To the Seimas of the Republic of Lithuania

# OPINION ON THE STRUCTURAL ADJUSTMENT TARGET SET BY THE DRAFT LAW ON THE APPROVAL OF THE FINANCIAL INDICATORS OF THE STATE BUDGET AND MUNICIPAL BUDGETS AND ON THE NEED FOR ADDITIONAL MEASURES (IN MONETARY TERMS) NECESSARY TO FULFIL THIS TARGET

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Article 6(6) of the Constitutional Law on the Implementation of the Fiscal Treaty sets out that structural adjustment targets as well as their guidelines for remaining years of the medium term shall be proposed by the Government to the Seimas, and the Seimas shall set them only for the year preceding which the actual or expected structural general government deficit is higher or actual or expected structural general government surplus is lower than the medium-term objective.

In the overview of the Republic of Lithuania Draft Law on the Approval of the Financial Indicators of the State Budget and Municipal Budgets for 2019, the Government indicated that the structural adjustment target has not been set because the expected structural general government deficit composing 0.4% of GDP in 2018 was lower than the medium-term objective.

According to the independent fiscal institution, the expected structural general government deficit for 2018 would be 0.5% of GDP, which is below the medium-term objective (deficit of 1% of GDP). Therefore, there were valid reasons not to set the structural adjustment target, when preparing the Draft Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets for 2019.

Performing the monitoring of compliance with the rules set out in the Constitutional Law on the Implementation of the Fiscal Treaty, based on principles recommended to the independent fiscal institutions by the Organisation for Economic Cooperation and Development (hereinafter – OECD), the fiscal institution has carried out an assessment of general government financial indicators for 2019 and hereby submits its opinion to the Seimas.

Budgets attributable to general government shall be prepared in accordance with national and European Union rules which apply to Lithuania as a member of the euro area. The national rules of fiscal discipline are intended to foster the sustainability of public debt and to stabilise the economy. When implementing counter-cyclical fiscal policy, the stabilisation of economy is necessary in order to avoid economic overheating and the resulting bust cycles. The establishment of sufficient fiscal space during good times would allow anti-cyclical economic stimulus or at least neutral fiscal policy to be implemented during a downturn.

### Regarding the budget governance

1. In autumn of 2017, fiscal institution pointed out that according to the best practice of the OECD, along with draft general government budgets, the so-called budget for citizens should also be drawn up: a document that summarizes the budget information in a language that is understandable for everyone.
2. For the first time the Government prepared and presented alongside with the draft budget of the general government for 2019 the budget for citizens - a document "The 2019 Budget at a Glance." This is one of the most important elements of the budgetary framework reform implemented by the Government, which increases transparency, accountability, strengthens surveillance and involvement of the budgetary framework. In order to achieve the desired impact, the Government should ensure the proper dissemination of this key element.
3. During the negotiations over the 2019-2021 budget appropriations, the Government applied a specific spending review, which was intended to save expenditure of general government and to cover the cost of implementation of the Government's priorities. Further improvement of this process should be done in order to bring it closer to the good practices of the member states of the OECD. The goal of review of expenditure is to ensure that all expenditures are compliant with the principles of effectiveness, efficiency, sustainability, and impact. The analysis and findings conducted during the expenditure review process are available to the public.

### Regarding compliance with the rules of fiscal discipline set out in the Constitutional Law on the Implementation of the Fiscal Treaty

4. The Government estimates that the financial indicators of general government planned for 2019 will ensure a neutral fiscal policy. It is the opinion of the fiscal institution that Lithuania's fiscal policy has been improving but will remain pro-cyclical. In addition, there is no sufficient fiscal space built to allow anti-cyclical economic stimulus or at least neutral fiscal policy to be implemented during a downturn.
5. According to the fiscal institution's *interim* assessment, it is likely that compliance with the surplus of general government rule will not be ensured in 2018, and that the expenditure growth limitation rule should have been applied during the preparation of the draft budgets of the general government for 2018, as it was said in autumn of 2017.
6. According to the Government, the general government surplus rule will be observed in 2019. The Government forecasts that the structural deficit of the general government will amount to 0.3% of GDP for 2019, i.e., 0.1% lower than it was expected in 2018 (0.4% of GDP).

   According to the fiscal institution's *ex-ante* assessment, there is a risk that the compliance with the general government surplus rule will not be observed in 2019. According to this rule, the structural deficit of the general government should decrease by 1% of GDP in 2019, as compared to the expected structural deficit for 2018. Compared to 2018, the general government structural deficit has grown by 0.4% of GDP in 2019 and currently composes 0.9% of GDP. Differences in the assessments are determined by different values of the gap between actual and potential output, as well as different general government balance values projected for 2018-2019 applied by the Ministry of Finance and the fiscal institution.

7. The fiscal institution hereby notes that as in autumn of 2017, any assessment of the potential GDP and output gap calculated by the Government is not included when approving the Economic Development Scenario, because this indicator is typically published after the endorsement of the Scenario. The extent of the output gap is significant in the preparation of conclusions regarding compliance with the general government surplus rule. When endorsing the economic development scenario, other Member States of the European Union also endorse the estimated extent of the output gap. Inclusion of the aforesaid indicator into the list of indicators approved by the economic development scenario would reduce the differences between the estimates of compliance with the general government surplus rule.

8. Except for the opinion regarding the general government surplus rule, the draft general government budgets for 2019 were prepared in accordance with the fiscal discipline rules set out in the Constitutional Law on the Implementation of the Fiscal Treaty.

9. According to the draft general government budgets for 2019, there is no fiscal space for additional liabilities which would increase expenditure or reduce revenue. If additional long-term liabilities were to be made, they should be compensated by new measures to ensure a long-term sustainable source of revenue.

### Regarding public debt

10. In addition, due to projected central government deficit of about 800 million euros in 2019, the nominal public debt will increase accordingly. The general government surplus in 2019 will not reduce public debt, however it is planned to be accumulated in the rainy-day fund. Debt-to-GDP ratio will remain stable due to favourable economic growth and a low interest rate.

11. It is necessary to decide on the size of the minimal fiscal reserve and/or that of cyclical revenues, which should be allocated for the debt reduction. The fiscal institution, just as the OECD, has emphasized the need for an optimal level of debt and the definition of fiscal space including the steps for creating it.

### Fiscal risk scoreboard

12. The fiscal institution has created a tool for performing qualitative analysis of the fiscal risk related to public finance – a fiscal risk scoreboard. Most macroeconomic indicators show a low level of fiscal risks for the period of 2017-2019, but the growing structural deficit of general government and low level of accumulated funds in the Reserve (Stabilization) Fund signals a medium and high risk respectively.

The analysis underlying this opinion is presented in the report on the Assessment of the General Government Financial Indicators, which is submitted to the Seimas together with the opinion.

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