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Sub-Theme II: Public Finance Management Reform: Trends and Lessons Learned

Lithuania is one of the European Union members who experienced severe effects of the shrunken world economy, felt the outflow of capital and a collapse of a banking system. In 2008, the Government of the Republic of Lithuania decided to implement a stringent programme of saving and economic reform. It saw cuts in public sector salaries, reduction of direct taxes, increase of VAT, extension of the retirement age, cuts in social expenditure, creation of a more flexible labour market and a simplified procedure for the establishment of companies. Having implemented such a “shock therapy“ programme, the national GDP sagged in 2009; however, in 2010 a rise in GDP was recorded.

The key short-term goal of Lithuania is to strengthen the confidence of financial markets in the long-term financial sustainability of the public sector: to further consolidate public finances and to essentially improve the condition of areas, which may ensure the economic breakthrough.

Convergence Programme of Lithuania 2012

The Convergence Programme foresees the following objectives: to implement the budget policy ensuring the confidence of financial markets in the long-term stability of the public sector finances retaining a solid confidence in the continuity of the currency board principle in Lithuania, as well as providing for the long-term price stability perspective. Having restored the confidence in macroeconomic stability, to accelerate business development and successfully implement the following structural reforms necessary for a sustainable economy: pension reform, education reform, reform of health care systems, reform of energy dependency on fossil fuel and reduction of air pollution. These reforms are under way in Lithuania. In order to timely execute the reforms and not to delay them, it is important to seek the achievement of a political agreement on the reforms to be executed and to ensure the public support.

The Convergence Programme provides for further execution of economic policy obligations of the currency rate mechanism, achievement of a sustainable compliance with convergence criteria established in the Treaty on the Functioning of the European Union in the mid-term, as well as preparations for the introduction of euro.

Prevention and control of financial crises

Lithuanian financial market is a part of the EU common market, therefore the strengthening of the stability of Lithuania‘s financial market and the preparation for the management of a crisis situation is conducted with regard to EU recommendations in the area of prevention and management of financial crises, which are laid out in the Memorandum of Understanding on Cooperation Between the Financial Supervisory Authorities, Central Banks and Finance Ministries of the European Union, which came into force on 1 June 2008.

Considering the above recommendations, in 2008 Lithuania approved the Plan for Prevention and Management of Financial Crises. Provisions of the Plan lay out definitions, identify indications of a threat of financial crisis, institutions involved, actions of the involved institutions, as well as the expected principles of exchange of information and cooperation in prevention and crisis management stages.

The Law on Financial Stability of the Republic of Lithuania adopted in 2009 sets measures for strengthening of financial stability, which may be taken where relevant to enhance the stability and reliability of the banking sector. Establishment of these, as well as preventive measures improves the ability to manage crisis situations and contributes to the increase in stability of the financial sector.

Budget reform

The aim of the Reform on the Drafting and Execution of the Budget is to gradually introduce such a system for identification of budget deficit, approval, execution monitoring and assessment of results of the budget, which would create maximum preconditions for the enforcement of the prudent national budget policy and allow the public to watch these obligations as a moral norm.

With the help of reform implementation measures Lithuania seeks to create elements of political culture: to define several significant terms ensuring that when discussing the consequences of macroeconomic budget the politicians have the same indicators in mind.

In the recession period, apart from economy of State finances, there was a constant endeavour to increase the efficiency of public finance management and result-oriented activity. In 2011, an information system for monitoring of programmes implemented by the State institutions was introduced. The system ensures a submission of a timely information to decision makers, as well as allows to expeditiously coordinate the interdepartmental activities: their planning, performance and the achieved results. Strategic planning documents were revised and improved, new programme evaluation and function revision systems were developed, efficiency evaluation criteria of general functions of the State institutions were determined, and their evaluation was started. These changes enable the authorities to take rational (evidence and analysis-based) management decisions as a response to the changing environment: the decreasing financial and human resources, introduction of new IT solutions, as well as new objectives and goals raised for authorities.

In the mid-2010, a public discussion on the Reform of the Drafting and Execution of the Budget was initiated. In 2011, it was supplemented with principles regulating the accumulation and use of the State treasury reserves ensuring the steady financing of the State functions during the recession.

The undertaken budget structure reform foresees a number of indicators, allowing to balance public finances and more comprehensive and efficient budget execution control.

Public Sector Accounting and Financial Reporting System Reform

In 2005, Accounting and Financial Reporting System Reform (hereinafter – accounting reform) of public sector including budgetary bodies, State social insurance funds, other reserve funds, tax funds, controlled health care public bodies, State and municipalities as separate legal entities was started. The aim of the accounting reform was the transition of the public sector to accruals-based accounting starting with 2010.

The implementation of the accounting reform required the drawing up of new public sector accounting and financial reporting standards, model accounting manuals, plans of accounts, consolidation manual, recommendations for individual groups of public sector entities; harmonization of legislation with the intended requirements of accounting standards; the analysis of information systems and software used for the management of accounting in the public sector; as well as the formulation of alternative optimization solutions for IT systems and software in the public sector.

During the implementation of the accounting reform as well as during the enforcement of the Law on Public Sector Reporting, 26 standards on public sector accounting and financial reporting were drawn up. Provisions of some of the standards were supplemented and/or specified taking into consideration remarks and recommendations of public sector entities, which had started applying new standards since 2009, shortcomings found in the submitted financial accounts, questions presented by public sector entities, as well as non-conformities identified during the development and introduction of the design of information system for consolidation of financial accounts in public sector entities.

New accounting information system for the management of the State treasury accounting was introduced; State treasury processes concerning the financial management and accounting were described and optimized. Information system for the consolidation of public sector accounting and accounts is being introduced.

All of these developments are a huge challenge and responsibility both for internal audit and external audit, as well as for public auditors.

Social Insurance Reform

Social insurance funds have a huge impact on the State public finances and their stability. In 2009, an audit conducted by the National Audit Office of Lithuania (NAOL) identified substantial shortcomings in social insurance system; factors, which allowed the development of the unbalanced State Social Insurance Fund (hereinafter – the Fund) were indicated; the audit pointed out that the principle of solidarity is not implemented to the full extent.

Wide discussions took place in the highest national level on the necessity to reform the social insurance system. In 2011, the Parliament of the Republic of Lithuania decided to approve the guidelines of the State Social Insurance and Pension System Reform in order to ensure that the income of the current and future pensioners are adequate and sustainable, social insurance system is secure and financially solid, ensuring the enforcement of the solidarity principle, encouraging the private accumulation of pensions, more efficient operation of bodies administering the system, that social insurance benefits would be more dependent on the paid contributions and social insurance length, while the ratio of an average pension and average wage would not decrease in the future.

State Social Insurance and Pension System Reform (hereinafter – reform) is based on the following principles:

- rectification of the system: separation of solidarity and social insurance parts in the system of pensions and other social insurance benefits thus rectifying national social insurance system and increasing its transparency;

- establishing of a clearer and stronger relation between contributions and benefits: linking the size of benefits with the size of contributions paid as well as with the period for which social insurance contributions were calculated and paid – it will encourage people to participate in social insurance system;

- establishing of a clear indexing procedure for benefits based on objective criteria.

Concrete measures are envisaged for the implementation of the reform aim. They will allow to balance social insurance budget and monetary flows in the future.

Under the guidelines of the reform of the State Social Insurance Fund Board, which were approved in the Parliament and which do not foresee the increase in contributions to the State Social Insurance Fund Board, new legislation was adopted, following which it was planned to increase and unify the retirement age of men and women: retirement of women would be annually delayed by 4 months, while the retirement of men – 2 months while it reaches the 65 year-limit. The retirement age was last changed in 1994 when it was gradually increased from 55 to 60 years for women while from 60 to 62.5 years for men.

The reform foresees State social insurance benefits, which compensate the income lost due to an insured event, from which social insurance contributions were calculated and paid. The reform also provides for the assessment of possibilities to calculate the social insurance retirement pension on the basis of the system of virtual accounts or on the basis of accounting units (“points“).

Trends and lessons learned

System and management of the State finances is constantly changing and improving. Changes in sovereignty, fiscal tension, regional cooperation, globalization and new information technologies have radically changed the environment in which the State finances are managed. Management of the State finances is constantly reformed in order to keep up with the quickly changing external environment. Two following key ways applied to reform the management of Lithuanian finances should be pointed out: first is the increase of accountability and the second is the involvement of the persons concerned. Greater fiscal transparency and higher fiscal accountability is also encouraged. The implemented reforms foresee a greater involvement of citizens in the management of the State finances.