The State of the Finances Says It All

An examination of the budget tells us much about a country's fiscal health

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If we were to take the Lithuanian saying "Tell me who your friends are and I will tell you who you are" and apply it to the state, it would run something like this: "Show me the state finances and I will tell you what kind of state it is."

Indeed, the information about where a government receives revenue from, and how much, where it spends it, how much, and in what proportions, how it forms its budget, whether it borrows money, how much and from where, can tell us much about the state.

Moreover, it can define the development prospects of the state. It is like a state's chiromancy, a map laid out on the palm whose lines we will try to trace in this article.

The fiscal system in Lithuania is based on three main issues, the state budget, local government budgets, and funds. These last include the state social insurance fund, the obligatory health insurance fund, the reserve (or stabilisation) fund and others. The state budget, along with local government budgets, is also referred to as the national budget. It accounts for the greater part of state finances.

Living on loans

For several years in succession, the state budget in Lithuania has been showing a deficit. Expected revenue for 2003 will amount to 9.56 billion litas, and expenditure will total 10.84 billion litas.

Compared to the GDP generated, the budget runs at a 2.5 per cent deficit, still within the 3 per cent tolerance limit set by the Maastricht Treaty. Compared to expenditure, the budget deficit is nearly 12 per cent.

This means that every tenth litas spent by state institutions will have to be borrowed, because the regular source of state finances – taxes – is insufficient to finance government needs. More than every tenth litas in the budget is used to cover the cost of servicing the state debt, for the payment of interest.

This equals approximately the amount used for financing the maintenance of public order (the police) and public safety. Local authority budgets show no deficit when they are approved, but local authorities do borrow from banks. This is a hidden share of the debt. The expected revenue for local government budgets, together with the subsidy from the state budget, will amount to 3.55 billion litas in 2003.

The state debt has been mounting steadily over the last ten years. Having started out on its life as an independent state unburdened with debts, the country is currently 13 billion litas in debt, which accounts for 26 per cent of the forecast GDP.

If people had to pay off the government's debts, each resident would have to take on a burden of 3,700 litas, of which 2,622 litas is owed to foreign creditors. This is a heavy burden for Lithuanians, as the average personal income doesn't even amount to 400 litas per month.

Of course, these figures do not exceed the tolerance limit of the Maastrich Treaty – 60 per cent of GDP. However, the speed of the debt's growth is causing concern. If an individual with this kind of record applied to a bank to get a loan, his ability to repay the loan would be severely in doubt.

Compared to other countries, however, the debt is not especially large or otherwise remarkable.

The international financial community considers Lithuania to be a rather reliable debtor, and this trust is reflected in its credit ratings. Various rating companies have evaluated the country's long-term liabilities: Moody's Baa1; Standard & Poor's BBB+; and Fitch BBB.

These credit ratings are lower than those of the other Baltic states, the Czech Republic, Slovenia, Hungary and Poland; but they are higher than those of Slovakia, Croatia, Russia and Bulgaria.

Budget expenditure

Since 2000, the formation of the budget in Lithuania has been based on a programme principle. Each public institution prepares programmes, which then receive budgetary financing.

But a real transition from institutional to programme budgeting has not taken place. What traditionally used to be allocated to public institutions is now earmarked for these institutions when they submit their programmes. Real selection and competition among programmes does not exist.

The law under which the budget is approved every year also reflects only a formal transition to programme financing. Expenses are traditionally presented according to the administrators of allocations.

Interestingly, these recipients include not only government institutions but also semi-commercial enterprises. For instance, state-owned holiday resort buildings are still subsidised from the state budget.

A large portion, around 19 per cent, of the state budget is transferred to local government budgets in subsidies and allowances. About 10.5 per cent is allocated to education, 9.7 per cent is used to maintain public order and public safety, 8.7 per cent is assigned to defence, and 6.1 per cent to agriculture.

Along with the yearly budget, the parliament passes a three-year state investment programme. Government investment is financed from three main sources: the state budget, the privatisation fund, and loans received on behalf of the state or with a state guarantee.

This investment in 2003 is expected to amount to 1.44 billion litas. The main areas for investment are transport and communications, defence and education.

Supervisors of state finances

Apart from the requirements mentioned for state finances (the ratio of debt to GDP and the ratio of fiscal deficit to GDP) set out in the Maastricht Treaty, during the last few years the country's finances have been managed according to a memorandum signed with the International Monetary Fund and its requirements for government spending.

Even though it was often criticised for proposing ill-fitting policies for countries in transition, the IMF propagated a welcome reduction in government expenditure and debt and prevented Lithuania from possible deleterious actions. The memorandum with the IMF expired in March this year, and a new document is not expected to be signed again.

New requirements for the fiscal system in Lithuania will arise as it becomes a member of the EU and assimilates EU structural funds. It is expected that the resources coming from structural funds will account for 45 per cent of the country's GDP.

A draft of a general document which lays down the strategic goals and directions for the utilisation of these funds has been approved, and the final version will be submitted later this year.

EU membership will change markedly the workings of the budget. A share of VAT and GNP will have to be contributed to the EU. This will come to around 170 million euros (587 million litas) per year. Therefore, it will be a significant portion of the budget, exceeding 5 per cent of budgetary expenditure if executed in 2003.

Even though the general balance of fund flows is expected to be positive, the first few years of EU membership will pose a serious challenge to the state's fiscal system.