future risks to the robustness of revenues, to safeguard compliance with the SGP.

Overall, Lithuania complied with the provisions of the SGP in 2018 and is projected to comply with them in 2019 and 2020.

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[3] Lietuvos Respublikos Vyriausybė. (2019). Retrieved from
http://lrv.lt/uploads/main/documents/files/Strategijos%20projektas_2.pdf

Table 4: Compliance with the requirements under the preventive arm

(% of GDP)	2018	2019	2020
Background budgetary indicators[1]			
Medium-term budgetary objective (MTO)	-1.0	-1.0	-1.0
Structural balance[2] (COM)	-0.8	-1.0	-0.9
Setting the required adjustment to the MTO			
Structural balance based on freezing (COM)	-0.6	-1.0	-
Position vis-à-vis the MTO[3]	At or above the MTO	At or above the MTO	At or above the MTO
Required adjustment[4]	0.0	0.0	0.0
Required adjustment corrected[5]	-0.7	-0.9	0.0
Corresponding expenditure benchmark[6]	6.9	7.6	5.2

		2018	2019		2020	
Compliance with the required adjustment to the MTO						
		COM	SP	COM	SP	COM
Structural balance pillar						
Change in structural balance[7]						
One-year deviation from the required adjustment[8]						
Two-year average deviation from the required adjustment[8]			Compliance			
Expenditure benchmark pillar						
Net public expenditure annual growth corrected for one-offs[9]						
One-year deviation adjusted for one-offs[10]						
Two-year deviation adjusted for one-offs[10]						
Finding of the overall assessment						

Legend

'*Compliance*' - the recommended structural adjustment or a higher adjustment is being observed.

'*Some deviation*' - a deviation from the recommended structural adjustment is being observed, but it is below the threshold for a significant deviation.

'*Significant deviation*' - a deviation which has reached or breached the threshold for a significant deviation (i.e. 0.5% of GDP over one year, 0.25% of GDP over two years on average).

Irrelevant for the Significant Deviation Procedure ' - a SDP would not be opened only based on the two-year deviation if the MTO has reached (at the time of the freezing or on the base of the last storage) in one of the two years.

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage point is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, 2018 edition, p.38.). In case of a SDP, the requirement corresponds to the Council recommendation when available; otherwise it refers to the Commission recommendation to the Council.

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[7] Change in the structural balance compared to year t-1. Ex post assessment (for 2018) is carried out on the basis of Commission 2019 spring forecast.

[8] The difference of the change in the structural balance and the corrected required adjustment.

[9] Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal)

[10] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Stability Programme (SP); Commission 2019 spring forecast (COM); Commission calculations.

5.   DEBT SUSTAINABILITY ANALYSIS AND FISCAL RISKS

Lithuania does not appear to face fiscal sustainability risks in the short[4], medium or long run. Nonetheless, as indicated in the 2019 Country Report[5], though fiscal sustainability of the pension system improved, the adequacy of pensions is expected to drop in the medium term, from an already low level. According to the current legislation, such situation would call for the government's action and could imply higher public spending.

Based on Commission 2019 spring forecasts and a no-fiscal policy change scenario beyond the forecast horizon, government debt, projected at 37% of GDP in 2019, is expected to remain close to this level until 2029, thus remaining below the 60% of GDP Treaty threshold. Sensitivity analysis gives similar results.[6] Overall, this highlights low risks for the country from debt sustainability analysis in the medium term. The full implementation of the Stability Programme would put debt on a decreasing path by 2029, thus further reducing risks.

The medium-term fiscal sustainability risk indicator S1[7] is at -1.2 percentage points of GDP, thus signalling low risks. The full implementation of the Stability Programme would put the sustainability risk indicator S1 at -2.7 percentage points of GDP, further mitigating risks. Based on the debt sustainability analysis and the S1 indicator, overall medium-term fiscal sustainability risks are, therefore, low.

The long-term fiscal sustainability risk indicator S2 is at 1 percentage point of GDP. In the long term, Lithuania therefore appears to face low fiscal sustainability risks. Full implementation of the programme would put the S2 indicator at 0.4 percentage points of GDP.[8] The debt sustainability analysis discussed higher points to low risks so that, overall, long-term fiscal sustainability risks are assessed as low for Lithuania.

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[4] This conclusion is based on the short-term fiscal sustainability risk indicator S0. See the note to Table 5 for a definition of the indicator.

[5] European Commission. (2019). Country Report – Lithuania. Retrieved from https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-country-report-lithuania_en.pdf

[6] Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Fiscal Sustainability Report 2018 for more details).

[7] See the note to Table 5 for a definition of the indicator.

[8] The projected costs of ageing that are used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the projections of the 2018 Ageing Report.

Table 5: Debt sustainability analysis and sustainability indicators

Time horizon			Commission Scenario		Stability Programme Scenario	
Short-term			**LOW risk**			
S0 indicator [1]			0.2			
	Fiscal subindex		0.0	LOW risk		
	Financial & competitiveness subindex		0.3	LOW risk		
Medium-term			**LOW risk**			
DSA [2]			LOW risk			
S1 indicator [3]			-1.2	LOW risk	-2.7	LOW risk
of which	Initial Budgetary Position		0.0		-1.0	
	Debt Requirement		-1.7		-2.4	
	Cost of Ageing		0.6		0.7	
	of which	Pensions	0.0		0.1	
		Health care	0.2		0.1	
		Long-term care	0.2		0.2	
		Other	0.2		0.3	
Long-term			**LOW risk**			
DSA [2]			LOW risk			
S2 indicator [4]			1.0	LOW risk	0.4	LOW risk
of which	Initial Budgetary Position		0.6		0.0	
	Cost of Ageing		0.4		0.4	
	of which	Pensions	-1.1		-1.1	
		Health care	0.3		0.3	
		Long-term care	0.8		0.8	
		Other	0.4		0.4	

Source: Commission services; 2019 stability/convergence programme.

Note: the 'Commission' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2019 forecast until 2020. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2018 Ageing Report.

[1] The S0 indicator of short term fiscal challenges informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon. To estimate these risks S0 uses a set of fiscal, financial and competitiveness indicators selected and weighted according to their signalling power. S0 is therefore a composite indicator whose methodology is fundamentally different from the S1 and S2 indicators, which quantify fiscal adjustment efforts. The critical threshold for the overall S0 indicator is 0.46. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.36 and 0.49*.

[2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections*.

[3] The S1 indicator is a medium-term sustainability gap; it measures the upfront fiscal adjustment effort required to bring the debt-to-GDP ratio to 60 % by 2033. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2021 for Commission scenario and from last available year for the SCP scenario); it must be then sustained, including financing for any additional expenditure until the target date, arising from an ageing population. The critical thresholds for S1 are 0 and 2.5, between which S1 indicates medium risk. If S1 is below 0 or above 2.5, it indicates low or high risk, respectively*.

[4] The S2 indicator is a long-term sustainability gap; it shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical thresholds for S2 are 2 and 6, between which S2 indicates medium risk. If S2 is below 2 or above 6, it indicates low or high risk, respectively*.

* For more information see Fiscal Sustainability Report 2018.

6. FISCAL FRAMEWORK

Lithuania's fiscal framework contains two main numerical fiscal rules. The first one states that the structural balance should improve each year when the real economic growth exceeds potential. In addition, there is a rule limiting the expenditure growth conditional on the average of the general government balance of the last five years and other escape clauses, indicated in the legislation.

Considering the data provided in the Stability Programme, Lithuania's structural balance, as in the previous year, improved and remained above the MTO. Therefore, Lithuania adhered to its national structural balance rule. This was also indicated in the report from the Government to the Parliament[9]. Furthermore, the report considers that an escape clause related to the average general government balance had been met and the expenditure rule was not applicable. The Independent Fiscal Institution, which is set up in the National Audit Office (NOA), is of a different opinion regarding the application of the escape clause for the expenditure rule for 2018[10]. The views of the Ministry of Finance and the Independent Institution diverged as they built their calculations of average general government balance on slightly different time series. Based on the information provided in the Stability Programme, the past, planned and forecast fiscal performance, Lithuania appears to comply with the requirements of the applicable national numerical fiscal rules.

On 29 March 2019, the Independent Fiscal Institution presented its opinion[11] to the Parliament endorsing the economic development scenario underpinning the Stability Programme. The Ministry of Finance had published the economic development scenario on March 21. The Independent Fiscal Institution assessed that the economic scenario was based on the recent available statistical data and did not contradict economic trends.

Finally, Lithuania considers its Stability Programme as its national medium-term fiscal plan in the sense of the Two-Pack Regulation 473/2013. Neither the Stability Programme nor the National Reform Programme provide indications on the expected economic returns on non-defence public investment projects that have a significant budgetary impact as required by Article 4(1) of the above-mentioned regulation.

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[9] Lietuvos Respublikos Vyriausybės 2019 m balandžio 24 d. nutarimas Nr. 386. Retrieved from https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/8dbee290681511e99684a7f33a9827ac?positionInSearchResults=0&searchModelUUID=a1bb37f5-2ad9-44d5-9a0a-cd8562a9f87c

[10] Lietuvos Respublikos valstybės kontrolė. (2019). *Lietuvos stabilumo 2019 metų programos vertinimas.* Retrieved from http://www.vkontrole.lt/bp/isvada.aspx?id=10295

[11] Lietuvos Respublikos valstybės kontrolė. (2019). *Išvada dėl ekonominės raidos scenarijaus tvirtinimo.* Retrieved from http://www.vkontrole.lt/bp/isvada.aspx?id=10286

7. SUMMARY

In 2018, Lithuania maintained the structural balance above its MTO and complied with the requirements of the preventive arm of the Stability and Growth Pact.

In its Stability Programme, Lithuania plans to remain above the MTO over the period 2019-2022. Based on the Commission 2019 spring forecast, the structural balance is projected to respect the MTO in 2019 and 2020. Therefore, Lithuania is expected to be compliant with the provisions of the Stability and Growth Pact in both 2019 and in 2020.

8. ANNEXES

Table I. Macroeconomic indicators

	2001-2005	2006-2010	2011-2015	2016	2017	2018	2019	2020
Core indicators								
GDP growth rate	7.6	1.6	3.8	2.4	4.1	3.4	2.7	2.4
Output gap [1]	-0.6	-0.4	-1.5	1.1	3.0	3.6	3.1	2.1
HICP (annual % change)	0.9	5.2	1.6	0.7	3.7	2.5	2.1	2.1
Domestic demand (annual % change) [2]	8.9	0.9	3.7	2.2	2.9	2.9	3.5	3.0
Unemployment rate (% of labour force) [3]	12.6	9.5	12.1	7.9	7.1	6.2	6.2	6.0
Gross fixed capital formation (% of GDP)	21.8	23.1	18.6	19.3	19.2	19.3	19.4	19.5
Gross national saving (% of GDP)	15.4	16.1	19.8	17.0	18.7	18.6	18.6	18.5
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	-1.7	-4.0	-3.1	0.2	0.5	0.7	0.3	0.0
Gross debt	20.3	22.4	39.8	40.0	39.4	34.2	37.0	36.4
Net financial assets	8.1	2.6	-24.5	-21.9	-17.3	n.a	n.a	n.a
Total revenue	33.1	34.9	33.6	34.4	33.6	34.7	34.7	34.9
Total expenditure	34.8	39.0	36.7	34.1	33.1	34.0	34.4	34.9
of which: Interest	1.1	1.0	1.7	1.3	1.1	0.9	0.8	0.7
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	-3.9	0.4	7.2	4.2	6.5	5.6	5.6	5.9
Net financial assets; non-financial corporations	-89.9	-109.9	-82.0	-83.9	-86.2	n.a	n.a	n.a
Net financial assets; financial corporations	-1.5	-0.2	1.9	0.7	0.0	n.a	n.a	n.a
Gross capital formation	14.7	14.8	12.3	10.3	10.4	11.1	11.3	11.1
Gross operating surplus	32.5	33.4	37.5	33.1	33.6	32.9	32.8	32.6
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	-0.2	-1.0	-1.4	-3.7	-4.9	-4.9	-4.5	-4.7
Net financial assets	47.6	54.1	56.2	62.2	67.5	n.a	n.a	n.a
Gross wages and salaries	31.6	34.1	31.6	34.3	34.2	34.8	44.4	44.8
Net property income	18.0	13.8	14.2	12.8	11.2	10.4	10.1	9.7
Current transfers received	12.2	16.3	15.7	15.3	15.1	15.8	16.2	16.7
Gross saving	3.1	2.0	1.2	0.1	-0.9	-0.7	-0.3	-0.6
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	-5.7	-4.6	2.7	0.7	2.1	1.3	1.4	1.2
Net financial assets	36.1	54.0	49.0	43.5	36.6	n.a	n.a	n.a
Net exports of goods and services	-6.2	-7.7	0.2	1.3	2.8	2.5	2.1	1.8
Net primary income from the rest of the world	-1.6	-1.8	-2.9	-4.0	-4.0	-4.5	-4.2	-4.1
Net capital transactions	0.5	2.7	3.0	1.5	1.2	1.3	1.5	1.6
Tradable sector	55.8	52.5	56.5	54.6	55.2	54.6	n.a	n.a
Non tradable sector	33.9	37.5	33.8	35.4	34.7	35.0	n.a	n.a
of which: Building and construction sector	6.1	8.0	6.0	5.9	5.9	6.4	n.a	n.a
Real effective exchange rate (index, 2000=100)	89.3	106.5	102.2	112.6	116.3	121.1	122.9	124.2
Terms of trade goods and services (index, 2000=100)	96.5	100.7	99.2	103.7	104.1	103.1	103.6	103.9
Market performance of exports (index, 2000=100)	74.6	88.8	118.6	119.4	128.2	129.5	130.1	130.4

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2015 market prices.

[2] The indicator on domestic demand includes stocks.

[3] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

Source:

AMECO data, Commission 2019 spring forecast

Mandatory variables not included in the Stability Programme

The Stability Programme does not contain several mandatory variables including changes in inventories and net acquisition of valuables (% of GDP), changes in inventories and net acquisition of valuables (Table 1a), statistical discrepancy (Table 1d), total expenditure and total revenue (Table 7). Not included mandatory variables do not impede the Commission's ability to assess the Stability Programme on the basis of the Programme's assumptions.