COUNCIL OPINION

of 5 July 2004

on the Convergence Programme of Lithuania, 2004-2007

(2004/C 320/05)

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(2) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

On 5 July 2004 the Council examined the convergence programme of Lithuania, which covers the period 2004 to 2007. The programme largely complies with the data requirements of the revised 'code of conduct on the content and format of stability and convergence programmes'.

The budgetary strategy underlying the programme aims at 'approximating a cyclically balanced general government budget by ensuring a successful implementation of economic policy goals', although the strategy is not fully reflected in the programme's deficit targets. In particular, the programme envisages a deficit reduction of just 0,2 percentage points between 2003 and 2007, when the deficit is expected to be 1,5 % of GDP. This results from an increase in the GDP-share of both revenues and expenditure. The rise in the revenue ratio over the programme period is expected to amount to 2 percentage points, primarily due to a significant increase in non-tax revenues related to EU financial assistance. Tax revenues are expected to increase by 0,4 percentage points of GDP, despite the planned elimination of the road tax in 2005, which is estimated to negatively affect revenues by 0,5 % of GDP in the same year. Following a significant decrease of the expenditure ratio in the last five years, the ratio is foreseen to increase by 1,8 percentage points over the period under consideration, fully explained by an increase in primary expenditure, which is expected to be only marginally compensated by an anticipated decrease in interest payments. The increase in primary expenditure is foreseen to be mostly led by 'other expenditures' which are expected to rise by 0,9 % of GDP, mainly related to contributions to the EU budget, and by transfers and subsidies which are expected to increase by 0,7 % of GDP, to a large extent related with increasing subsidies to farmers, the compensation for the loss of rouble savings and real estate restitution plans and pension reform. Government gross fixed capital formation is expected to increase significantly by 1 % of GDP in the programme's first two years, but is projected to fall back to 3,1 % of GDP in 2007, remaining about 0,2 percentage points above the initial level of 2003.

The macro-economic scenario underlying the programme seems to reflect rather favourable growth assumptions. In particular, the projected growth rate in 2005, which has been revised upwards from 6,5 % in the 2003 pre-accession economic programme to 7,3 % in the convergence programme, appears on the high side. The evolution of growth in the medium term projected in the programme, while more cautious than in the initial years of the programme, still appears relatively optimistic. The projections for inflation appear realistic.

[1] OJ L 209, 2.8.1997, 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

The programme's targets for the general government deficit are below the 3 % of GDP reference value in each year. However, they are not consistent with a position of close-to-balance during the programme period. Moreover, the budgetary stance in the programme does not provide a sufficient safety margin against breaching the 3 % of GDP deficit threshold with normal macroeconomic fluctuations, at least in the initial years of the programme period. The budgetary outcome could be worse than projected. In particular, the downside macroeconomic risks highlighted above and past experience with expenditure overruns in response to better-than-planned revenue outturns represent a risk to the envisaged budgetary targets.

In the light of this assessment, if the growth rates envisaged in the programme materialise, Lithuania is recommended to make further progress towards a close-to-balance budgetary position, particularly in view of its current account deficit and domestic demand pressures. Furthermore, Lithuania is urged to implement strictly the budget in order to reduce the risk of breaching the 3 % reference value in 2004. Finally, the Lithuanian authorities are encouraged to use better-than-projected revenues for deficit reduction.

Lithuania is placed relatively well to meet the budgetary costs of an ageing population although some risk may emerge in the long-run. A number of measures aimed at improving the age dependency ratio and at modernising the pension and health-care systems are being implemented to improve the long-term sustainability of public finances. Nevertheless, there are risks related to the short-term costs of the pension and health-care reforms and the outstanding contingent liabilities. Securing an adequate primary surplus is essential to ensure that the public finances remain on a sustainable footing.

Key projections from the convergence programme of Lithuania

	2003	2004	2005	2006	2007
Real GDP growth (%)	9,0	7,0	7,3	6,6	6,3
Employment growth (%)	2,0	0,7	1,0	0,2	0,2
HICP inflation (%)	− 1,2	0,9	2,0	2,1	2,5
General government balance (% of GDP)	− 1,7	− 2,7	− 2,5	− 1,8	− 1,5
Government gross debt (% of GDP)	21,5	22,4	22,2	21,4	21,0