NATIONAL AUDIT
OFFICE OF LITHUANIA
• BRINGING BENEFITS •

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 2020, the Government indicated that the expected structural deficit of the general government, after taking into account the structural reforms flexibility clause granted by the European Commission, will compose 0.9% of GDP, in 2019 and will be lower than the medium-term objective (deficit of 1% of GDP), therefore the structural adjustment target has not been set.

According to the independent fiscal institution, the expected structural deficit of the general government for 2019, after taking into account the structural reforms flexibility clause would be 0.9% of GDP, which is below the medium-term objective. 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 2020.

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, the fiscal institution has carried out an assessment of general government financial indicators for 2020 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 finances 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 counter-cyclical economic stimulus or at least neutral fiscal policy to be implemented during a downturn.

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

1. The Government estimates that financial indicators of general government planned for 2020 will ensure counter-cyclical fiscal policy. According to the assessment of the fiscal institution, Lithuania's fiscal policy will remain pro-cyclical in 2019, whereas it will improve its direction and will become neutral in 2020.

2. According to the fiscal institution's *interim* assessment, it is likely that compliance with the surplus general government rule will not be ensured in 2019 and that the expenditure growth limitation rule has not been applied reasonably during the preparation of the draft budgets of the general government for 2019, as it was said in autumn of 2018.

3. According to the Government, the surplus general government rule will be observed in 2020. The Government forecasts that the structural deficit of the general government will amount to 0.7% of GDP for 2020, i.e. 0.7 percentage points lower than it was expected in 2019 (1.4% of GDP) and is lower than the medium-term objective.

   According to the fiscal institution's *ex-ante* assessment, there is a risk that the compliance with the surplus general government rule will not be observed in 2020. According to this rule, the structural general government balance indicator in absolute value should be lower than the medium-term objective in absolute value. The structural deficit of the general government constitutes 1.3% of GDP in 2020, and is higher than the medium-term objective. The differences in the assessments of the Ministry of Finance and the fiscal institution are determined by different values of the general government expected balance for 2019 and the projected balance for 2020 as well as different estimates of the gap between actual and potential output.

4. Except for the opinion regarding the surplus general government rule, the draft general government budgets for 2020 were prepared in accordance with the fiscal discipline rules set out in the Constitutional Law on the Implementation of the Fiscal Treaty.

5. The draft budgets for the State Social Insurance Fund and for the Compulsory Health Insurance Fund were prepared in accordance with the fiscal discipline rules set out in the Constitutional Law on the Implementation of the Fiscal Treaty for the budgets attributable to the general government.

6. According to the draft general government budgets for 2020, 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

7. The balance of risk factors for the 2020 public debt is negative as the debt might be increased by higher than projected state budget deficit. The projected primary general government surpluses will not reduce public debt as surpluses of Social and Health Care funds sub-sector will be allocated for the accumulation of reserves. Debt-to-GDP ratio will remain stable due to favourable economic growth and a low interest rate, i.e. automatic debt dynamics.

8. 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 in Lithuania. The fiscal institution, as the Organisation for Cooperation and Economic Development, has emphasized the need for an optimal level of debt and the necessity of accumulation of financial reserves.

The analysis underlying this opinion is presented in the report on the Assessment of the General Government Financial Indicators for 2020, which is submitted to the Seimas together with the opinion.

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