



To the Seimas of the Republic of Lithuania

## OPINION ON THE COMPLIANCE WITH THE FISCAL DISCIPLINE RULES OF MUNICIPAL BUDGETS DURING 2020–2021

10 June 2021 No. BPE-4

Vilnius

The National Audit Office, implementing the functions of the fiscal institution, in accordance with the Constitutional Law on the Implementation of the Fiscal Treaty of the Republic of Lithuania (hereafter referred to as the Constitutional Law), submits its opinion on the assessment of the compliance with the fiscal discipline rules of municipal budgets attributed to the general government to the Seimas.

The objective of the performed assessment is to assess whether the fiscal discipline rules laid down in the Constitutional Law were adhered during the adoption of the 2021 budgets attributed to the general government. The Opinion also provides an *ex-post* assessment of municipalities to determine whether 2020 municipal budgets were implemented in accordance with the fiscal discipline rules.

**The assessment of the 2020 *ex-post* and 2021 *ex-ante* compliance of municipal budgets with the fiscal discipline rules shows that the rules were complied with.**

In accordance with Article 4(2) and (4) of the Constitutional Law, two groups of municipalities are subject to analysis: those for which the approved appropriations exceed 0.3% of GDP in the preceding year at current prices and those for which the appropriations do not exceed this threshold. Municipalities' compliance with the fiscal discipline rules is assessed by taking into account the level of the output gap.

**The *ex-post* assessment of municipalities' compliance with the fiscal discipline rules providing for the impact of the spread of COVID-19 and the related circumstances<sup>1</sup>.**

Since the estimated output gap for 2020 was negative, the budgets of 56 municipalities (all except for Kaunas, Klaipėda, Šiauliai and Vilnius cities) could have been implemented in such a way that allocations would not have exceeded revenue by more than 1.5%. The municipal budgets of Kaunas, Klaipėda, Šiauliai and Vilnius cities may have had higher expenditure than revenue, creating a nominal deficit of the size of the municipality's cyclical component. When assessing the *ex-post* compliance with the fiscal discipline rules of municipalities for the year 2020, the actual data from their budget execution reports were analysed.

---

<sup>1</sup> The output gap estimated by the Ministry of Finance on 24/03/2021 is negative "Due to a potential gap between gross domestic product and output gap during 2020–2024".

**Municipalities do not make full use of the flexibility instruments of the fiscal discipline rules during the pandemic.** In order to aid municipalities, the following flexibility instruments might have been used<sup>2</sup>: short-term loans<sup>3</sup>, grants for own contribution to EU-funded projects implemented by municipalities, additional borrowing possibilities for municipalities for projects selected by the Central Project Management Agency, and facilitation of advance payments to those implementing EU-funded projects, including municipalities. The possibility to use the latter is on a temporary basis, i.e. for the declared emergency period. The *ex-post* assessment of the municipal budgets' compliance with the fiscal discipline rules for the year 2020 shows that the budgets were executed in line with the rules. Nevertheless, the fiscal discipline rules have been adhered to without the additional flexibility instruments.

**The compatibility of the flexibilities introduced from 2016 with the Constitutional Law needs to be clarified.** In accordance with the Law amending Articles 17, 19, 21 and 37 of the Budget Structure No I-430 (14 April 2016), the revenue of the municipal budget for the current year is adjusted by adding the unused part of the revenue of the previous year. The laws on the approval of financial indicators of the State budget and municipal budgets for 2019–2020 stipulated that the compliance of each municipality's budget with the provisions of the Constitutional Law has to be achieved within a period of four years, starting from the first year of implementation of the investment project selected by the State Enterprise Central Project Management Agency. The Government Protocol of 8 April 2020 on the consequences of the coronavirus (COVID-19) for municipal budgets also provides for short-term loans to be considered as municipal revenue<sup>4</sup>.

When assessing the *ex-ante* compliance with the fiscal discipline rules of municipalities for the year 2021, the data from their primary budgets approved by municipal councils and the data published by the Lithuanian Department of Statistics (updated until 1 June 2021) were analysed. Since the estimated output gap for 2021 is negative<sup>5</sup>, the budgets of 56 municipalities (all except for Kaunas, Klaipėda, Šiauliai and Vilnius cities) could have been planned in such a way that appropriations would not have exceeded revenue by more than 1.5%. In the municipal budget plans of Kaunas, Klaipėda, Šiauliai and Vilnius cities, expenditure may have been reported as exceeding revenue, thus resulting in a nominal deficit of a municipality's cyclical component.

**Borrowing on behalf of the State provides significantly more favourable lending conditions than an individual municipality would obtain by borrowing independently from a financial institution.** During the pandemic and due to the negative output gap, municipal budgets are allowed to run deficits to a certain extent, however, the essential balancing of revenue and expenditure is ensured through central government grants and subsidies. In order to compensate municipalities for losses due to COVID-19 and to contain its spread in the event of a national emergency, additional grants to cover the expenditure<sup>6</sup>, amounting around EUR 18.5 million (or 0.04% of GDP), were allocated in 2020. In addition, short-term loans from the State budget to compensate for revenue losses, amounting to EUR 90.4 million (or 0.2% of GDP), were allocated (Figure 1).

---

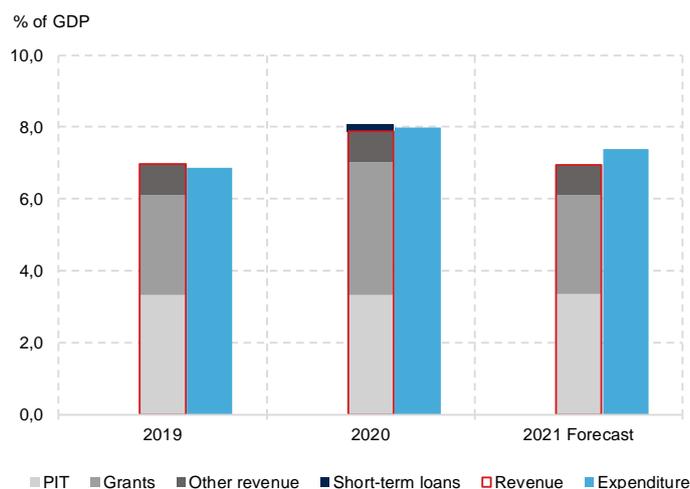
<sup>2</sup> FAQs asked by municipalities. Internet access: <https://finmin.lrv.lt/lt/veiklos-sritys/savivaldybiu-duk>.

<sup>3</sup> Government Protocol of 8 April 2020 on the consequences of coronavirus (COVID-19) for municipal budgets.

<sup>4</sup> This provision applies only for the 2020 assessment of compliance with fiscal discipline rules.

<sup>5</sup> The output gap estimated by the Ministry of Finance on 16/12/2020 was negative "due to a potential gap between gross domestic product and output gap during 2019–2023".

<sup>6</sup> Explanatory note to the set of summary statements on the implementation of the Ministry of Finance's budget estimates of expenditure for 2020.

**Figure 1.** 2019–2020 actual municipal expenditure and revenue, 2021 – projected

Source – [www.lietuvosfinansai.lt](http://www.lietuvosfinansai.lt), calculations by the National Audit Office implementing the functions of the fiscal institution

In 2020, compared to 2019, municipal spending reached 1.1% of GDP and revenue – 0.9% of GDP. According to the municipalities' expenditure and revenue plans for 2021, expenditure is projected to fall to 7.4% of GDP, while revenue is projected to return to 2019 level (around 7% of GDP). The largest share of municipal revenue comes from personal income tax: in 2021, it will be 0.1% of GDP higher compared to 2019–2020.

It should be noted that according to the draft amendment to the Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets for 2021, municipalities are expected to have higher revenues compared to the information provided in the municipal plans for 2021. For example, personal income tax revenue is projected<sup>7</sup> to increase by EUR 45.7 million, taking into account the faster growth of personal income.

**The *ex-ante* assessment of the compliance of the municipal budgets with 2021 fiscal discipline rules found that the budgets were adopted in line with the rules.** The actual compliance of municipalities with the fiscal discipline rules in their 2021 budgets will be assessed in the first half of 2022.

*The National Audit Office of the Republic of Lithuania, implementing its functions of the budget policy monitoring institution, is responsible for the monitoring of the compliance with fiscal discipline rules established in the Constitutional Law on the Implementation of the Fiscal Treaty of the Republic of Lithuania<sup>8</sup>, as well as for monitoring the implementation of the assignments and is authorised to prepare and present independent opinions to the Seimas of the Republic of Lithuania on the compliance with fiscal discipline rules and macroeconomic developments.*

*This opinion is accompanied by ex-post and ex-ante municipal fiscal discipline compliance spreadsheets.*

Auditor General

Mindaugas Macijauskas

<sup>7</sup> 14/05/2021 Draft Amendment No XIVP-495 to the Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets for 2021.

<sup>8</sup> Constitutional Law on the Implementation of the Fiscal Treaty. Internet access: <https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/6be2c020699a11e48710f0162bf7b9c5>.