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ANNEX 14

ANNEX

Country annex

LITHUANIA

to the

REPORT FROM THE COMMISSION

**presented under Article 8 of the Treaty on Stability, Coordination and Governance in
the Economic and Monetary Union**

LITHUANIA

Lithuania deposited its instruments of ratification of the Treaty on Stability, Coordination and Governance in Economic and Monetary Union (TSCG) with the General Secretariat of the Council of the European Union on 6 September 2012.

National provisions considered in the assessment are essentially those provided for by:

- the constitutional law on the implementation of the fiscal treaty No XII-1289 of 6 November 2014 (the Constitutional Law),
- the Law No X-1316 of 8 November 2007 on fiscal discipline, as amended by Law No XII-1290 of 6 November 2014,
- the Law No I-907 of 30 May 1995 on the National Audit Office, as amended Law No XII-1291 of 6 November 2014.

1. Legal status of the provisions

The Constitutional Law enjoys the second-highest legal position after the Constitution itself, and so has a higher status than that of an ordinary budget law with the consequence that such laws must be adopted in compliance with it.

Against that background, Lithuania's provisions comply with the criterion of provisions of "binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes".

2. The balanced budget rule

Formulation: The balanced budget rule is set out in Article 3(1) of the Constitutional Law.

Article 3(1) of the Constitutional Law provides that "the implementation of the commitments set out in the Fiscal Treaty shall be pursued by managing the structural general government balance indicator", in line with the provisions of the TSCG which provide that requirements must be set in structural terms and cover all public subsectors. The medium-term objective (MTO) is defined in Article 2(4) of the Constitutional Law as being the structural balance to be reached within four consecutive years and is set in line with the Stability and Growth Pact (SGP) and TSCG requirements in its Article 5. The authorities indicate to the Commission that Article 2(4) was designed to ensure that the structural target set nationally was at least equal to the MTO, without precluding the possibility to have such a target set at a higher level than the MTO. Article 5 also includes lower limits for the MTO that are consistent with the TSCG lower limits. Pursuant to Article 2 all the terms used in the Constitutional Law (such as, for instance, "structural balance" or "general government") shall be understood as having the meaning of the corresponding terms in the SGP.

The balanced budget rule is deemed respected if, at least, one of the following conditions is fulfilled: (Article 3(1)(1)) *"the general government structural balance is in surplus"*, (Article 3(1)(2)) *"the structural general government balance is in absolute value lower than the MTO in absolute value and is annually decreasing"*, (Article 3(1)(3)) *"the structural general government balance in absolute value is higher than the MTO, if the output gap is negative"* or (Article 3(1)(4)) *"the fiscal effort towards the Medium Term Objective is not lower than the targeted fiscal effort"*.

When the MTO is negative, all those provisions are in line with the TSCG.

However, when the MTO becomes strictly positive, the conditions laid down in Article 3(1)(1), Article 3(1)(2) and Article 3(1)(3) create a possible source of discrepancy with the TSCG as they do not guarantee that the Contracting Party must progress towards the MTO. On the other hand, the condition laid down in Article 3(1)(4) is always in line with the TSCG. That latter conclusion is confirmed by the joint reading of Article 3(1)(4) with Article 6(1) which provides that the targeted fiscal effort must be established in line with Council Regulation (EC) No 1466/97 and Council Regulation (EC) No 1467/97. The Ministry of Finance formally confirmed that all the provisions of the Constitutional Law, including those laid down in Article 3(1), are and will be interpreted in line with the SGP and the TSCG. In that respect, the Ministry of Finance committed to ensure that Article 3(1)(4) of the Constitutional Law was always binding when applicable, irrespective of other conditions set out in points (1) to (3) of Article 3(1)¹.

Convergence towards the MTO: As Lithuania already reached the MTO after the Constitutional Law entered into force, it is the provisions on deviations from the MTO, i.e. the correction mechanism, which are relevant.

Escape clauses: In line with TSCG provisions, Article 2(2) defines the exceptional circumstances by referring to Council Regulation (EC) No 1466/97. Moreover, the exceptional circumstances are established or revoked by the monitoring institution (Article 7 of the Constitutional Law), a safeguard against abusive use. Articles 2(4) and 3(1) of the Constitutional Law set out those exceptional circumstances that allow departure from the MTO or from the adjustment path towards it. Article 6(7) mentions that, for years where the "exceptional circumstances" clause applies, the "structural adjustment targets shall not be set". As clarified by the authorities, Article 6(7) should be read jointly with Article 6(1). The provisions stemming from Article 6(7) would only apply in case it does not contradict SGP requirements (for instance if the structural target is set at a higher level than the MTO).

Overall, the balanced budget rule complies with the TSCG requirements in light of the formal commitment provided by the Lithuanian authorities. Given this commitment, Article 3(1)(4) of the Constitutional Law would always be binding when applicable, irrespective of other conditions set out in points (1) to (3) of Article 3(1). Under that interpretation, the balanced budget rule always ensures consistency with the MTO. Moreover, while the Constitutional Law envisages the possibility of a "blank year" in the event of exceptional circumstances, the authorities confirmed that this provision will always be interpreted in line with SGP requirements.

3. The correction mechanism

The provisions relevant for the correction mechanism are mostly found in Articles 3, 6 and 8 of the Constitutional Law as well as in Article 4(1) of Law No XII-1291. The legislation does not include a dedicated section on the correction mechanism, which is not conducive to clarity. However, Article 8 of the Constitutional Law together with Article 3(2) institutes a procedure de facto similar to the activation of a correction mechanism. The requirements applying to the substance of the correction stem from Article 6, which sets the required path for the structural balance in general.

Activation: Article 3(2) of the Constitutional Law obliges the government to report by 1 May on the budget execution of the previous year, in particular *vis-à-vis* the structural balance

¹ Letter from the Lithuanian authorities of 19 July 2016.

objective and the structural adjustment target. In the event that the structural adjustment target has not been implemented, the government must submit to Parliament and the Budget Policy Monitoring Department (BPMD) within the National Audit Office a written explanation of the causes for the slippage (Article 8(1) of the Constitutional Law). Moreover, the BPMD in turn must submit to Parliament an assessment on the causes of the slippage. According to Article 4(1) of Law No XII-1291, that assessment must be delivered within 30 working days after the report from the government. The government shall then provide within one month to Parliament a final assessment of the reasons for not achieving the structural targets.

The Lithuanian legislation does not refer to the notion of a significant deviation. However, a literal reading of Articles 3 and 8 of the Constitutional Law, which was confirmed by the Lithuanian authorities, implies that any deviation from the structural adjustment target would constrain the government and the BPMD to report in accordance with those provisions. In that context, the BPMD will have an important role in monitoring the need for activation and checking the methodology for evaluating structural balances.

Finally, given that the structural targets set for the annual budget must be consistent with the terms and conditions laid down in Council Regulation (EC) No 1466/97 and Council Regulation (EC) No 1467/97 (Article 6(1)), the identification of a significant deviation by the Union institutions would automatically trigger the correction mechanism.

Substance of the correction: In the event of activation (for the purposes of Article 8(1) of the Constitutional Law), the government must submit to Parliament a list of measures which ensure the restoration of the structural balance path. The measures will be assessed by the BPMD.

The corrective measures must be sufficient to ensure compliance with the terms and conditions laid down in Council Regulation (EC) No 1466/97 and Council Regulation (EC) No 1467/97 (Article 6(1)), in accordance with the principle of consistency with the Union budgetary surveillance framework.

In addition, when the deviation from the MTO is less than 2 percent of GDP, the correction measures must ensure that the return to the MTO occurs within a maximum horizon of two years (Article 6(3)), in line with the TSCG requirement to implement the correction 'over a defined period of time' and with the common principles (principle n° 4).

In the event that the deviation from the MTO exceeds 2 percent of GDP, a literal reading of the Article 6(2) of the Constitutional Law suggests that the return to the MTO occurs within a maximum horizon of four years. While that period would be a defined horizon, it would also allow for the correction to be spread over many years and may lack credibility. However, the Lithuanian authorities have formally clarified that if the deviation from the MTO were to exceed 2 percent of GDP, Article 6(2) should actually be interpreted as requiring a return to the MTO within a maximum of two years following the occurrence of the deviation². This is consistent with the TSCG requirement to implement the correction 'over a defined period of time' and with the common principles (principle n° 4).

Overall: The correction mechanism is compliant with the TSCG requirements and the common principles in light of the clarifications provided by the Lithuanian authorities. Given those clarifications, a corrective procedure would be automatically activated in the event of any deviation from the MTO or the adjustment path thereto, and the substance of the

² Letter from the Lithuanian authorities of 19 July 2016. According to that interpretation, the first year of the four-year time span is the year preceding the occurrence of the deviation. It follows that the fourth year is the second year after the occurrence of the deviation.

correction would have to respect both Union-level recommendations and a two-year corrective horizon.

4. The monitoring institution

The Lithuanian monitoring institution is the National Audit Office (NAO), which implements the related functions *via* its Budget Policy Monitoring Department (BPMD).

Set-up and statutory regime: The NAO is established under the Constitution and regulated by Law No I-907. The amendments to Law No I-907 introduced by Law No XII-1291 conferred upon the NAO the additional function of "budget policy monitoring authority" envisaged by the Constitutional Law. Within the NAO, the BPMD has been established to effectively carry out the related tasks³. As of 14 July 2016, the BPMD is under the direct authority of the NAO's Auditor General⁴.

Mandate: The broadly delineated mandate of the monitoring institution covers the tasks foreseen by the Fiscal Compact and the common principles. According to Law No I-907 (Articles 2 and 4), the NAO performs the functions of the budget policy monitoring authority defined as monitoring of compliance with the rules and fulfilment of the tasks set out in the Constitutional Law and preparation of the opinions specified in Article 9(6). In connection with the Constitutional Law (Articles 7 and 8), Law No I-907 (Article 9(6)) requires the NAO to submit to Parliament: (i) an opinion on the validity of the reasons put forward by the government to explain the failure to implement the structural adjustment target and on the appropriateness of the measures proposed by the government for the implementation of the structural adjustment target; (ii) an opinion on the structural adjustment target set by the Draft Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets for a specific year and on the need for additional measures to achieve this target; (iii) an opinion on the endorsement of the economic development scenario prepared by the Ministry of Finance; (iv) an opinion on the correspondence between the current or projected situation with the definition of exceptional circumstances in accordance with the provisions of Council Regulation (EC) No 1466/97; (v) an opinion on the compliance of the guidelines proposed by the government to the parliament for setting the structural adjustment targets and the measures for the implementation of these targets with the time limit requirements for the achievement of the MTO established in the constitutional law. As part of its broader mandate, the BPMD produces other analysis as well, in particular a fiscal sustainability report.

Comply-or-explain principle: A 'comply-or-explain' principle is laid down in the Constitutional Law (Article 8), according to which the government takes note of the monitoring institution's assessment on the validity of reasons for the failure to implement the structural adjustment target and the appropriateness of the measures for the implementation the structural adjustment target before presenting to the Parliament a final notice on these two aspects. The Lithuanian authorities confirmed that, pursuant to that provision, the government explains in its final notice to the Parliament how it has taken into account the assessments of the monitoring institution, or the reason for not following them⁵. The Constitutional Law (Article 7) also provides for the government to submit a notice on exceptional circumstances to the monitoring institution for its approval. Exceptional circumstances are considered established or cancelled when the monitoring institution publishes its opinions on the

³ The Decree of the Auditor General V-244 of 19 December 2014 on the Regulation of the BPMD, as amended by Decree V-129 of 14 July 2016 sets tasks, functions, rights and organisation of the BPMD.

⁴ Letter from the Lithuanian authorities of 19 July 2016.

⁵ Letter from the Lithuanian authorities of 15 September 2015.

correspondence between the current or expected situation with the definition of exceptional circumstances established in Council Regulation (EC) No 1466/97 and on the endorsement of the economic development scenario.

Freedom from interference and capacity to communicate: The Constitutional Law (Article 9) provides that neither the monitoring institution nor any of its members should accept instructions from any other institution or person; State institutions and other persons are obliged to respect its independence. As regards the capacity to communicate, the BPMD opinions issued under Article 9(6) of Law No I-907 must be published on the NAO website⁶.

Nomination procedure: Article 27 of Law No I-907 establishes the procedure for the appointment of the Auditor General and some other general requirements. In line with Article 133 of the Constitution, the Auditor General is appointed for a five-year period by the Parliament, upon the recommendation of the President of the Republic. He/she may be appointed for no more than two successive terms. Any Lithuanian citizen who has an impeccable reputation, is not older than 65 and has a higher university education may be appointed Auditor General, without any reference to competence and experience. However, according to the Lithuanian authorities⁷, the competence and suitability of the candidate to perform the duties of the Auditor General (including implicitly that of heading the monitoring institution) is assessed through the special parliamentary procedure for appointment. The requirements for competence and experience of the BPMD staff are set in job descriptions approved by the Auditor General. Article 9 of the Decree of the Auditor General V-244 of 19 December 2014 provides for the BPMD to be headed by a Director. The Director and the other staff members are recruited under the general procedures prescribed by the Law on Civil Service and the Labour Code.

Resources and access to information: The budget of the NAO includes a separate budget line for the performance of the monitoring institution function, which is used only for this purpose. The BPMD is composed of seven staff members, including the Director. As from April 2016, two foreign experts support the work of the BPMD, in particular by providing methodological advice.

As regards access to information, the Constitutional Law (Article 9) gives the monitoring institution a right to receive from State and municipal bodies all relevant information which is necessary to perform its functions.

Overall, the set-up of the Lithuanian monitoring institution is compliant with the TSCG requirements and common principles in light of the clarifications provided by the national authorities on the competence requirements for the head of the monitoring institution. The NAO is grounded in law and its mandate has been expanded to provide the necessary basis for carrying out – through the BPMD – the tasks foreseen by the Fiscal Compact and the common principles. The legal framework includes appropriate safeguards for functional autonomy. Although there are no legal provisions setting competence requirements for the Auditor General as head of the monitoring institution, his/her competence and suitability are assessed through the special parliamentary procedure for appointment. The 'comply-or-explain' principle is provided for in the law. Adequate provisions and institutional arrangements concerning the NAO and BPMD's endowment with resources and access to information are in place.

⁶ <https://www.vkontrole.lt/bp>

⁷ Letter from the Lithuanian authorities of 15 September 2015.

5. Conclusion

The national provisions adopted by Lithuania are compliant with the requirements set in Article 3(2) of the TSCG and in the common principles in light of the formal commitment provided by the national authorities on the substance of the balanced budget rule, the clarifications provided by the national authorities on the activation and substance of the correction mechanism and the clarifications provided by the national authorities the competence requirements for the head of the monitoring institution.