EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 30 April 2014

on public finances

(CON/2014/30)

Introduction and legal basis

On 27 March 2014, the European Central Bank (ECB) received a request from the Lithuanian Ministry of Finance for an opinion on the draft constitutional law on the implementation of the fiscal treaty (hereinafter the 'draft constitutional law').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the third indent of Article 2(1) of Council Decision 98/415/EC[1], as the draft constitutional law relates to Lietuvos bankas. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft constitutional law

1.1 The purpose of the draft constitutional law is to ensure the sustainability of the general government sector finances and a stable development of the economy. The draft constitutional law aims to implement the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG)[2], and takes into account the earlier ECB opinion on the implementation of the TSCG in Lithuania[3].

1.2 The objectives of the TSCG are to be achieved by managing the structural balance of the general government sector in order to ensure that the general government sector finances are in surplus or balanced.

1.3 The draft constitutional law sets two ratios for assessing the management of the structural balance of the general government sector: (i) the medium-term objective and (ii) the structural impetus target. The medium-term objective sets a structural general government sector balance indicator. This must be reached within four successive years, excluding years when an unusual event occurs.

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1 Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

2 The TSCG was signed by 25 Member States on 2 March 2012. It entered into force on 1 January 2013, on the basis that 12 euro area Member States had deposited their ratification instruments by that date. The Lithuanian Parliament ratified the TSCG on 28 June 2012 and deposited the ratification instrument with the Council of the European Union on 6 September 2012.

3 Opinion CON/2012/105. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

The structural impetus target sets a targeted annual change (impetus) in the structural general government sector balance indicator towards the medium-term objective, and is measured in GDP percentage.

1.4 The draft constitutional law also lays down rules limiting the increase in the general government sector expenditure[4]. More particularly, if the average of the general government sector's balance indicators during the last five years is in deficit, the average increase in expenditure of any individual general government sector budget that exceeds 3 % of GDP cannot exceed half of the average multi-annual potential GDP growth.

1.5 The draft constitutional law provides for several exemptions. First, the rules governing the structural balance of the general government sector do not apply in the case of an unusual event as defined in Council Regulation (EC) No 1466/97[5]. Second, the draft constitutional law provides for five exceptions to the rules on the limits on growth in public expenditure[6]. Third, the State Social Insurance Fund budget and the budgets of government sectors whose planned expenditure does not exceed 0.3 % of GDP are not subject to the requirement to have a surplus or balanced budget[7]. The rules and requirements applying to them are instead set out in Article 4(2) and (3) of the draft constitutional law.

1.6 Article 8 of the draft constitutional law lays down the procedures to be followed in the event of a failure to implement the 'structural impetus target' defined in Article 2. These procedures shall start after the submission, no later than 1 May, of the report of the Government or its authorised institution to the Parliament for the preceding year on the implementation of the structural impetus target and on the indicator of the structural balance of the general government sector. The Prime Minister is required to provide to the Parliament and the control institution information on the reasons for such failure and 'guidelines on the measures for implementation' of the target, and to make an oral presentation in the Parliament. Moreover, within 30 working days of receipt of this information, the control institution is required to provide the Parliament with a conclusion on the validity of the reasons for failure to implement the target and the appropriateness of the guidelines on the measures to be taken. Finally, within one month after receipt of the conclusion of the control institution, the Prime Minister is required to provide the Parliament with the information on the final reasons for failure and guidelines on the measures to be taken to meet the target.

1.7 The State Audit Office is designated as a budget policy control institution (hereinafter 'control institution') responsible for monitoring the implementation of the structural impetus target and the achievement of the medium-term objective[8].

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4 Article 3 of the draft constitutional law.

5 Article 3(1) and Article 7 of the draft constitutional law and 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 (OJ L 209, 2.8.1997, p. 1).

6 Article 3(3) of the draft constitutional law.

7 Article 4(1) of the draft constitutional law.

8 Article 2(1) and Article 9 of the draft constitutional law.

1.8 Lietuvos bankas is required to submit its macroeconomic projections to the control institution each time these projections are updated, and at least twice per calendar year[9].

2. General observations

2.1 The ECB welcomes the consulting authority's initiative and the objective of implementing the TSCG[10]. Although Lithuania is no longer subject to an excessive deficit procedure, enactment of the draft constitutional law is important in modernising the Lithuanian legal framework in relation to the budgetary process[11].

2.2 Article 14(5) of the TSCG provides Lithuania, as a Member State with a derogation, with the opportunity to declare its intention to be bound by all or part of the provisions in Titles III (Fiscal Compact) and IV (Economic Policy Coordination and Convergence) of the TSCG[12] at an earlier date than that when the abrogation of the derogation in accordance with Article 140(2) of the TFEU takes effect. Lithuania has not made such a declaration and the ECB notes that the draft constitutional law will only enter into force as from the date when the abrogation of the derogation takes effect, i.e. once the euro is introduced in Lithuania[13].

3. Form of implementation of the balanced budget rule and correction mechanism

3.1 Article 3(2) of the TSCG provides that the 'balanced budget rule' shall take effect in national law through 'provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes'. In accordance with the Communication from the Commission on Common principles on national fiscal correction mechanisms adopted in accordance with Article 3(2) of the TSCG (hereinafter the 'Common Principles')[14], the legal status of the correction mechanisms to be triggered in case of significant observed deviations 'should be such that their provisions cannot be simply altered by the ordinary budgetary law'.

3.2 The ECB welcomes that the draft law has been designed as a constitutional law, which represents a ranking in the Lithuanian hierarchy of laws in line with the requirements of the TSCG[15].

4. The nature of the correction mechanisms

4.1 Article 3(1)(e) of the TSCG requires the automatic triggering of a correction mechanism in the event of significant observed deviations from the medium-term objective or the adjustment path

9 Article 9(3) of the draft constitutional law.
10 See paragraph 2.1 of Opinion CON/2012/105.
11 See paragraph 2.2 of Opinion CON/2013/91.
12 Titles III (Fiscal Compact) and IV (Economic Policy Coordination and Convergence).
13 See paragraph 2.3 of Opinion CON/2012/105.
14 COM (2012) 342 final.
15 See paragraph 3.2 of Opinion CON/2013/91.

towards it. This mechanism shall include the obligation to implement measures to correct deviations over a defined period of time. Common Principle 4 further provides that the size and timeline of the correction shall be framed by predetermined rules, thereby limiting, though not entirely ruling out, the scope for discretion in devising a response to a significant budgetary deviation. In addition, a Member State is expected to restore the medium-term objective as fast as is reasonably possible, which generally means either in the year immediately following the occurrence of the deviation or the subsequent year.

4.2 The draft constitutional law[16] specifies procedural steps in three layers of reporting, as described in paragraph 1.6 above. However, it does not stipulate the automatic triggering of the measures to be taken, but leaves it to the Government's and the Parliament's discretion. This is not in line with the above-mentioned provisions of the TSCG and Common Principle 4[17]. In particular, a correction mechanism that implements consolidation measures automatically, e.g. unless the Parliament vetoed them with a qualified majority, would provide a better guarantee of future fiscal stability.

4.3 Article 3(1)(c) of the TSCG provides that in exceptional circumstances there may be temporary deviations from the medium-term objective or the adjustment path towards it. This would include an unusual event outside the control of the concerned Member State that has a major impact on the government's financial position, or periods of severe economic downturn as defined in the Stability and Growth Pact, including at euro area level. Common Principle 6 makes it clear that any suspension of the correction mechanism due to the use of an escape clause may only be temporary. Once the escape clause no longer applies, the correction mechanism may provide for a minimum of structural adjustment, with the requirement of the Stability and Growth Pact being the lower limit. In addition, once the escape clause no longer applies, the Member State shall adopt a corrective plan in respect of the budget that must be adhered to during the correction period.

4.4 The escape clauses provided for in the draft constitutional law, as described in paragraph 1.5 above, go beyond the temporary deviations permitted by the TSCG 'in exceptional circumstances'. In finalising the draft constitutional law, it should be ensured that escape clauses adhere to the concept of 'exceptional circumstances' laid down in Article 3(3)(b) of the TSCG and to the requirements of Common Principle 6.

5. Medium-term objective

The ECB notes that Article 3(1)(b) of the TSCG requires Lithuania to ensure rapid convergence towards its medium-term objective. The timeframe for such convergence will be proposed by the Commission taking into consideration sustainability risks specific to Lithuania.

16 Article 8 of the draft constitutional law.

17 See paragraph 4.2 of Opinion CON/2013/90 and paragraph 3.3 of Opinion CON/2012/105.

6. Control institution

6.1 The State Audit Office is designated as a control institution responsible for monitoring compliance with the rules laid down in the draft constitutional law. In this regard, the ECB notes that a control institution has to comply with criteria laid down in the Common Principles[18].

6.2 The ECB understands that fulfilment of the criteria under the Common Principles will be facilitated, inter alia, by recruiting independent experts both from Lithuania and abroad as provided for in the draft constitutional law[19]. It should be ensured that the State Audit Office complies with all criteria laid down under the Common Principles, in order for it to effectively carry out the tasks of a control institution.

7. Lietuvos bankas' role

7.1 As indicated by the ECB in recent opinions, the role of a national central bank (NCB) should not go beyond monitoring activities that result from or are linked – directly or indirectly – to the discharge of their monetary policy mandate[20]. Ensuring compliance with the obligations under Article 3(1) of the TSCG is the responsibility of the Lithuanian government[21].

7.2 Lietuvos bankas is already producing macroeconomic projections as provided for in Article 9(3) of the draft constitutional law. These are made publicly available[22]. The ECB understands that the draft constitutional law provides that Lietuvos bankas will merely forward its existing projections produced for monetary policy purposes to the control institution. Consequently, the draft constitutional law raises no concerns relating to compliance with the prohibition on monetary financing, to the principle of central bank independence or to interference with monetary policy.

7.3 In any event, even outside the scope of the draft constitutional law, Lietuvos bankas should retain its existing role regarding the production and quality control of government finance statistics[23] in

18 Principle 7 (the role and independence of monitoring institutions). These criteria include; (i) a statutory regime grounded in law; (ii) freedom from interference, whereby such institutions should not take instructions, and should be in a capacity to communicate publicly in a timely manner; (iii) nomination procedures based on experience and competence; (iv) adequacy of resources and appropriate access to information to carry out the given mandate.

19 Article 9(4) of the draft constitutional law.

20 See paragraph 4.3 of Opinion CON/2012/105, paragraph 5.5 of Opinion CON/2013/90 and paragraph 5.5 of Opinion CON/2013/91.

21 See paragraph 4.3 of Opinion CON/2012/105.

22 Available on Lietuvos bankas' website at http://www.lb.lt/macroeconomic_forecast

23 See paragraph 5.4 of Opinion CON/2013/90.

accordance with Council Regulation (EC) No 479/2009[24], Guideline ECB/2013/23 on government finance statistics, and the memorandum of understanding on the cooperation between the members of the European Statistical System (ESS) and the members of the ESCB, dated 24 April 2013[25].

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 30 April 2014.

[signed]

The President of the ECB

Mario DRAGHI

24 Council Regulation (EC) No 479/2009 of 25 May 2009 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community (OJ L 145, 10.06.2009, p. 1).

25 Available on www.ecb.europa.eu