NATIONAL AUDIT
OFFICE OF LITHUANIA
• BRINGING BENEFITS •

To the Seimas of the Republic of Lithuania

OPINION ON THE STRUCTURAL ADJUSTMENT TARGET SET OUT IN THE DRAFT LAW ON THE APPROVAL OF 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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The National Audit Office of Lithuania, implementing the functions of the fiscal institution, in accordance with the Constitutional Law on the Implementation of the Fiscal Treaty and the recast version of the Law on National Audit Office[1], which entered into force on 1 July 2021, within 15 working days of the submission by the Government of the Law (amendment to the Law) on the Approval of Financial Indicators of the State Budget and Municipal Budgets for a given year to the Seimas, submits to the Seimas its opinion on the structural adjustment target.

Article 6(6) and (7) 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 sector deficit is higher or actual or expected structural general government sector surplus is lower than the medium-term objective. Structural adjustment targets shall not be set for the year of exceptional circumstances.

As part of the functions of the budget policy monitoring institution, the National Audit Office issued an opinion[2] on 26 March confirming that the situation in Lithuania corresponds to the definition of an unusual event and therefore exceptional circumstances can be set. In response to the impact of the COVID-19 pandemic on the economy and general government finances, the application of fiscal discipline rules has been temporarily narrowed over the period 2020–2022. The general escape clause of the Stability and Growth Pact has been activated at the level of the European Union, allowing countries to deviate from the requirements for the general government budgets.

[1] Constitutional Law on the Implementation of the Fiscal Treaty, Art. 4(1); Law on National Audit Office, Art. 8(7) pt. 2.
[2] No BPE-1 of 26 March 2020 entitled “Opinion on the Compliance of the Unusual event with the definition of Exceptional Circumstances“.

In its overview of Draft Financial Indicators of the State and Municipal Budgets for 2022, the Government indicated that 4.1% of GDP structural government deficit is expected in 2021, however, given the exceptional circumstances, the structural adjustment target has not been set reasonably, as the structural adjustment targets are not set for the years of exceptional circumstances.

The National Audit Office, performing the functions of the budget policy monitoring institution, in carrying out the monitoring of compliance with the rules set out in the Constitutional Law on the Implementation of the Fiscal Treaty and on the basis of the principles recommended to independent fiscal institutions by the Organization for Economic Cooperation and Development, has carried out an assessment of the general government financial indicators for 2022 and submits its opinion to the Seimas.

The short–term COVID-19 related expenditure is replaced by growing long–term liabilities. The Draft Law on the Approval of Financial Indicators for the State Budget and Municipal Budgets for 2022 (hereinafter – the Draft Budget 2022) foresees not only short–term expenditure for further containment of the COVID-19 pandemic, but also long–term expenditure for which long-term sources of income are not foreseen. In the 2022 draft budget, EUR 304.2 million is planned to finance COVID-19-related measures, while non-temporary expenditure not covered by sustainable income will increase by EUR 695.6 million. It should be noted that this type of expenditure averaged 1.0 % of GDP over the period 2017–2021 annually. Prior to the pandemic, they were covered by unsustainable cyclical revenues due to the faster growth of the Lithuanian economy than its potential GDP.

Economic development between 2021 and 2022 is likely to exceed its potential. The projected general government revenue-to-GDP ratio is higher than average between 2015 and 2019, without adding additional sources of revenue. Uncertainty related to the cyclical situation of the economy limits the ability to accurately assess which part of the tax plan is of a cyclical nature. As a result, the structural general government deficit may be higher than indicated in the Draft Budget 2022. There is a risk of inflationary pressure and overheating of the economy.

On 1 October 2021, Statistics Lithuania significantly revised GDP data for 2020. This revision could not be included in the preparation and adoption of the Economic Development Scenario 2021–2024 and in the assessment of the size of the output gap. The focus and extent of the revision may lead to a higher positive estimate of the output gap, and therefore the pro-cyclical fiscal momentum may be higher than currently expected. It is appropriate to harmonise the calendars for the publication of official statistics and the preparation of the draft budget.

Based on the current demographic structure of Lithuania and the most favourable projections for the population of EUROPOP2019, a decline in the number of employed persons and an increase in the number of people of retirement age are projected in the long-term. Under the EUROPOP2019 scenario (no migration) and the assumptions that the activity rate in Lithuania will rise to 80 % or 83 %, the number of employed persons is projected to decrease by 9 % or 5 % respectively in 2030. This will have a negative impact on the revenue of the State Social Insurance Fund budget, as well as on the collection of the personal income tax most of which is allocated to the financing of the basic pension. The social insurance pension system is likely to be increasingly affected in the future by the challenges posed by an ageing population. In 2021, the largest number of resident population in Lithuania was in the 55-59 age group, reaching 211.5 thousand. More than 200 000 were also in the 50-54 and 60-64 age groups. This population age structure warns about a significant increase in the number of people of retirement age in the near future.

The part of the personal income tax allocated to the financing of the general part of pensions does not cover the state budget appropriations for the budget of the SSIF. The financing deficit of the general pension component exceeds the surplus generated in the budget of the SSIF. Together with the Draft Budget 2022, changes to the procedure for calculating social security pensions are proposed. When adopting changes that may affect the sustainability of the pension system, it is important to take into account demographic challenges and to anticipate long-term sources of income.

Considering favourable real GDP and interest rate dynamics, the general government debt-to-GDP ratio is expected to decline moderately between 2021 and 2022. According to the assessment carried out implementing the functions of the fiscal institution, the general government debt is projected to reach 45.3 % of GDP and 44.7 % of GDP in 2021–2022 respectively.

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

1. Under exceptional circumstances, in 2020–2022 the surplus general government rule and expenditure growth limiting rule are not applied reasonably. Since the European Commission[3] has informed that the general escape Clause of the Stability and Growth Pact will remain valid in 2022, it is assumed that the exceptional circumstances will be lifted in 2023 and that all fiscal discipline rules will apply.

2. The budgets of the State Social Insurance Fund and the Compulsory Health Insurance Fund for the period 2021–2022 are likely to meet their requirements.

3. The compliance of the municipal budgets for 2021 and 2022 with fiscal discipline rules will be assessed in the first half of 2022 when the 2022 budgets are drawn up.

The National Audit Office of the Republic of Lithuania, in its capacity as the budget policy monitoring institution, is responsible for monitoring compliance with the rules of fiscal discipline laid down in the Constitutional Law on the implementation of the Fiscal Treaty of the Republic of Lithuania, has carried out an assessment of the Draft Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets for 2022 submitted to the Seimas by the Government on 14 October 2021 and has issued an opinion. In accordance with Article 8(7)(2) of the Law on National Audit Office of the Republic of Lithuania, the National Audit Office hereby submits its opinion to the Seimas of the Republic of Lithuania.

The analysis underlying this opinion is presented in the report "Assessment of draft general government budgets for 2022", which together with the opinion is submitted to the Seimas.

Auditor General — Mindaugas Macijauskas

[3] 02/06/2021 European Semester Spring Package 2021. Available at: https://ec.europa.eu/info/publications/european-semester-spring-package-2021-economic-coordination_en.