COUNCIL OPINION

of 27 February 2007

on the updated convergence programme of Lithuania, 2006-2009

(2007/C 71/06)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies ([1]), and in particular Article 9(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On 27 February 2007 the Council examined the updated convergence programme of Lithuania, which covers the period 2006 to 2009. The update was submitted almost two weeks beyond the 1 December deadline set in the code of conduct in view of a change in the approval procedure for the programme which now involves the Parliament.

(2) The macroeconomic scenario underlying the programme envisages that real GDP growth will decelerate progressively from 7,8 % in 2006 to 4,5 % in 2009. Assessed against currently available information, this scenario appears to be based on cautious growth assumptions from 2007. The programme's projections for inflation appear to be on the low side in the light of recent developments.

(3) For 2006, the general government deficit is estimated at 1 % of GDP in the Commission services' autumn 2006 forecast against a target of 1,4 % of GDP set in the previous update of the convergence programme. The updated programme presents a deficit estimated at 1,2 %. However, preliminary data for the whole of 2006 point to an even better deficit outcome close to balance. This is due to much higher-than-foreseen economic activity and employment, faster wage growth and improvements in tax collection and was achieved in spite of a budget amendment in July 2006 which increased expenditures by around 0,5 % of GDP.

(4) The main goal of the programme is to gradually reduce the general government deficit throughout the programme period so as to achieve the medium-term objective (MTO, see below) by 2008 and a balanced budget in 2009. The primary deficit is expected to be in balance by 2007 and to record a surplus of 0,8 % of GDP at the end of the programme period. Compared with the previous update, the planned adjustment is more ambitious, but backloaded against a less favourable macroeconomic scenario towards the end of the programme period. The envisaged fiscal consolidation relies on an increase in the revenue-to-GDP ratio that is higher than the increase in the expenditure-to-GDP ratio (2,6 percentage points compared to 1,4 percentage points). On the revenue side, only 0,5 percentage point is explained by an increase in the tax ratio, which is mainly due to an expected improvement in tax collection. The rest of the increase is not specified in the programme, but seems to be linked to the inflow of EU funds. On the expenditure side, the changes stem from a rise in public investment, social transfers and 'other' primary expenditures, which is less than fully offset by a significant cut in government consumption as a percentage of GDP (by more than 2 percentage points).

([1]) OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). The documents referred to in this text can be found at the following website:
http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

(5) The structural balance (i.e. the cyclically-adjusted balance net of one-off and other temporary measures) calculated according to the commonly agreed methodology is planned to gradually improve from a deficit of 1¾ % of GDP in 2006 to a surplus of ½ % of GDP in 2009. As in the previous update of the convergence programme, the medium-term objective (MTO) for the budgetary position presented in the programme is a structural deficit of 1 % of GDP, which the programme aims to achieve by 2008. As the MTO is more demanding than the minimum benchmark (estimated at a deficit of around 2 % of GDP), achieving it should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit. The MTO lies within the range indicated for euro-area and ERM II Member States in the Stability and Growth Pact and the code of conduct and adequately reflects the debt ratio and average potential output growth in the long term.

(6) The risks to the budgetary projections in the programme appear broadly balanced until 2007, but budgetary outcomes could be worse than projected in the programme from 2008 onwards. The budgetary strategy relies on a significant increase in the revenues-to-GDP ratio and the substantial cut in public consumption-to-GDP ratio, which could have been better substantiated, taking into account the medium-term framework for the planning and control of public finances which is not sufficiently binding. While the likely carry-over from a lower-than-estimated deficit outcome in 2006 implies that the target for 2007 could be achieved, the lack of detailed information on the envisaged measures introduces considerable uncertainty for the achievement of the budgetary targets from 2008 onwards.

(7) In view of this risk assessment, the budgetary stance in the programme may not be sufficient to ensure that the MTO is achieved by 2008, as envisaged in the programme. However, it seems to provide a sufficient safety margin against breaching the 3 % of GDP deficit threshold with normal macroeconomic fluctuations throughout the programme period. According to the programme, the pace of the adjustment towards the MTO is in line with the Stability and Growth Pact which specifies that the adjustment should be higher in good economic times and could be lower in bad economic times. Nevertheless, in view of the risks identified above, the planned structural adjustment should be strengthened by backing it up with measures so that the annual improvement in the structural balance is 0.5 % of GDP as a benchmark, as required for euro-area and ERM II Member States.

(8) Government gross debt is estimated to have reached 18½ % of GDP in 2006, well below the 60 % of GDP Treaty reference value. The programme projects the debt ratio to remain at around 19 % of GDP in 2007-2008 before decreasing to 17¾ % in 2009.

(9) The long-term budgetary impact of ageing in Lithuania is lower than the EU average, with a limited increase in pension expenditure over the coming decades, influenced by the pension reforms enacted. The current level of gross debt is very low in Lithuania and improving the budgetary position as planned in the convergence programme update would contribute to containing the risks to the long-term sustainability of public finances. Overall, Lithuania appears to be at low risk with regard to the sustainability of public finances.

(10) The convergence programme does not contain a qualitative assessment of the overall impact of the October 2006 implementation report of the national reform programme within the medium-term fiscal strategy. However, it provides systematic information on the direct budgetary costs of the main reforms envisaged in the national reform programme and its budgetary projections seem to take into account the public finance implications of the actions outlined in the national reform programme. The measures in the area of public finances envisaged in the convergence programme seem consistent with those foreseen in the national reform programme. In particular, both programmes highlight the ongoing pensions, health care and tax reforms. Nevertheless, the general government deficit targets presented in the convergence programme are significantly lower than those presented in the national reform programme.

(11) The budgetary strategy in the programme is broadly consistent with the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008.

(12) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme provides all required and most of the optional data [1].

The Council concludes that, in a context of strong growth prospects, the programme envisages progress towards the MTO, which is targeted to be reached by 2008. However, there are risks to the achievement of the budgetary targets from 2008 onwards. A strong budgetary position is particularly important in view of pressures on inflation and the current account.

In view of the above assessment, the Council invites Lithuania to:

(i) exploit the good times by aiming for a more demanding deficit target in 2007 in view of the likely better deficit outcome in 2006 and back-up the adjustment towards the MTO with measures which would ensure an annual improvement in the structural balance of 0,5 % of GDP as a benchmark as required for euro-area and ERM II Member States, and the intended improvement beyond the MTO.

(ii) continue to improve the medium-term framework for the planning and control of public finances.

Comparison of key macroeconomic and budgetary projections

		2005	2006	2007	2008	2009
Real GDP (% change)	**CP Dec 2006**	**7,6**	**7,8**	**6,3**	**5,3**	**4,5**
	COM Nov 2006	7,6	7,8	7,0	6,5	n.a.
	CP Dec 2005	*7,0*	*6,0*	*5,3*	*6,8*	*n.a.*
HICP inflation (%)	**CP Dec 2006**	**2,7**	**3,9**	**4,7**	**3,4**	**3,1**
	COM Nov 2006	2,7	3,8	4,6	3,3	n.a.
	CP Dec 2005	*2,7*	*2,7*	*2,7*	*2,5*	*n.a.*
Output gap (% of potential GDP)	**CP Dec 2006** [1]	**1,9**	**2,4**	**1,6**	**0,1**	**– 1,9**
	COM Nov 2006 [5]	1,2	1,4	0,7	– 0,6	n.a.
	CP Dec 2005 [1]	*2,9*	*2,1*	*0,5*	*0,6*	*n.a.*
General government balance (% of GDP)	**CP Dec 2006**	**– 0,5**	**– 1,2**	**– 0,9**	**– 0,5**	**0,0**
	COM Nov 2006	– 0,5	– 1,0	– 1,2	– 1,3	n.a.
	CP Dec 2005	*– 1,5*	*– 1,4*	*– 1,3*	*– 1,0*	*n.a.*
Primary balance (% of GDP)	**CP Dec 2006**	**0,3**	**– 0,4**	**0,0**	**0,4**	**0,8**
	COM Nov 2006	0,3	– 0,2	– 0,4	– 0,5	n.a.
	CP Dec 2005	*– 0,9*	*– 0,8*	*– 0,7*	*– 0,4*	*n.a.*

[1] In particular the data on the contributions of the stock-flow adjustment to changes in the debt and estimates of the contributions to potential GDP growth by labour, capital and TFP are not submitted. The method of the Hodrick-Prescott filter was applied to estimate the output gap which is the possibility foreseen in the Code of Conduct for recently acceded Member States.

		2005	2006	2007	2008	2009
Cyclically-adjusted balance (% of GDP)	**CP Dec 2006** (1)	**– 1,0**	**– 1,8**	**– 1,3**	**– 0,5**	**0,5**
	COM Nov 2006	– 0,8	– 1,4	– 1,4	– 1,2	n.a.
	CP Dec 2005 (1)	*– 2,3*	*– 2,0*	*– 1,4*	*– 1,2*	*n.a.*
Structural balance (2) (% of GDP)	**CP Dec 2006** (3)	**– 1,0**	**– 1,8**	**– 1,3**	**– 0,5**	**0,5**
	COM Nov 2006 (4)	– 0,8	– 1,4	– 1,4	– 1,2	n.a.
	CP Dec 2005	*– 2,3*	*– 2,0*	*– 1,4*	*– 1,2*	*n.a.*
Government gross debt (% of GDP)	**CP Dec 2006**	**18,7**	**18,4**	**19,2**	**19,0**	**17,7**
	COM Nov 2006	18,7	18,9	19,6	19,8	n.a.
	CP Dec 2005	*19,2*	*19,9*	*19,8*	*18,9*	*n.a.*

Notes:

(1) Commission services calculations on the basis of the information in the programme.
(2) Cyclically-adjusted balance (as in the previous rows) excluding one-off and other temporary measures.
(3) There are no one-off and other temporary and other temporary measures in the programme.
(4) There are no one-off and other temporary measures taken from the Commission services' autumn 2006 forecast.
(5) Based on estimated potential growth of 7,9 %, 7,7 %, 7,8 % and 7,9 % respectively in the period 2005-2008.

Source:

Convergence programme; Commission services' autumn 2006 economic forecasts (COM); Commission services' calculations