LATVIJAS REPUBLIKAS FISKĀLĀS DISCIPLĪNAS PADOME

Reģ.nr. 90010248231; Smilšu ielā 1-512, Rīgā, LV-1919
tālrunis: (+371) 6708 3650; e-pasts: info@fdp.gov.lv; mājaslapa: http://fdp.gov.lv

Approved
at the meeting of the
Fiscal Discipline Council
on 9 February 2016
Minutes No 1 (14) 7.2§

THE FISCAL DISCIPLINE COUNCIL: A SELF-ASSESSMENT REPORT

Riga, 2016

Contents

Introduction

This report provides a description and assessment of the activities and functions of the Fiscal Discipline Council of the Republic of Latvia (hereafter – Council). The report consists of three sections.

The first section provides context for the recent prominence of independent fiscal institutions (hereafter - IFIs);

The second section contains a description of the Council;

The third section is an assessment of the Council in light of OECD principles for IFIs.

The report concludes that the Council generally conforms to the qualities that an independent fiscal institution should exhibit and the principles such institutions should observe. However, it also notes areas where improvements can be made and acknowledges the need for external evaluation.

Context: The Crisis and Deficit Spending

The sustainability of public finances is predicated on fiscally responsible policies and manageable levels of public debt. The 2015 edition of the *Fiscal Sustainability Report*[1] considers the issue of financial sustainability in relation to high levels of public and private debt, and the current macroeconomic context of low inflation and slow GDP growth. In view of the above, the report contends that the reduction of public debt can only be achieved through growth-friendly and fiscally responsible policies. In addition, it is suggested that sustainable public finances and low levels of public debt are important for ensuring that European Union (hereafter – EU) member states have sufficient fiscal buffers to cope with adverse macroeconomic developments and future spending pressures.

A growing sensitivity to a need for fiscal buffers and sustainable levels of public debt is due, in part, to the legacy and experience of the most recent global financial crisis. The so-called Great Recession damaged the credibility of government commitment to prudence with regard to public finance and government debt. The crisis led to the largest increase in average government debt levels since World War II. In the EU debt levels rose by 26 percentage points between 2007 and 2012. The effect of the financial crisis and its aftermath was even more pronounced in Latvia where the debt level rose by 33 percentage points during the same period[2]. In the EU, this has led to concerns over the long-term effects of growing debt levels, and stimulated attempts at restoring public debt sustainability. Furthermore, there has been a general recognition that the uncertainties of the political cycle and the pursuit of short term gains can (i) force policy-makers to adopt sub-optimal courses of action, (ii) encourage the practice of deficit spending and (iii) produce over-optimistic macroeconomic and revenue forecasts, thus putting additional strain on public debt.

In an attempt to address and rectify the issue mentioned above, the last few years have seen a marked increase in the number of independent fiscal institutions (IFIs). According to the IMF Fiscal Council Dataset, 27 out of the 39 IFIs were established after 2007[3]. IFIs are publicly-funded

[1] Available at: http://ec.europa.eu/economy_finance/publications/eeip/ip018_en.htm, accessed on: 03/03/2016.
[2] *How would a new crisis affect Latvia's government debt?*, Fiscal Discipline Council of the Republic of Latvia, available at: http://fiscalcouncil.lv/files/uploaded/20151210_GDebt_EN.pdf, accessed on 04/02/2016.
[3] Available at: http://www.imf.org/external/np/fad/council/, accessed on 03/03/2016.

government institutions mandated to provide independent oversight of fiscal performance and key aspects of fiscal policy in a politically neutral manner. In short, such institutions monitor whether fiscal policy is consistent with long-term debt sustainability and sensitive to macroeconomic conditions and potential shocks. Current EU legislation references functionally autonomous independent institutions that monitor compliance with fiscal rules and endorse (or produce) macroeconomic forecasts[4]. However, the particular shape and functions of IFIs vary across countries and reflect prior institutional arrangements, the availability of resources (both human and financial) and the specific causes of deficit spending and increasing levels of public debt. Nonetheless, it has been suggested that IFIs should (i) be free from partisan influence, (ii) foster public debate on fiscal issues, (iii) assess official forecasts and (iv) monitor compliance with existing fiscal rules.

Independence

The word "independent" can refer to the institutional status of the IFI, but it is often taken to mean that the institution in question is free from partisan influence. IFIs should analyse policy proposals objectively. As such, it is argued that IFIs should focus on descriptive and technical issues, and refrain from making normative statements. In order to do this successfully, an IFI has to demonstrate technical competence and approach the proposals of all political parties dispassionately. Consequently, members of an IFI should be selected on the basis of competence and expertise, rather than political affiliation. Operational independence should be legally guaranteed (e.g. legal protection from arbitrary budget cuts or staff cutbacks), though few IFIs are granted such privileges.

Public Debate

IFIs do not have any policy instruments at their disposal. Fiscal policy involves a distributive element, and this precludes its delegation to unelected officials. This means that one of the primary channels through which IFIs can influence fiscal policy is by contributing to public debate and, by extension, educating the public on questions of public finance. This last point in particular has relevance in the context of fiscal illusion. Fiscal illusion refers to an informational asymmetry whereby the public is insufficiently informed about government revenues and expenditures. Consequently, the public over- or under-estimates the costs associated with government, or is unable to identify the source of funding for public services. A pertinent example would be a tax cut that is compensated by an increased deficit and, consequently, additional strain on public debt. Furthermore, deficit spending can become common practice in systems lacking transparency. By encouraging fiscal transparency, IFIs can improve the public's understanding of the consequences of a certain fiscal policy and so better align the expectations of voters with the actions of their representatives. For example, one of the functions of the IFI in the Netherlands involves assessing the economic platform of major political parties during electoral campaigns. Moreover, it has been suggested that an objective analysis of fiscal performance could help voters assess whether fiscal outcomes are the result of luck or competent policy making.

Assessing Forecasts

A task often delegated to IFIs is the assessment of forecasts. This does not mean that the institution has to prepare its own forecasts. Comparing the government's forecast with those of other respected organisations and drawing attention to noticeable discrepancies is recognised as a suitable course of action, especially if resources are limited. Research suggests that the presence of an IFI is associated

[4] Article 2.1a of Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (hereafter - Regulation (EU) No 473/2013).

with more accurate and less optimistic forecasts[5].

Fiscal rules

Fiscal rules promoting counter-cyclical fiscal policy have become popular in the last two decades, and their importance has grown as a result of the latest financial crisis. It has been established that they have a positive effect on fiscal performance if they are respected by the entire political spectrum and embedded in a transparent fiscal process. However, they may suffer from weak enforcement. This is why many countries supplement fiscal rules with an IFI that monitors whether legislative proposals and draft budgets are consistent with targets and comply with national and international fiscal rules. In other words, IFIs function as a guarantee that fiscal rules will be observed.

The Fiscal Discipline Council of the Republic of Latvia

The Fiscal Discipline Council (Council) is one among many IFIs that have been established following the latest financial crisis and subsequent changes in EU legislation[6]. The Council is an independent collegial institution, and its core competences are the monitoring of fiscal discipline and the assessment of fiscal policy and issues related to macroeconomic development. The Council was established on 1 January 2014 to monitor compliance with the requirements and principles of the Fiscal Discipline Law (FDL) during the preparation, implementation and amendment of the annual state budget and the medium-term budget framework (MTBF).

The mandate, role and specific responsibilities of the Council are defined in national legislation – the FDL. The Council has three primary responsibilities: (1) to monitor whether annual state budget and MTBF law are drafted in conformity with the principles stipulated in the FDL, (2) to monitor whether the annual state budget is executed in conformity with FDL stipulations, as well as (3) to supervise the correction mechanisms of the minimum planned structural balance of the general government budget. While the mandate of the Council, as defined broadly in the FDL, is conservative in nature, the Strategy 2016-2018[7] specifies that the Council intends to be pro-active and forward-looking.

The primary document published by the Council is the Monitoring Report, **but other reports are prepared if and when necessary.** During the budget drafting process the Council assesses the proposed policies and forecasts, and prepares a Monitoring Report that is submitted to the Cabinet of Ministers together with the draft annual state budget law and draft MTBFL. The Chairman of the Council appears before the Budget and Finance Committee to elaborate on the arguments put forward in the report. In addition, the Council prepares an interim report on the Stability Programme and an endorsement report regarding the macroeconomic forecasts of the Ministry of Finance. If necessary, the Council prepares an opinion on matters of fiscal policy and a non-conformity report when the Council detects infringements of the FDL or any infringements become known to the Council. The report provides a

[5] Debrun, X., Kinda, T., Curristine, T., Eyraud, L., Harris, J. and Seiwald J. (2013) 'The Functions and Impact of Fiscal Councils", IMF Policy Paper, available at: http://www.imf.org/external/np/pp/eng/2013/071613.pdf, accessed on 03/03/2016.

[6] The so-called Two Pack – Regulation (EU) 473/2013 and Regulation (EU) 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability.

[7] The Strategy is an internal medium-term policy planning document developed to ensure the efficient fulfilment of the Council's tasks and functions. Available at: http://fiscalcouncil.lv/files/uploaded/FDP_1_01_1013_20151218_Strategy_2016_2018.pdf, accessed on 04/02/2016.

description of the non-conformity and contains recommendations for the rectification of said non-conformity.

The Council produces brief analyses on selected issues, but it does not currently perform costing of legislative proposals, nor does it produce baseline or other projections. In 2016, the Council is planning to carry out research on several topics (e.g. tax morale) pertaining to compliance with the principles of fiscal discipline and counter-cyclical fiscal policy. Additionally, the Council's secretariat performs internal analyses on topics that become salient in the public debate and have an impact on fiscal performance (e.g. micro-enterprise tax). However, the Council does not assess the fiscal impact of legislative proposals and does not produce its own forecasts.

The Council currently consists of 6 council members. All Council members have to be appointed by the Latvian parliament (the Saeima). Three Council members were nominated by the Saeima, and the remaining members were appointed by recommendation of the Minister of Finance and the Governor of the Bank of Latvia. The Council members exercise their responsibilities in the Council through participation in Council meetings and working group meetings. The design of the Council encourages international expert participation, and there are currently two non-Latvian members on the Council. Council members are elected for a 6 year term and can be re-appointed once. The appointment of Council members is independent of the parliamentary electoral cycle. No Council member is allowed to hold a position in a political party.

On 19 December 2013, in accordance with Section 22 of the FDL and Part 9 of the Transitional provisions, the Latvian parliament (Saeima) approved six Council members. For a six-year period: Janis Platais, former advisor to the Finance Minister on public financial management issues; Ingars Erins, Vice-Chancellor of the Riga Technical University and Ulo Kaasik, vice president of the Bank of Estonia (national of Estonia). For a three-year period: Inesis Feiferis, Chairman of the Credit Union's associations; Martins Kazaks, chief economist of Swedbank in Latvia and Morten Hansen, Head of Economics Department Stockholm School of Economics (national of Denmark). On 23 April 2015, Inesis Feiferis was relieved from the duties due to resignation from the Council. On 3 September 2015, Andzs Ubelis, an expert on public financial management, was appointed as a Council member for six years.

The Council's Secretariat currently has four members of staff, who continuously improve their analytical capacity. The Council's Secretariat currently employs three economists and one sociologist. The Council can hire and fire staff at its own discretion based on their qualifications. Members of staff regularly improve their capacity by attending appropriate training events and seminars. Based on the needs identified in the employee's annual assessment, priority educational requirements are aligned with the budget of the Council. The Secretariat regularly improve their capacity at the Joint Vienna Institute and other institutes in Latvia and abroad.

The Council cooperates with local partners and similar institutions in the other Baltic States and the EU more generally. Locally, the Council's main partner in developing and implementing responsible fiscal policy is the Ministry of Finance, with whom the Council signed a Memorandum of Understanding on 8 February 2016. Consequently, the Council is responsible for assessing and endorsing macroeconomic forecasts produced by the Ministry of Finance. The Council also closely cooperates with the Treasury, the Bank of Latvia, National Audit Office, Central Statistical Bureau, Ministry of Welfare, State Social Insurance Agency, representatives of the European Commission and other state institutions. Internationally, the Council cooperates with, and learns from, IFIs in other EU member states. It is a member of the Network of EU Independent Fiscal Institutions and participates in the annual meeting of Baltic IFIs.

Members of the Council regularly appear in local media and express their opinion on issues pertaining to fiscal policy and government finances. An annual press conference is held regarding the publication of the Monitoring Report, and members of the Council participate in the wider discussion on economic development and fiscal issues in Latvia, also when exercising their primary professional duties.

It is presently difficult to definitively establish the extent of the Council's impact on fiscal discipline in Latvia. The Council has been in place since 2014, and it has voiced its opinion on a number of occasions and expressed its concerns in relation to the government's plans and macroeconomic forecasts. However, there is not enough information to establish the extent to which the presence or activities of the Council have had an effect on the quality of macroeconomic and general government budget balance forecasts, the transparency of government finance, or the quality of public discourse on matters pertaining to fiscal discipline in Latvia. A notable exception is the endorsement procedure for the macroeconomic forecasts produced by the Ministry of Finance, as the forecasts were revised in response to the Council's comments.

The Council through the Lens of OECD'S Principles for Independent Fiscal Institutions

The publication *Recommendation of the Council on Principles for Independent Fiscal Institutions*[8] by the OECD lists a number of principles and characteristics that IFIs should follow and exemplify. Below you will find a short description of each of the 9 headings under which the principles are grouped, followed by an assessment of how the Council's current status fits into the framework proposed by OECD.

Local ownership

IFIs should be attuned to, and informed by, the specificities of the local environment (e.g. legal framework, political system), have support across the political spectrum and local needs should govern its focus.

The Council was established as a result of changes in Latvian legislation – the passing of the FDL. The Saeima passed the FDL on 31 January 2013, and it came into force on 6 March 2013. The responsibilities of the Council are defined in the FDL, which specifies the role of the Council in the context of fiscal discipline and the planning and execution of, and amendments to, the annual state budget and MTBF of Latvia. Reports produced by the Council have to be submitted to the Cabinet of Ministers and the Saeima, and all Council members have to be approved by the Saeima.

Independence and non-partisanship

IFIs should be non-partisan bodies, whose purpose is the provision of oversight and analysis of, and potentially advice on, fiscal policy. Both members of staff and members of the council should be selected on the basis of competence and expertise, rather than political affiliation. Term lengths should be clearly specified and independent of the electoral cycle.

All Council members were appointed by the Saeima and chosen based on their experience and

---

[8] Available at: http://www.oecd.org/gov/budgeting/recommendation-on-principles-for-independent-fiscal-institutions.htm, accessed on 04/02/2016.

professional achievements[9], and the Council can hire and fire staff at its own discretion based on their qualifications. Council members are elected for a 6 year term, and their election and appointment are independent of the parliamentary electoral cycle. No Council member is affiliated with a political party, and Section 24 of the FDL forbids Council members from holding positions in political parties. The reports produced by the Council do not exhibit preference for the policies of any political party. The Monitoring Report contains recommendations and suggestions for future courses of action that derive from, and are in line with, the principles of fiscal discipline specified in the FDL. However, the influence of personal views (e.g. on economic equality) cannot be fully discounted. Furthermore, it should be noted that the position of Chairman is not a full time position, and 3 Council members were nominated by the ruling coalition.

Mandate
The mandate of IFIs should be clearly defined in legislation. This should specify the reports and analysis that the IFI has to produce, as well as its role in the budget process. IFIs should be permitted to produce additional reports and analysis at their own initiative, provided that these are consistent with their mandate.

The Council's mandate is defined in Chapter 3 of the FDL. The Chapter stipulates the competences and responsibilities of the Council, as well as the reports that the Council has to produce, and the conditions that trigger the need for non-conformity reports. The Council is permitted to carry our research on topics that pertain to, are consistent with, its competences and responsibilities, and the principles of fiscal policy, as specified in Section 4 of the FDL.

Resources
IFIs should be provided with resources commensurate with their responsibilities. Multiannual funding commitments by the government can further increase independence and insulate the IFI from political pressure.

The Council has adequate resources (both human and financial) to carry out the tasks that have been delegated to it. The budget of the Council can be reviewed on an annual basis. However, its inclusion in the MTBF means that there is an implicit commitment to continue funding the Council.

Relationship with the legislature
The IFI should be accountable to the legislature. The release dates of major reports should be established and coordinated with relevant government documents, IFI reports should be sent in time for legislative debates, and representatives should appear before the parliament or relevant committees to provide responses and clarifications to questions. The IFI should respond to requests from committees or sub-committees, rather than individuals.

According to Section 29, Part 1 of the FDL, the Council submits its Monitoring Report to the Saeima for consideration along with the draft annual state budget and the draft MTBF. Representatives of the Council attend the meetings of the Budget and Finance Committee (hereafter - Committee) once the aforementioned documents have been submitted for the consideration of the Saeima to participate in discussions on matters with fiscal impact. While there is informal communication between representatives of the Council and members of the Budget and Finance committee, the Council consults and makes its case to the Committee as a whole.

[9] The FDL does not specify this as a requirement.

Access to Information
IFIs should have access to all relevant information in a timely manner to be able to carry out its duties. Such information should be provided free of charge, and the obligation to supply the Council with relevant information should be guaranteed in legislation. Any restrictions should be clearly defined in legislation.

In accordance with Section 28, Part 9 of the FDL, the Council has access to all relevant information from other state institutions upon request. Employees of the Council's Secretariat have access to, or can request, information pertaining to agenda items discussed in the Cabinet of Ministers. On 8 February 2016 the Council signed a Memorandum of Understanding with the Ministry of Finance and now has access to the macroeconomic forecasts used during the preparation of the Stability Programme and the annual state budget and MTBF.

Transparency
IFIs have a duty to be as transparent as possible. A clear account of their work, activities and reports can protect the independence of IFIs and build trust and credibility with the public. Documentation should be made freely available when possible.

Transparency is among the principles of fiscal policy listed in Section 4 of the FDL. It means that the objectives, achievements and results of fiscal policy should be made publicly available. The Council publishes all of its reports and papers on its website where they are available free of charge. A short comment listing the main points of discussion is published after every Council and working group meeting, and press releases accompany meetings with significant conclusions on topical issues. The Council makes its procurement information and contracts available on its website.

Communication
IFI have to be open and consistent in their communication with the media and the public in general. The role and influence of IFIs is based on persuasion and dissuasion, rather than coercion. Media coverage assists in encouraging public debate and putting pressure on the government to behave in a responsible and transparent manner.

Members of the Council, the Chairman Jānis Platais in particular, regularly appear in local media and express their opinion on matters pertaining to fiscal policy and government finance. A press conference is held regarding the publication of the Monitoring Report. Two conferences have been held thus far – on 6 December 2014 and 25 September 2015, and both conferences were covered by the main news networks. Members of the Council also appear in local media in their primary professional capacities. For example, Mārtiņš Kazāks communicates his opinions as the chief economist at Swedbank Latvia, but his Council membership is also mentioned. Similarly, Morten Hansen has a private blog with the local magazine „Ir", where his Council membership is mentioned. In February 2016 the Council signed a contract with Baltic Communication Partners to develop a communication strategy and improve its communication with the media and the general public. What is more, since January 2016 the Council has access to a media monitoring service that identifies publications pertaining to fiscal discipline. This will hopefully allow the Council to gauge its impact on public debate and improve its communication strategy accordingly.

External Evaluation
IFIs should develop mechanisms for external evaluation to ensure the quality of its analysis. This can

take the form of a review of a particular report, a permanent advisory board or peer review.

There are currently no external evaluation mechanisms in place.

Conclusions

Future spending pressures and a need for sustainable levels of public debt have paved the way for the emergence of IFIs, which encourage prudent fiscal policy and more realistic macroeconomic and revenue forecasts. The number of such institutions has significantly increased in the last decade, and the Fiscal Discipline Council is one among many IFIs that have been established following the latest financial crisis. The Fiscal Discipline Council broadly conforms to the criteria included in OECD's principles for IFIs.

	Fully conforms	Partially conforms	Does not conform
Local ownership	X		
Independence and non-partisanship	X		
Mandate	X		
Resources	X		
Relationship with the legislature	X		
Access to information	X		
Transparency	X		
Communication		X	
External evaluation			X

It was created to fulfil the requirements of the Fiscal Discipline Law, which specifies the responsibilities and competences of the Council, and stipulates the need for independence by forbidding Council members from holding positions in political parties. However, a more consistent approach to communication with the public and the media would strengthen the Council's influence on public debate, and an assessment by an external observer could enhance the quality of the Council's output.

References

Calmfors, L. and Wren-Lewis, S. (2011) “What Should Fiscal Councils Do?”, Department of Economics Discussion Paper Series, No. 537, available at: http://www.economics.ox.ac.uk/Department-of-Economics-Discussion-Paper-Series/what-should-fiscal-councils-do, accessed on 03/03/2016.

Debrun, X. And Kinda, T. (2014) “Strengthening Post-Crisis Fiscal Credibility: Fiscal Councils on the Rise—A New Dataset”, IMF Working Paper, No. 14/58, available at: https://www.imf.org/external/pubs/cat/longres.aspx?sk=41472.0, accessed on 03/03/2016.

Debrun, X., Kinda, T., Curristine, T., Eyraud, L., Harris, J. and Seiwald J. (2013) ‘The Functions and Impact of Fiscal Councils”, IMF Policy Paper, available at: http://www.imf.org/external/np/pp/eng/2013/071613.pdf, accessed on 03/03/2016.

European Commission (2014) “Independent Fiscal Institutions Across the EU”, in Public Finances in the EMU – 2014, European Economy 9: pp. 54-67, available at: http://ec.europa.eu/economy_finance/publications/european_economy/2014/ee9_en.htm, accessed on 03/03/2016.

European Commission (2015) Fiscal Sustainability Report 2015, Institutional Papers 18, available at: http://ec.europa.eu/economy_finance/publications/eeip/ip018_en.htm, accessed on: 03/03/2016.

Hagemann, R. (2011) “How Can Fiscal Councils Strengthen Fiscal Performance?”, OECD Journal: Economic Studies, Vol. 2011/1, available at: http://dx.doi.org/10.1787/eco_studies-2011-5kg2d3gx4d5c, accessed on 03/03/2016.

Kopits, G. (2011) “Independent Fiscal Institutions: Developing Good Practices”, OECD Journal on Budgeting, Vol. 11/3, available at: http://dx.doi.org/10.1787/budget-11-5kg3pdgcpn42, accessed on 03/03/2016.

OECD Council (2014) Recommendation of the Council on Principles for Independent Fiscal Institutions, available at: http://www.oecd.org/gov/budgeting/recommendation-on-principles-for-independent-fiscal-institutions.htm, accessed on 03/03/2016.