

# BUDGET LAW OF THE REPUBLIC OF LITHUANIA UNDER THE INFLUENCE OF THE EUROPEAN UNION LAW

## Abstract

The article deals with the question of the impact of the European Union law on budget regulation in the law of the Republic of Lithuania after its accession to the European Union in 2004. The influence of the European Union law on the Lithuanian budget law is twofold - direct when the requirements of the relevant European Union legislation are transposed into national budget law, and indirect, when national budget law is changed during the harmonization of national tax laws with the requirements of the European Union law. As the article deals only with the aspects of direct impact, such questions, as harmonization of annual and medium-term budget planning, changes in the budget planning process, strengthening of fiscal discipline, the requirements of the Stability and Growth Pact and their implementation in national law are analysed in the article.

**Keywords:** budget, budgetary framework, budget law, budget planning, fiscal discipline, Lithuania

## Introduction

Probably it would not be surprising to say that for the Republic of Lithuania (hereinafter "Lithuania") the date 1 May 2004 was and still is a date that marked essential changes in its legal framework. Similarly to other states, within the context of the European Union (hereinafter "EU") accession Lithuania changed whole spheres of the national law framework with a view to harmonising them with the EU law. The present article sees the sphere

of public finance as most important, while budget law in particular and changes in it are the result of the EU accession, too. For the sake of objectivity, it must be noted that changes in the Lithuanian budgetary framework were determined not so much or not only by the EU membership, but rather by an urgent need for reforming the budgetary framework to enable it to meet the most important financial needs of the State and the needs of financing public functions [Sudavičius, Vasiliauskas 2014, p. 470]. It should be noted that at the time of the EU accession the relation of the amendments to the budget laws with EU laws was minimal since it is common knowledge that the budgetary framework is not part of *EU Acquis*. It must be stressed within the context of this paper, however, that in 2004 the Lithuanian national budget was the first Euro-integration budget that merged Lithuanian state and the EU cash flows.

Although the budget of the State is the main centralised fund of financial resources through which a considerable share of the created Gross Domestic Product (hereinafter "GDP") is distributed and the establishment of which is provided for already in the Constitution of the Republic of Lithuania (hereinafter "the Constitution"), Lithuanian legal theorists have not analysed in principle either the budget process problem in general or the issues of the influence of the EU law on budgeting. During the whole period of independent Lithuania, there have been just a few scientific articles on these problems [Birmontienė 2012; Sudavičius 2013, 2014, 2017, 2019; Sudavičius, Vasiliauskas 2014].

It should be noted that the influence of the EU law on the Lithuanian budgetary law is twofold:

1. direct when the requirements of the relevant EU legislation are transposed into national budgetary law,
2. indirect, when national budgetary law is changed during the harmonization of national tax laws with the requirements of the EU law<sup>1</sup>.

The article, based on the analysis of existing laws and usage of the systemic, logical, comparative, critical, analytical and other methods of analysis, is aimed not only at explaining the gist of the principles of budget planning in Lithuania but also at disclosing the influence of the EU law on these phenomena (their legal framework).

### **Harmonisation of Annual and Medium-Term Budget Planning in Lithuania**

The problem of the introduction of long-term planning in the sphere of budget planning is not new. For many years discussion has been going on with regard to the question of extending the budgetary period. It has been noted, inter alia, that a one-year period is too short, especially when addressing the planning and funding of investments; that an annual budget fails to meet long-term, forward-looking economic development plans, and that budgets for a longer period must be drawn up in addition to annual budgets [Sudavičius 2013, p. 7]. Therefore, a gradual transition to the implementation of the principles of long-term budget planning must take place. One has to admit, however, that in practice priority, for a long time, was granted exclusively to annual planning of public finance, which only resulted in the establishment and approval of annual budgets at different levels. Essential changes in the review of the principles of budget planning occurred in the second half of and late 20th century when the principle of long-term planning began gaining a strong foothold in the public finance planning practice of most states (including Lithuania). In some cases this principle is implemented in conjunction with the principle of annual budget planning, while in other cases it even replaces annual budget planning. In any case it is evident that the governments

<sup>1</sup> See more on the harmonization of Lithuanian tax law with EU law [Lukas, Medelienė, Paulauskas 2014].

of most countries have been looking, more or less actively, for ways to achieve a better distribution of financial resources.

Generally it can be stated that almost throughout the 20th century the one-year budget planning was a universally accepted rule enshrined in national law, even at Constitutional level, - Art.129 of the Constitution stipulates: 'The budget year shall start on the 1st of January and shall end on the 31st of December'. Although the legal doctrine quite often featured criticism of this principle and there were proposals to replace (supplement) it with the principle of long-term planning of revenues and appropriations. Essential changes only came around in the late 20th century when both the EU and its Member States began to apply the principle of long-term planning in their public finance planning practice.

As for the establishment of the principle of long-term budget planning in Europe, the main reason that deserves mentioning is the positive experience of the EU in public finance planning and the toughening requirements for the EU Member States in this sphere. Such long-term financial plans (called an *EU multiannual budget* in some contexts and *financial perspectives* in other cases) have been drawn up in the EU since 1988. Under the Treaty of Lisbon, the multiannual financial framework has become a legally binding act. Moreover, Art. 312 of the Treaty on the Functioning of the European Union (hereinafter "TFEU") stipulates that 'the multiannual financial framework shall ensure that Union expenditure develops in an orderly manner and within the limits of its own resources' and 'the annual budget of the Union shall comply with the multiannual financial framework', thus establishing a basis for financial discipline. Drawing up long-term financial plans in the whole EU allows the Member States to plan their long-term finances in a more efficient manner, with account of the expected financial support from the Structural Funds on the basis of the multiannual EU budget. It should be mentioned that the Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States stimulates medium-term budget planning in the Member States.

The practice of different states allows distinguishing the following organisational/legal forms of the implementation of the principle of public finance planning for a certain period:

1. short-term planning: the planning of a budget for a period of one year,

2. long-term planning: the planning for a period longer than one year,
3. short-term planning based on long-term fiscal projections,
4. short-term planning based on the general long-term plan of the whole public finance sector,
5. annual planning based on the determination of medium-term objectives.

In accordance with the legal framework in force before 2000, Lithuania was in the first group of states where budgeting was based exclusively on a one-year period.

To achieve more effective governance of financial resources, on 22 October 1998 the Seimas passed a resolution on the concept of the budget structure that initiated reform of the budget structure and specified the key principles of its implementation, such as:

1. “To plan the state budget for three years and to approve the same for one year”,
2. “To establish the state budget by programmes drawn up by respective appropriation managers”,
3. “From 2000, to establish municipal budgets also by programmes”,
4. “To introduce a transitional five-year period for the establishment of a consolidated budget during which all resources of the state and municipal budgets and funds will be combined”.

The legal basis for the implementation of multiannual planning in budgeting was a law amending the Law on the Budget Structure of 11 July 2000. Art. 17(2) of the Law on the Budget Structure in force stipulates: “A draft of forecasted indicators of the totality of the state budget and municipal budgets for a period of three budget years shall be prepared on the basis of the Government Programme, the Stability Programme of Lithuania, the State Progress Strategy, the National Programme for the Advancement of Lithuania, [...], this Law, the Law on Fiscal Discipline, other laws and other legal acts, the country’s medium-term economic development scenario, EU financial support strategic documents, strategic plans of activities of appropriation managers and preliminary basic indicators of the state budget and municipal budgets as approved by the Government, also the programmes submitted by managers of state budget appropriations and draft estimates of the programmes”. It is obvious that from this moment Lithuanian legislation has enshrined a transition from annual budgeting to

medium-term planning based on long-term objectives [Sudavičius 2014, pp. 66-67].

Important changes in further improvement of budget planning took place after Lithuania’s accession to the EU and the preparation of the first Convergence Programme in 2004. Point 3.1.1 of the Programme stated that “The key medium-term objective of the fiscal policy is to achieve a cyclically-balanced government budget by ensuring the implementation of the economic policy objectives. Today’s objective is to keep the government deficit below 3 percent of the GDP, and create conditions for this deficit to consistently decline by a percentage point of GDP during later years, as required by the Law on Fiscal Discipline”. According to the Art. 1 of this Law “Finances of the general government sector shall be managed to adhere to the medium-term objective of the general government sector being in surplus or close to balance”.

Thus, it can be maintained that the model of medium-term budgeting based on the application of the programme method (as required by the EU legislation) is gaining dominance in Lithuania as the laws establish that a draft state budget is prepared for three budget years (medium-term budget) but is approved for one budget year (annual budget) [Sudavičius, Vasiliauskas 2014, pp. 480-481].

The budget planning procedure is as follows: after the Government approves the three-year preliminary key budgetary targets and the draft general principles for determining maximum appropriations, the Ministry of Finance informs the appropriation managers of the estimated limits of the appropriations that could be allocated to them for three years. On receiving this information, the state budget appropriation managers draw up their strategic action plans and programmes, prepare preliminary draft programme estimates without exceeding the maximum limits for financing expenditure as indicated by the Ministry of Finance, and submit them to the Ministry of Finance. The limits of appropriations for the expenditure of budgetary institutions for respective years are determined on the basis of the previous year plan and the use of appropriations for the following two years and their differentiation by separate state functions, with account of an upward bias in macroeconomic indicators and national budget revenue, as well as the criteria set out in the Stability Programme of Lithuania, and the priority programmes and measures approved by the Government. It is evident that medium-term budgeting

at present has a sufficient legal basis in Lithuania, and its shortcomings (officially identified by the National Audit Office) are in principle related to the activities of entities involved in budget planning [Sudavičius 2013, p. 16].

## **Strengthening of Budgetary (Fiscal) Discipline**

With regard to the influence of the EU law on the budget planning of Lithuania, attention should be drawn to the provisions of the so-called fiscal surveillance which establish an EU framework aimed at protecting the stability of the Economic and Monetary Union. This framework has its source in the so-called Stability and Growth Pact which consists of the Resolution of the Amsterdam European Council of 17 June 1997 on the stability and growth pact, and two Council Regulations: Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, and Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure.

The first document enshrining budgetary surveillance of the Member States was the 1992 Treaty on European Union (Maastricht Treaty). Accordingly, Art. 121 and 126 of the TFEU of 1997 lay down the principles of budgetary surveillance for the Member States establishing the so-called 'preventive' and 'corrective' arms. The preventive arm aims to ensure sound public finance of all EU Member States over the medium term, i.e. compliance with the so-called medium-term budgetary objective, which is expressed as a balanced budget over a medium-term with budget deficits close to zero or excessive. In accordance with the preventive arm, budgetary surveillance is conducted by supervising compliance of the Member States with the three-year convergence (for non-euro area Member States) or stability programmes (for euro area Member States) submitted by them to the European Commission<sup>2</sup>. These programmes must specify how the Member States intend to attain or safeguard the achieved fiscal position over the medium term, taking into account the impact of the ageing population on the budget. The stability and convergence programmes

<sup>2</sup> In 2015 Lithuania joined euro area and since then has been submitting Stability programmes.

contain the following information covering the previous and current year and at least three following years:

1. A medium-term objective representing a budgetary position of a state that safeguards against the risk of breaching the 3% of GDP threshold and ensures the long-term sustainability of public finances and the adjustment path towards the medium-term objective and the expected path of the debt ratio;
2. The underlying economic assumptions (economic growth, employment, inflation and other important economic variables);
3. A description and assessment of policy measures to achieve the programme objectives;
4. An analysis of how changes in the main economic assumptions would affect the budgetary and debt position;
5. Medium-term fiscal policy objectives and their relationship with price and exchange rate stability (for non-euro area Member States).

The Council examines the programmes and issues its opinion on them, based on the assessments of the European Commission and the Economic and Financial Committee. The greatest attention is devoted to the following issues:

1. Whether the economic assumptions are plausible,
2. Whether the medium-term budgetary objective contains a threshold safeguarding against excessive deficit, and the adjustment path for attaining the objective is appropriate,
3. Whether the political measures are adequate for achieving the medium-term budgetary objective,
4. What the risks of the ageing population for the long-term sustainability of public finances are,
5. Whether the economic policy strategies are in line with the broad economic policy guidelines.

On noticing any inconsistencies with or deviations from these programmes, the Council may issue country-specific recommendations on the economic policy pursued by a Member State. Meanwhile, the corrective arm requires the Member States to avoid excessive deficits and observe a certain public debt limit: the government deficit may not exceed 3% of GDP and public debt may not be more than 60% of the GDP. If these rules are ignored, the European Commission determines whether the excessive deficit is of an accidental and temporary or regular nature. On finding that the excess of the deficit indicator is not accidental, the Excessive Deficit Procedure is

launched, during which a Member State must take steps to balance its budget. EU continued to enhance budgetary surveillance and in 2011 adopted the six-pack of five European Parliament and Council regulations and one directive. This legislation introduced corrections to both the preventive and corrective arms but with a greater focus on prevention. The key modifications relating to prevention were as follows:

1. Member States were required to present national reform programmes along with the convergence and stability programmes to the European Commission,
2. A new government expenditure growth rule was introduced, according to which government expenditure growth should not exceed the potential GDP growth of a Member State concerned,
3. If a Member State fails to justify deviation from the medium-term objective, a sanction equal to 0.2% of GDP may be applied,
4. Minimum standards for Member States' budget governance were introduced, i.e. instruments were determined that must be implemented in a Member State (compulsory macroeconomic projections of the Fiscal Council and independent sources, reliability of statistical data, etc.).

Amendments relating to the corrective arm were as follows:

1. The concept of "debt brake" was defined, according to which a debt brake is a situation where the average reduction of the debt/GDP ratio is 1/20 over three years,
2. The list of economic circumstances was extended for the Member States to allow deviation from the medium-term objective,
3. A possibility was provided to impose sanctions at any stage of the Excessive Deficit Procedure,
4. The voting system for the imposition of sanctions was modified to make it more difficult for the Member States to agree while voting and this way avoid sanctions.

The reform was not limited to these modifications and the budgetary framework instruments were improved further. Here one should mention an intergovernmental agreement signed on 2 March 2012 – a Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. The essence of this Treaty is expressed through a commitment to transpose the provisions of the so-called Fiscal Compact into national law. The

provisions of the Fiscal Compact to be enshrined in national law are as follows:

1. a medium-term objective,
2. establishment of an automatic correction mechanism in case of deviation from the medium-term objective,
3. establishment of an independent Fiscal Council that would monitor compliance with the rules of the Fiscal Compact,
4. restatement of the debt brake rule,
5. establishment of coordination between the Member States in issuing government securities, i.e. borrowing, obliging Member States to notify both the European Commission, the EU and the Council of any planned issues in advance.

The purpose pursued when signing this Treaty was to ensure that the provisions of the Fiscal Compact are transposed into national law of the Member States by laws that have primacy over ordinary laws. Lithuania had transposed the provisions of the Fiscal Compact into national law by a special Constitutional law on the implementation of the fiscal treaty. The purpose of the Law shall be "to ensure the sustainability of general government finances and stable development of the economy and to implement the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union" (Art. 1).

The budgetary governance framework for the whole EU is completed by the so-called Two-Pack which entered into force in May 2013 and consists of two regulations of the European Parliament and of the Council which apply exclusively to euro area Member States. The key purpose of these two regulations is to enhance the budgetary surveillance mechanism in the euro area. The main provisions of this legislation are as follows:

1. The European Commission gains the right to carry out an annual review of the draft budget for the following year of each euro area Member State. Member States are obligated to present their draft budgets for the following year to the Commission by 15 October of the current year. The Commission assesses compliance of a draft budget with the Stability Programmes approved by the Member States,
2. A more stringent surveillance mechanism is established for those euro area Member States which are subject to the Excessive Deficit Procedure; each three to six months such Member States

must submit detailed reports to the Commission on the progress made,

3. Additional surveillance measures are introduced for euro area Member States in economic difficulty.

An assessment of all the above budgetary surveillance provisions on the EU scale makes it obvious that the budget process is increasingly regulated by the EU law, and with respect to euro area Member States one can speak in principle of a centralised budgetary surveillance policy. Therefore, from this aspect, the influence of the EU legal provisions on national law is of sufficient importance.

## Conclusions

For Lithuania 1 May 2004 is a date that marked essential changes in its legal framework. Similarly to other states, within the context of the EU accession Lithuania changed whole spheres of the national law framework with a view to harmonising them with the EU law, including budgetary law.

As regards budget planning in terms of time, different models are possible, ranging from annual to medium-term or even long-term planning. A specific model is chosen by each subject independently, with account of its needs (in case of the EU Member States, they must also take the requirements of the EU legislation into consideration when solving budget planning issues). In accordance with the legal framework in force before 2000, the Republic of Lithuania was a state where budget planning was based exclusively on a one-year period. Essential changes in the transition to long-term budget planning occurred following the adoption of the Seimas Resolution on the Concept of the Budget Structure and, to implement this concept, the adoption of a Law amending the Law on the Budgetary Structure which enshrined programme-based draft state budget preparation for three budget years. Beginning with the budget year 2014 Lithuania has introduced a new budget planning model based on the provisions of Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States. The essential feature of the new model is that starting from 2014 forecasted indicators of a totality of the state budget and municipal budgets for a period of three budget years were approved, and also the requirement of Art. 9 of the above Directive to adopt 'a fiscal planning horizon of at least 3 years' is

implemented. Also stricter requirements for compliance with three-year budgetary targets are introduced.

It seems to follow that these and other measures provided for in the Law on the Budget Structure will not only allow extending the limits of medium-term budget planning but will also ensure transparency in budget planning, improve the quality of macroeconomic and budget projections required for fiscal planning and enhance compliance of budget planning with the requirements of the EU legislation.

The influence of the EU legislation on the legal framework of the budgetary procedures of Lithuania is increasing steadily and allows acknowledging the existence of centralised surveillance of the Member States' budgets on the EU scale, especially with respect to euro area Member States. The trends of enhancing budgetary surveillance carried out by the EU institutions are expected to continue into the future.

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