LATVIJAS REPUBLIKAS
FISKĀLĀS DISCIPLĪNAS PADOME

Fiscal discipline council: Annual summary 2016

Riga, 21 December 2016

Fiscal safety reserve, spending review and improvements to the management of fiscal risks

This was the first year when Latvia's medium-term budget framework for 2017-2019 was adopted with the fiscal security reserve in the amount of 0.1% of GDP. This is approximately 25-27 million euro annually. The reserve does not foresee additional funds but is more like an insurance policy to cover the costs of unexpected one-off transactions in the upcoming years. Such transactions can significantly impact the state budget balance and lead to sanctions for deviations from the budget balance criteria. The Council is pleased that the requirements of the Fiscal discipline law have been observed. If usual budgetary practices that allow for positive annual balances (e.g. this year there will be a saving of 14 million euro from better than planned servicing of public debt) persists, a reserve established in the minimum amount is sufficient. The amount of the fiscal safety reserve will have to be revised if all annual savings are spent each year.

During the preparation of the budget for 2017 the practices of carrying out spending reviews, which was first carried out in 2011, was renewed, resulting in an additional 64 million euro for the budget. Performing such a review every year would provide an opportunity to identify public sector, or at least government budget, expenditures that are obsolete or are used insufficiently effectively. International practice shows that spending reviews are more effective if they are not performed in all sectors every year but focus on a different subset of areas every year and analyse them in great detail.

The Statement of fiscal risks was prepared for the third year in a row and for the first time included the requirement that line ministries should present a risk management report to the Ministry of Finance during the preparation stages. This modification is essential, as it increases the responsibility of line ministries and their level of awareness about the state owned enterprises that they manage, the associated fiscal risks as well as other projects and regular work that has a significant impact on the government balance during crises. The Council hopes that further quantification of fiscal risks will continue i.e. there will be fewer qualitative risks and there will be more that contribute to the reduction of uncertainty in medium-term budget planning.

Endorsement of macroeconomics forecasts – first year with a formal procedure

According to the Memorandum of Understanding (concluded on 8 February 2016) with the Ministry of Finance from 2016 onwards the Council will endorse macroeconomic indicator forecasts. The Memorandum of Understanding establishes the Council as an independent body that endorses the country's macroeconomic projections that serve as the basis for the budget-drafting process. The Memorandum has also specified the information exchange procedure and the *comply or explain* principle.

Macroeconomic forecasts were approved with comments in February (for the preparation of Latvia's Stability programme) and in June (before commencing work on next year's budget). In both cases there were several rounds of discussions with the Ministry of Finance, in which the assumptions underlying the macroeconomic forecasts were discussed and a number of adjustments to the data were made.

While the Council endorsed the main macroeconomic indicators, the Council noted that the real GDP growth forecast for 2017-2019 was optimistic, but attainable if the investment sector recovers.

Fiscal council reports and Government response

On 5 October 2016 the Council issued the annual fiscal discipline surveillance report. The main recommendations concerned the need for a fiscal security reserve and a long-term tax strategy with a reform plan to reach the intended tax-to-GDP ratio of 1/3. The Council expressed its concerns regarding the deficit increase to implement reforms in the health care sector. The Ministry of Finance has not yet provided the response on the report.

On 11 April 2016 the Council issued and opinion (interim report) on Latvia's Stability programme. The main recommendations were in line with those outlined above. In addition, the Council drew the government's attention to long-term risks associated with ageing and social care, as well as the deficiencies of the health care system.

On 9 December 2016 the Council issued an opinion regarding the verification of compliance with the requirements of Article 11 of the Fiscal discipline law, inviting the Ministry of Finance to also apply the expenditure rule during the assessment of budget execution, thus aligning expenditure growth with the economic potential.

On 11 November 2016 the Council issued a non-conformity report regarding the reallocation of appropriations from the Ministry of Finance's budget sub-programme "Payments to the budget of the European Community", and the main objections were regarding the reallocation of savings from specially protected budget expenditure items, and the failure to respect the symmetry principle in the context of risk management. On 24 November the Council received the Ministry of Finance's response, which confirmed that the legal provisions had not been violated. During the Council's final meeting of 2016 it was agreed with the Ministry of Finance to continue work on this matter to clarify the application of the symmetry principle in practice.

All Council reports and government responses are published on the Council’s website under "Reports".

International co-operation

Council members are frequently invited to meet with international credit-rating agencies and international institutions during their visits to Latvia.

On 1 June 2016, in cooperation with the European Commission Representation in Latvia, the Council organised the international conference "Latvia's Fiscal discipline law: the first three years and future prospects".

The Council is a full member of the network of the independent fiscal institutions of the European Union, as well as the annual seminars of the Baltic States.

Strengthening the analytical capacity of the Secretariat and first results

Secretariat staff published three research papers devoted to issues of relevance to the Fiscal discipline council and independent fiscal institutions more generally. Among the issues discussed were public perception of taxes, the role of independent fiscal institutions in educating the public on matters of fiscal policy and future sustainability issues related to deficit spending and the increase of public debt.