OPINION ON THE APPLICATION OF EXCEPTIONAL CIRCUMSTANCES IN 2024

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A RETURN TO THE APPLICATION OF FISCAL DISCIPLINE RULES WOULD HELP REDUCE THE NEED FOR PUBLIC BORROWING IN THE CONTEXT OF MODERATE ECONOMIC GROWTH

The fiscal institution, the function of which is implemented by the National Audit Office (hereafter – NAO FI), provides its opinion on the application of exceptional circumstances in 2024. The opinion is given in the context of a situation where the Government (its authorized institution) has not submitted a notice on the cancellation of exceptional circumstances, as referred to in Article 7(2) of the Constitutional Law on the Implementation of the Fiscal Treaty of the Republic of Lithuania (hereafter – the Constitutional Law). In this context, the exceptional circumstances in Lithuania will remain in force in 2024, unless the Government or the institution authorised by it submits to the NAO FI a notice on their cancellation together with the December Economic Development Scenario. In the absence of evidence at the time of the endorsement of the Economic Development Scenario that the grounds for the application of exceptional circumstances in Lithuania prevail, the NAO FI invites the Government to prepare the state budget for 2024 in accordance with all national fiscal discipline rules, and to also submit a notice on the lifting of these exceptional circumstances together with the December Economic Development Scenario.

According to Council Regulation (EC) No 1466/97 of 7 July 1997, exceptional circumstances are defined as "<…> an unusual event outside the control of the Member State concerned which has a major impact on the financial position of the general government or in periods of severe economic downturn for the euro area or the Union as a whole".

The NAO FI reminds that exceptional circumstances allowed Lithuania to derogate from the national and EU fiscal discipline rules since 2020. Pursuant to the Constitutional Law, on 26 March 2020, the National Audit Office implementing the function of a fiscal institution published an opinion on the compliance of the unusual situation initiated by the Ministry of Finance of the Republic of Lithuania on 20 March 2020 with the definition of exceptional circumstances. In this context, exceptional circumstances were declared in Lithuania for the first time. On 20 September 2022, the NAO FI issued an opinion[1] on the cancellation of the

[1] Opinion on the compliance of the current situation to the definition of exceptional circumstances, 20-09-2020. Available online at: https://www.valstybeskontrole.lt/EN/Product/24132/opinion-on-the-endorsement-of-the-economic-development-scenario.

exceptional circumstances initiated by the Ministry of Finance of the Republic of Lithuania on 13 September 2022 on the grounds of the COVID-19 pandemic, and the establishment of exceptional circumstances in the Republic of Lithuania due to the geopolitical situation and the possible negative impact on general government finances.

The general escape clause of the Stability and Growth Pact was also activated in 2020. This meant that Member States could take crisis management measures by deviating from the medium-term budgetary requirements that would normally apply under the European fiscal framework. Following a declaration by the European Commission and the Council that the COVID-19 virus pandemic could be considered an "unusual event outside the control of the Government", on 23 March 2020 ministers endorsed the European Commission's proposal to activate the general escape clause of the Stability and Growth Pact at the Economic and Financial Affairs Council. Following Russia's subsequent war in Ukraine, in a Communication published on 23 May 2022, the European Commission[2] noted that the resulting increased uncertainty about macroeconomic development, unprecedented energy price hikes and the disruption of raw materials and supply chains caused by the pandemic justified the extension of the general escape clause of the Stability and Growth Pact until the end of 2023.

Fiscal discipline rules contribute to fiscal sustainability and macroeconomic stability. Given the rules, general government finances are managed in such a way as to accumulate surpluses when the economy is above its potential and to stimulate the economy when it is below its potential. Fiscal discipline rules also help to ensure that long-term liabilities, such as social security, health and defence, are covered by revenue and that their costs are not passed on to future generations through debt. Compliance with fiscal discipline rules ensures that general government deficits are reasonable and in line with economic conditions, thereby ensuring the sustainability of public finances. During the exceptional circumstances, the surplus general government and expenditure growth limiting rules have not been applied in order to give fiscal policy space to respond quickly to emerging challenges.

With economic development remaining relatively stable and the European Commission announcing that the general escape clause of the Stability and Growth Pact will expire at the end of this year, the NAO FI does not have any information that would justify further application of exceptional circumstances in Lithuania. In this context, the 2024 state budget should be based on all national fiscal discipline rules. According to the NAO FI's assessment, the economy will remain below its potential level in the coming years, thus even without the application of exceptional circumstances, there will be a possibility to form general government sector deficits given the size of the output gap. **According to the assessment of the NAO FI, continued application of exceptional circumstances is not justified in light of the information available at the time of the endorsement of the Economic Development Scenario:**

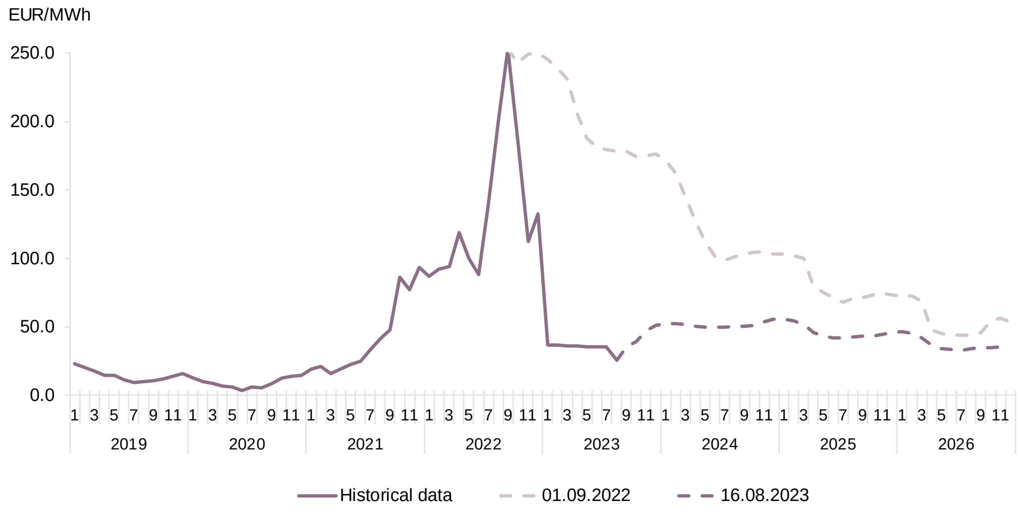
- The September Economic Development Scenario projects moderate GDP growth in 2024 and a stable labour market situation. Risks to economic development are also more balanced compared to last year. Therefore, the NAO FI believes that there is no reason to consider such economic development as a shock which requires significant general government financial resources to contain it.
- The strengthening of national defence in the current geopolitical context should be a long-term strategic objective and, therefore, the sources of funding should be sustainable. Uncertainties remain high, especially with regard to the course of the war,

[2] EC Spring Semester European Semester Toolkit of 23 05 2022. Available online at: https://commission.europa.eu/publications/2022-european-semester-spring-package-communication_en.

but adequate supervision of public finances and preserving fiscal space increase the chances of responding adequately to emerging challenges.

- Faced with energy price shocks, such as gas, electricity and oil, many countries have responded by using public resources to mitigate their impact. Energy prices are still higher than in 2021 but below the 2022 average. As Europe continues to expand its energy infrastructure and natural gas storage is rapidly filling up, the energy price spikes observed in 2022 are less likely (Figure 1). As energy prices stabilise and inflation falls, the need for large-scale support measures is no longer relevant.
- In EU countries, a return to fiscal discipline is likely from 2024. The EC Fiscal Policy Guidelines[3] published on 8 March 2023 indicate that the general escape clause of the Stability and Growth Pact will be lifted at the end of 2023.

Figure 1. The average price of gas TTF* futures for 2023–2026 is significantly lower than a year ago



* TTF (Title Transfer Facility) - a virtual trading point for natural gas in the Netherlands that is widely used for gas transactions in the EU. The TTF index is also used to determine the price of Lithuanian gas.

Source: https://www.barchart.com

The National Audit Office of the Republic of Lithuania, implementing the functions of the budget policy monitoring institution set out in the Constitutional Law on the Implementation of the Fiscal Treaty of the Republic of Lithuania hereby submits its opinion on the application of exceptional circumstances in 2024.

Head of Budget Monitoring Department — Jurga Rukšėnaitė

[3] Available online at: https://economy-finance.ec.europa.eu/document/download/cd3da41e-9b91-4b18-8e88-4dfa5c89d40e_en?filename=COM_2023_141_1_EN_ACT_part1_v4.pdf.