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**Fiscal Design Across Levels of Government
Year 2000 Surveys**

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GENERAL INTRODUCTION TO THE SURVEY

In accordance with decisions made by the “Fiscal Decentralisation Initiative for Central and Eastern Europe” (FDI), the OECD has initiated surveys on fiscal decentralisation for the purpose of providing international comparisons on the design of fiscal systems across levels of government.

FDI is a joint initiative of the OECD, the World Bank, the Council of Europe, the Open Society Institute, UNDP, USAID and OECD Member countries to assist transition economies in Central and Eastern Europe in carrying out intergovernmental reforms. The main objectives of the Initiative are: to encourage local democracies to improve the capacity of local governments to plan and administer expenditures and raise revenues; and to support local governments in their efforts to become more responsive and accountable to their constituencies.

Thereby the survey has been written in response to a questionnaire designed by the OECD and follows the structure outlined in the questionnaire.

The survey specifically indicates the state of the following fiscal decentralisation issues:

- The design of fiscal systems.
- The profile of sub-national revenues.
- The profile of sub-national expenditures.
- The match between locally-managed expenditures and the corresponding revenues.
- The institutional arrangements for ensuring fiscal discipline and budgetary constraints.
- The design of intergovernmental fiscal relations.

The surveys in 2000 took place in six countries in Central and Eastern Europe: three OECD Member countries - the Czech Republic, Hungary and Poland - and the three Baltic states - Estonia, Latvia and Lithuania.

The survey was carried out between April 2000 and January 2001.

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1. EXECUTIVE SUMMARY

1.1 Main features of local finance and intergovernmental relations

The essential element of the system of municipal financial resources is municipal budgets. Every municipality has an independent budget. Municipal budgets are approved deficit-free. From 1998, a significant step was made towards the development of a modern, reliable and sustainable system of municipal budget revenues. The system sets the overall volume of municipal expenditures, as well as the principles and procedure for the allocation, calculation and transfer of revenue sources assigned to this volume. The Seimas approved in 1999 the Law on the Methodology of Determination of Municipal Budgetary Revenues based on budgetary co-operation. One of the principles of the law is that the main financial indicators should be established through negotiations between central government (represented by the Ministry of Finance) and the municipalities (represented by the Municipal Association). Another important principle is that the evaluation of a municipality's fiscal requirement is based on calculated expenditure requirements, which are determined on a three-year basis.

The state budget and the municipal budgets make up the national budget of the Republic of Lithuania. The essential criterion reflecting effective macroeconomic control is that the municipal budgets must be balanced prior to approval. The law on the methodology of determination of municipal budgetary revenues defines the ratio of the size of municipal budgets to the size of the national budget. In this case, municipal expenditures are linked with the general state of the state economy and of the national budget revenues. Municipal borrowing is controlled by Central Government and the Ministry of Finance.

The use of municipal budget resources is inspected by the controllers of municipalities. In certain cases, the execution of municipal budgets is inspected by the state controller.

1.2 Major empirical findings

By analysing the changes in the revenue and non-tax income of local governments, we can conclude that income tax of natural persons becoming an income source solely for local governments is a positive tendency in forming a base for local government budgets. Compared to 1997, income tax revenues of natural persons in local government budgets increased by 45%. Lithuania's economy experienced difficulties due to Russia's financial crisis of 1998. That is why, in 1999, as compared to 1998, the revenues from the income tax of natural persons in local government budgets increased only by 6.4%. Assigning said taxes to the budgets of local governments, knowing that budget revenues will not change, should give more confidence to local government administrations. These conclusions are backed up by the example of the decrease in revenues at other administrative levels, in 1999, partially due to Russia's financial crisis of 1998. Tax-revenues of municipalities increased constantly (4.93% in 1997, 6.18% in 1998 and 6.63% in 1999 of GDP). Analysing tax classification, the major part (about 90% in 1999) of the municipal tax revenues consists of taxes on income, profits and capital gains. The rest (about 10% in 1999) consists of taxes on property: as a share of tax revenue, this is decreasing but as an absolute amount, it is increasing. Local governments only have the right to impose a small part of their own taxes. These taxes are assigned to the non-tax revenues. Local governments have the right to set the tax base and tax rate for local levies and for municipal budgetary revenue obtained for the services rendered. The two types of revenue comprise up to 10% of all non-tax revenue of local governments.

Grants in total have decreased during the period 1997 – 1999, from LTL 852.6 million to LTL 128.4 million, i.e. by more than 6 times. This was caused due to a considerable decrease in both general and special grants. The amount of the general grants is based on the expenditure volume of municipal budgets

and the volume of tax and non-tax revenues assigned to cover such expenditure volume, according to tax laws. During the last two years (1998 and 1999), these revenues have increased more than municipal expenditures, therefore the amount of general purpose grants has decreased accordingly. Basically, it was due to the fact that, from 1998, personal income tax became the basic revenue source for municipal budgets, and revenues from that tax have increased. The decrease in specific grants, to cover standard costs, is noticeable due to the recent Government policy to decrease the amount of such grants. Grants, allocated to cover actual costs, are oriented to state social policy implementation, therefore the amount of grants has remained quite stable.

An analysis of the expenditures reveals that the largest portion of municipal expenditures is allocated to social services which include education, health-care, social security and welfare, sports and culture. Municipal expenditures on social services constitute about three quarters of total expenditures (72.6% in 1997, 74.1% in 1998, and 77.8% in 1999). Education absorbs the major part of the expenditures, i.e. 49.4% of the total expenditures in 1997, 52.8% in 1998 and 56.3% in 1999. Social security and welfare consumes about 15% of total expenditures. Expenditures on health-care within municipal budgets are quite moderate, because, since the health-care sector reform, in 1997, these services have been financed from the budget of the Compulsory Health Insurance Fund. The number of health-care institutions funded from municipal budgets was reduced and, as of 1 July, 1997, was very small. In 1998 and 1999, municipal budgets financed primary health-care services only. Another significant part of municipal appropriations (about 10 per cent) is used for housing and community amenities, which are - exceptionally - municipal functions. Services attributed to fuel and energy, as well as transport functions, constitute between 3 and 3.5% of municipal budgets each. Appropriations in these expenditure line items are used to compensate expenses incurred due to application of passenger transport benefits as well as to compensate heating costs for low-income households. The function of public order and public security, for which municipalities spend up to 1% of their budgets, is delegated to municipalities who organise the activities of their fire-prevention agencies.

Having analysed the changes in municipal budgetary expenditures in the past few years, we can conclude that the budgetary resources allocated for social services remain stable and are even increasing, notwithstanding the changes in the municipal revenue sources. This increase could be explained by the fact that municipalities are responsible for more and more functions in the sphere of social services and this is also related to the Government's social policy.

An analysis of municipal expenditures shows that they represent the major part of the three basic political sectors, like any other current expenditure of state or municipal budgets for a certain sector. This is, first of all, true of municipal expenditures for such services as pre-school training, general education, sanitation and environment protection, street lighting, other functions in the sphere of housing amenities and public utilities. Funding for pre-school institutions and general schools accounts for 83% of the total state expenditures for this sector, while expenditures on sanitation and environment protection, street lighting and other services in the sphere of housing amenities and public utilities account for 100% of the total state expenditures for this sector. This is also related to the fact that these functions are mainly within the competence of municipalities – the division of expenditures between the central government and municipalities is mainly determined under generally accepted principles (municipalities are only responsible for pre-school and general education, and public utilities, for their residents, whilst the central government is responsible for services that are used by all citizens of the country, such as national defence or public order and security).

1.3 Main issues in the fiscal design

The main quality of the new Law on Local Self-government is the more precise and clear description of its functions, together with a link to legal and procedural aspects. The new law clearly regulates the powers and rights of municipal institutions. In the old version of the Law, only two types of function were

described: autonomous and those delegated by the State. Functions delegated by the State included: civil registration, keeping the register of municipal, state and private enterprises as well as public organisations; carrying out secondary health activities; they may also have managed state parks (national and regional), organised the municipal police, civil security and fire safety, and implemented other functions delegated by law. Autonomous functions were described separately for each part of the internal management system: the Council, the Mayor and the Board. Moreover, autonomous functions included many procedural functions, which were actual rules of internal management and responsibility, and these were not clearly defined, either. This caused co-operation between levels of governments to be ineffective, and created contradictions and difficulties in appraising functions financially (in the budget preparation process).

At present, discussions are taking place in Lithuania on state (transferred to local self-government) functions and the funding necessary to implement them. The problem is that there is no existing, unified methodology for the calculation of the cost of the functions, especially when the Government delegates certain functions related to state or public management, the cost of which differs in each municipality. In addition, there are certain inadequacies between implementing functions and municipal budgets. Therefore, some conventional decisions are to be made in relation to the above-mentioned shortcomings, in the near future.

The new Law on Budget Structure regulates the implementation of objectives and tasks, and gives a legal basis for budget reform . The Law contains certain basic principles:

- Appropriations are defined as resources of the state and municipal budgets, approved by the Law on the Approval of the State Budget and decisions of municipal councils concerning the approval of municipal budgets; and assigned for the implementation of activities and programmes of the state and municipal institutions.
- The introduction of the concept of “special programmes”, i.e. whose expenditures are covered not only by the funds of the national budget but also by other funds.
- The definition that taxes, obligatory payments, and levies collected in the Republic of Lithuania may only be allocated through the National Budget of Lithuania, the State Social Insurance Fund, the Obligatory Health Insurance Fund, and the Privatization Fund.
- The determination of the main duties, rights and responsibilities of the appropriation managers.
- The definition of requirements for the publicity of budget information.
- The definition of requirements for the adoption of other laws that affect budget revenues and expenditures.
- The draft state budget shall be prepared for a period of one budget year and estimated for a period of three budget years.
- It is also planned to submit to Seimas performance measures of the appropriation managers’ programme results.
- The definition that state budget revenue received in excess, and appropriations that are no longer valid, shall be used for: the repayment of public debt, the financing of carried over appropriations; covering shortfalls in municipal tax revenue, with the exception of cases where the Seimas pass amendments to the current year budget.

The annual state budget has to be prepared according to the long-term strategic plan of Central Government and strategic activity plans of ministries and Government agencies. The need to have a strategic plan was formed in order to implement effective reforms in the areas of public administration and the legal system. The Strategic Planning Manual was prepared in order to help ministries, government agencies and other public management institutions to prepare strategic plans, programmes and draft budgets. The manual covers the principles of strategic planning and budget formation. The manual helps to implement the integrated planning and budget system as approved by the Government. Planning and budget reforms can only be implemented successfully when both reforms are carried out together. Strategic priorities are not implemented successfully when they are presented without a reliable financial plan and firm financial obligations.

Central Government has recommended that municipalities apply strategic planning principles. Specific training in municipalities has begun. Recently, certain municipalities have introduced these principles.

1.4 Status of policy reform considerations

One of the key factors bringing about new aspects of the self-government reform is the Program for 2000 to 2004 of the new Government that was formed after the election to the Parliament in 2000.

With the view to limit the power of the central government over municipalities and relying on potential capacities of municipalities to act more efficiently, economically and more understandably to the public, the Government of the Republic of Lithuania has set in its program for 2000 - 2004 the following measures to be taken:

- - to detail all functions of the central government and municipalities, to eliminate overlapping of the functions, to specify in as much detail as possible the powers and to limit authority;
- - to develop an efficient legislative mechanism to ensure that each institution of the respective municipality is observing the laws on its own will;
- - to give municipalities the power to deal with land-related and land management issues;
- - to transfer all institutions dependent on regional administrations as well as other bodies to the supervision of those town and regional municipalities, in the territory of which the above-referred institutions and other bodies are located;
- - to gradually phase-out centralised re-allocation of budgetary resources. To give possibilities for the municipalities to form their budgets from local taxes and levies. To set that both natural and legal persons shall pay two types of taxes – a fixed amount to the state and to the municipality.
- - to set statutory limits, within which a municipality may itself set the size of taxes due to it;
- - when changing administrative borders of municipalities, to take account of the opinion of the public and to set the procedure for remuneration of losses;
- - to give the property, which is not necessary for the needs of the central government and which is not to be returned to its former owners, to municipalities;
- - not to delegate any functions to municipalities, unless they are appropriately financed;

- - to promote social housing development in municipalities, to grant state support to socially vulnerable people and young families;
- - to finance schools by the principle “money follows a student”, to guarantee equal opportunities to non-governmental and governmental educational institutions;
- - to implement the principle “money follows a child” in supplementary education field as well.

In the 1st quarter of 2001, it is planned to draft the methodology for calculation of the need for the resources from the state budget of the Republic of Lithuania to perform the functions delegated to municipalities so that budget proposals to finance central government functions and those delegated to municipalities collected to draft a law of the respective year on approval of financial indicators of the state and municipal budget are well-grounded.

In the 2nd quarter of 2001, the Law of the Republic of Lithuania on the Methodology for Estimating Municipal Budgetary Revenues shall be amended to adapt it to the provisions of other legislation already applicable (Local Self-Government Law, Law on Budgeting) and to be still adopted (relevant taxation legislation).

Quite a significant portion of the expenditures that are currently financed by municipalities will be financed centrally, i.e. by state budget grants.

To finance other functions performed by municipalities, the same revenue equalisation mechanisms as provided for in the currently applicable law will be applied, since the differences between tax revenues of individual municipalities per capita are very large. Therefore, it is forecast that both the equalisation of differences in tax revenues and equalisation of differences in expenditure structures among individual municipalities will be further applied. Levels of tax revenue equalisation and demographic indicators to be used to determine the levels of equalisation of differences in the structure of expenditures are planned to be established in a single Methodology Law.

It is anticipated that after the fiscal reform of municipalities planned by the Government is implemented, the principle of revenue equalisation will be more applicable to perform independent functions of municipalities, while expenditure setting principles will be applied with respect to functions delegated by the central government, the latter being financed by special grants from the state budget. We can forecast that as a result the ratio of grants within municipal budgets will increase in the coming years.

2. THE TECHNICAL FRAMEWORK - CLASSIFICATION OF LEVELS OF GOVERNMENT AND ECONOMIC TRANSACTIONS

2.1 Administrative structure

There are three administrative levels of government in Lithuania:

- Central government;
- Regions (counties);
- Local self-government (municipalities).

These administrative levels are defined as well as described by the Lithuanian Constitution, Law on Central Government, the Law on Management of a County, and the Law on Local Self-government. In accordance with Lithuania's Constitution (1992), the budgetary system of Lithuania consists of the independent State Budget and the independent local government budgets. The regional, de-concentrated administrative units (counties) operate as arms of the central government to deliver central government services throughout national territory.

2.1.1 Central government

The Government acts in compliance with the Constitution, Laws and Treaties of the Republic of Lithuania, other legislative acts passed by the Seimas (the Parliament), the Government programme, decrees of the President of the Republic, the Law on Central Government, and other legislative acts. It consists of the Prime Minister and Ministers. The Government is responsible to the Seimas for the general activities of the Government. The Ministers, in directing the spheres of administration entrusted to them, are responsible to the Seimas, the President and those directly subordinate to the Prime Minister. The Central Government has executive power in Lithuania.

2.1.2 Regions (counties)

At the regional level, Lithuania is divided into 10 Counties, higher territorial administrative units - the governing of which is organised by the Central Government. These are deconcentrated units of the Central Government implementing the government's regional policies. Counties are managed by County Governors who are proposed by the Prime Minister and appointed and removed from office by the Government. The Central Government approves the composition of the county governor's administration as well as its regulations. The Seimas of Lithuania, upon the recommendation of the Government, set or alter the County limits, and give or change its name. The funds that are necessary for the governing of the

County and for the discharge of functions of the governor are appropriated from the state budget. The main tasks of the County Governor are:

- to implement state policy in the spheres of social maintenance, education, culture, health care, territorial planning, monument protection, land use and protection, as well as agriculture, environmental protection and other related spheres, and to implement state and inter-regional programmes;
- to co-ordinate the activities of the ministries and other structural subdivisions of Government institutions lying within the county, as well as to co-ordinate the activities of executive institutions of local authorities in implementing regional programmes;
- to provide for the priority trends of the county's development and prepare its programmes.

The formation of comprehensive regional policy in Lithuania began in 1998. The legal foundation of this policy centres refers to the Law on Regional Development (adopted in July 2000), the Government Decree on Regional Policy Guidelines (adopted in July 1998) and the Government Decree on the Implementation of Regional Policy Guidelines (adopted in May 1999). As indicated in the guidelines, the national policy for regional development shall be primarily implemented at the county level, but in special circumstances, after identifying specific conditions and problems, regions may be set up consisting of a number of adjacent counties and/or districts. The same principle is foreseen in the Law on Regional Development. The Law strengthens the role of counties in designing and managing regional policy. It also provides the principles of close co-operation with districts, social and economic partners, and the public.

The term 'Regional policy' comprises two components: 1) the formation and implementation of the national policy for regional development whose main objective is the reduction of disparities between the regions; and 2) the implementation of the certain principles of the European Union's regional policy which mainly involves the preparation for the management of the EU structural funds.

The national policy for regional development was limited for a long time to the definition of functions/responsibilities of all levels of territorial-administrative units, as well as the application of the system of equalisation of local government revenues. In 1998-1999, the concept underwent fundamental changes when the need to identify regional development priorities and to link them closely to budgetary resources emerged. Therefore, comprehensive regional policy is currently at the formation stage. The progress achieved in 1998-1999 mainly centres around: 1) raising the awareness of civil servants, socio-economic partners and the public of the usefulness of regional policy and of directions for its formation and implementation; 2) formation of institutional structures to manage the co-ordination of regional policy, and the definition of their responsibilities; and 3) preparation of sectoral and comprehensive planning documents defining directions for the formation and implementation of regional policy.

The key objectives of Lithuanian regional policy are:

- to support the development of a market economy in each region;
- to create favourable conditions for long-term development;
- to improve infrastructure so that it responds to social-economic and environmental demands; and
- to reduce economic, cultural and educational disparities, as well as disparities in living conditions, between the Lithuanian regions.

The key principle of the policy is that permanent support of the Government may only be provided if:

- the unemployment level in a region is significantly higher than the country’s average; and/or
- living conditions in a region are significantly worse than in other regions of the country.

The implementation of the objectives of national policy for regional development can be financed by the state and municipal budgets, loans, private funds, and EU structural funds.

In seeking a higher contribution from each region to the overall development of the Lithuanian economy, the medium-term plans are: to put a regular mechanism of integrated, national, regional development planning in place; to consolidate the legal basis for the national regional policy and implementing institutions, including public administration bodies, state supported non-governmental and private establishments; apply measures promoting the development of regional economy in terms of human resources, business, agricultural and **rural development, transport and environmental infrastructure.**

Table 2.3 Counties by size

Population	Number of counties
< 200 000	3
200 000 - 420 000	5
750 000 - 900 000	2
Total	10

Source: Lithuanian Department of Statistics (beginning of 2000).

2.1.3 Local self-government (municipalities)

The Constitution suggests that the State will support local governments notwithstanding local government independence. The Constitution explicitly gives local governments the right to draft and approve their own budgets and the right, within the established limits and according to the procedure provided by law, to establish local dues, and to provide for the leverage of taxes and duties. The Law on Local Government has legalised functions of municipalities.

In Lithuania, local governments have played, and continue to play, a significant role in Lithuania’s public sector and in the overall economy. Municipal budgets represents about a third of the national budget (central plus local government) and a quarter of the general government consolidated budget (including social security and extra-budgetary funds). The key public services such as education and public utilities are primarily the responsibility of municipal governments. They also play a significant role in social protection.

One of the key elements of the reform was amended the Law on Local Self-government on 12 October, 2000. The newly drafted Law establishes the general procedure for the organisation, functions and activities of the self-government institutions, defines the principles of self-government, and the rights and responsibilities of the municipal control institution, describes the financial and economic activity of self-government, the representation to the community of settlements and other things which were not well (or not at all) described in the previous version of the law. In the new Law, the functions of self-government are divided into autonomous, delegated (limited autonomous), state (transferred to self-government), and conventional. (For specific details, see Chapters 2 and 4.)

As part of the process of ongoing local government reform, the reform of the administrative units of the territory of the Republic of Lithuania has been divided into 2 stages. Under Stage 1, in 1995, 10 new higher administrative units, i.e. regions, were formed; district councils were abolished; former territorial administrative units of the higher level (11 towns of republican subordination and 44 districts) were

transformed into administrative units (Municipalities). The Government organises the management of the 10 regions. Fifty-six municipalities were given self-government rights. Under Stage 2, it is planned to increase the number of municipalities to 93. Stage 2 is also divided into 2 phases. The first phase was completed in 2000 with elections to municipal councils on 19th March. Five new municipalities were established and one liquidated. Thereby, we now have 60 municipalities. The second phase will be completed in 2003.

A municipality is an administrative unit of the territory of the State, the community of residents of which has the right to self-government guaranteed by the State. Local self-government denotes the right and actual power of the institutions of a local government which is elected by the residents of an administrative unit (municipality) of the territory of Lithuania, to freely and independently, under their own responsibility, regulate and manage public affairs and meet the needs of local residents, according to the Constitution and laws of the country. Self-government is implemented on the basis of the following basic principles:

- the co-ordination of the interests of the municipality and the State;
- the direct participation of the citizens of Lithuania residing in the respective municipality in the election to the municipal council, polls, meetings of the residents and petitions;
- the accountability of self-government institutions and their officers to residents;
- publicity and response to public opinion;
- lawfulness and social justice;
- economic independence;
- respect for human rights and freedom.

Functions of municipalities can be divided into four categories:

- **Autonomous.** These functions are executed in municipalities under the powers provided by law. In implementing the functions, municipalities are free to initiate and make decisions. Municipalities are responsible for the execution of these functions.
- **Delegated** (limited autonomous). Municipalities execute these functions by implementing legal acts, taking into consideration local conditions and circumstances.
- **State** (transferred to self-government). These are functions of the state, assigned to municipalities by law, taking into account the interests of inhabitants. Municipalities can exercise some discretion, defined by law, in the execution of these functions. The funds to execute these functions are appropriated from the state budget or other state resources and transferred to municipalities as special grants.
- **Conventional.** The execution of these functions is based on contracts.

The basic principles of the legal supervision of the activities of local government are established in the Constitution and the Law on Local Self-government. A Government Representative is an independent officer subordinate only to the central government and not included in the county administration structure. In accordance with the law, a Government Representative verifies whether decisions adopted by self-government institutions violate the rights of citizens or organisations and ensures the adherence of local authorities to the Constitution and other laws.

When considering the functions of local government, it should be noted that local financing of pre-primary, primary and secondary education makes up about 83% of total government expenditure on the policy sector. Local financing of sanitation, the reduction and control of pollution, and other functions of community amenities makes up 100% of total government expenditure on the policy sector, and social welfare makes up 25%.

Co-operation between municipalities can take the form of: joining into unions, co-operating with foreign municipalities; joining international local self-government organisations; etc. Municipalities can also make joint management or procurement contracts with state institutions or other municipalities to achieve goals. Municipalities can make decisions with other municipalities with regard to the joint establishment of businesses.

The main goals of the second phase of territorial reform, approved by Government in 1999, are:

- to form territorial administrative units which would be able to solve public problems and satisfy the needs of inhabitants;
- to bring local administrative agencies closer to inhabitants, combining to a maximum the interests of inhabitants and state;
- to create conditions which will increase the interest of inhabitants in solving public problems in the local self-government territory;
- to abolish contradictions between municipalities;
- to improve state management of regional development.

These will mainly result in cheaper and more comfortable contact between inhabitants and municipal administrative centres, decrease unemployment, increase the effectiveness of public management, and attract small investors.

In 1995, when temporary methodology (from January 1995 to July 1997) on municipal budgets and the establishment of grants was approved by Law, Lithuania's capital, Vilnius, was given a separate status with respect to local self-government. According to the methodology, taking into account the nature of the capital city, calculated expenditures were increased by five per cent. In other acts applicable at that time, the status of the capital city was not separated though there was one provision whereby total municipal debt could not exceed 20 per cent (30 per cent for Vilnius) of the revenues approved for that particular year (see Chapter 4.5).

The average size of a municipality is about 58 000 inhabitants, excluding Vilnius. This unusually high average population is due to the extensive area of each municipality, with 80% of the districts covering between 1 000 and 2 000 km². Almost two thirds of the municipalities have between 30 000 and 100 000 inhabitants.

Table 2.2 Municipalities by size.

Population	Number of municipalities	Proportion of the whole population (approx. %)
< 10 000	2	0.3
10 000 - 30 000	13	7
30 000 - 50 000	25	24.7
50 000 - 100 000	15	28
100 000 - 200 000	2	8
> 200 000	3	32
Total	60	3 698 500

Source: Lithuanian Department of Statistics (beginning of 2000).

2.2 Public finance structure

In Lithuania, public finance is basically divided into three sub-systems:

- State budget;
- Municipal budgets;
- Segregated funds (mainly social security).

The State budget and the municipal budgets make up the national budget of the Republic of Lithuania. The budgetary year is the same as the calendar year. Appropriation managers of the state and municipal budgets use allocated budget appropriations in accordance with the established purpose for the implementation of programmes of their institution. They allocate budget resources to agencies subordinate to them for the implementation of their operations and programmes, and the achievement of their objectives. They establish and approve the expenditure estimates of programmes of their subordinate institution, within the limits of approved appropriations, including current expenditure, salaries and capital expenditure. They organise the formation and execution of programmes financed from the state budget. They are held accountable in accordance with the procedure established by the Government or institution authorised by it. They control liabilities and carry out audits of financial accounting by subordinate agencies. They ensure the fairness of the financial and statistical statements of their institution, and they guarantee the effective and efficient implementation of programmes and the use of approved appropriations.

V.A.T. is the main source of State budget income. Personal income tax brings in a major part of local government budget revenue.

2.2.1 State budget and municipal budgets

The draft state budget and the financial indicators of municipal budgets are prepared by the Ministry of Finance. The draft state budget is prepared for a period of three budget years, in accordance with: Lithuanian laws and acts; macroeconomic projections of the country's development; strategic planning principles; and the approved basic preliminary indicators of the national budget, programmes submitted by appropriation managers and expenditure estimates of these programmes. Appropriation managers prepare programmes and their draft expenditure estimates on the basis of the strategic goals (priorities) defined by the Government.

The Government submits to the Seimas the draft state budget and financial indicators of the municipal budgets no later than 75 days before the end of the budget year. The Government also presents draft financial indicators of municipal budgets to the Association of Municipalities, in accordance with the procedure for the co-ordination of financial indicators, as established by the Government. The draft law on the approval of the state budget and financial indicators of the municipal budgets shall specify:

- The total amount of revenue and its distribution according to the type of revenue.
- The allocation of payments into the state budget that will be used for the funding of special programmes by appropriation managers.
- The total amount of appropriations and their distribution, per institution, for the implementation of programmes approved by the Government. Appropriations shall be allocated for current expenditures (including salaries) and capital expenditures.
- The distribution of the total amount of state budget appropriations according to their functional classification.
- The resources for the formation (replenishment) of the state budget's working capital.
- The annual ceiling for public debt.
- The limit for requested government guarantees during the budget year.
- The limits for municipal borrowing.
- The amounts of general and targeted grants to municipal budgets, and the compensation of the general grant.
- The amount of budget tax revenue for each municipality.
- The portion (in %) of Personal Income Tax distributed to municipal budgets.

The implementation of state budget cash operations is organised by the Ministry of Finance through Lithuanian credit agencies. The implementation of municipal budget cash operations is organised by the Finance offices of municipalities through credit agencies. Institutions authorised by law control the assessment and collection of taxes and other levies for the municipal budget.

Each municipality has its own autonomous budget. Municipal budgets should be balanced prior to approval. The executive bodies of municipalities prepare draft municipal budgets on the basis of the Budget Law, other laws, financial indicators of municipal budgets approved by the Seimas, Procedure for the Formation and Execution of the budgets as approved by the Government, national statistical data, social and economic programmes. The executive bodies submit draft budgets to municipal councils. The Councils review the draft budgets on the basis of reports made by the executive bodies of municipalities, and the recommendations and opinions of municipal committees, and in accordance with the regulations of municipal councils. Municipal budgets are approved by municipal councils who specify:

- the total amount of revenues and their distribution according to the type of revenue;
- the total amount of appropriations and their distribution to institutions for the implementation of their programmes. Appropriations shall be allocated for current expenditure, salaries, and capital expenditure;

- the amount of working capital.

Municipal councils must approve budgets within two months of the approval of the state budget and financial indicators of municipal budgets. The Mayors of municipalities submit the approved budgets to the Ministry of Finance. If a municipality does not approve its budget during the specified time, certain state treasury payments are suspended.

Within the limits approved by the Seimas and in accordance with the procedure established by the Government, municipalities may:

- take out long-term* domestic and foreign loans, or grant guarantees, for the financing of investment projects only;
- take out short-term** domestic and external loans, or grant guarantees, in order to cover temporary shortfalls in revenue and when the amount of the working capital of a municipal budget is not sufficient for that purpose.

*more than one year, and whose maturity is not in the same budget year.

** with the maturity in the same budget year

In accordance with procedure established by Government, during the budget year, municipalities may take out short-term, zero-interest rate loans from the state budget in order to cover temporary shortfalls in revenue when the amount of the working capital in the municipal budget is not sufficient for that purpose. Short-term loans of municipalities shall be repaid to creditors in accordance with the terms provided for in the loan agreements, and by the end of the budget year. Appropriation managers of the state and municipal budgets are not allowed to borrow resources and undertake debt obligations on their behalf. The Ministry of Finance is responsible for the management of government guarantees and loans.

In accordance with certain Government regulations, when a municipality takes on a debt, it can only guarantee the repayment of the debt from its budget funds. Moreover, a Council decision gives municipalities the right to undertake liabilities in accordance with guarantee contracts.

For more detailed analysis, see Chapter 4.5.

2.2.2 Segregated funds (mainly social security)

In the year 2000, about 25 segregated state funds were closed or transformed into programmes for the state budget (financing of LTL160 million is planned for 2001). Four funds were left: 1&2) separate state insurance funds for health and social security (about 10% of GDP), collected mostly from employers; 3) the Privatisation Fund (about 1% of GDP) financed by the sale of state enterprises; 4) the Fund for the Decommissioning of the Public Company Nuclear Plant of Ignalina. The reorganisation of segregated funds has increased the transparency of the state budget. In 2002, the same reform is going to be executed / finalized in municipal budgets. According to the Law on Budget Structure, revenue of the state and municipal budget agencies resulting from services provided shall be included in state and municipal budgets from 1st January, 2002 (except for special resources by public institutions and control organisations).

2.2.3 Budget reform

The new budget reform was caused by the rapid restructuring of the state economy, the structural reforms of state authorities intended to ensure the functioning of the market economy, active privatisation, the

increase in the development of small- and medium-sized businesses, new technologies, foreign trade and foreign investment.

All the above-mentioned state development measures reflected preconditions for the reform of the whole state budget structure, which could generalise the changes implemented in this public sector and create possibilities for improved efficiency of the budgeting process. This reform was stimulated by the Concept of Budget Structure passed by the Government in Spring 1998, which sets forth the objectives, tasks and implementation instruments of the reform. This budget reform was also appreciated by the Lithuanian Seimas which, on October 22, 1998, passed a resolution on the Concept of the Budget Structure of the Republic of Lithuania. The new Law on Budget Structure was passed in July 2000, taking into account all essential changes in state development strategy and budgeting.

The new Budget Law:

- introduced three-year budget planning;
- applied programme-based budgeting principles;
- increased public awareness of the budget;
- basically reduced the non-budgetary management of state funds;
- set norms for the adoption of legislation affecting state income;
- revised the responsibility of state institutions in the budgeting process;
- improved the expenditure control system and other budget management systems.

Table 2.1 Gross Domestic Product, 1997 – 1999. Market prices.

National currency - Litas. (LTL millions)

Lithuania	GDP
1997	38 340
1998	42 990
1999	42 597

Source: Lithuanian department of Statistics.

3. GOVERNMENT FINANCE STATISTICS ON SUB-NATIONAL GOVERNMENTS

3.1 Sub-national revenue

Municipal budget revenues consist of tax, non-tax revenues and subsidies from the state budget (grants).

For comments on Table 3.1 “Total revenue by level of government”, please see page 14.

According to the given (FDI) classification of tax revenues, the following revenues shall be assigned to the budgets of local governments:

3.1.1 *Income tax, profits tax and capital gains:*

- income tax of natural persons, after the 30 per cent deduction for the Health Insurance Fund;
- profit / corporate tax of legal persons (only in 1997 in the Table -).

Until 1998, the income tax of natural persons and the profits tax of legal persons was a common source of revenue for both the State budget and local government budgets. The Seimas used to set the proportion of the appropriations (in percentage terms) for the budgets of local governments. The proportions for the income tax of natural persons and the profits tax of legal persons used to be set separately through the Law on Confirmation of Financial Indicators of the State Budget and the Budgets of Local Governments for the year in question.

3.1.2 *Taxes on property:*

- taxes on land;
- tax on the lease of state-owned land and water reservoirs for commercial or amateur fishing;
- real-estate taxes imposed on undertakings and organisations;
- inheritance tax, donated property tax.

Of all taxes on property, real estate taxes imposed on undertakings and organisations contribute the largest share to the budgets of local governments (70-72%).

STRUCTURAL OUTLINE OF OVERALL REVENUE

The following generalisations can be drawn from an analysis of local government revenue structure.

As mentioned before, until 1998, the income tax of natural persons and the profits tax of legal persons was a common source of income for both the State and local government budgets. In 1997, State budget revenues from income tax of natural persons equalled LTL 426.4 million, or 47.1% of total income tax,

profits tax and capital levy (LTL. 1,672.1 million, or 91.5% for local government). Profits tax of legal persons equalled LTL 479.4 million, or 52.9% of the total income tax, profits tax and capital levy (LTL 141.5 million, or 8.5% for local governments).

Income tax, profits tax and capital levy represented 58.1% of all local government income sources in 1997, 67.6% in 1998, and 83% in 1999.

In 1998, the country's economic revival (GDP increased by 12% compared to 1997) had an impact on the income growth of local government budgets.

In 1998, income tax of natural persons became an income source for local governments only, while the profits tax of legal persons became an income source for the State budget only.

Compared to 1997, income tax revenues of natural persons in local government budgets increased by LTL 749.9 million, or 44.8% (but it should be noted that State budget income tax revenues totalled LTL 426.4 million in 1997). This was one of the predetermined factors of the Government's resolution on wage increases - in 1997 and 1998, the minimum wage, the minimum hourly wage, the minimum base salary, and salaries to employees of budgetary institutions were increased.

Lithuania's economy experienced difficulties due to Russia's financial crisis of 1998. That is why, in 1999, as compared to 1998, the revenues from the income tax of natural persons in local government budgets increased by LTL 154.4 million, or 6.4%.

Over the past two years, property taxes, as well as the non-tax income assigned to the budgets of local governments, has remained at about the same level.

By analysing the changes in the revenue and non-tax income of local governments, we can conclude that income tax of natural persons becoming an income source solely for local governments is a positive tendency in forming a base for local government budgets. Tax bases of this tax and of property taxes are less influenced by changes in economic activity than, for instance, value-added tax, profits tax of legal persons, or excise duty. Assigning said taxes to the budgets of local governments, knowing that budget revenues will not change, should give more confidence to local government administrations. These conclusions are backed up by the example of the decrease in revenues at other administrative levels, in 1999, partially due to Russia's financial crisis of 1998.

Grants – another local government income source– are described in Chapter 3.1.3. In general, it could be mentioned that grants are funds, received from the State budget, and consist of:

- a subsidy from the State budget (its amount is set in accordance with the Law on Methods of Determining Revenues of Local Governments of the Republic of Lithuania);
- other funds received from the State budget (in accordance with Resolutions of the Seimas and the Government).

Table 3.1 Total revenue by level of government, 1997, 1998 and 1999.

(in LTL millions)

	Central Government			Social Security Funds			Local Government			General Government (Consolidated)		
	1997	1998	1999	1997	1998	1999	1997	1998	1999	1997	1998	1999
Tax Revenue												
1000 Taxes on income, profits & capital gains	905,8	580	360,8	822,9	1019,8	1038	1672,1	2422	2576,4	3400,8	4021,8	3975,2
2000 Social security contributions	0	0	0	2343,7	3052,4	2954,6	0	0	0	2343,7	3052,4	2954,6
3000 Taxes on payroll and workforce	0	0	0	0	0	0	0	0	0	0	0	0
4000 Taxes on property	0	0	0	0	0	0	216,8	235	246,6	216,8	235	246,6
5000 Taxes on goods and services	5056,5	5592,7	5433,5	0	0	0	0	0	0	5056,5	5592,7	5433,5
6000 Other taxes	292,2	265,6	214,2	0	0	0	0	0	0	292,2	265,6	214,2
Total Tax Revenue	6254,5	6438,3	6008,5	3166,6	4072,2	3992,6	1888,9	2657	2823	11310	13167,5	12824,1
Non-Tax Revenue												
Oper. surpl. of dept. enterpr. & prop. income	127,6	311,8	329,3	3,2	3,8	2	0,6	2,5	12	131,4	318,1	343,3
Fees, sales, fines	271,7	200,8	230,8	5,6	6,5	6,9	115,6	116,8	129	392,9	324,1	366,7
Contr. to govt. employee pension funds	0	0	0	0	0	0	0	0	0	0	0	0
Other Non-tax revenue	38,1	30,7	26,9	3,5	5,8	3,1	17,9	25,2	9,1	59,5	61,7	39,1
Total Non-Tax Revenue	437,4	543,3	587	12,3	16,1	12	134,1	144,5	150,1	583,8	703,9	749,1
Grants	0,3						852,6	781,8	128,4			
Total Revenue	6692,2	6981,6	6595,5	3178,9	4088,3	4004,6	2875,6	3583,3	3101,5	11893,8	13871,4	13573,2
Tax revenue as % of GDP	16,31%	14,98%	14,11%	8,26%	9,47%	9,37%	4,93%	6,18%	6,63%	29,50%	30,63%	30,11%
Sub-national tax revenue as % of total tax revenue							16,70%	20,18%	22,01%			

NOTE: In the table the data on the state budget, municipal budgets, extra-budgetary funds, state social security fund, compulsory health insurance fund, general government are consolidated.

3.1.1 Tax revenue

COMPOSITION OF TAX REVENUE

The following taxes are assigned to the tax revenues of municipal budgets according to the Law on budget structure:

- 1) personal income tax of natural persons, following deduction of the funds allocated to the compulsory health insurance fund in accordance with the Law on Health Insurance;
- 2) land tax;
- 3) lease tax on state-owned land and bodies of water belonging to the state water stock, leased for commercial or amateur fishing purposes;
- 4) real estate tax of enterprises and organisations;
- 5) stamp duty, established in the Law on Stamp Duty;
- 6) market place tax;
- 7) inheritance or gift property tax;
- 8) other tax revenue established by laws.

The territorial unit of the state tax inspectorate transfers tax revenues assigned to municipal budgets directly to those budgets. The inspectorate transfers to the municipal budgets the percentage share of personal income tax set by the law on approval of state budget and municipal budget financial indicators.

COMMENTS ON TABLE 3.2 “CLASSIFICATION OF TAXES OF SUB-CENTRAL GOVERNMENT” (see page 17)

Here, taxes of municipal budgets should be subdivided into categories of decreasing tax autonomy and then should be ranked by decreasing order of control that the local government can exercise over this revenue source:

- (a) Local Government sets tax rate and tax base;
- (b) Local Government sets tax rate only;
- (c) Local Government sets tax base only;
- (d.1) Local Government determines revenue-split;
- (d.2) Revenue-split can only be changed with consent of Local Government;
- (d.3) Revenue-split fixed in legislation, may unilaterally be changed by Central Government;
- (d.4) Revenue-split determined annually by Central Government as part of the budget;
- (e) Central Government sets rate and base of Local Government tax.

The taxes and other payments to municipal budgets are only set by law. The State Tax Inspectorate, which comprises the central tax administrator and territorial state tax inspectorates (local tax administrators), administers taxes, i.e. keeps records of taxpayers' and other payments into the state (municipal) budget; controls computation of payments into the state (municipal) budget; exacts interest for late payment and penalties imposed in accordance with tax laws, and also refunds surplus payments and wrongly exacted taxes, interest and penalties; implements municipal decisions regarding the provision of tax relief, collections and deductions from the budget; apportions taxes and other payments into state and municipal budgets, etc. The local tax administrator is subordinate and accountable to the central tax administrator.

As shown in Table 3.2, tax revenues of the municipal budgets are assigned to category (e). According to Lithuanian law, only central government can set the tax rate and base of local government, on a multi-annual basis.

Local governments only have the right to impose a small part of their own taxes. These taxes are assigned to the non-tax revenues. Local governments have the right to set the tax base and tax rate for local levies

and for municipal budgetary revenue obtained for the services rendered. The two types of revenue comprise up to 10% of all non-tax revenue of local governments.

3.1.2 Non-tax revenue

COMPOSITION OF NON-TAX REVENUE

The following revenues are assigned to non-tax revenues of municipal budgets according to the Law on Budget Structure:

- 1) revenue from municipality owned assets (property);
- 2) fines and revenue resulting from confiscation in accordance with procedures established by law;
- 3) local tax collection in accordance with the Law on Local Levies;
- 4) municipal budgetary revenue obtained for the services rendered;
- 5) other revenue;
 - a) revenue on the balances of municipal funds in current accounts;
 - b) revenue income derived from the lease or sale, according to established procedure, of plots of state-owned land, not designated for agricultural use;
 - c) other, non tax-derived income, established by law.

See also Chapter 4.3.

Table 3.2 Classification of taxes of sub-central government. Local Government, 1997-99.

(in LTL millions)

Category	1997					Total a-e			
	a	b	c	d.1	d.2		d.3	d.4	e
1000 Taxes on income, profits & capital gains								1672,1	1672,1
2000 Social security contributions								0	0
3000 Taxes on payroll and workforce								0	0
4000 Taxes on property								216,8	216,8
5000 Taxes on goods and services								0	0
6000 Other taxes								0	0
Total								1888,9	1888,9
(% distribution)								100%	100%
Category	1998					Total a-e			
	a	b	c	d.1	d.2		d.3	d.4	e
1000 Taxes on income, profits & capital gains								2422	2422
2000 Social security contributions								0	0
3000 Taxes on payroll and workforce								0	0
4000 Taxes on property								235	235
5000 Taxes on goods and services								0	0
6000 Other taxes								0	0
Total								2657	2657
(% distribution)								100%	100%
Category	1999					Total a-e			
	a	b	c	d.1	d.2		d.3	d.4	e
1000 Taxes on income, profits & capital gains								2576,4	2576,4
2000 Social security contributions								0	0
3000 Taxes on payroll and workforce								0	0
4000 Taxes on property								246,6	246,6
5000 Taxes on goods and services								0	0
6000 Other taxes								0	0
Total								2823	2823
(% distribution)								100%	100%

3.1.3 Inter-government financial relations – Grants

As was specified in Chapter 3.1.2, grants to local governments are funds received only from the central state budget. The grants are:

1. A subsidy from the state budget (the amount is set according to the Law on the Methodology of Determination of Municipal Budgetary Revenues);
2. Other funds from the state budget, decided by the Seimas and the Government. (If the Seimas or the Government decides on something which imposes changes to municipal revenues or expenditures, then mutual settlements should be made between state and municipal budgets). In principal, these funds are assigned during the budget year.

See also Chapter 4.4.

Table 3.4 The profile of central grants to local governments, 1997, 1998 and 1999.

(in LTL millions)

Year	Specific Grants			General Purpose Grant			Total
	Current			Objective criteria		Discretionary	
	Conditional		Not Conditional	Without own tax effort	With own tax effort		
	Standard Costs	Actual Costs					
1997	485.9	39.5		327.2			852.6
1998	334.2	21.1		426.5			781.8
1999	16.3	41.8		70.3			128.4

COMMENTS ON TABLE 3.4

As shown in Table 3.4, grants in total have decreased during the period 1997 – 1999, from LTL 852.6 million to LTL 128.4 million, i.e. by more than 6 times. This was caused due to a considerable decrease in both general and special grants.

The amount of the general grants is based on the expenditure volume of municipal budgets and the volume of tax and non-tax revenues assigned to cover such expenditure volume, according to tax laws. During the last two years (1998 and 1999), these revenues have increased more than municipal expenditures, therefore the amount of general purpose grants has decreased accordingly. Basically, it was due to the fact that, from 1998, personal income tax became the basic revenue source for municipal budgets, and revenues from that tax have increased.

The decrease in specific grants, to cover standard costs, is noticeable due to the recent Government policy to decrease the amount of such grants.

Grants, allocated to cover actual costs, are oriented to state social policy implementation, therefore the amount of grants has remained quite stable.

SPECIFIC GRANTS

As stated above, these grants are related to state policy implementation (to execute decisions made by the Seimas and the Government).

Grants, allocated to cover actual costs, are oriented to state social policy implementation.

In 1997, these grants totalled LTL 39.5 million:

- LTL 10.2 million was allocated to paying state benefits to families with children, in accordance with the Law on state benefits;
- LTL 29.3 million was allocated to compensate for the heating allowance granted to low income families by the Government;

In 1998, these grants totalled LTL 21.1 million:

- LTL 19.6 million was allocated to paying state benefits to families with children, in accordance with the Law on state benefits;
- LTL 1.5 million was allocated as compensation for damages to people involved in work-related accidents or who participated in the liquidation work of the Chernobyl nuclear power plant.

In 1999, these grants totalled LTL 41.8 million:

- LTL 40.3 million was allocated to paying state benefits to families with children, in accordance with the Law on state benefits;
- LTL 1.5 million was allocated as compensation for damages to people involved in work-related accidents or who participated in the liquidation work of the Chernobyl nuclear power plant.

The main part of special grants is allocated to covering standard costs.

These grants include grants to finance capital investments according to the State Investment Programme of the year in question. This type of funding from the state budget is decreasing i.e. from LTL 170.4 million in 1997, to LTL 202.9 million in 1998, and LTL 15 million in 1999.

Other special grants include grants to execute certain decisions made by the Seimas and the Government:

- In 1997, the decision was made to increase civil servant salaries of all budgetary institutions (LTL 196.5 million was allocated);
- In 1997, Seimas passed a decision to acknowledge the credit liability (up to the year 1997) of institutions (which were financed by the municipal budgets) to the state internal debt. (LTL 64.9 million was assigned to cover the loan);
- In 1997, LTL 36.7 million was allocated from the state budget to cover subsidies to the producers of heating energy which was supplied to inhabitants. (Until July 1997, heating energy was still managed centrally.);
- In 1998, it was decided to increase the salaries of civil servants in certain budgetary institutions (in the social, culture, health and education sectors). (LTL 120.1 million as allocated.)

These grants also include grants allocated to municipalities upon their special request. The grant, taken from the Government Reserve Fund, is made through a Government decision. In 1997, these totalled LTL 17.4 million, in 1998 they totalled LTL 11.2 million, and in 1999 they totalled LTL 1.3 million.

GENERAL GRANTS

First, there follows a description of the principles of revenue equalisation of municipal budgets.

The principle of the formation of municipal budgets was quite simple until 1998: the process of preparing the financial indicators for municipal budgets was based on the volume of expenditure of each municipality, for which forecasted revenues were assigned (for certain territories of the municipality). If there were not enough revenues, then the difference was covered by general grants from the state budget. When forecasted revenues exceeded the required amount to cover the volume of expenditure, the excess was assigned to the state budget. Accordingly, shares of personal income tax and legal income tax assigned to municipal budgets were approved each year.

According to the previous legal system, functions - both delegated by the state government and independent - assigned to and carried out by municipalities were regulated by legal acts. To implement such functions, certain revenue sources had to be assigned but not all municipalities enjoyed sufficient revenues collected from the revenue sources assigned to them; and they did not have much freedom to introduce additional sources. Under today's economic conditions, the state budget does not have the financial power to close the gap between the tax revenues of poor municipalities and those of the stronger ones, without the support of the strongest municipalities. Within the last few years, the tax revenues of the stronger municipalities (with large-scale units of economic industry) increased more rapidly than those of the so-called "rural" municipalities. Moreover, the main functions of all municipalities are quite similar, and the same level of services are provided, therefore, efforts were concentrated on avoiding large differences in revenues between municipalities.

From 1998, a significant step was made towards the development of a modern, reliable and sustainable system of municipal budget revenues. The system sets the overall volume of municipal expenditures, as well as the principles and procedure for the allocation, calculation and transfer of revenue sources assigned to this volume. The Seimas approved the Law on the Methodology of Determination of Municipal Budgetary Revenues based on budgetary co-operation. One of the principles of the law is that the main financial indicators should be established through negotiations between central government (represented by the Ministry of Finance) and the municipalities (represented by the Municipal Association). Another important principle is that the evaluation of a municipality's fiscal requirement is based on calculated expenditure requirements which are determined on a three-year basis.

The amount of general grants is determined according to the amount of expenditures expected for the planned years of all municipalities minus the expected amount of tax and non-tax revenues of all municipalities and minus special grants planned to be assigned from the state budget.

All these components are the object of long-lasting negotiations between the Ministry of Finance and the Municipal Association. When contradictions arise, the Central Government, which is responsible for overall national policy, decides the issue. In practice, contradictions arise during the debates to determine the municipal budget share of expenditures from national budget expenditures. The final decision is made by the Seimas, which approve the municipal budget financial indicators.

In the formation of municipal budget financial indicators, certain principles are followed:

- functions assigned to municipalities should only be regulated by specific laws;
- municipal budgets should be balanced in order to implement assigned functions and to ensure the supply of services;
- together with the proposed new laws, government resolutions and other legal acts, which government institutions and municipalities are obliged to follow, a calculation should be presented containing an evaluation of the financial costs of the proposal and the impact on revenues and expenditures;

- the institution’s proposals (see point above) to the Government/Seimas should include acceptable financing resources;
- the assignment of expenditures to certain institutions, by the new legal acts, can only be made in accordance with governmental expenditure policy;
- all proposals which would have an impact on the revenues and expenditures of municipal budgets should be co-ordinated with municipalities;
- municipalities have the right to revenue or expenditure compensation, regulated by legal acts, and in accordance with mutual co-ordination and determined conditions.

Basic indicators determining the volumes of municipal budgets and the levels of equalisation are planned for a three-year period to enable municipalities to achieve stable forecasting of their own activities, priorities, investments and a better supply of services.

General grants, without own tax effort (see Table 3.4, p.18) are assigned to the basic indicators and are therefore planned for a three-year period. On the other hand, when the Seimas approve the state budget for the year, indicators for each municipality are approved for one year. This is due to the revenue equalisation principal, stated in the law on the methodology of determination of municipal budgetary revenues.

In that methodology, grants are determined, based on formulas, to level municipal revenues. There are two principles of equalisation:

- levelling / equalisation of municipal tax revenues (support is given to those municipalities whose estimated tax revenues per capita of municipality population are less than the estimated average tax revenues per capita of the population of all municipalities, adjusted by the stipulated percentage (for example: 72.5% of estimated average tax revenues per capita of the population of all municipalities is approved for the 2001-2003) which is approved for three years,
- levelling of differences in the structure of municipality expenditures which are brought about by objective factors which do not depend on municipal activity.

Municipalities themselves can determine the demographic, social and other indicators and coefficients assigned to apportionment funds to level differences in municipal expenditure structures. There could be a lot of such indicators – and municipalities have to decide which factors will result in the levelling of differences in the structure of municipality expenditures. In 2000, the levelling was made according to three groups of expenditures and 13 coefficients allocated to those groups.

The funds allocated to the levelling of municipal tax revenues and differences in the structure of municipality expenditures consist of:

1. General grants from the state budget (without own tax effort –see Table 3.4);
2. The share of the tax revenues of those municipalities, whose estimated per capita tax revenues are greater than the estimated average per capita tax revenues, adjusted according to the stipulated percentage (which is approved for three years).

In 1998, municipalities, whose estimated per capita tax revenues were lower than estimated average per capita tax revenues, were granted a share of general grants.

General grants to municipalities have decreased noticeably due to state efforts to balance the state budget. Moreover, as it was stated above, tax revenues of municipalities have increased more rapidly than the volume of expenditures during 1998 - 1999.

3.2 Sub-national expenditure

Municipal budgets accumulate funds to be used to finance social and economic and other local programmes and to support municipal institutions.

Municipal budget appropriations are used for the following purposes:

- to finance programmes of education, culture, health-care, sport and environmental protection implemented by local self-government institutions, as well as programmes of social security and support;
- to develop and regulate municipal economy;
- to support local self-government institutions;
- to increase the working capital of municipal budgets;
- to compensate expenses incurred due to the application of beneficial usage of public passenger transportation;
- to implement other measures set in the legislation of the Republic of Lithuania and decided upon by municipal councils.

COMMENTS ON TABLE 3.6 (see page 24) “CURRENT EXPENDITURE BY FUNCTION AND LEVEL OF GOVERNMENT”

An analysis of the data in Table 3.6. reveals that the largest portion of municipal expenditures is allocated to social services which include education, health-care, social security and welfare, sports and culture. Municipal expenditures on social services constitute about three quarters of total expenditures (72.6% in 1997, 74.1% in 1998, and 77.8% in 1999). Education absorbs the major part of the expenditures, i.e. 49.4% of the total expenditures in 1997, 52.8% in 1998 and 56.3% in 1999. Social security and welfare consumes about 15% of total expenditures. Expenditures on health-care within municipal budgets are quite moderate, because, since the health-care sector reform, in 1997, these services have been financed from the budget of the Compulsory Health Insurance Fund. The number of health-care institutions funded from municipal budgets was reduced and, as of 1 July, 1997, was very small. In 1998 and 1999, municipal budgets financed primary health-care services only.

Another significant part of municipal appropriations (about 10 per cent) is used for housing and community amenities, which are - exceptionally - municipal functions (as can be seen from the Table on current expenditures broken down by function and level of administration).

Services attributed to fuel and energy, as well as transport functions, constitute between 3 and 3.5 % of municipal budgets each. Appropriations in these expenditure line items are used to compensate expenses incurred due to application of passenger transport benefits as well as to compensate heating costs for low-income households.

The function of public order and public security, for which municipalities spend up to 1% of their budgets, is delegated to municipalities who organise the activities of their fire-prevention agencies.

Having analysed the changes in municipal budgetary expenditures in the past few years, we can conclude that the budgetary resources allocated for social services remain stable and are even increasing, notwithstanding the changes in the municipal revenue sources. This increase could be explained by the fact that municipalities are responsible for more and more functions in the sphere of social services and this is also related to the Government's social policy.

COMMENTS ON TABLE 3.7 (see page 25) "EXPENDITURE INDICATORS BY THE THREE MOST IMPORTANT POLICY SECTORS. LOCAL GOVERNMENT."

An analysis of municipal expenditures shows that they represent the major part of the three basic political sectors, like any other current expenditure of state or municipal budgets for a certain sector (Table 3.6). This is, first of all, true of municipal expenditures for such services as pre-school training, general education, sanitation and environment protection, street lighting, other functions in the sphere of housing amenities and public utilities. Please note that vocational schools are not financed from municipal budgets.

Funding for pre-school institutions and general schools accounts for 83% of the total state expenditures for this sector, while expenditures on sanitation and environment protection, street lighting and other services in the sphere of housing amenities and public utilities account for 100% of the total state expenditures for this sector. This is also related to the fact that these functions are mainly within the competence of municipalities – the division of expenditures between the central government and municipalities is mainly determined under generally accepted principles (municipalities are only responsible for pre-school and general education, and public utilities, for their residents, whilst the central government is responsible for services that are used by all citizens of the country, such as national defence or public order and security).

Expenditures for funding social services account for about one quarter of the total state expenditures for this sector, although in the municipal budgets these expenditures only constitute up to 2%.

Notwithstanding the changes in the sources of municipal revenues, both the expenditures for pre-school institutions and general schools and expenditures for the social protection sector remain stable and are even increasing. Conversely, other expenditures for housing amenities are already related to the available sources of municipal budgets and have, therefore, decreased by 23 per cent in 1999 compared to 1998.

Since tax and non-tax revenues, which, by law, are attributed to the municipal budget revenue sources, are not tightly bound to specific municipal expenditures which they must be used to finance, and, since there is no regulation about which particular tax revenues should be used to finance a certain sector, it is not possible to identify which municipal expenditures for a certain sector are financed with non-tax revenues.

Table 3.6 Current expenditure by function and level of government, 1997, 1998 and 1999

(in LTL millions)

	Central Government and Social Security			Local Government			General Government (Consolidated)		
	1997	1998	1999	1997	1998	1999	1997	1998	1999
1 General public services	423,4	510,5	475,3	95,2	127,4	124,9	518,6	637,9	600,2
2 Defence	254	341,3	396,6	0	0	0	254	341,3	396,6
3 Public order & safety	795,5	911,8	778,1	17,8	21	20,9	813,3	932,8	799
4 Education	644	725,4	710,7	1099,8	1413,1	1510,3	1743,8	2138,5	2221
5 Health	1379,1	1969,7	1836,7	114,5	19,2	12,7	1493,6	1988,9	1849,4
6 Social Security & Welfare	3320,7	4158,5	4524,8	306,5	408,5	431,8	3627,2	4567	4974,6
7 Housing & community amenities	0,5	0,1	0	239,5	268,9	212,5	240	269	212,5
8 Recreational, cultural & religious affairs	205,7	246,8	233,8	96,4	141,7	132,9	302,1	388,5	366,7
9 Fuel & energy	113,8	11,5	5,1	58	97,2	84,7	171,8	108,7	89,8
10 Agriculture, forestry, fishing & hunting	889,2	516,1	523,7	0	0,1	0,1	889,2	516,2	523,8
11 Mining, manufacturing & construction, except fuel & energy	76,3	66,9	35,2	0	0	0	76,3	66,9	35,2
12 Transportation & communication	64,4	512,3	504,3	77,9	86,6	91,6	142,3	598,9	595,9
13 Other economic affairs	49,1	61,2	60,3	0,2	0,7	1,1	49,3	61,9	61,4
14 Other functions	526,1	879,9	889,9	120,5	92,6	58,6	646,6	972,5	948,5
15 Total current expenditure	8741,8	10912	10992,5	2226,3	2677	2682,1	10968,1	13589	13674,6
16 Current government expenditure % of GDP	22,80 %	25,38%	25,81%	5,81%	6,23%	6,30%	28,61%	31,61%	32,10%

Table 3.7 Expenditure indicators by the three most important policy sectors. Local Government.

	4.2 Pre-primary, Primary, Secondary, Professional Education			6.2 Social Welfare			7.2 – 7.5 Sanitary affairs, pollution abatement and control, street lighting and other functions in the area of housing and community amenities		
	1997	1998	1999	1997	1998	1999	1997	1998	1999
Local expenditure (on policy sector), (LTL, million)	986,7	1263,4	1353,2	33,1	40	42,9	190,9	222,9	171,9
	%	%	%	%	%	%	%	%	%
Local expenditure (on policy sector) as a proportion of total local expenditure	44,32	47,19	50,45	1,49	1,49	1,60	8,57	8,33	6,41
Local expenditure as a proportion of total government expenditure on (policy sector)	82,34	84,33	83,15	22,23	21,51	25,66	99,74	100	100
Proportion of local expenditure (on policy sector) covered by specific grants *	0,40	2,80	0	12,69	13,75	3,50	3,09	0,99	0,17
Proportion of local expenditure (on policy sector) covered by non-tax revenues **									

* - Data consolidated, i.e. without transfers to Social Security Fund budget.

** - Both tax and non-tax revenues don't have direct purposes in financing municipal expenditures.

4. EVALUATIONS ON SUB-NATIONAL AUTONOMY AND NATIONAL FISCAL CONSTRAINTS

4.1 General presentation of the sub-national government system. Summary on government finance reform policies.

OVERVIEW OF DISTRIBUTION OF RESPONSIBILITIES AND POWERS

There are three administrative levels in Lithuania: Central Government, Regions/County Administration, and Local Self-government/Municipality (see also Chapter 2).

Note: Table 4.1 “Expenditure assignment-actual status of the legal framework” (see page 33) summarises the overall distribution of expenditure responsibilities of the whole public sector.

Central Government

The Lithuanian Constitution and the Law on Central Government regulate the powers and responsibilities of the Central Government.

The Government:

- protects the constitutional order and inviolability of the territory of the Republic of Lithuania, administers national affairs, ensures State security and public order;
- enforces laws and resolutions of the Seimas concerning the implementation of laws and national programmes, as well as decrees of the President of the Republic, and implements the Government programme approved by the Seimas;
- co-ordinates the activities of the ministries and other Government institutions;
- prepares the draft State budget and submits it to the Seimas; implements the State budget and submits a State budget account to the Seimas;
- manages State property in accordance with specific laws, and establishes a procedure for the management and use thereof;
- drafts laws and other legislative acts and submits them to the Seimas for consideration;
- submits proposals to the Seimas for the establishment and abolition of ministries;
- establishes and abolishes Government institutions and institutions under the ministries;
- approves the regulations of ministries, Government institutions and institutions under the ministries;
- together with the President of the Republic, carries out foreign policy; establishes and maintains diplomatic relations with foreign countries and international organisations, submits proposals to the President of the Republic to appoint or recall diplomatic representatives of the Republic of Lithuania in foreign states and at international organisations;
- following procedure set by law, organises government in higher administrative units;

- proposes to the Seimas the establishment of direct government in the territory of a municipality, in cases provided by law;
- has the right to appeal to the Constitutional Court with a request to investigate the conformity with the Constitution of the Republic of Lithuania of laws of the Republic of Lithuania and other legislative acts adopted by the Seimas;
- appoints and dismisses county governors and representatives of the Government who exercise administrative supervision of the activities of local authorities;
- sets up commissions and committees; and
- discharges other duties prescribed to the Government by the Constitution of the Republic of Lithuania, and other laws.

The Central Government also:

- exercises control over how appointed representatives of the Government discharge the powers conferred on them by law, supervising the compliance with the Constitution and laws of the Republic of Lithuania and implementation of the resolutions and decisions of the Government by local authorities; and
- submits recommendations to local authorities concerning the issues of social security, health, education and culture, and other issues.

The Government plays quite a strong part in the overall organisation and execution of the country's activity, unlike the Prime Minister. The Cabinet makes decisions; the Prime Minister can only express his wishes. To resolve this problem, in 2000, a Strategic Planning Committee was set up in the Central Government, with the Prime Minister as chairman. Before the Cabinet accepts the most important decisions, they are deliberated with the experts in that committee, and support from other ministers is assured.

Regions (County administration)

As stated in Chapter 2, administration at the regional level of Lithuania consists of higher territorial administrative units, the governing of which is prescribed in the Law on the Governing of the County. The governing of the County is organised by the Government through the county governor, the Ministries and other Government institutions. The government of the county is a constituent part of state administration.

The main competencies and responsibilities:

The County Governor in the area of education, culture and social welfare:

- in the manner prescribed by law, establishes, reorganises and liquidates state institutions and establishments of education, culture, physical culture and sport, social assistance and care, within the county;
- is responsible for the functioning and maintenance of the state institutions referred to above;
- supervises the implementation of state general education, cultural and social policy;
- in conjunction with territorial labour exchanges, resolves employment problems of the population.

The County Governor in the area of health:

- takes part in health security reform implementation, as well as determining priority trends in primary health care activities;
- establishes, maintains, reorganises and liquidates county health care facilities, hospitals and others;
- analyses the health of the population and changes in it;
- organises the implementation of state inter-regional and county health programmes;
- recommendations to Government when to declare part of the county's territory as hazardous or harmful to health.

The County Governor in the areas of territorial planning and monument conservation:

- organises preparation of documents on general and special county planning;
- assembles and manages a data bank of territorial planning and the register of territorial planning data, as well as furnishing information to data banks of other levels;
- furnishes information, findings and recommendations for the preparation of general and special plans of the territory of the Republic of Lithuania;
- establishes conditions for the preparation of territorial planning documents for municipalities and co-ordinates them;
- performs state supervision of the municipal territorial planning, design, construction, and operation of public buildings, structures and equipment and their legal registration;
- co-ordinates municipal and state institutions in the execution of topographic, geodetic and cartographic work;
- protects cultural valuables and monuments, keeps a record of them, and supervises monument conservation;
- acts as the client for the construction of structures attributed to the county.

The County Governor in the areas of land use planning, land cadastre and agriculture:

- manages free state land stock, with the exception of land transferred to the possession of local authority institutions;
- implements land reform;
- performs state regulation of land servitudes (ownership) and land use, as well as state control of land use;
- co-ordinates agricultural issues, allocates state procurement quotas of agricultural produce;
- controls the use of chemicals for plant protection;

- carries out state maintenance of land reclamation and hydro-technical equipment, and organises the operation of state-owned land reclamation and hydro-technical equipment.

The County Governor in the areas of the utilisation of natural resources and environmental protection:

- proposes the utilisation limits of natural resources;
- organises the activities in protected territories attributed to the county and takes part in the management of other protected territories (with the exception of nature reserves);
- in the prescribed manner and without exceeding his powers, assesses the impact of business activities on the environment and co-ordinates the projects;
- within the scope of his competence, exercises state control over the condition, utilisation, recreation and protection of forests;
- without exceeding his powers, organises the management of water bodies and the maintenance of protected strips and zones, and controls how water bodies attributed to other economic entities are being maintained;
- organises ecological education.

The County Governor in other areas of activity:

- considers the applications and requests of natural and legal persons, and takes decisions in their regard. Decisions of the governor may be appealed against in court;
- analyses the social, economic, and ecological condition of the county and changes in it, and informs the population thereof;
- oversees the implementation of the requirements provided for in the Law on Competition;
- registers the statutes of non-government organisations, the activities of which embrace the territory of more than one municipality and the registered office of which is located in the county centre or in another territory of the county, which is in the urban or rural territory;
- organises the maintenance of county (district) roads;
- registers tractors, self-propelled vehicles, tractor trailers and road-building machines;
- performs the legal registration of buildings, structures and apartments;
- organises the liquidation of the consequences of natural calamities and accidents, searches and rescues.

Until 2001, county affairs came under the responsibility of the Ministry of Public Administration Reforms and Local Authorities. From 2001, they are planned to be assigned to the Ministry of Internal Affairs. Debates are currently taking place on the need for counties, on whether to decrease their number, on whether this form of government is important, and whether the functions of county administration duplicate those of local self-government. However, this part of government is included in the Constitution,

and there are no official plans to eliminate it. This could change depending on the regional development implementation policy of the European Union.

According to the Law on Regional Development, a National Regional Development Plan should be formed, together with implementation projects, in order to form and implement national regional policy. There should also be formed a National Regional Development Council (inter-institutional co-ordinating committee, where members from all levels of government participate) together with Regional Development Councils (with members from regions and municipalities). The Municipality Council delegates its representatives to the Regional Development Council on the basis of the number of inhabitants in the municipality (1 representative for up to 50 000 inhabitants, 2 representatives for between 50 000 and 200 000 inhabitants, and 3 representatives for over 200 000 inhabitants).

Local Self-government (Municipality)

The competence of self-government institutions is described in the new Law on Local Self-government. The competencies and responsibilities (summary) under certain function:

Autonomous functions of the Municipality:

- pre-school education;
- supplementary education of children and youngsters, their extra curricular activities, professional training;
- non-formal education of adults;
- providing services of public nutrition in pre-school and secondary education institutions;
- establishing and supporting institutions which provide social services, and co-operating with non-governmental institutions in providing social services;
- supporting the health care of residents by additional financing from municipality funds;
- organising the employment, qualification and retraining of residents; organising public and seasonal jobs;
- providing cultural education for residents, fostering culture and ethno-culture (establishing public libraries, museums, theatres and other cultural institutions and controlling their activity);
- developing physical culture and sport,
- organising tourism and leisure;
- defining municipality-protected territories; proclaiming features of landscape, nature and culture as municipality-protected;
- creating conditions for expanding business activities and encouraging this kind of activity.

Delegated (limited autonomous) functions of the Municipality:

- organisation of general education of children and adults;

- territorial planning;
- improvement and security of the quality of the environment;
- supervision of local streets;
- participation in the formation and implementation of regional development programmes;
- protection of children's rights;
- social support: social services;
- social integration of the handicapped
- primary personal and public health care;
- preparation of municipal health care programmes, their planning and implementation;
- participation in ensuring public order and peace;
- management of municipality-protected territories.

State (transferred to local self-government) functions:

- organisation of civil security;
- calculation and payment of compensation;
- registration of civil state acts;
- regulation of those registers attributed to municipalities by law;
- organising the municipality fire-prevention services;
- participation in managing state parks;
- organising the nutrition of children from poor families, in all types of schools;
- social payments;
- preparation of documents to solve citizenship problems;
- ensuring the requirements of state language are met;
- arranging for the archiving of documents attributed to municipalities by law;
- providing data for the state register;
- participation in organising the Seimas, Presidential and municipality board elections and referendums.

The main quality of the new Law on Local Self-government is the more precise and clear description of its functions, together with a link to legal and procedural aspects. The new law clearly regulates the powers and rights of municipal institutions.

In the old version of the Law, only two types of function were described: autonomous and those delegated by the State. Functions delegated by the State included: civil registration, keeping the register of municipal, state and private enterprises as well as public organisations; carrying out secondary health activities; they may also have managed state parks (national and regional), organised the municipal police, civil security and fire safety, and implemented other functions delegated by law. Autonomous functions were described separately for each part of the internal management system: the Council, the Mayor and the Board. Moreover, autonomous functions included many procedural functions, which were actual rules of internal management and responsibility, and these were not clearly defined, either. This caused co-operation between levels of governments to be ineffective, and created contradictions and difficulties in appraising functions financially (in the budget preparation process).

At present, discussions are taking place in Lithuania on state (transferred to local self-government) functions and the funding necessary to implement them. The problem is that there is no existing, unified methodology for the calculation of the cost of the functions, especially when the Government delegates certain functions related to state or public management, the cost of which differs in each municipality. In addition, there are certain inadequacies between implementing functions and municipal budgets. Therefore, some conventional decisions are to be made in relation to the above-mentioned shortcomings, in the near future.

STATE FINANCE SYSTEM

The new Law on Budget Structure regulates the implementation of objectives and tasks, and gives a legal basis for budget reform (see also Chapter 2). The Law contains certain basic principles:

- Main concepts that relate to the budget area are defined in the draft law. Appropriations are defined as resources of the state and municipal budgets, approved by the Law on the Approval of the State Budget and decisions of municipal councils concerning the approval of municipal budgets; and assigned for the implementation of activities and programmes of the state and municipal institutions.
- It is determined that revenue and expenditures of the state and municipal budgets may only be money.
- The introduction of the concept of “special programmes”, i.e. whose expenditures are covered not only by the funds of the national budget but also by other funds.
- The definition that taxes, obligatory payments, and levies collected in the Republic of Lithuania may only be allocated through the National Budget of Lithuania, the State Social Insurance Fund, the Obligatory Health Insurance Fund, and the Privatization Fund.
- The determination of the main duties, rights and responsibilities of the appropriation managers.
- The definition of requirements for the publicity of budget information.
- The definition of requirements for the adoption of other laws that affect budget revenues and expenditures.
- Revenue of the state budget is made up also of revenues received by budget agencies for services provided by them.

- The definition of usage of the state reserve fund;
- It is planned that Seimas will approve general amounts of funds according to institutions, and Government will have right to allocate amounts between programmes.
- The introduction of the chapter on budget implementation control and performance evaluation.
- The draft state budget shall be prepared for a period of one budget year and estimated for a period of three budget years.
- It is planned that together with the State Budget, the budgets of the State Social Insurance Fund, the Obligatory Health Insurance Fund, and the Privatization Fund shall be submitted to the Seimas for review.
- The introduction of the requirement to also form the budget according to the requirement of the Government's strategic planning principles.
- It is also planned to submit to Seimas performance measures of the appropriation managers' programme results.
- The definition that state budget revenue received in excess, and appropriations that are no longer valid, shall be used for: the repayment of public debt, the financing of carried over appropriations; covering shortfalls in municipal tax revenue, with the exception of cases where the Seimas pass amendments to the current year budget.

The annual state budget has to be prepared according to the long-term strategic plan of Central Government and strategic activity plans of ministries and Government agencies. The need to have a strategic plan was formed in order to implement effective reforms in the areas of public administration and the legal system. The Strategic Planning Committee was established in accordance with the Government Resolution of 16th April, 1999. The Strategic Planning Committee is an advisory body that drafts recommendations concerning government policy strategy, its strategic goals/priorities, their implementation, and state budget formation and implementation. The Committee consists of the Prime Minister and other Ministers. The Chancellery of the Government and its special planning subdivision works for the committee and drafts material for its review.

In accordance with the Plan of the Preparation of the Year's State Budget and Financial Indicators of Municipal Budgets, ministries, government agencies and other public management institutions have to prepare a strategic activity plan their institution. The Strategic Planning Manual was prepared in order to help ministries, government agencies and other public management institutions to prepare strategic plans, programmes and draft budgets. The manual covers the principles of strategic planning and budget formation.

The manual helps to implement the integrated planning and budget system as approved by the Government. Planning and budget reforms can only be implemented successfully when both reforms are carried out together. Strategic priorities are not implemented successfully when they are presented without a reliable financial plan and firm financial obligations.

The integrated planning and budget formation system is based on the following principles:

- Priorities as a driving force

- Transparency
- Increased responsibility
- Specification of results
- Balanced top-down and down-top planning
- Continuous improvement

Central Government has recommended that municipalities apply strategic planning principles. Specific training in municipalities has begun. Recently, certain municipalities have introduced these principles.

Another important part of finance reform is the evaluation of budget execution. For this purpose, the internal audit system is being established in both central and local government.

MUNICIPAL FINANCE SYSTEM

The essential element of the system of municipal financial resources is municipal budgets. Every municipality has an independent budget. Municipal budgets are approved deficit-free. The Law on the Methodology for Setting Revenues of Municipal Budgets played an important role in improving municipal finances (see also Chapters 2 and 3).

Municipal expenditures on their programmes are not included in the annual state budget, but are planned there. That mainly involves investment projects, co-financed by the European Union. The investment projects of municipalities are financed by the debt funds and under the State Investment Programme whose main financing resources are state debt funds and the state budget Privatisation fund.

At the political level, considering the overall economic-financial status of the country, the volume of expenditures of all municipal budgets is determined as a percentage of total expenditure of state and municipal budgets. In 1999, this was 31.77%; in 2000 - 2002, a figure of 31.86% has been approved. Central Government together with the Municipal Association present these indicators to Seimas for approval for the three year period.

Table 4.1 Expenditure assignment – actual status of the legal framework

		Central Government	Local Government
1	General public services	X	X By law
2	Defence	XX	
3	Public order & safety	X (main)	X (only for fire protection) By law
4	Education	X	X (main, for general education – up to 18 y.) By law
5	Health	X XX (from 1998)	X By law
6	Social Security & Welfare	X	X By law
7	Housing & community amenities		XX By law
8	Recreational, cultural & religious affairs	X	X By law
10	Fuel & energy	X	X XX (from 1998) By law
11	Agriculture, forestry, fishing & hunting	XX	
12	Mining, manufacturing & construction, except fuel & energy	XX	
13	Transportation & communication	X	X By law
14	Other economic affairs	X (main)	X By law
15	Other functions	X	X By law

Note: X – shared competence;

XX – overall competence.

4.2 Local discretion - Tax administration and relation to central government

The laws of Lithuania define taxes and other payments to budgets. The Government of Lithuania and, if an authorisation is given, the Ministry of Finance, implement the tax laws passed by the Seimas. No other state institution may be assigned to implement tax laws, if this is not provided for in the tax law. In the course of implementing tax laws, the Government establishes appropriate methods and regulations, ensuring tax administration, or delegates the Ministry of Finance to carry this out. The State Tax Inspectorate administers all taxes except value added tax and excise tax, which are administered by Customs, and state natural resources tax, oil and gas resources tax and pollution tax which are administered by the Ministry of the Environment (see also Chapter 3).

As shown in Table 3.1, tax revenues (consolidated) in 1998 increased from LTL 11 310 million to LTL 13 167 million. Following the 1998 Russian financial crisis, Lithuania's economy suffered a lot of difficulties in 1999 (GDP decreased by 4.1%, in 1999); that also had an influence on budget revenues (consolidated tax revenues decreased from LTL 13 167 million, in 1998, to LTL 12 824 million, in 1999). When analysing the decrease in revenues, it is important to note that municipal tax revenues escaped the decrease and actually increased by 6%, in 1999. There is a similar situation when analysing tax revenue as a percentage of GDP: there was a decrease in central government and social security funds, and an increase at municipal level.

Consolidated non-tax revenues increased by 28.3% in the period 1997-1999. These revenues were not strongly impacted by the difficulties of the economy of that period. The largest impact of the economic situation was reflected only in the non-tax revenues of the Social security funds, which comprise 3% of all revenues of Social security funds (in 1999/1998 these revenues decreased by 25%).

The same trend can be seen in the share of tax revenues of GDP. The consolidated share of these revenues increased from 29.63% in 1997 to 30.63% in 1998, but then decreased to 30.11% in 1999. This decrease has only influenced Central Government (14.98% of GDP in 1998 and 14.11% of GDP in 1999) and Social security funds (9.47% - 1998 and 9.37% - 1999), respectively. Only tax-revenues of municipalities increased constantly (4.93% in 1997, 6.18% in 1998 and 6.63% in 1999 of GDP).

The share of sub-national tax-revenues in all tax revenue has constantly increased (16.7% in 1997, 20.18% in 1998 and 22.01% in 1999).

As shown in Table 3.2, the major part (about 90% in 1999) of the municipal tax revenues consists of taxes on income, profits and capital gains. The rest (about 10% in 1999) consists of taxes on property: as a share of tax revenue, this is decreasing but as an absolute amount, it is increasing.

4.3 National regulation of the framework for non-tax revenues

As described in Chapter 3, the municipal council has the right to impose a small part of its own taxes, which are assigned to non-tax revenues. Such taxes include local levies whose base is set in the Law on Local Levies. According to this law, a local levy is an obligatory fee set by a municipal council decision to the fee payers and which is in force only in the municipal territory and is paid to the municipal budget. By its own decision, the municipal council:

- sets the rate of the local levy;
- approves regulations for the local levies;
- defines privileges to the taxpayers.

The procedure for the collection of local levies is specified by the regulations of local levies. Local levies are collected only in national currency and accounted for in the line item of other payments to municipal budgets.

Accounting within the local budgets of the collection of local levies and the receipt of revenue from them is controlled by municipal controllers. The Mayor bears the responsibility for the application of the Law on Local Levies.

An analysis of non-tax revenues of municipalities shows that the base of these revenues is not wide due to general economical conditions. It is planned to extend the base, in the future.

4.4 National policies on design of grants systems

The grant system is defined in the Law on the methodology of determination of municipal budgetary revenues.

A detailed structural and policy analysis can be found in Chapter 3.1.3.

The main points are:

- The significant increase in municipal tax revenues, and the Government's strict grant policy resulted in a decrease in the municipal grant's (from LTL 852.6 million, in 1997, to LTL 128.4 million, in 1999).
- The stable increase in municipal tax revenues is the main reason for the decrease in the general-purpose grants (from LTL 327.2 million, in 1997, to LTL 70.3 million, in 1999).
- Special grants assigned to cover actual costs, related to the Government social policy, have remained stable over the last three years.
- The significant decrease in special grants assigned to cover standard costs was related to the decrease in state grants to finance capital investments, as well as to the Government's grant limitation policy in salary or related subsidies to the budgetary sector, and policy in controlling the liability of budgetary institutions.

4.5 National control on borrowing

According to the Law on the methodology of determination of municipal budgetary revenues, municipalities may avail themselves of the following loans:

- A zero interest rate loan from the state budget, when the municipal budget is temporarily in need of funds, e.g. to pay salaries for annual holidays of employees working in educational agencies;
- Other loans.

According to the Law on the local self-government, a municipality, by the decision of its own council, may use loans for the following purposes:

- to finance projects stipulated in the state investment programme;
- to finance municipal investment projects;

- to cover debt (zero interest rate loan);
- to finance needs of execution of municipal budgets when they are temporarily in need of funds, i.e. to finance expenditures foreseen in the current year municipal budget.

Seimas determine the following limits to municipal borrowing:

- the total municipal debt may not exceed 20% (30% for Vilnius) of the revenues approved for that particular year (excluding special grants and the zero interest rate loan from the state budget);
- the total annual limit of municipal net borrowing is 15%; from that number the annual limit of short-term borrowing is 10% of the revenues approved for that particular year;
- the total amount of repayments of municipal loans and interests, as well as instalments related to the taking-out of loans during that particular calendar year, may not exceed 15% of the revenues approved for that particular year.

Seimas can only allow higher borrowing limits for investments which are financed from loans with a state guarantee.

In the total municipal debt are included: short-term (up to one year) and long-term (more than one year) loans from all borrowing sources, which are formed from:

- municipal loans minus repaid funds;
- municipal enterprises, when municipalities take loans under the guarantee agreements.

A municipality, in accordance with the decision of its council, can take out loans directly from foreign and local creditors. Long-term loans can only be taken out to finance investment projects. In these cases, an application should be forwarded to the Ministry of Finance; under the decree of the Minister of Finance a commission is formed to deliberate the application and give permission (with or without certain conditions) and make a call to tender. The municipality can then select the bank with the most favourable conditions (under the tendering procedure). If the municipality intends re-borrowing or making a guarantee or giving bail, it has to get permission from the Ministry of Finance. The Ministry of Finance controls municipal borrowing limits.

Generally, a municipality gives guarantees and bail-out to the loans which involve local transportation and energy agencies. Therefore these credits are usually used to finance heating system modernisation investment projects and various transport modernisation investment projects. A moratorium for loans is set by the Seimas by approving borrowing limits under the appropriate law.

The share of all municipal loans from total approved revenues, in July 2000, was 13.39% (the limit being 20%). The smallest such indicator was in the Klaipeda municipality, with 1.2%, and the biggest in the Anyksciu municipality, with 72.27%. Two municipalities (Palanga and Visaginas) did not have loans at all. The annual net borrowing for July 2000 was 1.96% (the limit being 15%). This indicator ranged from 0 to 6.5%. In July 2000, the total amount of repayments of municipal loans and interest, as well as instalments related to taking out loans during the current calendar year, was 3.72% of all municipal approved revenues (the limit being 15%). This indicator ranged from 0 to 14%.

Bail-out

The practical way in which local governments are helped when they get into financial difficulty is the zero interest rate loan from the state budget, when the municipal budget is temporarily in need of funds in order to finance the execution of the municipal budget. These are short-term loans to municipalities, which should be repaid in accordance with the terms provided for in the loan agreements, and by the end of the budget year. The annual average amount of such loans from the state budget to all municipalities in general is about LTL 100 million, used to pay salaries for the annual holidays of employees working in educational agencies, and up to LTL 50 million for other cases.

Table 4.2 Indebtedness of municipalities: local net debt, 1997, 1998 and 1999.

	(in LTL millions)		
	1997	1998	1999
General government deficit/ surplus	-735.8	-183.6	-3,006.8
General government gross debt ¹⁾	8,077.4	9,613.6	12,069.4
Local government deficit/ surplus	55.5	108.5	-229.5
Local government gross debt ²⁾	170.1	340.7	448.8
Local government deposits and securities ³⁾	118.2	157.0	204.8
Local government net debt ⁴⁾	-	92.7	227.1

Notes:

Calculations have been made according to the Accounts on the execution of the State Budget and Municipal Budgets.

- 1) including all guaranties that were given by the state (in accordance with the national law on debt).
- 2) and 4) there are no definite calculations for 1997, as municipal borrowing was only regulated in 1998; local gross debt includes all state guarantees on municipal loans.
- 3) mainly local government securities.

4.6 Local discretion - Expenditure

As shown in Table 3.6, the dynamics of the consolidated current expenditure for the period 1997 - 1999 is very similar to the revenue dynamics of the period, i.e. an increase in 1998 and a decrease in 1999 (in social security and central government down by 5%), except for local budget expenditures. This is not the case for current government expenditure as a percentage of GDP i.e. under the general government it is 28.61% / 31.61% / 32.10% for the period 1997 – 1999, and under the local government it is 5.81% / 6.23% / 6.30%.

Analysing by function, it is important to outline that, in 1999 (in comparison with 1998), there was a decrease in central government and social security expenditures (except defence, social security and welfare, and agriculture) as well as in local government expenditures (except education, and social security and welfare).

As shown in Table 3.7, expenditures for the pre-primary, primary, secondary and professional education make up about 50% of total municipal current expenditures. For that sector, local expenditure make up about 83% of total government expenditure (for the sector). From 1999, the sector has been financed by local revenues. Expenditures on social welfare make up about 1.5% of the total local expenditures, and about 25% of total government expenditure (for the sector). Expenditures for sanitation, the reduction and control of pollution, street lighting, and other functions in the area of housing and community amenities, make up about 7% of total local expenditures, and 100% of total government expenditure (for the sector).

4.7 General budget co-operation with central government

As stated in previous chapters, the state budget and the municipal budgets make up the national budget of the Republic of Lithuania. The essential criterion reflecting effective macroeconomic control is that the municipal budgets must be balanced prior to approval. The law on the methodology of determination of municipal budgetary revenues defines the ratio of the size of municipal budgets to the size of the national budget. In this case, municipal expenditures are linked with the general state of the state economy and of the national budget revenues. Municipal borrowing is controlled by Central Government and the Ministry of Finance.

The use of municipal budget resources is inspected by the controllers of municipalities. In certain cases, the execution of municipal budgets is inspected by the state controller.

The main reform element, defining co-operation between state and municipal budgets, is the law on the methodology of determination of municipal budgetary revenues. This law was improved in 1999, by setting requirements for the negotiation between municipal and central governments in the preparation of budget financial indicators, and ensuring the stability of municipal budgets.