

**Republic of Lithuania: Report on the Observance of Standards and Codes—Fiscal  
Transparency Module**

This Report on the Observance of Standards and Codes on Fiscal Transparency for the **Republic of Lithuania** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **November 1, 2002**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of the Republic of Lithuania or the Executive Board of the IMF.

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**International Monetary Fund  
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INTERNATIONAL MONETARY FUND

REPUBLIC OF LITHUANIA

**Report on the Observance of Standards and Codes (ROSC)  
Fiscal Transparency Module**

Prepared by the Fiscal Affairs Department

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November 1, 2002

**EXECUTIVE SUMMARY**

This report assesses fiscal transparency practices in Lithuania in relation to the requirements of the *IMF Code of Good Practices on Fiscal Transparency* based on the authorities' response to the IMF fiscal transparency questionnaire and other information provided by the authorities.

Lithuania's fiscal institutional framework meets many requirements of the Code of Good Practices on Fiscal Transparency. Important strengths are clearly-defined roles and responsibilities of the three branches of government; limited scope for quasi-fiscal activity at the central government level; and binding debt rules for all levels of government. Also, reforms that are being implemented promise to ultimately move Lithuania toward best practices in several areas. Still, Lithuania has much room for further improvement in a number of key fiscal transparency areas. In particular, a significant degree of fragmentation in the budget framework and budget processes—with various extrabudgetary funds, programs, and activities, and different concepts for planning, monitoring, and reporting budget activity—increases administrative burdens and adversely affects administrative efficiency. Also, while financial compliance controls over state budget execution are in place, the efficiency of fiscal management and planning systems needs to be enhanced with respect to a large number of budget institutions, and their comprehensiveness should be improved by including extrabudgetary funds, programs, and activities, and the operations of the municipalities.

IMF staff recommendations for enhancing fiscal transparency focus on three areas: enhancing the comprehensiveness of the budget framework; streamlining fiscal management procedures and practices; and strengthening fiscal documentation and analysis. Most immediate among these would be adopting a single, comprehensive budget framework for analytical purposes, fiscal decision making, and fiscal accounting and reporting. In addition, the staff suggests to further reduce quasi-fiscal activities (particularly at the municipal level), including by strengthening financial controls, as well as internal and external audits.

	Page
I. Introduction.....	5
II. Description of Practice.....	5
A. Clarity of Roles and Responsibilities .....	5
B. Public Availability of Information .....	13
C. Open Budget Preparation, Execution, and Reporting .....	17
D. Assurances of Integrity.....	24
III. IMF Staff Commentary .....	27
<i>Enhancing the comprehensiveness of the budget</i> .....	28
 Text Boxes	
1. The Reform of Municipal Finances.....	10
2. Main Sources of Fiscal Risk .....	15
3. The Budget Cycle .....	18

**ABBREVIATIONS, ACRONYMS, AND SPECIFIC TERMS**

BoL	Bank of Lithuania
CPI	Consumer Price Index
DoS	Department of Statistics
EBF	Extrabudgetary Fund
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
EU	European Union
FPAD	Financial Planning and Analysis Division of the State Treasury
FSSA	Financial System Stability Assessment
GFS86	Government Finance Statistics Manual of 1986
GFS01	Government Finance Statistics Manual of 2001
HIF	State Health Insurance Fund
IBRD	World Bank
IMF	International Monetary Fund
MoE	Ministry of Economy
MoF	Ministry of Finance
MoI	Ministry of Interior
MoJ	Ministry of Justice
NIB	Nordic Investment Bank
SPF	State Property Fund
PIP	Public Investment Program
QFAs	Quasi-fiscal activities
ROSC	Report on the Observance of Standards and Codes
RSF	Reserve Stabilization Fund
SBA	Standby Arrangement
SCO	State Control Office (External Audit)
SDDS	Special Data Dissemination System
SDMD	State Debt Management Department of the Ministry of Finance
Seimas	Lithuania's national parliament
SNA	System of National Accounts
SoDra	State Social Insurance Fund
SRA	Saving Restitution Account
TSA	Treasury Single Account

### LITHUANIAN WEBLINKS

AB Turto Bankas	<a href="http://www.turtas.lt">www.turtas.lt</a>
Association of Municipalities	<a href="http://www.lsa.lt">www.lsa.lt</a>
Bank of Lithuania	<a href="http://www.lbank.lt">www.lbank.lt</a>
Central Securities Depository	<a href="http://www.csdl.lt">www.csdl.lt</a>
Chamber of Auditors	<a href="http://www.lar.lt/">www.lar.lt/</a>
Commission for Prices and Energy	<a href="http://www.regula.is.lt">www.regula.is.lt</a>
Communications Regulatory Authority	<a href="http://www.rrt.lt">www.rrt.lt</a>
Constitutional Court	<a href="http://www.lrkt.lt">www.lrkt.lt</a>
Department of Statistics	<a href="http://www.std.lt">www.std.lt</a>
Deposit Insurance Fund	<a href="http://www.idf.lt">www.idf.lt</a>
Development Agency	<a href="http://www.lda.lt">www.lda.lt</a>
Export and Import Insurance Company	<a href="http://www.leidas.lt">www.leidas.lt</a>
Government of Lithuania	<a href="http://www.lrvk.lt">www.lrvk.lt</a>
Investments and Business Guarantees Company	<a href="http://www.invega.lt">www.invega.lt</a>
Ministry of Finance	<a href="http://www.finmin.lt">www.finmin.lt</a>
Ministry of Justice	<a href="http://www.tm.lt">www.tm.lt</a>
Mortgage Insurance Company	<a href="http://www.bpd.lt">www.bpd.lt</a>
National Stock Exchange	<a href="http://www.nse.lt">www.nse.lt</a>
Parliament (Seimas)	<a href="http://www.lrs.lt">www.lrs.lt</a>
President of the Republic	<a href="http://www.lrp.lt">www.lrp.lt</a>
State Audit Office	<a href="http://www.vkontrole.lt">www.vkontrole.lt</a>
State Health Insurance Fund	<a href="http://www.vlk.lt">www.vlk.lt</a>
State Procurement Agency	<a href="http://www.vpt.lt">www.vpt.lt</a>
State Property Fund	<a href="http://www.vtf.lt">www.vtf.lt</a>
State Social Insurance Fund	<a href="http://www.sodra.lt">www.sodra.lt</a>
State Tax Inspectorate	<a href="http://www.vmi.lt">www.vmi.lt</a>
Vilnius Municipality	<a href="http://www.vilnius.sav.lt">www.vilnius.sav.lt</a>

More links to government web sites are available at [www.online.lt/hgov.htm](http://www.online.lt/hgov.htm). *Seimas* has a comprehensive legal database available at [www3.lrs.lt/n/eng/DPaieska.html](http://www3.lrs.lt/n/eng/DPaieska.html). The Ministry of Justice provides translations of major laws at [www.tm.lt/Litlex/Eng/Frames/Laws/Laws.htm](http://www.tm.lt/Litlex/Eng/Frames/Laws/Laws.htm); the Ministry of Finance provides some translated laws at [www.finmin.lt/engl/istatmen.htm](http://www.finmin.lt/engl/istatmen.htm).

#### Lithuania: Basic Data

**Type of government:** unitary parliamentary republic

**Fiscal year:** January–December

**Population:** 3,475.6 thousand

**GDP (2001 preliminary):** LTL 47,968 million (US\$11,992 million)

**Public and publicly guaranteed debt in percent of GDP (2001 preliminary):** 29.2

## I. INTRODUCTION<sup>1</sup>

1. This report assesses fiscal transparency practices in Lithuania against the requirements of the IMF *Code of Good Practices on Fiscal Transparency*. The assessment has two parts. The first part is a description of practice, prepared by the IMF staff on the basis of discussions with the authorities and their responses to the fiscal transparency questionnaire, and drawing on other available information. The second part is an IMF staff commentary on fiscal transparency in Lithuania.

## II. DESCRIPTION OF PRACTICE

### A. Clarity of Roles and Responsibilities

2. **Lithuania maintains various domestic definitions of the scope of government fiscal activity that are different from more common international definitions.** Key domestic fiscal concepts are the state budget and the national budget, which classify some transactions differently than standard international concepts, and exclude a number of extrabudgetary fiscal operations.<sup>2</sup> In general, the domestic definitions are used for the annual budget documents and budget monitoring, and maintained in parallel to standard international definitions. As a subscriber to the SDDS, the Ministry of Finance (MoF) also prepares, on the basis of GFS86, annual data on consolidated general government operations, and summary monthly, quarterly, and annual data on central government operations.<sup>3</sup> A recent “ROSC—Data Module”<sup>4</sup> comments on the extent to which the reported data comply with GFS86 and makes recommendations for improving coverage and classification. Data on

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<sup>1</sup> This report was prepared by an IMF staff team comprising Gerd Schwartz, Jon Craig, and Elina Ribakova (all from the Fiscal Affairs Department), based on a mission that visited Vilnius during July 10–23, 2002. The team met with officials from the Ministries of Finance, Health, Education, and the Interior; the Central Bank; the Social Insurance Fund; the Health Insurance Fund; the State Tax Inspectorate; the State Property Fund; the State Procurement Agency; the State Control Office; the Price Commission; the Budget and Finance Committee of Parliament (*Seimas*); the Association of Municipalities; the municipality of Vilnius; the Free Market Institute; Vilniaus Bank; and A. Evans Consultants.

<sup>2</sup> For example, under the national definition, capital expenditures include some repayments of foreign debt, and budgeted interest expenditures include some provisions for loan defaults. Overall, the *State Budget* (budgetary central government) covers 1,066 budgetary entities (including the *Seimas*; the Presidency; all ministries, public agencies, and services; and the Supreme Court). Excluded from the state budget are EU grants, net lending operations, and the operations of extrabudgetary funds. The *National Budget* covers the state budget and the consolidated municipal budgets; there are 60 independent municipal budgets.

<sup>3</sup> The *Central Government* comprises the budgetary central government (including net lending and foreign grants), two extrabudgetary social funds—the State Social Insurance Fund (SoDra) and the Compulsory Health Insurance Fund (HIF)—and, in 2002, six other extra-budgetary special purpose funds. The *General Government* comprises the Central Government and all 60 municipal governments.

<sup>4</sup> See “Lithuania: ROSC—Data Module,” (September 2002).

the nonfinancial public enterprise sector and the consolidated nonfinancial public sector are not compiled.<sup>5</sup>

3. **In general, government activities are separated from the activities of the public enterprise sector, but fiscal risks from public enterprise operations remain.** Rapid progress with privatization, and the establishment of a comprehensive legal framework based on individual property rights have helped significantly to reduce the scope for quasi-fiscal activities (QFAs) and fiscal risk, particularly at the central government level. The government does not require public enterprises to provide services on a noncommercial basis, although some public tariffs (e.g., for public transportation and district heating) have not always been fully adjusted to reflect cost developments. Also, the government continues to be exposed to fiscal risks resulting from potential losses of the remaining financial and nonfinancial state enterprises.<sup>6</sup> Similarly, the government continues to incur contingent liabilities by extending loan guarantees to state enterprises. Finally, progress on separating government activities from the activities of the public enterprise sector has been less pronounced at the municipal level.

4. **The central bank is independent and does not play a fiscal role or carry out QFAs, and the financial public sector is small.** Under the currency board arrangement, the Bank of Lithuania (BoL), as the country's central bank, is prohibited from lending to the government or purchasing government securities in the primary market.<sup>7</sup> This prohibition covers all types of lending operations (also including, for example, overdrafts), and extends to all institutions of executive authority, and to state and municipal enterprises. The BoL acts as treasury agent: it holds government deposits on which it pays interest, and carries out payment operations on behalf of the government for which it is remunerated.<sup>8</sup> Also, while the BoL may purchase government securities in the secondary market (i.e., for monetary policy purposes) or obtain them as collateral in its open market or overnight lending operations, in practice these operations have been extremely limited. In general, the government is not liable for BoL obligations, and the BoL is not liable for obligations of the government. The

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<sup>5</sup> There are no official definitions of the public sector or nonfinancial public sector, and there is no comprehensive list of nonfinancial public sector enterprises at state and municipal levels. Main sectors in which nonfinancial public sector enterprises operate are energy and transport, but over 72 percent of GDP is now generated by the private sector.

<sup>6</sup> A recent FSSA noted that, at least for some of the public financial sector, there are widespread expectations that enterprises would be bailed out by the government if they were to become insolvent. See "Lithuania: Financial System Stability Assessment," IMF Country Report No. 02/19 (February 2002).

<sup>7</sup> See Law on the Bank of Lithuania; No. I-678 of December 1994. The BoL pays a share of its annual profits to the government; the amount is determined by formula. The mission noted that the BoL continues to carry on its balance sheet a small credit to the government from before the 1994 law took effect.

<sup>8</sup> For details see "The Procedure for Investment of Temporarily Free State Monetary Reserves," Order 49 of the MoF, dated February 28, 2001; and "The Rules on Management of Depositor's Accounts at the Bank of Lithuania" Resolution 82 of the Board of the BoL, dated June 8, 2000.

BoL is accountable to the *Seimas*. The scale of the rest of the financial public sector<sup>9</sup> is now relatively small, following the recent sales of the Lithuanian Savings Bank and the Lithuanian Agricultural Bank, which completed the privatization of the public banking sector.

**5. Government regulations for the nonbank private sector are fairly transparent.** The existing laws and regulations—including laws on enterprise establishment and operation, types of business establishments, investments, tax and customs administration, property rights, and other laws regulating corresponding fields of business activities<sup>10</sup>—provide a comprehensive framework for private sector operations, although further streamlining of administrative procedures and regulations would facilitate private sector activity. While regulated prices are maintained for roughly 20 percent of the CPI consumption basket (including for electricity, gas, domestic heating, public transport, and water supply services), most, but not all, of these are maintained at market levels. Recent changes to the Company Law enhance shareholders' and creditors' rights, and elaborate on corporate reorganizations in line with EU guidelines. Similarly, various legal acts on intellectual property have been introduced and the framework for a competition policy was established in line with EU requirements.<sup>11</sup> The government is currently working on strengthening private sector auditing and accounting procedures and supervision.

**6. The transparency of the privatization process has significantly increased.** Since 1998, the State Property Fund (SPF) has been increasingly entrusted with the ongoing privatization program.<sup>12</sup> The SPF is governed by a board of directors, consisting of representatives from different Ministries (e.g., Finance and Justice), and it reports on its

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<sup>9</sup> In addition to the BoL, the financial public sector comprises the Deposit Insurance Fund; AB Turto Bankas (which manages nonperforming assets that are transferred to it by the government); the Central Credit Union; the Housing and Urban Development Fund; the Mortgage Insurance Company; a Company for Investment and Business Guarantees for Small and Medium Enterprises (INVEGA, which also administers loan interest subsidies); and the Export and Import Insurance Company (LEID). In addition, the state maintains minority shareholdings in the National Stock Exchange (44 percent) and the Central Securities Depository (32 percent).

<sup>10</sup> See the main laws on enterprises (No. 14-395, 1990) and registration of enterprises (No. 24-599, 1990), the laws on enterprise types, including the Company Law (No. 64-1914, 2001), and the law on investments (No. 16-2127, 1999).

<sup>11</sup> The European Commission: 2001 Report on Lithuania's Progress Towards Accession.

<sup>12</sup> The SPF was established by the Law on the State Property Fund (No. VIII-482 of November 1997). It has four main functions: to privatize state assets of any kind (e.g., equity holdings, structures, facilities, companies) in line with the Law on Privatization of State-Owned and Municipal Property (No. VIII-480 of November 1997) and the Law on Public Trading in Securities (No. I-1169, as amended in July 1996); to manage and represent the interests of the state for all state assets held in its trust; to draft and submit to the government regulations on privatization and asset management; and to represent the Government in court proceedings related to privatization transactions. Comprehensive information on the SPF's role, supporting legal documents, and summary information on state equity holdings and annual SPF activities can be found on the SPF website. To finance its operations, the SPF receives 14 percent of the receipts from privatizing real estate, and 3.2 percent from the sale of shares (0.7 percent when external advisors are hired).



operations quarterly to *Seimas*. The SPF is also audited annually by an independent external auditor and the State Control Office (SCO). An independent Privatization Commission, set up by *Seimas*, supervises the privatization process and the approval of privatization contracts; the sale of large or strategic enterprises may also require direct government approval. Foreign and domestic investors have equal rights to acquire state-owned assets, and information on currently available privatization opportunities is widely disseminated. Prior to 2000, some large privatization transactions were completed without SPF involvement, which adversely affected transparency, and politicized the privatization process. Municipalities may still privatize the assets they hold without SPF involvement.<sup>13</sup>

**7. Privatization in key economic sectors is nearing completion, but the recording of remaining government asset holdings could be improved.** The privatization of the insurance and banking sectors was fully completed in 1999 and 2002, respectively, and much of the privatization of the telecommunications sector was completed during 1998–2000. The planned disposal of assets in the energy (gas & electricity) and transportation (air & rail transport) sectors will largely complete the government’s strategic privatization agenda.<sup>14</sup> About two-thirds of privatization receipts have been deposited into the government’s Privatization Fund and earmarked for specific uses (including savings restitution, investment programs, reserve stabilization, and debt service), the remainder has not been subject to earmarking.<sup>15</sup> While the SPF oversees government asset and equity holdings that are slated to be privatized,<sup>16</sup> there is no requirement that government agencies register their holdings with the SPF, and, hence, there is no comprehensive government asset registry.

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<sup>13</sup> However, about 10 municipalities have contracted the SPF as their privatization agent.

<sup>14</sup> Still, public ownership remains fairly extensive in numbers. Municipalities, in particular, continue to own a large number of enterprises, ranging from large-scale public utilities, to building maintenance companies, and retail stores. The municipalities of Vilnius and Kaunas, for example, each own and operate over 100 municipal enterprises. See “Lithuania: Issues in Municipal Finance” World Bank Report No. 23716-LT (May 16, 2002).

<sup>15</sup> The restitution of savings lost by depositors in the early 1990s during high inflation was initially envisaged a main use for privatization revenues. The Law on Savings Restitution (No. VIII-240 of June 1997) states that no less than two thirds of privatization monies must be allocated for this purpose, though no time schedule was set for payment. Amendments to the law had effectively suspended the savings restitution plan during 2000–01, but current legislation requires the government to resume payments in 2002, with LTL76 million (0.1 percent of GDP) having been allocated for this purpose.

<sup>16</sup> The SPF’s 2001 report states that, at end-2001, the government held equity participations in 1,140 joint-stock and private companies, of which 78 were state-controlled, 204 were bankrupt, and 113 were under liquidation; it also held in trust 1,176 real estate assets. As trustee and manager of state assets, SPF representatives also participated in 1,120 general meetings of company shareholders, and in 148 corporate managing bodies. Among others, the SPF performs financial and economic analyses of the assets, and it leases and transfers real estate assets. The report is available at <http://www.vtf.lt/english/Report%20of%20SPF%20-%202001.htm>.

8. **The roles and responsibilities of the executive, legislative, and judicial branches of government in the budgetary process are clearly defined.** The Constitution<sup>17</sup> sets out the separation of the three branches of government, and defines their responsibilities in separate chapters on the *Seimas* (Chapter 5); the President of the Republic (Chapter 6) and the government (Prime Minister and Ministers) (Chapter 7); and the court system (Chapters 8 and 9). The Constitution also has a separate chapter on State Finances and the State Budget (Chapter 11), and stipulates that the government prepare a draft state budget, and submit it to *Seimas* no later than 75 days before the end of the budget year, which then has to consider and approve it by the beginning of the new budget year.<sup>18</sup> In considering the draft state budget, *Seimas* may only increase expenditures upon specifying their sources of financing; *Seimas* may change the budget during the budget year. The government is responsible for executing the state budget. In addition, in practice the Constitutional Court can play an important role in fiscal issues through its decisions on matters referred to it by the government.<sup>19</sup>

9. **The legal bases for fiscal management are comprehensive but the administrative framework is significantly fragmented.** A number of laws and government resolutions define the legal bases for fiscal management;<sup>20</sup> they are primarily focused on ensuring accountability and financial compliance. In addition, the legal framework supports the government's strategic planning efforts within a multi-year framework, and provides a basis for the program budgeting framework that has been put in place since 2000. While the various laws are adhered to, the fiscal decision-making process remains fragmented by a number of factors, including the maintenance of separate extrabudgetary funds, programs, and operations; the maintenance of a separate public investment program (PIP); and a lack of synchronization of planning cycles.<sup>21</sup> In addition, the budget is not always revised in the light of changes in policies, which adversely affects the integrity of the budget process.<sup>22</sup>

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<sup>17</sup> Available in English at <http://www.lrkt.lt/konst/eng/constitution.htm>.

<sup>18</sup> If the state budget is not approved in time, monthly budget expenditures in the new fiscal year may not exceed one-twelfth of the total state budget expenditures of the previous budget year.

<sup>19</sup> For example, in July 2002, the Constitutional Court ruled as unconstitutional five legal acts which stipulated that a fixed percentage share of GDP should be devoted to certain sectors (e.g., health, education).

<sup>20</sup> These include permanent laws (e.g., those on Budgetary Institutions (1995), Budget Structure (2001), and the State Treasury (1994)), annual laws (e.g., the annual law on approval of the state budget and financial indicators of municipal budgets), and government resolutions, many of which relate to the procedures of fiscal management (e.g., the annual resolution on the Procedure for Drawing up and Implementing State Budget and Municipal Budgets). For an earlier overview on fiscal management, also see "Public Management Profiles of Central and Eastern European Countries: Lithuania," prepared by OECD/Phare Sigma (September 1999).

<sup>21</sup> For example, decisions on the use of the privatization funds are made on a half-year basis, separate from the state budget operations. Similarly, the medium-term planning framework is only updated after a new annual budget has been passed.

<sup>22</sup> For example, revisions in tax laws that affect revenue collections during the year would not necessarily trigger a revision of the annual budget law.

**10. Inter-governmental fiscal relations are being strengthened, but the issue of municipal arrears still requires a comprehensive solution.** The 2002 reform of municipal finances was a significant achievement (Box 1).

### **Box 1. The Reform of Municipal Finances**<sup>1/</sup>

Lithuania has a three-tier administrative structure with a central government, 10 regional administrations, and 60 municipal governments. Municipal expenditure assignments focus on primary and secondary education, selected health and welfare services, and the provision of public utilities and other services (e.g., district heating, water supply/sewerage, and municipal public transit).

A reform of municipal finances implemented in 2002 aimed at securing funds for delegated municipal expenditure responsibilities; simplifying revenue sharing and distribution arrangements; and improving the targeting of transfers.<sup>2/</sup> Delegated functions were separated from the autonomous municipal functions, and the central government assumed responsibility for financing delegated functions. Based on sector-specific need indicators (e.g., student enrollment) and preliminary cost estimates by the municipalities, the central government establishes transfer amounts for each delegated function. In 2002, delegated functions were estimated at approximately 55 percent of the total municipal expenditure, and 40 percent of personal income tax revenue have been assigned to delegated municipal expenditure functions. However, the central government has to transfer to the municipalities the full amount for all delegated expenditures. This has significantly reduced the exposure of local governments to budgetary uncertainties.

Autonomous municipal expenditure functions will continue to be financed from local fees and centrally administered municipal taxes (e.g., property taxes),<sup>3/</sup> and revenue equalization arrangements, which aim at redistributing funds from higher to lower income municipalities. The funds are allocated based on two criteria: per capita revenue in a municipality compared to the national average, and various indicators of need (such as remaining education financing requirements, number of pensioners, land area, and length of roads). Previously, allocations were estimated based on per capita tax revenues in the preceding budget year. In 2002, only revenue from the personal income tax is redistributed; allocations are recalculated every month based on the actual personal income tax collections; criteria of need have been clarified.

The 2002 reforms also tighten access to municipal borrowing, and provide incentives to municipal governments to exercise greater spending control by giving municipalities clear authority over non-delegated expenditure functions, and by allowing them to keep some of the expenditure savings they achieve for state-delegated functions. However, the reforms were not sufficiently clear on the repayment of the municipal arrears, but under the current SBA with the IMF the government is committed to achieve permanent reductions in the stock of municipal arrears. In this context, a new three-year debt relief arrangement started to be implemented in 2002. Accordingly, continued transfers to municipalities for arrears clearance operations are conditional on municipal arrears for the previous reporting period having been reduced by an amount no less than the amount of the previous transfer that was provided.

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1/ For a more detailed assessment see "Lithuania—Issues in Municipal Finance," World Bank Report No. 23716-LT, of May 16, 2002.

2/ Amendments to the Law on Local Self-Government were enacted in 2000, and to the Law on Methodology of Revenue Redistribution among Municipalities in 2001.

3/ At present, there are two property taxes in Lithuania, a land tax and a real estate tax. A draft law, which is expected to be submitted to the *Seimas* by end-2002, envisages unifying the two, with a view of simplifying tax administration and in line with the EU guidelines.

In this context, expenditure assignments were revised, and municipalities were given more control over the management of delegated expenditure functions (e.g., teacher salaries),<sup>23</sup> while central government transfer payments to carry out these functions were based on specific need indicators (e.g., number of students). Municipalities receive transfers from the state budget to carry out delegated functions, take part in revenue sharing (which is subject to horizontal equalization arrangements), and have some own sources of revenue (e.g., municipal fees, and centrally-administered local taxes).<sup>24</sup> The equalization arrangements are complex but transparent. Within the borrowing limits approved by *Seimas*, municipalities may borrow domestically and abroad,<sup>25</sup> and cover temporary shortfalls of revenue during the budget year by short-term bridge-financing that is to be repaid in the current budget year. However, in practice, these arrangements have not prevented municipalities from accumulating significant arrears, including to suppliers, their municipal enterprises, and the central government.<sup>26</sup>

**11. The existence of extrabudgetary funds (EBFs), activities, and programs adversely affects fiscal transparency.** The scope of extrabudgetary activity has been significantly reduced, with the integration into the state budget of a number of extrabudgetary funds. In 2002, there were a total of eight EBFs, including the two main social funds.<sup>27</sup> This is a substantial

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<sup>23</sup> The various state-delegated, semi-autonomous, and autonomous functions of the municipalities were specified in the amendments to the Law on Municipalities enacted in 2000.

<sup>24</sup> About ¾ of all municipal revenues are derived from the centrally-administered PIT, which, although fairly buoyant in the past, is generally vulnerable to economic downturns. In addition, the new PIT law, which will become effective in 2003, is expected to reduce municipal revenues from this source.

<sup>25</sup> For investment projects approved by the central government, municipalities can also borrow from international financial organizations with a central government guarantee. Under the current IMF Standby Arrangement (SBA), the central government will not support external borrowing by municipalities.

<sup>26</sup> The World Bank report on "Lithuania Issues in Municipal Finance" (Report No. 23716-LT of May 16, 2002) states that, as of October 1, 2001, the stock of municipal arrears was equivalent to about 0.9 percent of GDP. A recent IMF Staff Report (IMF Country Report No. 02/131 of July 2002) shows that as of April 2002, total municipal overdue payables, arrears, and short-term debt to commercial banks amounted to about 1.3 percent of the projected GDP for 2002, of which 0.6 percent of GDP were overdue payables (0–45 days), 0.4 percent of GDP were arrears, and 0.2 percent of GDP was short-term debt to commercial banks. Still, the full extent of municipal arrears is difficult to assess due to the relatively poor state of municipal financial data. As noted in the World Bank report, "municipal financial statements do not reveal the extent of transactions with enterprises or the amount of subsidies, hidden or transparent, that are needed to keep these enterprises operating. Better information on municipal enterprises would help municipal officials decide what to do with them. It would also provide a more accurate picture of municipalities' financial condition. Until municipalities recast their financial statements to include the accounts of the special funds and enterprises, their true financial position, healthy or otherwise, will not be known." Under the SBA with the IMF, the central government is committed to take specific measures to reduce the stock of municipal arrears on a permanent basis. The latest amendments to the budget law (July 4, 2002, No. IX-1031) stipulate that "a special targeted subsidy to a municipality shall be transferred only of its arrears for the previous reporting period have been reduced by an amount no less than the amount of the previously transferred special targeted subsidy."

<sup>27</sup> In addition to the two social funds (SoDra and HIF), these include the Privatization Fund; the Ignalina Nuclear Power Station Closing Fund (Ignalina Fund); the Guarantee Fund; the 1990 Blockade Fund; the Reserve Stabilization Fund; and the Savings Restitution Account; with the latter two being funded from Privatization Fund resources. In addition, some EBFs have their own EBFs, like the Employment Fund, which is operated under the supervision of SoDra. All EBFs have specific purposes. For example, the Savings Restitution Account was established to compensate depositors for losses they incurred through underindexing of their deposits during the period of high inflation in the early 1990s; it is financed with privatization proceeds. Similarly, the 1990 Blockade

(continued...)

improvement compared even to 2000, when 22 EBFs were still functioning. All EBFs operate on the basis of specific government decrees, and have their operations audited annually by the SCO. While the government exercises financial supervision and control over the EBFs, their continued existence adversely affects fiscal transparency as they remain outside of the scope of the state budget. More generally, mechanisms for managing and coordinating the interactions between budgeted and extrabudgetary activities could be improved. While, in principle, extrabudgetary funds are required to be in surplus or balance after state budget transfers, this requirement has not always been adhered to. For example, both the SoDra and the HIF have been permitted to borrow from commercial banks to finance their deficits.

**12. Tax legislation is transparent, but the rules governing public input in the drafting process for new laws could be strengthened to further enhance transparency.** A comprehensive set of new tax laws has recently been introduced, aimed, among others, at providing an equitable and proportional distribution of the tax burden and fostering fair competition and proper harmonization of Lithuania's tax legislation with the EU.<sup>28</sup> All tax laws are applied uniformly, and tax incentives are clearly specified. Existing tax laws and explanatory notes are available on the website of the state tax inspectorate (STD). New tax laws benefit from comments by the general public during the legislative process in *Seimas*. At the drafting stage, the public may also be invited to comment (via dissemination of copies to interested parties, and publication on the MoF website) although the consultative process is not yet formalized or implemented in a uniform fashion.

**13. Ethics standards for civil servants have been strengthened, and a formal Ethics Code is to be introduced by end-2002.** Since 1997, significant progress has been made in strengthening ethics regulations, but changes are still ongoing, and the actual impact of the new regulations still remains to be fully evaluated. Among others, the rights and responsibilities for civil servants have been clarified; a framework for disciplinary sanctions was established; recruitment and dismissal procedures were elaborated; and remuneration structures were streamlined and made more transparent.<sup>29</sup> Preparations are underway for introducing, by end-2002, a new Ethics Code, and establishing a Civil Service Management Agency.<sup>30</sup> In addition, an Independent Ethics Commission, that was set up by *Seimas*, is responsible for monitoring

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Fund holds valuables donated by Lithuanians during the Russian blockade of Lithuania in the early 1990s. In addition to EBFs, there are also extrabudgetary programs and activities. For example, own receipts of budgetary units (e.g., hospitals) that are in excess of budgeted receipts can be kept by these units and do not flow through the budget.

<sup>28</sup> In this context, laws on taxing corporate income (CIT), personal income (PIT), value added (VAT), and excises were recently adopted by *Seimas*; new legislation on extending real estate taxation to private persons is currently being drafted. The new CIT law came into force in January 2002; the new VAT and excise tax laws in July 2002. The PIT law was adopted by *Seimas* in July 2002 and will become effective as of January 2003.

<sup>29</sup> See the Laws on the Adjustment of Public and Private Interests in the Public Service (VIII-371; July 1997), Lobbying Activities (VIII-1749; June 2000); Public Administration (VIII-1234; June 1999); and Civil Service (VIII-1316; July 1999). A new Ethics Code is being drafted with EU support.

<sup>30</sup> The Ministry of Public Administration Reform and Local Administration was abolished in early 2001, and the relevant functions were transferred to the Public Service Department in the Ministry of the Interior (MoI). A database of all government officials is available at [www.vataras.lt](http://www.vataras.lt).

potential conflicts of interest of civil servants. Specific groups of civil servants are obliged to prepare annually a declaration of assets and a declaration of conflicts of interest.<sup>31</sup> To combat corruption, a National Anti-Corruption Strategy was approved in 2001, administrative capacities to follow up on allegations of corruption against civil servants were strengthened, and an inter-institutional Cooperation Agreement on Anti-Corruption Operations was signed by different government institutions.

## **B. Public Availability of Information**

14. **The annual budget law, which follows a domestic classification, is available to the public together with some supporting information.** The annual budget document sent to *Seimas* contains an explanatory letter by the Minister of Finance, a draft of the annual budget law for the national budget, and a large amount of supporting data. The national budget covers the state budget (budgetary central government) and the budgets of the municipalities. The 2002 budget document also included overview budgets for the SoDra and the HIF, and the budgets of the Privatization Fund, the Reserve Stabilization Fund, and the Ignalina Fund; information on the other three EBFs was not presented in the budget document.<sup>32</sup> More detailed information on the SoDra and the HIF budgets was provided in separate budget documents for each institution. The budget document shows consolidated national budget revenues and expenditures within a functional classification, institutional presentations with summary data on the cost of programs, and considerable detail on economic input costs for each state budget institution. However, the analytical framework, coverage, and budget classifications used differ from international standards, and the budget presentation itself remains fragmented.<sup>33</sup> While the finalized version of the annual budget law and the summary budget tables are made available on the *Seimas* web site, the full supporting information is not provided to the public; the MoF web site provides a hyperlink to the budget information on the *Seimas* web site.

15. **Defense expenditures are comprehensively reported in the budget.** As part of its commitment to joining NATO, Lithuania has adopted a target to maintain defense spending at a minimum of about 2 percent of GDP. In 2002, budget outlays for current defense expenditures account for about 65 percent of the total, while defense-related investment spending through the PIP accounts for the remainder. Overview data by programs and activities are provided in the budget document.

16. **The annual budget document provides an overview of historical fiscal data, but does not compare the initial budget and projected outcomes for the current fiscal year.** The

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<sup>31</sup> The declaration of assets—required, among others, from the President, and all government employees—is submitted to the STI and publicly available. The declaration on potential conflicts of interest—prepared by civil servants in senior positions—is submitted to the Ethics Commission; a clear follow-up procedure has not yet been established.

<sup>32</sup> The 1990 Blockade Fund; the Guarantee Fund; and the Savings Restitution Account.

<sup>33</sup> The domestic classification used for the budget process also excludes from the state budget EU grant operations and net lending; these are presented separately in the budget document. A GFS-consistent classification for the central government would require consolidating into the state budget these and all extrabudgetary funds. Similarly, there should be a clear indication of how the budget deficit will be financed (e.g., via domestic or external borrowing, privatization receipts, etc.), which is not currently provided.

budget document for 2002 provided overview tables on actual state and municipal revenues and expenditures for 1997–2000, projected outcomes for 2001, and the detailed budget amounts for 2002. However, the 2002 budget did not provide information on how projected 2001 outcomes compared with the original 2001 budget. Instead, it provided a comparison between the budget estimates for 2002 and 2001.

17. **The budget document contains few details beyond the upcoming fiscal year.** The budget document does not provide detailed medium-term projections. A separate government resolution, sent to *Seimas* together with the draft budget document, sets out, for a three-year period, the main budget parameters: national budget revenues, municipal expenditures, state budget expenditures, and ceilings for providing new state guarantees.<sup>34</sup> However, no details are provided on individual budget items (e.g., specific taxes or spending programs). While ministries prepare detailed three-year programs for government approval, they are only presented to *Seimas* after the annual budget is approved.<sup>35</sup>

**The budget contains only partial information on contingent liabilities.** Explicit government obligations, such as government guarantees, are included in the state budget debt estimates at their full principal amount. The state budget also makes provisions for possible payments resulting from guaranteed loans. Other contingent liabilities, such as commercial borrowing by state-owned enterprises and government obligations to the people (restitution of real estate ownership rights and restitution of savings), are also registered and monitored to the extent they are known, but these are not presently reported in the budget documents. The government's annual "Pre-Accession Economic Programme" contains a comprehensive account of potential fiscal risks (see Box 2).<sup>36</sup>

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<sup>34</sup> In the discussions on the 2002 budget, revisions to the 2002 budget estimates for these variables did not lead to changes to the 2003–2004 data, and the government resolution went into effect with the changes for 2002 only. This may suggest that there are no automatic linkages between the budget projection for the upcoming fiscal year and the three-year estimates provided in the government resolution. Also, the three-year estimates do not imply a strong commitment beyond the upcoming year, and the government does not explain the changes in the projected allocations (say, for state budget expenditures in 2002) between the original government resolution and the detailed budget that will eventually have to be presented.

<sup>35</sup> Any changes made by *Seimas* during the annual budget discussions are incorporated in the documents prior to their release.

<sup>36</sup> See the government's annual "Pre-Accession Economic Programme of the Republic of Lithuania," Vilnius (September 2001 and August 2002).

## Box 2. Main Sources of Fiscal Risk <sup>1/</sup>

Under the currency board arrangement, fiscal policies are the government's main policy tool. Maintenance of this framework requires maintaining strong fiscal discipline at all levels of government. While this box focuses on fiscal risks for the central government, maintaining disciplined subnational government finances is of utmost importance. <sup>2/</sup> In particular, a continued build-up of municipal arrears could pose enormous risks to government's ability to maintain the current policy framework.

**Deposit Insurance.** Deposit insurance was introduced in Lithuania in June 1996 with the establishment of the Deposit Insurance Fund (DIF). While banks follow a conservative approach to lending and risk management, and while stress tests indicate that the Lithuanian financial system should be able to cope with most shocks, the funds held by the DIF provide insurance cover only for deposits in the smaller banks and credit unions. They would be insufficient to meet likely insurance claims should an of the large banks fail. In the even of the failure of a large bank, DIF would need to obtain government financial support in order to meet its obligations. <sup>3/</sup>

**Debts of State Enterprises.** As of April 2001, the commercial debt of state enterprises not guaranteed by the government was about 2.3 percent of GDP. Where such enterprises do not have sufficient financial assets to cover their debts, they would need to be covered from the state budget.

**Restitution of Savings.** Total savings to be compensated amount to about 7.5 percent of GDP. Up to June 2001, restituted deposits transferred to deposit accounts of residents amounted to about 3.1 percent of GDP. Transfer of restituted deposits was discontinued in December 1999, and an amount of LTL 105 million will be set aside annually for this function in 2003 to 2005. The actual amount paid each year may be varied by the Government.

**Decommissioning of the Ignalina Nuclear Power Plant.** The decommissioning of Unit 1 of the Ignalina Nuclear Power Plant is estimated to cost about 4.6 percent of GDP, excluding the expenses for the safe disposal of the nuclear fuel.

**Liabilities related to the privatization of state-owned enterprises.** Total loans on-lent by the government as of the end of 2001 amounted to about 7.9 percent of GDP. About two-thirds of the loans are on-lent to enterprises where the government holds a controlling interest. Upon privatization, there is a probability that the conditions of the loan may be revised and this can influence the recorded government liability.

**Government Guarantees.** For 2001, the amount of special provisions for loans with a government guarantee totaled 0.2 percent of GDP. The government expects the amounts needed for such provisions to diminish over time, so that their impact on the general government budget will become increasingly less significant.

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<sup>1/</sup> Also see Government of the Republic of Lithuania, "Pre-Accession Economic Programme of the Republic of Lithuania," (Vilnius, September 2001). For an update, also refer to the government's pre-accession program for 2002, which was released in August 2002.

<sup>2/</sup> This is demonstrated, for example, by the case of Argentina, where the recent unwinding of the country's policy framework owed largely to weak fiscal discipline at the subnational government level, and the inability of the central government to impose fiscal discipline.

<sup>3/</sup> Also see International Monetary Fund, "Lithuania: Financial System Stability Assessment" February 2002; IMF Country Report No. 02/19.



18. **There are no comprehensive data on tax expenditures.** In the context of the ongoing tax reform, some progress has been made in reducing tax expenditures, and some further tax expenditures may be eliminated in the context of EU accession.<sup>37</sup> In general, however, the extent of tax expenditures remains significant. There is no comprehensive statement of tax expenditures, but the authorities do make available to *Seimas* cost estimates of newly proposed exemptions and deductions, particularly for the discussion of tax policy changes during budget deliberations and when specific laws are changed or introduced.

19. **There are no comprehensive data on quasi-fiscal activities.** While the scope for QFAs has been reduced significantly over the last several years, also as a result of privatization, the government does not provide estimates on the extent of its remaining QFAs. While the operations of the remaining (nonbank) public financial institutions continue to pose a potential fiscal risk, their operations are likely to contain only small quasi-fiscal elements. Similarly, QFAs of state enterprises have been limited through transparent regulation and oversight. The scope for QFAs remains more pronounced at the municipal level, as reflected, for example, by the maintenance of administered prices for some municipal services (e.g., transportation and district heating), and the existence of significant municipal arrears (including to their own municipal enterprises and the state government).

20. **Timely data on government debt are published regularly, but their comprehensiveness could be enhanced.** The MoF regularly provides detailed information on central government debt,<sup>38</sup> and the DoS is responsible for compiling general government debt data. The MoF's annual debt review—which includes information on liabilities classified by creditor, type of debt instrument, and debt maturity, and data on the composition by currencies and interest rates payable—is approved by *Seimas* together with the annual budget execution statement. Also, there is a comprehensive register of all central government guarantees, and total central government debt data include government guarantees (in the form of “contingent debt”). As discussed in the recent “ROSC—Data Module,” the comprehensiveness of the government debt data could be enhanced by including the debt contracted by the EBFs and the municipalities;<sup>39</sup> also, the inclusion of non-securitized debt (e.g., municipal arrears, which are currently accounted for separately by the MoF) would further enhance fiscal transparency.

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<sup>37</sup> For example, the EU generally does not allow a reduced VAT rate for heating.

<sup>38</sup> This includes a monthly government debt and borrowing review (which, among others, provides information on central government debt, government securities, and budget balances), and additional monthly information disseminated under the SDDS and available on the MoF website; state debt data are also included in regular MoF press releases. In addition, the MoF prepares a detailed annual review of state debt.

<sup>39</sup> Also, the “ROSC—Data Module” contained various recommendations for improving consistency and classification of the government debt data.

21. **Comprehensive data on government financial assets are not yet available.** Using MoF data, the DoS is compiling for EUROSTAT annual historical data for the financial assets of the general government. When the exercise is completed—which is likely to be the case later in the year—it will be possible to estimate historical net debt data for the general government.

22. **Lithuania has been subscribing to SDDS since May 1996.** Advance release calendars, as well as information on the coverage of the fiscal accounts, are available at both the MoF and BoL websites. A recent mission by the IMF's Statistics Department has made a number of suggestions for improving the quality, coverage, dissemination of the data provided, and for enhancing the supporting and explanatory information.

### **C. Open Budget Preparation, Execution, and Reporting**

23. **The annual budget process is open with an emphasis on financial compliance.** The budget process is clearly defined in the Law on the Budget Structure (Organic Budget Law), which specifies the fundamental requirements for the preparation and execution of the national budget, budget reporting, and the auditing of government accounts.<sup>40</sup> The stated goals of the law are to ensure that budget formation and execution are directed toward the overall economic and social welfare of Lithuania's citizens, and that financial resources are used effectively. As outlined below, the law also provides for the development of performance budgeting and medium-term planning.

24. **The overall balance of the general government is used as a main indicator of the fiscal position in the context of the program with the IMF, but not in the budget documents.** The annual budget focuses on the state budget and national budget balances; standard international definitions of the budget deficit are used in the context of the current standby arrangement with the IMF and interactions with other international organizations and international financial market participants.

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<sup>40</sup> No. VIII-1821 of July 2000. Accordingly, the law defines the content of state and municipal budgets (i.e., the national budget), the legal bases for collecting revenue and use of appropriations of the budgets, the basic provisions and procedures for preparing, approving, executing, evaluating, and controlling budgets, and the duties, rights, and responsibilities of those who are involved in the budget process. For an overview of the budget cycle, also see Box 3.

### Box 3. The Budget Cycle

**January.** The government discusses strategic goals (priorities) for a three-year period, and focuses on planning the three-year budget estimates. Ministries work out and adjust sectoral development strategies, and submit them to the Ministry of Economy. The latter evaluates them, works out and adjusts the general development strategy, and after co-ordination with the Ministry of Finance, submits it to the Strategic Planning Committee of the Government (the Strategic Planning Committee) for consideration, and to the government for approval. The medium-term state borrowing strategy is established by Government Resolution, establishing the borrowing limits and targets for debt management.

**February to March.** Projected macroeconomic and other indicators are issued for use in preparing the three-year national budget revenue forecasts, state and municipal budgetary expenditures, and limits for new government guarantees.

**March to July.** The MoF issues quantitative guidelines to budget institutions on their maximum financial allocations for the budget year and the two subsequent years. Appropriation managers prepare estimates of required appropriations for the coming budget year, plus indicative estimates for the two subsequent years. Appropriation managers hold discussions with the MoF, consolidating differences in their views and opinions.

**July to September.** The MoF updates macroeconomic indicators. Budget proposals are considered by Cabinet of Ministers for final approval.

**October 17 (75 days before the end of the year).** The draft state budget document is submitted to *Seimas*.

**November and December.** The annual budget is considered by the Budget and Finance Committee of *Seimas* and final approval by *Seimas* is sought by December 31.

25. **Increased emphasis is being given to medium- and long-term planning.** The government has elaborated a long-term strategy that sets key strategic goals.<sup>41</sup> These long-term plans provide qualitative guidance for preparing three-year estimates of revenue and expenditure. In the same context, since 2000, the government has also been working on establishing program-based medium-term budgeting to link its national strategic plans with the spending priorities of individual budget institutions.<sup>42</sup> While the system has been formally introduced, it remains to be made fully operational. In general, in formulating program structures at the institutional level, attention is given to establishing mission goals for each institution as well as the objectives, activities and budget requirements of each

<sup>41</sup> The government has determined four key strategic expenditure priorities: preparation for EU membership; development of national defense and integration into NATO; further development of the education, science, and health care systems; and financing of agriculture.

<sup>42</sup> The Law on Budget Structure (July 2000), provided the basis for implementing program-based budgeting principles. The procedures to be followed were elaborated in subsequent documents, including the Strategic Planning Methodology (May 2000); the Resolution on Approval of Procedures for Assessing the Implementation of Programs by the State Budget Appropriation Managers (April 2001); and the Resolution on Approval of Procedure for Drawing up and Implementing the State Budget and Municipal Budgets (May 2001).

program managed by the institution. The new system also encompasses an ambitious performance measurement and evaluation framework that requires collecting considerable detail from budget institutions. The government is seeking to improve the quality and systematic preparation of program information, coordinate activities across agencies, enhance public awareness of programs, and evaluate the results.

26. **The PIP has been maintained as a separate three-year planning and management mechanism.** The PIP allocates funding to high-priority capital projects within an overall capital spending ceiling proposed by the government and approved by *Seimas*.<sup>43</sup> The PIP identifies four sources of funding for these projects: state and municipal government budget funds; the Privatization Fund; the approved state and municipal borrowing programs; and guaranteed borrowing and grants from the EU and international financial institutions.<sup>44</sup>

27. **Multi-year plans remain to be fully integrated into the annual budget process.** Each year, the MoF provides expenditure ceilings for elaborating sectoral spending plans for a three-year period. In planning their activities, ministries and agencies are asked to take account of inter-sector relationships, although this process is still being developed. The draft budget document presented to *Seimas* shows aggregate spending plans for each function and program only for the relevant budget year. The detailed multi-year plans of the ministries and agencies are provided to *Seimas* and published after the annual budget document has been approved. Estimates beyond the relevant budget year are purely indicative and do not carry a formal endorsement by the government. Further work is required to integrate the strategic and medium-term planning frameworks with the annual budget approval process.<sup>45</sup>

28. **The government's planning efforts have been supported by significantly strengthened macroeconomic analyses.** The MoF accompanies the budget preparation and execution process with regular updates of macroeconomic projections and forecasts. Official forecasts are provided every four months. The government's annual "Pre-Accession Economic Programme" provides a comprehensive review and analysis of recent macroeconomic developments and policies, and detailed medium-term fiscal projections.

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<sup>43</sup> The PIP is constructed around three main priority areas: projects that fall under the defense spending targets agreed with NATO; projects funded under the EU Acquis program with co-funding by Lithuanian budget institutions; and projects that meet priority capital needs as defined by decrees of government or *Seimas*. Funds are distributed under 13 functional categories (general public administration, defense, courts and prisons, health, education, social affairs, environment, culture, energy, agriculture, police and security, transport, and other).

<sup>44</sup> These include the World Bank (IBRD), the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), and the Nordic Investment Bank (NIB).

<sup>45</sup> The EU found that "the notion of a multi-annual budget...needs to be made operational in the process of budget planning and execution. The same is true for the coordination and integration of the Public Investment Program and the National Development Plan with the State Budget." See "2001 Regular Report on Lithuania's Progress Towards EU Accession," Commission of the European Communities (Brussels), Doc. SEC(2001) 1750 (November 13, 2001).

29. **Budget documents do not analyze how changes in the macroeconomic assumptions would affect the budget estimates.** The MOF prepares a baseline macroeconomic scenario on which the budget estimates are based. It also produces 3-year ahead forecasts that include some general risk assessments and information on key assumptions. Overall, however, the budget documents contain limited information on the macroeconomic assumptions used in preparing the budget and do not contain a comprehensive sensitivity analysis that shows how changes in key macroeconomic variables would affect budget outcomes. Nevertheless some detailed additional risk assessments are provided in the government's pre-accession economic programs for 2001 and 2002, which are available to the public (including on the Internet).

30. **Fiscal sustainability issues are examined in the contexts of the program with the IMF and EU Accession, but are not an integral part of the budget process.** There is no formal sustainability analysis contained in the annual budget documents or in other information regularly elaborated by the MoF. However, fiscal sustainability issues are examined in the context of the current standby arrangement (SBA) with the IMF, and the EU accession documents.

31. **Binding debt rules are applied to both state and municipal governments.** The annual budget law specifies limits on new net borrowing by the state and the municipalities.<sup>46</sup> Within the limit on new net borrowing by the state, there are additional limits for the state government on issuing securities and contracting loans for the purposes of financing the state budget deficit, financing public investment, and covering temporary shortfalls of SoDra funds. The law also states that short-term interest free loans from the state budget used for bridging temporary municipal revenue shortfalls shall not be included in the borrowing limits. Also, borrowing operations by municipal enterprises without government guarantees are not covered by these arrangements.

32. **The Budget documents do not provide estimates of the costs of new policy initiatives.** While the new program budgeting framework makes provisions for the separate identification of new policies within each program, the budget documents do not provide separate data on the aggregate costs of ongoing and of new programs and initiatives.

33. **Internal financial control procedures are in place, but their efficiency and scope could be enhanced.** Since 1999, the government has put strong emphasis on developing

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<sup>46</sup> The limit on new net borrowing by the state is expressed in local currency; the limit on borrowing by municipalities is subject to a number of ceilings, namely that the gross debt stock cannot exceed 35 percent of approved municipal revenues (50 percent for the Municipality of Vilnius); total municipal borrowing may not exceed 20 percent of approved municipal revenue and short-term borrowing may not exceed 10 percent; and that interest payments and expenses for contracting a loan may not exceed 20 percent of municipal revenue. The budget law provides some discretion to the government to increase the borrowing limits for municipalities whose investment projects are included in the medium-term investment program and are financed from government-guaranteed or government-contracted loans.

effective internal control mechanisms.<sup>47</sup> Financial compliance controls over budget execution by the state budget units have been put in place, using a system of appropriation managers.<sup>48</sup> While the system is broadly effective in controlling state budget expenditures, it is not very efficient due to the maintenance of a large number of budget units (over 1,000) and appropriation managers (about 200).<sup>49</sup> In addition, the system does not exert control over extrabudgetary resources or the municipalities. Also, the financial control procedures do not explicitly cover “special programs” of budget units. In particular, budget units that receive revenue for services provided, are allowed to keep and carry forward in the coming fiscal year, revenues collected in excess of the amount of income initially foreseen for the special programs, as if they were new appropriations, thereby reducing the extent of extrabudgetary activity.<sup>50</sup> Within this overall framework, the MoF oversees budget revisions, and supplementary budgets are used infrequently.

**34. Internal audit procedures are being strengthened.** The organization of internal audits is rooted in a government resolution from early 2000,<sup>51</sup> which requires that internal audit services be established in all ministries and regional administrations. This affected some 110 government institutions and agencies, and audit units have already been

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<sup>47</sup> Until 1998, internal financial oversight was carried out by the finance units of each ministry. In February 1998, the government approved the “Program for the Introduction of Internal Audit in the Public Sector,” which served as a basis for creating a unified internal audit and control system in the public sector.

<sup>48</sup> According to the Law on Budget Structure (July 11, 2000), appropriation managers of the state budget are heads of public institutions and agencies that are funded from the state budget, or managers of financial resources approved by the government or other institutions that have appropriate authority, as directed by *Seimas*; appropriation managers of municipal budgets are the heads of municipal institutions or agencies, as specified in the municipal budget, appropriations for which were approved by the municipal board (mayor) as directed by the municipal council. .

<sup>49</sup> A recent financial control peer review stated that the large number of budgetary units creates an overly complicated and dispersed system of financial control, and also unduly burdens the workload during budget preparation and revision. In addition, the peer review questioned the benefits of the appropriation manager system, and noted that their relatively large number increases the number of transactions, which adversely affects the speed of budget implementation, increases risks of error or fraud, and, more generally, diverts resources that could be used more efficiently if pooled into bigger units. See SIGMA “Peer Assistance to the Public Internal Financial Control System in Lithuania” (Draft Report, May 2002). Similarly, the EU recently noted that “the efficiency of the financial management and control of national budget income and spending appears to remain relatively weak; basic accounting systems and practices have not reached acceptable standards.” See “2001 Regular Report on Lithuania’s Progress Towards Accession,” Commission of the European Communities, Brussels, No. SEC(2001) 1750 (November 13, 2001).

<sup>50</sup> This is in accordance to Article 14 of the Organic Budget Law, which states that “excess or unused payments into the budget, including revenue of state budget agencies received as a result of provided services, meant for the funding of special programs during the current budget year or carried forward to the next budget year, and remaining amounts of unused appropriations for the funding of unfinished construction projects may be used above the amount of total appropriation amounts approved by *Seimas*. Also see SIGMA “Peer Assistance to the Public Internal Financial Control System in Lithuania” (Draft Report, May 2002).

<sup>51</sup> Government Resolution 127 of February 2000 (amended by Resolution 1098 of September 2001).

established in all ministries and regional administrations.<sup>52</sup> The fairly dispersed institutional organization means that many internal audit structures are of comparatively small scale, and, in practice, there are many one-person audit units. An internal audit charter has already been approved, an internal audit manual has been prepared.<sup>53</sup> The new internal audit methodology is based on international best practice, with an emphasis on risk assessment of budget management processes within each organization and a focus on both performance and financial compliance. The internal audit units provide to the head of the institution an annual report on the activity performed by the Internal Audit Unit; the report is copied to the MoF. These reports may also be released to the SCO if approved by the relevant appropriation manager. Technical assistance on internal auditing is being provided by the EU, which has emphasized the need to maintain the impetus of the reform, and to construct detailed action programs with defined objectives, targets, responsibilities, and deadlines for achievement in a comprehensive and systematic manner.<sup>54</sup>

**35. Clear public procurement legislation and procedures have been established.** The existing Public Procurement Law complies with international standards in its strong emphasis on open tendering processes, clear advertising rules, and absence of discriminatory provisions.<sup>55</sup> The procurement system is operated in a decentralized fashion, where individual procuring entities bear the responsibility for the conduct of procurement planning, the tender process, and contract management. The procuring entities are required to report to the SPA. In general, procuring entities create their own tender commissions that conduct the tender process and make recommendations. Given the fairly large number of fairly small procuring entities, there are only few permanent procurement units and few permanent

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<sup>52</sup> At present, 291 out of 389 internal audit positions are filled. Internal audit services are also required for other public institutions and enterprises (including their subordinated units) that employ more than 300 people; an internal auditor position is to be established in those that employ less than 300 but at least 100 people. Municipal governments operate their own internal audit arrangements. According to the Law on Local Self-Government, the Municipal Controller, usually answering directly to the municipal board, is the municipal controlling institution responsible for the direct control of the use of the municipal budget.

<sup>53</sup> To further develop internal audit as an effective management tool, additional legislation on specific issues of audit procedures is under discussion in government. In addition, to strengthen the professionalism and technical skills of internal audit services, training programs have been put in place.

<sup>54</sup> See SIGMA "Peer Assistance to the Public Internal Financial Control System in Lithuania" (Draft Report, May 2002).

<sup>55</sup> Information on public procurement legislation, procedures and activities is provided on the website of the State Procurement Agency (SPA). The existing law is currently being redrafted to comply fully with the EU practices, including, for example, with respect to time limits, exemptions, technical specifications, and evaluation criteria. The new law is expected to come into force by end-2002 and the implementing by-laws during 2003. Also see SIGMA "Peer Assistance to the Public Internal Financial Control System in Lithuania" (Draft Report, May 2002), which provides a detailed review of public procurement control issues.

professional procurement staff. In 2002, an Independent Committee for Public Procurement Complaint Review was established to investigate contractors' complaints.<sup>56</sup>

36. **The automated accounting system is not yet capable of producing complete and accurate in-year reports on central and general government budget outturns.** The automated accounting system provides reports on state budget operations on both a monthly basis (with a lag of one month), and a quarterly basis (presented two months after the end of the quarter). The monthly data cover cash transferred to appropriation managers, while the quarterly data cover actual cash payments by budget institutions. GFS data on central and general government operations, must be compiled separately, using personal computer spreadsheet applications, based on reports by the extrabudgetary funds and the municipalities, and recorded inflows of grants and loans (and spending from these flows). The monthly and quarterly GFS data on central government operations are subject to frequent revisions, and it is difficult to consolidate data from different sources. The appropriation structures adopted in the state budget also contribute to difficulties in distinguishing debt interest and amortization payments from capital spending, particularly at the municipal level. Also, no aggregate balance sheet data can presently be generated from the accounting system.

37. **The status of tax administration, and tax payers' rights and obligations are defined clearly.** Current legislation<sup>57</sup> establishes the State Tax Inspectorate (STI) as an institution of the Ministry of Finance. The head of the STI is appointed and relieved of his duties by the Minister of Finance; there are no stipulations or mechanisms for protecting the head of the STI from political interference. The law on tax administration outlines tax payers' rights and obligations, as well as dispute procedures. Tax administrators are obliged to respond in writing or over the phone to inquiries by taxpayers. Taxpayers may dispute all actions of the tax administrator or his/her supervising officer, following certain steps. There exists a comprehensive three-step procedure for handling tax disputes, which consists of an initial appeal to the central tax administration, followed, if necessary, by mediation proceedings by a tax dispute commission, and, as a possible final step, court proceedings. The latter is a two-step process, where lower-court decisions can be appealed to a higher court.

38. ***Seimas* reviews the state budget at least once a year, but there is no formal "mid-year" review requirement.** The government provides to *Seimas* regular monthly and quarterly progress reports on budget implementation, and ministerial officials provide additional information to *Seimas* upon request. The official macroeconomic forecasts are revised three times a year (February, June, and October). While these revisions affect budget

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<sup>56</sup> The establishment of the committee is specified in the existing Public Procurement Law; the committee is required to review each complaint within 20 days of submission.

<sup>57</sup> See the Law on Tax Administration (No. I-974, 1995, as amended in 2001). The law defines the rights and responsibilities of tax administrators, and the rights and obligations of tax payers, and it sets out procedures for handling overdue taxes and for settling disputes.



planning for the coming year, the government is not required to present to *Seimas* formal revisions of budget forecasts for the current year.

39. **Audited final accounts are usually available within six months after the end of the fiscal year.** The government presents final accounts for the state budget within three months after the end of the budget year, and the SCO provides its audit report three months later (by June). This report is then discussed by *Seimas*, and final approval is required by November. Separate annual audit reports are also prepared on the main EBFs, but they do not have to be presented jointly with the state budget reports. The municipal budget laws do not require municipalities to prepare audited annual reports.<sup>58</sup>

#### D. Assurances of Integrity

40. **Budget estimates have improved significantly, and differences between budgeted and actual outturns are disclosed and analyzed.** The regular publication of monthly state budget execution reports, and the periodic updates of the macroeconomic framework, have helped to enhance fiscal transparency and public budgetary oversight. While the accuracy of budget forecasts has improved, it has been particularly challenging to provide good revenue forecasts. Revenue forecasting is always a difficult task in a small open economy like Lithuania, but the task has been further complicated by the many changes in the legal and regulatory frameworks that have occurred over the last decade. Revenue shortfalls have often required amending the expenditure side of the budget to adhere to agreed fiscal targets.

41. **Statements of accounting policy are not included in the budget and final accounts documents.** Accounting is currently on a cash basis, but consideration is being given to supplementing this, by 2004, with a system based on accrual accounting. This, and fiscal reporting more generally, would be greatly assisted by the early implementation of the State Treasury's new system for accounting and payments,<sup>59</sup> and a comprehensive set of accounting standards for preparing and reporting budget execution data.<sup>60</sup>

42. **There are difficulties in reconciling fiscal data with monetary and balance-of-payments data.** As noted in the ROSC-Data Module, there remain problems in preparing GFS reports that provide a consistent picture between central and general government operations and government debt data. In particular, the "below-the-line" (financing) data drawn from the monetary survey and the balance-of-payments are difficult to reconcile with the available "above-the-line" data on revenues and expenditures. The discrepancy between

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<sup>58</sup> However, some local governments are considering preparing such a report, and the City of Vilnius has appointed external auditors to examine its 2002 accounts.

<sup>59</sup> There are plans to move from the VBAMS (NAVISION) system to a more modern Windows-based IT system (NAVISION FINANCIAL). This would be a more comprehensive and integrated system, capable of providing more broadly based, timely, flexible, and reliable financial information to the government.

<sup>60</sup> The Law on Accounting requires the MoF, in consultation with other parties, to develop a set of accounting standards based on international best practice.

these two sets of data appears to reflect a number of problems, including differences in coverage, timing, and classification.<sup>61</sup> The authorities plan to establish a working group of experts from the BoL, the MoF, and the DoS for reconciling fiscal (including debt) and balance-of-payments data, and ensuring methodological consistency.

43. **External audit is independent of the executive branch and accountable to Seimas.** The status of the SCO, which is defined in the Constitution as well as the Law on State Control, complies with the main conditions of independence laid down in the Lima Declaration of INTOSAI.<sup>62</sup> The Constitution stipulates that a State Controller be appointed for a five-year term by *Seimas* upon the nomination of the President, authorizes him/her to supervise state budget execution, and requests him/her to provide to *Seimas* an annual account of state budget execution. The SCO budget is prepared using the same procedures as for other budget institutions. It has the authority to audit all institutions and bodies which receive funds from the state budget or which manage and use state-owned assets, including the BoL and the municipalities; it can carry out both financial audits and performance audits, although much of the emphasis has remained on financial compliance. The SCO prepares an audit program at the beginning of the year, which is shown to *Seimas*. The State Controller is free to accept *Seimas* suggestion, but retains the final determination on the bodies that are to be audited. In practice, the audit program is set with a view to cover at least 75 percent of state-budget spending, and any areas identified as being of high risk.

44. **A strengthening of external audit capacity is required to handle likely future increases in demand.** At present, about 60 percent of resources are devoted to financial auditing. There is likely to be strong growth in the demand for auditing services resulting from the further development of the program budgeting system (which will require reports on performance measurement), and from the audit requirements for EU funds. At present, the SCO has a total staff of only about 290, of which about 70 percent are involved in auditing. The SCO also has only moderate technical capacities and will need additional computer-assisted audit software and equipment to meet the required standards; the EU has been providing technical support and training to the SCO.

45. **Municipal audits are in need of strengthening.** Municipal controllers, who are elected by a majority of the local council and accountable to the mayor, manage municipal finances, and organize control and audit of the finances of the municipalities and their enterprises. The municipal controllers currently combine internal and external audit functions, and there are no specific external audit requirements for municipalities (although they may be audited by the SCO). In general, municipal control and audit appear to be of variable quality. The government has been considering several reform initiatives, including the separation of internal and external audit and control functions, and the development of an internal audit institute under SCO oversight, which would encourage municipalities to adopt common standards and procedures for internal control and auditing. Municipalities would

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<sup>61</sup> During 1998–2001, annual discrepancies have amounted to up to 0.4 percent of GDP.

<sup>62</sup> See Constitution of the Republic of Lithuania, and Law on State Control (December 2001).

also be encouraged to audit and publish annual reports. No decision on these initiatives has been taken yet, although a Law on Internal Control and Internal Audit has been drafted.

46. **The legislature follows up on external audit reports.** Each year, the SCO submits to *Seimas* a conclusion on the accounts of the state budget, the Government's report on public debt, the report on the management of state property, and about 40 or more audit reports and findings on specific issues. The SCO also prepares for *Seimas* a conclusion on the draft budget for the year ahead. The SCO sends copies of its reports the government and the budget institutions concerned to inform them of its findings. *Seimas* may follow up issues by requesting the government and the institutions concerned to respond to the issues raised. Where criminal or fraud issues are involved, the SCO may alert *Seimas* and the government, but any follow up is the sole responsibility of the relevant law enforcement authorities. SCO audit reports are also available on the web and are discussed in the press. *Seimas* has decided to establish a parliamentary sub-committee on public accounts to ensure a systematic follow-up on SCO audit reports.<sup>63</sup>

47. **Macroeconomic models, assumptions, and forecasts are reviewed in different government agencies, and in the context of the IMF program.** The MoF coordinates macroeconomic and budget forecasting, and interacts with forecasters in the BoL and different line ministries who are involved in producing various budget forecasts. Approved forecasts and general macroeconomic assumptions are published on the MoF website regularly. The MoF also discusses its forecasts with international organizations that prepare forecasts for the Lithuanian economy, including IMF and EU staff. There is no formal forum for consultations or interactions on macroeconomic forecasts with the private sector.

48. **The statistics-producing entities have an adequate legal and institutional framework.** Three entities have legal authority for providing fiscal data and statistics—the FPAD and SDMD of the MoF, and the DoS. The authority for the MoF departments to produce GFS and debt data is provided by decrees and resolutions;<sup>64</sup> the DoS has statutory assurance of technical independence under the Law on Public Statistics.<sup>65</sup> Although the ROSC—Data Module judged the DoS arrangements to be adequate, it recommended that the legal basis for confidentiality be enhanced by eliminating the exclusions from the confidentiality provision in the Law on Statistics which ensure that the input of no single respondent can be identified, or derived, in any statistical series without express permission.

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<sup>63</sup> See Resolution No. IX-465 of July 2001.

<sup>64</sup> On government finance statistics, see Government Resolution No 537 of June 1997, and the Order of the Minister of Finance No. 292 of December 1998, and, on debt compilations, see the Law on the Public Debt No. 1-1508 of August 1996, and the Resolution of the Minister of Finance “On Approval of the State Debt Accounting Methodology,” No. 353, of December 2000.

<sup>65</sup> See Law on Statistics (VIII-1511 of December 1999).

### III. IMF STAFF COMMENTARY

49. **Lithuania's public administration has absorbed and implemented many new fiscal management concepts over a fairly short time span.** The rapid economic changes that have taken place over the last decade have placed a heavy burden on the public administration to adapt, including with respect to its fiscal management framework. The various governments have accomplished much in this regard, but additional changes are ahead. Lithuania is well-placed to conclude negotiations to join the EU in the first wave in 2004—with agreement already having been reached on 28 of the 31 chapters of the *acquis communautaire*—and departments of European integration have been set up in each ministry and in other public institutions to ensure implementation of the decisions of the Government Commission of European Integration. In this context of ongoing institutional change, there is also a strong need to continue to strengthen the country's fiscal management and decision-making framework, and streamline administrative procedures with a view toward reducing administrative burdens.

50. **Lithuania's fiscal institutional framework already meets many requirements of the Code of Good Practices on Fiscal Transparency.** Key strengths are the clearly-defined roles and responsibilities of the executive, legislative, and judicial branches of government, as well as the limited scope for quasi-fiscal activity at the central government level, given the independence of the central bank under the currency board arrangement and the completed privatization of all public banks. Also, binding debt rules are applied to state and municipal governments. Similarly, the status of tax administration, and tax payers' rights and obligations are defined clearly; government regulations of private-sector activity are transparent (but complex); and clear public procurement legislation and procedures have been established.

51. **In addition, the reforms that are currently being implemented ultimately promise to move Lithuania toward best practices in several areas.** These include the recent introduction of multi-year strategic budget planning within a macroeconomic framework; increased emphasis on priority setting and performance management in public programs; enhanced focus on sustainable intergovernmental financial relations; the establishment of non-discretionary tax policies; various advancements in debt management, procurement, and civil service management practices; and strengthening of internal control and audit arrangements.

52. **At the same time, there are a number of weaknesses with respect to some aspects of the Code. The IMF staff's recommendations for enhancing fiscal transparency and, in this context, strengthening of fiscal management, focus on three main areas:**

- enhancing the comprehensiveness of the budget;
- streamlining fiscal management procedures and practices;
- strengthening documentation and analysis.

*Enhancing the comprehensiveness of the budget*

53. **The maintenance of different budget concepts, and of various extrabudgetary funds, activities, and programs, adversely affects fiscal transparency.** The significant fragmentation of Lithuania's budget process—with its maintenance of separate accounting frameworks and budget cycles for the national budget and the extrabudgetary funds; and different and largely partial concepts for planning, monitoring, and reporting budget activity—adversely affects fiscal transparency and weakens the position of the Ministry of Finance in implementing sound fiscal policies. It also increases administrative burdens, fragments administrative resources, and has contributed to a situation where, in practice, the fiscal data do not fully comply with international standards.

54. **A single and comprehensive framework for budgetary decision making, and fiscal accounting and reporting should be adopted.** A clear advantage of having—for all purposes, including the annual budget cycle—a single GFS-consistent accounting framework for central and general government operations, would be that it conforms to international standards and practices, and allows for a better focusing of government resources, thereby strengthening the ability of the Ministry of Finance to implement sound fiscal policies.<sup>66</sup> Such a broadly-recognized standard becomes particularly important as Lithuania readies itself to join the EU. Conceptually, adopting a GFS-consistent framework for all accounting and reporting purposes, would require consolidating into the budget accounts the accounts of all extrabudgetary funds, activities, and programs, as well as all foreign grants and net lending operations.<sup>67</sup> Having a comprehensive fiscal accounting framework is also a precondition for achieving a satisfactory degree of correspondence of between revenue and expenditure (above-the-line) data, and the available (below-the-line) data on financing of the government balance. More broadly, it would help to improve the consistency between fiscal and monetary data.

55. **Additional efforts should be undertaken to strengthen the available information on government debt and assets.** Comprehensive general government debt statistics are indispensable for a variety of purposes, including carrying out meaningful analyses of the fiscal policy stance (and its overall fiscal adjustment needs) in the light of assessing fiscal sustainability. This will become particularly important in an EU context, where fiscal policies have to be coordinated between governments. Similarly, developing a comprehensive and timely data base on general government assets (both financial and nonfinancial), would facilitate estimating the government's net debt, which is a key indicator fiscal sustainability.

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<sup>66</sup> This would free up administrative capacities in the Ministry of Finance that are now devoted to preparing, monitoring, and/or verifying budget data based on different fiscal concepts; and in the main extrabudgetary funds, which have to maintain separate budget departments. It could also reduce the workload of *Seimas*, which currently has to approve separate budgets and budget execution statements (e.g., for the state budget and extrabudgetary funds), and the State Control Office, which also has to provide separate audit reports.

<sup>67</sup> The extrabudgetary funds could still be maintained as legally separate entities with dedicated revenue sources as long as their accounting framework is fully integrated into the central government's accounts.

*Streamlining fiscal management procedures and practices*

56. Streamlining fiscal management procedures and practices would further help to enhance fiscal transparency. Particular issues that should be addressed in this regard are:

- **Strengthening the automated accounting system.** Efforts to improve the comprehensiveness of the budget will need to be accompanied by improvements in the automated accounting system with the goal to produce complete and accurate in-year reports on central and general government budget outturns in a standard international format.
- **Integrating the annual budget process with strategic planning.** While progress has been made in developing fiscal planning, there is a need to establish a clear quantitative correspondence between annual, medium-term, and long-term planning models, which is a precondition for fiscal transparency. This would facilitate adapting annual budgets to changing longer-term priorities, and updating longer-term priorities in line with annual budget outcomes. A key step in this process will be to improve the quality of the medium-term estimates so that they can be published in the annual budget document as representing a firm policy commitment of the government (but not a legal obligation beyond the annual appropriation). The published medium-term estimates should then become the basis for initial discussion for the preparation of the next annual budget, and the government should fully explain the reasons for deviations between actual outcomes and projections, and the reasons behind changes in its fiscal and budgetary forecasts.
- **Establishing a formal mid-year review of fiscal and macroeconomic policies.** While various reviews already take place, including in the context of preparing the annual budget for the coming fiscal year, having a single, formal mid-year review of budget implementation for the current year, and of fiscal and macroeconomic policies, would help the Ministry of Finance to focus and channel the discussions in this area, and enhance its communication with the public. This review could take place each June, in the context of presenting the macroeconomic forecasts for the upcoming budget year. As part of the review, the Ministry of Finance should present a comparison between the original budget and projected/actual budget outcomes. In addition, updated information on actual budgetary outturns should be presented in this context and the budget discussions.
- **Implementing policies to contain arrears on a permanent basis, and further reducing the scope for quasi-fiscal activity.** While the government has made good progress in addressing these issues, its efforts have focused on mechanisms to reduce the existing stock of arrears, which is clearly the first priority. In addition, however, efforts need to be made to address the various sources of arrears. This would include, among others, further advancing with administered price adjustments (also to further reduce the scope for quasi-fiscal activity); enhancing supervision and control of municipalities and their enterprises; and exploring the scope for new own municipal

revenue sources. While many of the root problems are known, resuming regular high-level discussions (that include representatives of ministries, extrabudgetary funds, and municipalities) would facilitate finding a comprehensive and permanent solution.

- **Strengthening financial controls, as well as internal and external audits.** With the demand for financial controls and audits inevitably increasing, there is a strong need to build-up capacities, including in new fields such as performance-oriented audits. The administrative streamlining suggested by the staff, including the harmonization of the budget frameworks and processes should facilitate the streamlining of control and audit structures and processes, and allow building up stronger units. At the municipal level, internal auditing and financial reporting functions should be strengthened, and formal and compulsory annual external audit procedures should be established.
- **Establishing clear and uniform procedures for interactions with the public.** Having clear and transparent procedures for interacting with the public, for example for inviting public comments on macroeconomic forecasts, and on tax and other legislation at the drafting stage, would help to guide public expectations and channel public comments, and could be a useful forum for explaining the government's views.
- **Establishing a broader set of release schedules for fiscal information.** Establishing clear release schedules for all fiscal information, and beyond the fairly narrow confines of SDDS requirement (i.e., also for the various documents that provide fiscal information according to domestic classifications), would help the Ministry of Finance to strengthen its position vis-à-vis other parts of the government in requesting information in a timely fashion, and it would help to focus administrative resources on producing this information.

### *Strengthening documentation and analysis*

57. **Further improvements in fiscal documentation and analysis would help to improve transparency.** While a good fiscal accounting framework would provide transparent, comprehensive, and timely information to fiscal policy makers, it needs to be complemented by good documentation and analysis. In this regards, various pieces of information should be presented in a routine fashion. In particular:

- **An estimate of the cost of all new policies** would facilitate decision making in *Seimas*, and the government's dialogue with the public. Hence, the budget documents should clearly identify the cost of newly proposed policies, and separate them from the cost of existing policies; the information should be publicly available.
- **A statement of existing tax expenditures** should be introduced, included in the budget documents, and provided to the public. This will ensure transparency with regard to the tax revenue foregone due to the existing and proposed special treatment provisions in the tax laws.

- **A comprehensive analysis of fiscal risks**—similar to the analysis already presented in the government’s pre-accession economic program—should be included in the budget documents and provided to the public. This should cover the state and municipalities, and include all contingent liabilities.
- **A long-term debt sustainability assessment**, should accompany all medium-term fiscal projections and forecasts, forcing these projections to be addressed in the context of a discussion on the sustainability of fiscal policies.
- **A more detailed sensitivity analysis of the budget estimates** should be included the budget documents, and made public. This would give the *Seimas* and other budget users a better understanding of how various macroeconomic shocks (or other changes in the underlying macroeconomic assumptions) could effect budgetary outcomes. This would allow policy makers to assess the budget estimates in the context of potential macroeconomic risks, and will be particularly important, given the increased emphasis on strategic and medium-term planning.
- **Strengthening overall communication with the public.** As Lithuania moves toward EU accession, the demand for interactions with the general public (both domestic and foreign) will increase, including in the area of fiscal policy, which will remain the government’s main policy tool. In this context, consideration should be given to developing a regular (e.g., quarterly) publication of fiscal policy implementation and prospects which would complement the already available information with analysis prepared by the staff of the Ministry of Finance. In addition, regular methodological notes to document various assessments (e.g. the debt sustainability analysis) should be published. This will help to improve communication with market participants and other users of fiscal information, including in *Seimas*. There is no need to provide detailed model assumptions, but only broad outlines of the analysis.