LATVIJAS REPUBLIKAS FISKĀLĀS DISCIPLĪNAS PADOME

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Content

Abbreviations

BoL	Bank of Latvia
Council	Fiscal Discipline Council
EC	European Commission
ESA	European system of accounts
EU	European Union
FDL	Fiscal discipline law
SFR	Statement of Fiscal Risks
IMF	International Monetary Fund
Surveillance report 2016-2019	Fiscal Discipline Surveillance Report 2016-2019
MoF	Ministry of Finance
MTBF	Medium term budget framework
MTBFL 2017/19	Medium term budget framework law for 2017-2019
GDP	Gross domestic product
NA	Not applicable / not available
OECD	Organization for Economic Cooperation and Development
SB	State budget
SBL	State budget law
SBL 2017	State budget law for 2017
SGP	Stability and growth pact
SP	Latvia's Stability Programme
SP 2016/19	Latvia's Stability Programme for 2016-2019
VAT	Value added tax

Executive Summary

The Government of Latvia remains broadly compliant with the principles of fiscal discipline, but both 2014 and 2015 saw negative deviations from budget balance targets approved in budget law. The outturn for 2014 and the estimate for 2015 for the general government balance and the special budget balance are below the balance targets for the respective years. The Council finds that the deviation from the general government budget balance target in 2015 was caused by an economically prudent decision to acquire the State Revenue Service building. However, the deterioration of special budget balance outcomes requires scrutiny to avoid future risks.

The Council urges the Government to develop a fiscally sustainable long-term approach to the provision of public health care and objects to the implementation of health care reforms by increasing the deficit objective for 2017. The Council has stressed that health care reforms are necessary to improve Latvia's public health indicators. Additional funding and reforms should be targeted at rectifying current inefficiencies in order to create a sustainable public health system that could improve the quality of life of both current and future generations. There are several challenges for the current funding model, and the Council urges the government to consider the long-term fiscal impact and sustainability of reforms to the provision and funding of health care. Nonetheless, the Council objects to the use of deficit financing for the expansion of the delivery of health care services, as envisaged in the draft budget for 2017.

The Council notes that the the current tax-to-GDP ratio forecast does not indicate that the Government's objective can be achieved by 2020, which is why the Council recommends developing a reform plan for the tax system to reach the intended tax-to-GDP ratio of 1/3. For 2017 the Government approved temporary measures, without significant improvements to the ratio of tax revenues and compulsory state social contributions to GDP. By repeatedly postponing the discussion on sustainable revenue flows and opting for temporary measures, the Government exposes the country to increasing fiscal uncertainty. A bold and coherent approach to (i) the reduction of the shadow economy, (ii) increasing revenues from non-distortionary taxes, (iii) reducing the scope of tax exemptions and (iv) adequately taxing income and capital is required to achieve the objectives set forth in the Declaration of Māris Kučinskis' Cabinet. The Council advises that all efforts should be directed at building a reliable and sustainable revenue flow and coherent tax policy framework.

The Council recommends regular efficiency assessments and more detailed expenditure reviews to better utilise budget funds. The Council welcomes the 2016 expenditure review and endorses the decision to incorporate this procedure into the budget drafting process. Line ministries should be encouraged to conduct their own assessment to divert savings towards important priorities and supporting growth-enhancing and cost-saving reforms. Furthermore, allocation of funding to priority areas should be contingent upon efficiency assessments and clearly specified performance indicators. Using proceeds from temporary revenue measures to finance permanent (baseline) expenditures should be avoided.

The Council welcomes the Government’s proposal to establish a fiscal security reserve for 2017-2019, invites the Saeima to accept it, and consents that **the minimum amount stipulated by the FDL (0.1% of GDP) is currently sufficient.** While additional efforts are required to improve the quantification, management and mitigation of several sources of risk, the Council welcomes the modifications to the Statement of Fiscal Risks. The Council endorses the decision to establish a fiscal security reserve for 2017-2019, as the fiscal security reserve is a safety measure against different risks that may cause a deterioration of the government budget balance. Furthermore, after carrying out a historical assessment of the impact of several items on the general government balance, the Council agrees that the fiscal security reserve can currently be established at the minimum amount, conditional upon savings and excess revenues being used to improve the general government budget balance.

The persistently slow GDP growth during recent years should be addressed by growth-enhancing policies, potentially overseen by a national productivity board. Real GDP growth since 2013 has been consistently lagging behind the forecasted numbers, and the slow growth pace is not sufficient to allow for convergence to average EU productivity and welfare levels. The Government's efforts with respect to implementing growth-enhancing policies so far has not had sufficient impact.

The macroeconomic forecast for the horizon period is considered realistic, while vigilance should be maintained with regard to real GDP growth and inflation. The slower growth outcome in the first half of 2016 is largely explained by the construction sector that suffered severely in the first half of 2016. The real GDP growth forecast for 2017-2019 is optimistic, but it is achievable if the investment sector recovers. Similarly, the average annual inflation forecast for 2017-2019 is realistic, but the recent experience of consistently optimistic inflation forecasts urges caution. The Council sees Latvia's economy as performing slightly below its potential level in 2016 and 2017, but a positive output gap is expected to open in 2018.

The Council reiterates the need for a sensitivity analysis in view of the risk of the nominal GDP falling short of the forecasted level. A sensitivity analysis should be integrated into the MTBF to assess the impact of lower nominal GDP level outcome on tax revenues, as well as estimate the necessary expenditure cuts to meet the medium-term budget balance objective.

The Council contends that the calculations of the 2017 expenditure ceiling should be based on the balance rule (instead of the continuity rule, which was proposed by the Ministry of Finance), resulting in the need to correct expenditures for 2017 by 30.1 million euro (0.1% of GDP. The Council assessed the execution of the fiscal rules, based on the data, which was submitted to the Cabinet of Ministers on 2 August. The main cause of the required correction is a stricter minimum permissible balance, which derives from the recommendation to not finance the health care reform by increasing the deficit target. The expenditure ceilings should be corrected by 111.6 million euro (0.4% of GDP) for 2018 and 148.1 million euro (0.5% of GDP) for 2019.

Responsible fiscal policy must also be observed in the future. The Council encourages the Government to consider prudent planning of the budget deficit below the maximum threshold permitted by legal acts in order to secure a downward trend of the government debt level, consequently securing an improved fiscal position to weather another potential financial and economic crisis in the future. Significant revisions to the time series of macroeconomic indicators require corrections to the execution of fiscal rules starting from 2013.

1 FISCAL POLICY CHALLENGES

The Government of Latvia remains broadly compliant with the principles of fiscal discipline, even though both 2014 and 2015 saw negative deviations from the budget balance target approved in the budget law. While in 2013 the actual general government structural budget balance exceeded the objective (by 0.3% of GDP), the outturn for 2014 and the estimate for 2015 are below the objectives set in the MTBFL for those years by 0.6% and 0.3% of GDP respectively.

	2013	2014	2015
General government budget balance target approved in the MTBF	-1.4[1]	-0.9[2]	-1.0[3]
Actual outcome[4]	-0.9	-1.6	-1.3

Table 1.1 General government budget balance 2013-2015 (% of GDP) Source: CSB.

While the Council notes that 2015 budget execution results were worse than anticipated in the SP 2016/2019, the Council finds that the reason was economically justified. During the preparation of the MTBF 2016/18, it was anticipated that the deviation from the approved budget balance for 2015 would reach 0.4% of GDP. However, in the SP 2016/19 the forecasted general government balance for 2015 was revised to -1.0% of GDP. The preliminary revision resulted from corrections according to ESA 2010 methodology. Nonetheless, CSB estimates (April 2016) suggest that the general government balance for 2015 was -1.3%, which is by 0.3% of GDP lower than planned. This is mainly due to the acquisition of the State Revenue Service building by the Government. The Council finds that this decision has clear long-term fiscal benefits, as it reduces future expenditures on rent.

The Council notes that special budget balance outcomes have been deteriorating. While the special budget balance outcome was better than planned until 2013, the outcomes for 2014 and 2015 indicate a deterioration compared to the plans, mainly due to expenditures exceeding estimates.

	2011	2012	2013	2014	2015
Approved budget balance target	-337.79[5]	-190.38[6]	-80.11[7]	132.40[8]	162.87[9]
Actual outcome	-177.66	-70.4	-57.91	100.35	91.13
Deviation:	160.13	119.98	22,2	-32.05	-71.74

Table 1.2 Special budget balance 2011-2015 (million euro) Source: MoF.

[1] On the medium-term budget framework 2013, 2014 and 2015, Article 5, available at: https://www.vestnesis.lv/op/2012/192.2?search=on, accessed on 27/09/2016.
[2] On the medium-term budget framework 2014, 2015 and 2016, Article 6, available at: https://www.vestnesis.lv/index.php?menu=doc&id=262267, accessed on 27/09/2016.
[3] On the medium-term budget framework 2015, 2016 and 2017, Article 5, available at: https://www.vestnesis.lv/ta/id/271302-par-videja-termina-budzeta-ietvaru-2015-2016-un-2017-gadam, accessed on 27/09/2016.
[4] http://www.csb.gov.lv/en/notikumi/general-government-budget-deficit-and-debt-decreased-2015-44057.html%20, accessed on 03/10/2016.
[5] "On the state budget for 2011", Annex 1, available at: https://www.vestnesis.lv/ta/id/223570-par-valsts-budzetu-2011-gadam, accessed on 03/10/2016.
[6] "On the state budget for 2012", Annex 1, available at: https://www.vestnesis.lv/ta/id/242017-par-valsts-budzetu-2012-gadam, accessed on 03/10/2016.
[7] "On the state budget for 2013", Annex 1, available at: https://www.vestnesis.lv/op/2012/192.1, accessed on 03/10/2016.
[8] "On the state budget for 2014", Annex 1, available at: https://www.vestnesis.lv/op/2013/232.1, accessed on 03/10/2016.
[9] On the state budget for 2015", Annex 1, available at: https://www.vestnesis.lv/op/2014/257.24, accessed on 03/10/2016.

The Council has previously noted the need to assess the sustainability of, and the future risks associated with, the special budget. Population ageing and the shadow economy significantly impact revenues from compulsory state social insurance contributions and can create serious consequences for the sustainability of special budget commitments. The recent spending overrun in the special budget appears to be the result of discontinuing the policies for containing expenditures during the economic crisis, particularly in sickness and unemployment benefits. The effect of such an expansive policy has not received the required scrutiny regarding its social and fiscal impact.

1.1 Health Care Reform

The Council reiterates its objection to increasing the budget deficit objective to finance the implementation of health care reforms. The Government received permission from the EC[10] to increase the general government structural deficit objective for 2017 and, contingent upon the implementation of the proposed reforms, for the remainder of the MTBF 2017/19 to continue structural reforms in health care. The Council objects to the use of deficit financing for the expansion of the delivery of health care services, as envisaged in the draft budget for 2017.

The Council urges the Government to consider measures which would ensure the funding of the health care sector, without deteriorating the government budget balance and increasing the debt burden for future generations. While the Council objects to the deviation from the budget balance objective to implement health care reforms, the Council has stressed that health care reforms are necessary to improve Latvia's public health indicators. To this end, revenue measures or expenditure reviews should be considered, which would improve the cost-effectiveness of delivering health care services, without increasing the budget deficit during the horizon period of the MTBF 2017/19 and from 2020 onwards.

A recently published OECD review[11] notes that Latvia needs a data-driven approach to the health care system and a strategic vision for the sector as a whole. The OECD report on the Latvian health system states that Latvia needs to make significant improvements to the quality and accessibility of health care and increase the available funding, based on a strategic vision for the provision of public health care. Furthermore, more widespread use of data must be made to systematically to measure, compare and improve the performance of services, based on clearly defined indicators.

The Council invites the government to develop a fiscally sustainable long-term approach to the provision of public health care. Population ageing, developments in medical technology and Latvia's comparatively high economic inequality and poor population health indicators pose challenges for the current funding model and the provision of public health care. In the previous report the Council noted that the overall efficiency and sustainability of the health care system should be assessed. Additional funding and reforms should be targeted at rectifying current inefficiencies in order to create a sustainable public health system that could improve the quality of life of both current and future generations. Furthermore, several proposals for the provision and funding of public health care have been discussed[12] during the preparation of the MTBF 2017/19. The Council encourages the government to consider the long-term fiscal impact and sustainability of all such proposals when deciding whether to implement them.

The Council suggests continually assessing the outcomes of the implemented reforms in health care. As outlined in the National Development Plan 2020, one of the indicators of the success of the

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[10] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016H0818(20)&from=EN, accessed on 03/10/2016.
[11] OECD (2015) *OECD Reviews of Health Systems: Latvia 2016*, Paris: OECD Publishing.
[12] For example: https://www.makroekonomika.lv/latvijas-bankas-priekslikumi-veselibas-aprupes-sakartosanai-detalizeta-koncepcija, accessed on 03/10/2016.

health care reform is a decrease in the annual loss of healthy life years. It was claimed that this indicator should decrease from 6746 in 2010 to 5300 in 2020. Estimates provided by the Ministry of Health about 2014 show that there have been gradual improvements in this regard. Furthermore, the funds allocated for the implementation of the health care reform between 2014 and 2016 exceeded the requirements of the National Development Plan 2020. In view of this, the Council recommends regularly assessing the outcomes of health care reforms and clarifying whether the targets for the period in question have been reached.

1.2 Revenues

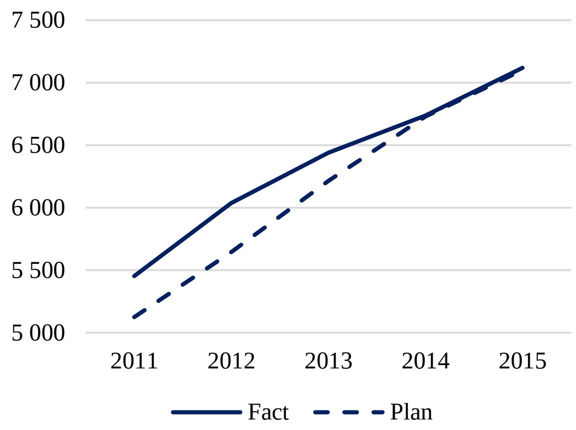


Chart 1.1 Execution of the tax revenue plan 2011-2015 (million euro). Source: State Revenue Service.

Tax revenue targets have been achieved despite deteriorating macroeconomic conditions and slower growth, while non-tax revenues have recently been lower than planned. After summarising the information published by the State Revenue Service on the execution of the revenue plan in the last five years, the Council concludes that tax revenues have consistently been higher than planned. The results of 2015 are of particular note, as revenue collection was executed according to the State Revenue Service plan, even though nominal GDP growth was lower than anticipated (5.2% forecasted growth in the MTBF versus 3.4% actual outcome). This may indicate a positive trend of the shadow economy shrinking faster as a result of State Revenue Service efforts.

Strong and professional leadership maintains public trust in the State Revenue Service. The previous Director General of the State Revenue Service resigned in May 2016, and the selection process of the new director has been complicated and fraught with controversy. This may have a damaging effect on the reputation of the Government and the perceived independence of the State Revenue Service. Research shows that trust in the revenue collecting agency influences compliance with tax law[13] and, consequently, tax revenues. This is why a transparent and merit-based selection of a professional Director General is crucial to maintaining the reputation of the institution. Furthermore, structural issues should be addressed to allow attracting and maintaining highly qualified professionals in the top management posts of the State Revenue Service.

The draft MTBF 2017/19 does not demonstrate significant improvements to the ratio of tax revenues and compulsory state social contributions to GDP (hereafter – tax-to-GDP ratio), but the new proposals indicate intentions to address issues identified in previous Council reports. With the policy changes set forth in the draft MTBF 2017/19, the tax-to-GDP ratio in the horizon period is currently not on track to reach the Government's objective of 1/3 of GDP, established in the Declaration of Māris Kučinskis' Cabinet. Furthermore, the Council is concerned that after the discussion on revenue measures for 2017 the Government approved temporary measures, rather than developed a plan containing long-term measures. By repeatedly postponing the discussion on sustainable revenue flows and opting for temporary fixes, the Government exposes the country to increasing fiscal uncertainty. Nonetheless, it is salutary that the adopted revenue measures address tax evasion and tax avoidance. Furthermore, revenues from environmental taxes have been increased, and more indications regarding reforms in taxation should emerge in early 2017. These are issues that the Council noted in previous Surveillance Reports.

The Government's plan to increase tax revenues primarily by reducing the shadow economy is commendable, but the Council believes that reducing the shadow economy will not be enough to

[13] For more information see Annex 3.

reach the intended tax-to-GDP ratio. The Government aims to reduce informal economic. Limiting the shadow economy increases revenues without further burdening individuals and companies that already pay taxes in full. The Council contends that the intended tax-to-GDP ratio cannot be reached only by focusing on the reduction of the shadow economy. The options for increasing revenues from non-distortionary taxes, reducing the scope of tax exemptions and adequately taxing income and capital should also be considered when working on revenue-increasing measures will have to be considered. Such an approach would allow for a stable and foreseeable revenue policy, which would not hamper economic growth or place additional burdens on participants of the formal economy.

Modifications to the current tax system should be mindful of the system as a whole. The MoF has stated that it will continue work on developing a tax policy in 2017, using the results of the tax system review carried out by the World Bank. The Council welcomes efforts to improve the existing tax system – particularly equalising the tax burden between different groups of taxpayers and reducing the regressive elements in the tax system (e.g. shifting the tax burden from low salaries to undertaxed income from capital). Moreover, the Council urges the government to approach the tax system as a whole and advises that all changes should be directed at building a coherent and reliable tax framework.

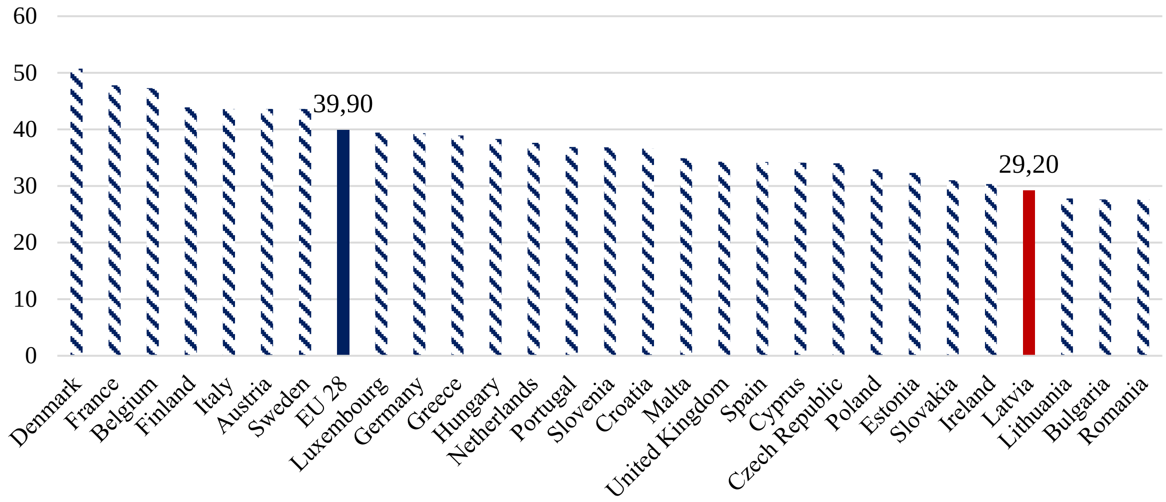


Chart 1.2 Tax revenues & social contributions in 2014 (% of GDP). Source: Eurostat.

The Council reiterates its suggestion that the revenue potential of taxes on immovable property should be fully utilised. A recent OECD publication[14] notes that property taxes are non-distortionary and, in many cases, have a positive distributional impact. In addition, an EC publication on tax reforms[15] states that taxes on immovable property are a way to increase revenues and move away from more distortionary (e.g. labour taxes) taxes. In view of this, the Council maintains its suggestion that property and real estate taxation should be carefully considered and the economic and social effects should be fully assessed when preparing policy changes.

The Council supports the Government's proposal that the micro-enterprise tax regime should be abolished at the end of 2018, and alternative measures should be introduced to support start-ups. The micro-enterprise tax regime has become an expensive instrument for encouraging entrepreneurship. The analysis performed by the Council indicates that the micro-enterprise tax regime

[14] Brys, B., Perrett, S., Thomas, A. and O'Reilly, P. (2016) *Tax Design for Inclusive Economic Growth,* available at: http://www.oecd-ilibrary.org/taxation/tax-design-for-inclusive-economic-growth_5jlv74ggk0g7-en, accessed on 03/10/2016.

[15] European Commission (2015) *Tax Reforms in EU Member States 2015*, available at: http://ec.europa.eu/economy_finance/publications/eeip/pdf/ip008_en.pdf, accessed on 03/10/2016.

currently has several significant deficiencies and creates a future strain on the special budget. In view of this, the Council supports the proposition to abolish the micro-enterprise tax regime and support start-ups.

The solidarity tax should be reconsidered in favour of alternative measures, which can be collected more effectively. While the Council commends the government for the attempt to reduce income inequality, the revised revenue forecasts and public backlash against the solidarity tax suggest a need to reconsider it. Alternative inequality-reducing measures, which can be administered effectively, should be developed.

1.3 Expenditures

The Council could not identify strong support for structural reform measures when reviewing the new policy initiatives for incorporation into the draft budget. Following the Cabinet meetings of 16 August and 18 August, the decision was made to approve new expenditure measures for 2017 in the amount of 144.1 million euro[16]. While the approved measures address several important areas (such as teachers' salaries and the availability of ambulatory care), there is little evidence that growth-enhancing structural reforms will be implemented, which are crucial for stimulating economic growth.

The Council advises against using proceeds from temporary revenue measures to finance permanent (baseline) expenditures. After reviewing the new policy measures approved by the Government, the Council notes that several temporary or one-off revenue measures (e.g. 34.2 million from the vehicle exploitation tax and 20 million from sales of confiscated goods) are being used to finance permanent expenditures, including remuneration. The Council advises against such a practice, as it simply postpones the task of developing sustainable revenues or cutting inefficient spending.

The Council welcomes the 2016 expenditure review and endorses the decision to incorporate this procedure into the budget drafting process. An expenditure review was carried out in the first half of 2016. A report by the MoF claims that a total of 64.2 million euro became available for new expenditures in 2017, and 62.2 million euro in 2018[17]. Line ministries should be encouraged to conduct their own assessment to divert savings towards important priorities and supporting growth-enhancing and cost-saving reforms. The government-wide review led by the Ministry of Finance should continue and encourage responsible allocation.

The Council advises that allocation of funding to priority areas should be contingent upon efficiency assessments and clear performance indicators. While several areas of government spending are underfunded compared to EU average (e.g. health care and social protection), others compare favourably to the EU average, while the results and outcomes could be better. Further allocation of funding should be made based on outcomes and assessments of how efficiently the available funding is being used, in order to eliminate waste. Furthermore, additional funding should be allocated with clear outcomes and progress indicators in mind.

[16] http://www.fm.gov.lv/lv/aktualitates/jaunumi/budzets/53181-nakamgad-valdibas-prioritarajiem-pasakumiem-bus-pieejams-1441-miljons-eiro, accessed on 03/10/2016.

[17] http://www.fm.gov.lv/lv/aktualitates/jaunumi/budzets/52713-pirmo-reizi-padzilinati-izverteti-visu-ministriju-budzeti, accessed on 03/10/2016.

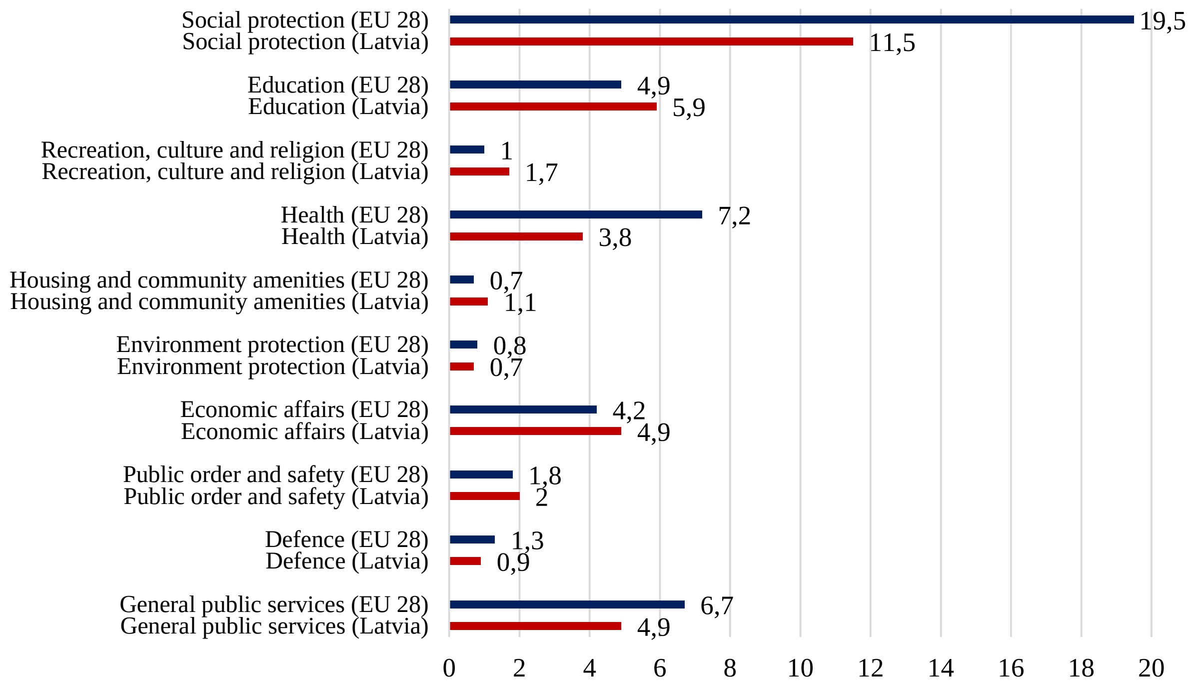


Chart 1.3 General government expenditure in 2014 (% of GDP). Source: Eurostat

The Council notes insufficient analytical support for the legislative process in the Saeima. The 2016 iteration of the *Sustainable Governance Indicators* survey[18] claims that the Latvian parliament lacks adequate resources to monitor government activity. The Council suggests that this situation can be rectified by strengthening the analytical support in legislation. This can help the parliament to obtain pertinent information and specialised expertise on, and a deeper understanding of, complex policy and legislative matters. This can include more in-depth international comparisons and using best practices as a point of reference. This would also allow parliamentarians to critically evaluate government policies and steer towards improvement[19].

Recommendations

1. Adopt a structural reform plan for the tax system, indicating a clear path towards reaching a tax-to-GDP ratio of 1/3, while supporting economic growth and equality, and broadening the tax base.
2. Develop and implement performance-enhancing reforms in the health care sector in a fiscally sustainable manner, without deviating from budget deficit targets.
3. Identify issues and adopt measures for containing the long-term risks for the special budget, in view of demographic trends, the situation in the labour market, impact of policy changes, and previous deviations from budget expenditure forecasts.
4. Carry out regular efficiency assessments and more detailed expenditure reviews to better utilise budget funds.

[18] http://www.sgi-network.org/2016/Governance/Executive_Accountability/Legislative_Actors%E2%80%99_Resources/Parliamentary_Resources, accessed on 03/10/2016.

[19] For more information see: http://www.ifla.org/node/9758, accessed on 03/10/2016.

1.4 Assessment of the Statement of Fiscal Risks

The Government has a responsibility to carry out a comprehensive assessment of fiscal risks, prepare a Statement of Fiscal Risks (hereafter – SFR) and establish a fiscal security reserve. The management of fiscal risks requires the identification of specific sources of risk and their potential impact on the general government balance. This information is included in the SFR, which is attached to the draft MTBFL upon submission to the Saeima. Based on the SFR, the fiscal security reserve should be calculated and included in the budget to counter the fiscal impact of all of the included risks, should they materialise and cause the general government balance to deviate from the objective approved in the MTBFL.

The FDL stipulates that a fiscal security reserve should be established at least in the amount of 0.1% of GDP. The FDL states that the fiscal security reserve for 2016 should have been established in the amount of 0.1% of GDP and a fiscal security reserve of no less than 0.1% of GDP for subsequent years.

The Council welcomes the decision to establish a fiscal security reserve for 2017-2019. Expenditure needs motivated the Cabinet's decision against establishing a fiscal security reserve for 2016 – a decision which was contrary to Part 3 of the Transitional Provisions of the FDL. In the Cabinet meeting of 2 August 2016 the decision was made to establish a fiscal security reserve for MTBF 2017/19 in the minimum amount stipulated by the FDL – 0.1% of GDP. The Council endorses this decision, as the fiscal security reserve is a safety measure against different risks not directly reflected in the budget and MTBF that may cause a deterioration of the government budget balance.

After conducting a historical assessment, the Council concurs that the fiscal security reserve for 2017 has been set at a sufficient amount. The Council carried out an analysis of the impact of several items (e.g. Southern Bridge and Parex Bank) on the general government balance. The Council concludes that the negative impact was partly offset by expenditure savings from the approved appropriations and revenues exceeding budget estimates. The Council agrees that the fiscal security reserve can currently be established at the minimum amount, conditional upon savings and excess revenues being used to improve the general government budget balance.

The Government has included in the SFR for 2017-2019 risks that were not previously reflected, while the impact of most risks remains unquantified. This year's SFR contains a section on risks stemming from the financial sector, which was not included in the previous SFR. While the Council welcomes attempts to broaden the range of fiscal risks, it notes that the probabilities and potential impact of most risks (e.g. public-private partnerships, state-owned enterprises) remains unquantified. The exceptions are state loans and state-guaranteed loans, whose potential fiscal impact has been determined.

The Council suggests more transparency in the analysis underpinning the required amount of the fiscal safety reserve. The SFR includes several risks whose potential fiscal impact has not been assessed. Furthermore, the analysis underpinning these judgements is sometimes vague, and the reasoning is not explicit. The SFR should include a more detailed account of risk assessment procedures – particularly as they pertain to the assignment of specific probabilities, and the assumptions underpinning these judgements. This would allow an independent observer to gain a better understanding as to why specific probabilities can be assigned in some cases, and insight into the reasons why a specific amount cannot be given in others.

Risk management would be improved by a clear establishment of responsibilities. Appropriate identification and quantification of fiscal risks is crucial for effective risk management and mitigation.

The risks could be managed most effectively if clear responsibilities are established for line ministries[20]. By delegating risk management, making clear the benefits of appropriate risk management and encouraging a consistent methodological approach, the MoF can compel other line ministries and state institutions to identify and assess sector-specific risks, and provide more accurate forecasts and information.

The Council advises caution and careful planning, drawing on international experience, to avoid unexpected complications regarding the Ķekava bypass public-private partnership project. More than 70% of all transport-related public-private partnerships are road projects[21]. The preparation and design phases should learn from previous projects and develop a clear and careful framework for managing the Ķekava bypass. This should contain a cautious cost and risk assessment, and provisions regulating the respective responsibilities of partners, and alterations of funding arrangements in case of significant changes in circumstances.

The applicability of the symmetry principle to government finance remains unclear. The Council has previously noted its concerns regarding the use of the symmetry principle in the SFR. After consulting with experts from Ernst & Young Baltic[22], the Council remains unconvinced that the symmetry principle is applicable in the way it is currently being used.

The continued use of the symmetry principle requires further refinement. Future SFRs should provide additional information and justification regarding the period of time chosen, and the role and impact of mitigating or exacerbating factors that influenced outcomes. Furthermore, evidence is required that positive outcomes contributed to lower deficits and less strain on public debt. This would establish that the symmetry principle is being implemented consistently.

The inclusion of a subsection dealing with ex post assessment of the MTO in the SFR is salutary. The SFR provides the main reasons for the deviation from the planned budget balance in 2015. This is consistent with the recommendation that the Council made in its previous Monitoring report.

Assessment

The Council suggests that the following improvements be made to future SFRs:

1. Endeavour to forge a more definite link between the potential impact of risks on the fiscal balance, mitigating factors (e.g. expenditure savings) and the required amount for the fiscal safety reserve.
2. Improve the quality of risk assessment by clearly establishing the responsibilities of the relevant institutions for assessing and managing fiscal risks in their respective sector, with a clear link to the necessary allocation in the fiscal safety reserve.
3. Provide a more detailed and precise description of how probabilities are assigned to particular risks so that the specific content of claims and conclusions can be evaluated by independent observers.
4. Draw on international experience to develop robust frameworks for public-private partnerships.
5. Establish and clarify the applicability of the symmetry principle in the context of government finance.

[20] For more information see Annex 5.
[21] http://ec.europa.eu/economy_finance/events/2016/20160302-pfn/documents/03_tomasi_presentation_on_en.pdf
[22] For more information see Annex 5.

2 MACROECONOMIC OUTLOOK AND OUTPUT GAP

According to the MoU[23], the Council has assumed the responsibility of endorsing MoF's macroeconomic forecast. An early review and endorsement of the MoF's macroeconomic projections by the Council has been agreed upon to support the Government in the preparation of two annual documents – the SP and the MTBF. Most recently, the Council endorsed MoF's macroeconomic forecast on 16 June 2016. The full endorsement text is available in Annex 2. The Council assessed the forecast as a whole, and provides an endorsement of the key macroeconomic indicators (see Table 2.1).

	2016	2017	2018	2019
Real GDP growth	2.5	3.5	3.4	3.4
Nominal GDP growth	2.8	5.3	5.7	6.1
Inflation	0.0	1.6	2.0	2.5
GDP deflator	0.3	1.7	2.2	2.7
Potential GDP growth	2.4	2.6	2.8	2.8
Output gap	-1.1	-0.3	0.2	0.7

Table 2.1 Macroeconomic forecast indicators endorsed by the Council in June 2016, %.

While real GDP growth has been consistently lagging behind the forecasted numbers since 2013, the slow growth pace is also not sufficient to provide for convergence to the average EU level of welfare. Lower than expected growth is attributable to external factors like weak global growth and political uncertainty, as well as local problems that could at least partly be resolved by introducing efficient growth-enhancing policies. The Council has repeatedly noted the need to develop and implement well-designed structural reforms to continue convergence to average EU levels in terms of income and welfare, however, the Government's progress in this respect so far has been limited.

Establishment of a national productivity board should be initiated to facilitate the development of growth-enhancing policies. After the Five President's Report[24]outlined the idea of enhancing countries' competitiveness through the creation of a euro area system of competitiveness authorities, in September 2016 the EC issued a recommendation to establish national productivity boards[25]. The key duties of such an authority would include assessing policies, tracking developments and contributing to the public debate on productivity and competitiveness.

Data for the first half of 2016 suggest that real GDP growth is slower than in the MoF forecast, which the Council endorsed on 16 June 2016. Real GDP growth in the first 6 months of 2016 reached 2.1% compared to the first half of 2015. One of the key underlying assumptions of the macroeconomic scenario presented by the MoF was a resumed flow of EU structural funds into the economy during 2016, which continues to lag. Consequently, the current slowdown is partly explained by the prolonged period without the inflow of EU funds into the economy: historically, EU funded programmes start demonstrating positive effects 3-4 years after an agreement between the EC and Latvia is reached – 2017-2018 for the current planning period.

The construction sector has suffered severely in the first half of 2016, but so far no major negative spillovers to other sectors of the economy have been observed. The construction industry dropped by 19% in the first half of 2016, compared to the first half of 2015, which is largely due to the delayed disbursement of EU funds. This contributes to a slump in investment activity. So far, this negative hit has largely been contained within the construction industry, without a major spillover to other sectors. For instance, consumption is still growing, wage growth (though slower and less steady than in the past year) still continues, the export sector continues to recover from the trade embargo with Russia and grew in the second quarter of 2016.

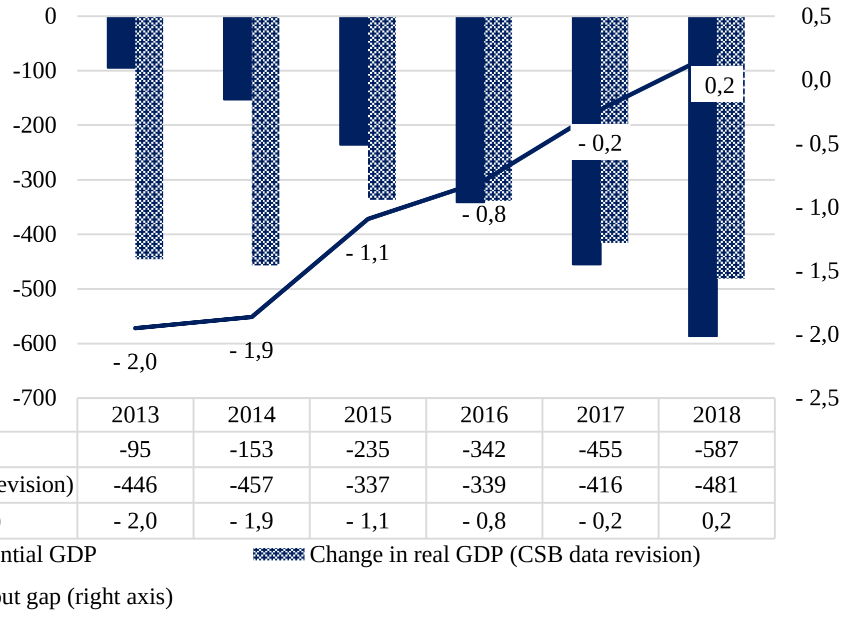
[23] http://fiscalcouncil.lv/files/uploaded/FDP_1_09_969_20160729_MoU_FDC_MoF_consolidated.pdf
[24] https://ec.europa.eu/priorities/sites/beta-political/files/5-presidents-report_en.pdf
[25] http://data.consilium.europa.eu/doc/document/ST-12330-2016-INIT/en/pdf

The Council sees a potential risk of imbalances appearing in the construction sector. With the disbursement of EU structural funds, a massive inflow of funding into the construction sector is likely. However, the uptake capacity of the construction sector has been reduced by this year's recession. Consequently, there is a risk of bottleneck effects, resulting, among other things, in inflationary pressure.

The real GDP growth forecast for 2017-2019 is optimistic, but it is achievable if the investment sector recovers. With the inflow of EU funds, it is reasonable to expect growth acceleration. Lending to businesses more than doubled in the second quarter of 2016 compared to the same period in 2015. Unemployment continues to gradually decrease, the manufacturing industry is growing and confidence indicators are broadly stable, with the exception of the construction sector.

The average annual inflation forecast for the horizon period is realistic, but recent experience urges caution. In August 2016 the annual inflation rate was considerably lower than forecasted for 2016, reaching -0.3%. Major downward pressures come from the energy and food markets, while core inflation is positive at around 1%. In the remaining months of 2016 inflation is expected to recover as a result of the disappearance of base effects of energy prices and the end of the seasonal decline in food prices. Inflation performance in 2017-2019 highly depends on global oil prices and unprocessed food prices. Although the base effects causing low inflation have disappeared by now, the recent experience of consistently optimistic inflation forecasts suggest the need to maintain vigilance.

After downward revisions of the GDP time series by the CSB and revised potential GDP data, output gap estimates for 2013 – 2017 are more negative than when the MTBF 2016/18 was being drafted. In September 2015, CSB revised the whole GDP time series, which resulted in substantially lower GDP figures (e.g. both the nominal and real GDP figures for 2014 fell by ~2% after the revision). During the macroeconomic forecast endorsement procedure for the SP 2016/19 (in February 2016), after several rounds of consultations between the MoF and the Council, the potential GDP data (both historical and future) were revised slightly downwards. The total effect of these revisions is a more negative output gap for 2013-2017 than estimated previously (see Chart 2.1).



	2013	2014	2015	2016	2017	2018
Change in potential GDP	-95	-153	-235	-342	-455	-587
Change in real GDP (CSB data revision)	-446	-457	-337	-339	-416	-481
Change in output gap (right axis)	- 2,0	- 1,9	- 1,1	- 0,8	- 0,2	0,2

Chart 2.1 Change in real GDP, potential GDP (mill EUR) and the resulting change in the output gap (as % of potential GDP) from MTBF 2016/18 to MTBF 2017/19. Source: CSB, MoF, Counicl's calculations.

The Council sees Latvia's economy as performing slightly below its potential level in 2016 and 2017, but a positive output gap is expected to open in 2018. This is mainly related to the above-mentioned idleness in the investment sector. Assuming recovery of the construction sector and ongoing decrease in unemployment rate, according to current projections, a positive output gap is forecasted to start opening in 2018.

The Council reiterates the need for a sensitivity analysis in view of the risk of the nominal GDP falling short of the forecasted level. Lower than planned growth in 2016 can lead to lower nominal GDP levels in 2017-2019, even if the growth rates reach the forecasted figures for the horizon period of the MTBF 2017/19. The Council reiterates the need to integrate a sensitivity analysis into the MTBF to assess the impact of lower nominal GDP level outcome on tax revenues, as well as estimate the necessary expenditure cuts to meet the MTO.

Recommendations

1. Initiate the process of establishing a national productivity board to facilitate the implementation of growth-enhancing policies.
2. Develop a sensitivity analysis for the case of nominal GDP falling short of the forecasted level, the resulting lower tax revenues than planned and implications on government expenditures to meet the MTO.

3 Assessment of Compliance with Numerical Fiscal Rules

According to Section 28, Part 1 of the FDL, the Council has the responsibility (i) to verify the application of the numerical fiscal rules stipulated by the FDL in the preparation of the SB and the MTBF, (ii) to assess the impact of the amendments thereto and also (iii) to verify rules after the budget has been executed (so called – ex post assessment). Council has performed fiscal rules assessment based on the data received from the MoF on 2 August 2016.

The objective of the fiscal rules is to establish expenditure ceilings for the central government at a level that would take into account the conditions, e.g., of the economic cycle, of natural changes in recipients, of one-off measures, with the achievement of the MTO in mind.

3.1 Applicable Fiscal Rules in 2013-2016

The Council has carried out an assessment of the fiscal rules for 2015 and 2016 and has concluded that the expenditure ceilings have changed significantly. While preparing the state budget and the MTBF for 2015 and 2016, the balance rule was selected as the tightest and most appropriate criterion for determining fiscal space during budget preparation. The actual results of the fiscal rules were significantly influenced by macro-economic development, including lower than forecasted inflation, which is reflected in a lower than planned GDP deflator at a lower cost and the revised potential GDP, which influences the structural component. Retrospective assessment indicates that the maximum permissible budget expenditure level for 2015 and 2016 should have calculated employing the expenditure rule.

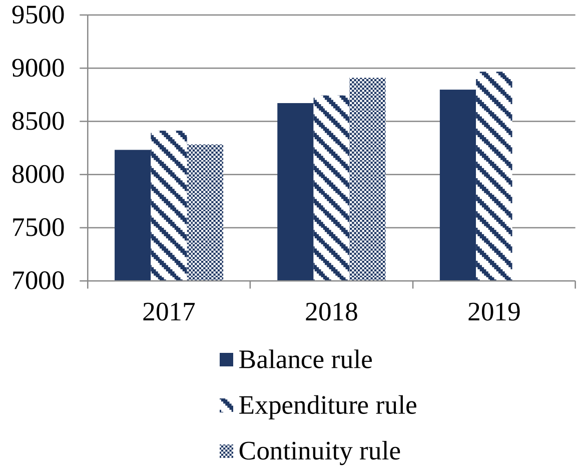
The calculations presented above will not affect the maximum government expenditure level for 2017. The calculation methodology and assumptions employed do not allow the Council to assess in sufficient detail whether the fiscal rules are applied appropriately for 2015 and 2016. Additionally, the Council expects the final CSB data on 2015 budget execution results according to ESA methodology prior to the approval of the final assessment in accordance with Article 11 of the FDL.

However, the calculation of fiscal rules will affect the assessment of the government's performance in relation to meeting fiscal objectives. The Council therefore calls on the MoF to make a calculation for all fiscal conditions for the period since 2013, in accordance with Article 11 of the FDL.

Recommendation

1. Perform a retrospective assessment of the application of the fiscal rules starting with 2013 in accordance with Article 11 of the FDL based on the actual results of the macroeconomic and fiscal indicators.

3.2 The Assessment of Fiscal Rules for MTBF 2017/19



3.1 Chart. State budget expenditure ceilings, MTBF 2017/19, million eiro. Source: Council calculus..

The Council contends that the balance rule provides the lowest value of the expenditure ceilings for all three years of the MTBF 2017/19 (see Chart 3.1). The Council agrees with MoF calculations for 2018 and 2019, while disagrees with the MoF that the continuity rule should be applied for 2017.[26] The Council continues to highlight that the proposed deviation from the MTO on account of the reform in the health care sector is not in line with the principles of fiscal discipline, which demand a sustainable approach to public finance. The Council contends that the balance rule should be applied for 2017. Pursuant to the Council's revised data and according to the balance rule, the expenditure ceilings are 8 205.1 million euro for 2017, 8 644.8 million euro for 2018 and 8 961.9 million euro for 2019.

The Council draws attention to slight differences in its approach compared to the MoF, resulting in a different assessment of the expenditure ceilings. They are as follows (see Table 3.1):

1) Similar to the Council's assessment of the SP 2016/19. for the calculation of the balance rule the deviation from the MTO on account of the health care structural reform should not be made, resulting in the following adjustments:

– 2017 -34.3 million euro,
– 2018 -111.6 million euro and
– 2019 -148.1 million euro compared to MoF's calculations (see discussion on the deviation from the MTO on account of the health care reform in Section 1 *Fiscal policy challenges*) (see Chart 3.2).

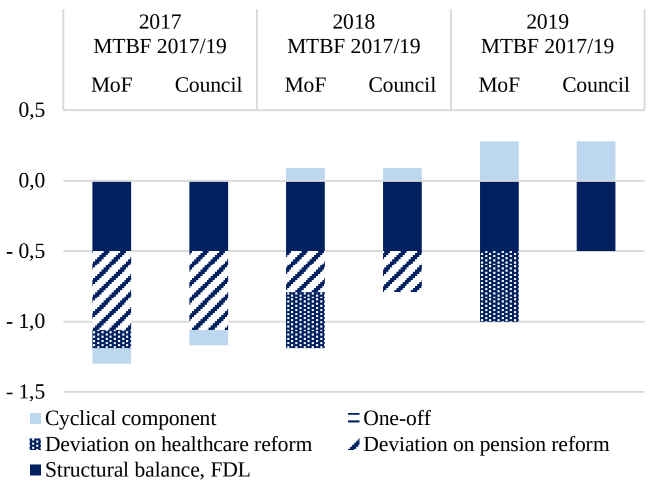


Chart 3.2 The general government budget headline balance by component, % of GDP. Source: MoF, Council calculus.

2) The Council does not challenge MoF's calculation of the expenditure rule. Nevertheless, the calculation of potential GDP growth, which takes into account the recalibrated convergence margin, is different in the national methodology and the EC methodology, and the latter is stricter. However, due to the limited public availability of data both methodologies are used for 2017, but only the national methodology is used for 2018 and 2019. The expenditure rule demands more transparency regarding the numerous assumptions behind the calibration procedures.

3) In the calculations of the continuity rule the Council has also included the expenditures arising from the decision of the Constitutional Court (in summer 2016) regarding the remuneration of the employees of the Ministry of Inferior (22 million euro). The continuity rule could not be applied for

[26] According to the FDL the continuity rule is applicable if the difference among the continuity rule and the next strictest rule is less than 0.1% of GDP.

establishing expenditure ceilings after the adjustment, because the resulting value of the expenditure ceilings would exceed 0.1% of GDP.

	2017 (draft MTBF)		2018 (draft MTBF)		2019 (draft MTBF)	
	MoF	Council	MoF	Council	MoF	Council
(1) Balance rule	8 265.8	8 231.5	8 784.3	8 672.7	9 139.5	8 991.5
(2) Expenditure growth rule	8 411.2	8 411.2	8 792.4	8 792.4	9 285.6	9 285.6
(3) Continuity rule	8 279.6	8 301.6	8 860.8	8 882.8	x	x
(4) = MIN [(1);(2)]	8 265.8	8 231.5	8 784.3	8 672.7	9 139.5	8 991.5
(5) = (4) - (3)	-13.8	-70.1	-75.0	-208.6	x	x
(6) = [5]	13.8	70.1	75.0	208.6	x	x
(7) GDP, at current prices	26 403.4	26 403.4	27 905.1	27 905.1	29 614.7	29 614.7
(8) 0.1% of GDP, (8) = 0.1%* (7)	26.4	26.4	27.9	27.9	29.6	29.6
(9) Central government maximally permissible expenditure in accordance with fiscal rules, (9) = IF [(6) > (8); (4); (3)]	8 279.6	8 231.5	8 784.3	8 672.7	9 139.5	8 991.5
(10) Fiscal safety reserve	26.4	26.4	27.9	27.9	29.6	29.6
(11) CG expenditure, taking into account fiscal safety reserve, (11) = (9) - (10)	8 253.2	8 205.1	8 756.4	8 644.8	9 109.9	8 961.9
Deviation:	x	-48.1	x	-116.6	x	-148.1

Table 3.1 Summary of numerical fiscal rules execution in MTBF 2017/19 (million euro). Source: Council calculus.

When calculating government expenditure ceilings, it becomes apparent that the balancing element is the basic budget (in ESA – central government budget), as special budget expenditures are specific entitlements not subject to appropriation ceilings and have special provisions according to the Budget and financial management law. The government requires additional instruments to monitor state owned enterprises and derived public persons. Historically, the deviations (see Table 3.2) are mainly due to policy changes concerning transfer principles between the special budget and the basic budget, starting from 2014.

	2011	2012	2013	2014	2015
Basic budget balance target approved in budget law	-478.7	18.1	-111.3	-275.5	-380.2
Actual outcome	-428.4	199.8	70.3	-406.0	-386.3
Deviation:	50.3	181.7	181.6	-130.5	-6.1

Table 3.2 Basic budget balance 2011-2015 (million euro). Source: MoF.

Recommendation

1. After assessing the implementation of fiscal rules the Council recommends the following during the preparation and execution of the MTBF 2017/19:
    - The Council disagrees with the MoF's view that for 2017 expenditure ceilings should be calculated on the basis of continuity rule and takes the view that for 2017 it should be done on the basis of the balance rule;
    - The Council does not find the proposed deviation from the MTO on account of the reform in the health care sector compliant with FDL principles and recommends excluding it from the calculations of the fiscal rules and central government expenditure ceilings;
    - The structural balance for 2017 should be improved by 30.1 million euro (0.1% of GDP), for 2018 – by 111.6 million euro (0.4% of GDP), and for 2019 – by 148.1 million euro (0.5% of GDP).

3.3 Government Debt

The Section 14 of the FDL establishes the fiscal rule for government debt, which may not exceed 60% of GDP. There are no separate provisions for conducting fiscal policies in conditions where government debt is approaching or exceeding this specified level.

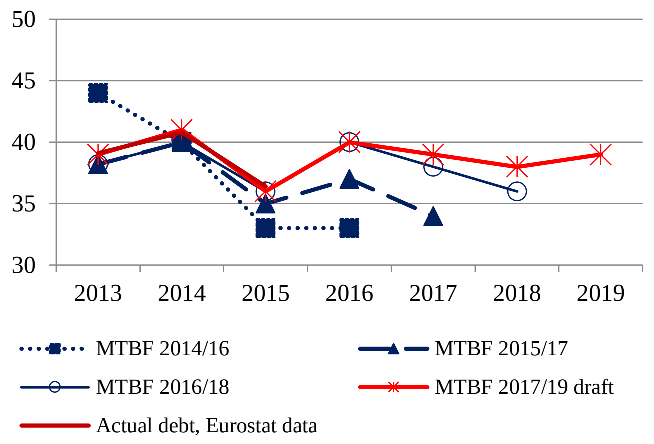


Chart 3.3 General government debt forecasts, % of GDP, Source: The Treasury, Eurostat.

Current forecasts of government debt have reached 40% of GDP (see Chart 3.3). The draft MTBF 2017/19 draft continues the practice of the previous years to increase the forecast substantially, e.g. for year 2016 – from 33% in MTBF 2014/16 to 40% in the current draft of the MTBF 2017/19, i.e. for 7% points.

The Council finds it necessary to reduce the debt level while economic growth persists. Policies envisaging increased debt levels would be irresponsible in view of the demographic situation in the country. The Council would encourage the Government to consider prudent planning of the budget deficit below the maximum threshold permitted by legal acts in order to secure a downward trend of the government debt level and, hence, ensure a better fiscal position if Latvia has to endure another financial and economic crisis in the near future.

The Council notes that, compared to the debt level for 2015 indicated in MTBF 2014/16, the actual debt level has increased by 3% points (see Chart 3.3). The practice of not reducing the debt to GDP ratio in so-called good years (and even increasing it by three percentage points of GDP) is not indicative of sustainable debt management, and it might increase the risk of incurring higher interest payments, reduces future fiscal space and the ability to absorb shocks.

The key reasons behind higher levels of debt have been (i) slower growth of nominal GDP, compared to earlier expectations, (ii) increased borrowing to cover higher than planned nominal deficits, as well as (iii) financing operations, including the provision of capital to airBaltic, the purchase of the SRS building, and the accumulation of liquid financial assets ahead of making large repayments of maturing debt.

Recommendation

1. The Council encourages the Government to consider prudent planning of the budget deficit below the maximum threshold permitted by legal acts in order to secure a downward trend of the government debt level, consequently securing an improved fiscal position to weather another potential financial and economic crisis in the future.

ANNEX 1. RECOMMENDATIONS PROGRESS

1 Fiscal policy challenges

Recommendations

1. The Council recommends a cautious fiscal policy for the remainder of 2015, bearing in mind the likelihood of having to correct the fiscal balance for 0.5% of GDP in case of significant deviations.
   The forecasted general government budget balance for 2015 is -1.3% of GDP, which is better than the forecast used when planning the 2016 state budget. See section 3.1 for further details.

2. Reaching a tax-to GDP ratio of 1/3 should be the key objective while developing a tax policy and administration strategy, focusing on the reduction of the shadow economy, improving the efficiency of tax collection, as well as reviewing tax rates and eliminating exemptions.
   Limited progress. *Several measures introduced during the preparation of the 2017 state budget aim to reduce tax evasion and tax exemptions. However, work on the tax policy will only commence in early 2017. The most recent Shadow Economy Index for the Baltic Countries suggests that in 2015 the shadow economy in Latvia decreased by 2.2% points of GDP.*

3. Consider the reduction of income inequality when designing future tax policy; in particular, look at increasing the tax burden on dividends and other capital income not used for reinvestment.
   No progress.

4. Increase budget revenues in a growth friendly manner by fully utilising the potential of property taxes and environmentally related taxes.
   Limited progress. *The revenue plan for 2017 includes higher revenues from environmental taxes, but the revenue potential of property taxes remains underutilised.*

5. Consider eliminating skill mismatch by increasing the professional relevance of the skills and qualifications provided by educational establishments to improve the long term productivity of the Latvian labour force.
   Limited progress. *Support for STEM disciplines has been increased. Of particular note is the decision made on 16 August 2016, which made 8.92 million euro available in 2017 and 11.16 million euro annually in both 2018 and 2019. Support for vocational education has been increased, and a recent publication*[27] *notes that the role of employers is being strengthened in legislation2. Support and funds for R&D have been increased, both in the academic and commercial sectors. Furthermore, the long-discussed teacher's salary reform was implemented. These efforts indicate that progress is being made on some of the issues identified in the 2015 Monitoring report.*

6. Consider addressing overall health system efficiency and sustainability by optimising the distribution of funding with the objective of improving population health status indicators and decreasing amenable mortality rates.
   No progress. *Additional funding has been granted to the Ministry of Health. Even though the funds will be used to improve population health indicators, it is unlikely that the measures will have a positive effect on the efficiency and sustainability of the health care system.*

[27] Daija, Z., Kinta, G. and Ramina, B. (2016) *Supporting teachers and trainers for successful reforms and quality of vocational education and training: mapping their professional development in the EU – Latvia*, available at: http://www.cedefop.europa.eu/en/publications-and-resources/country-reports/supporting-teachers-and-trainers-successful-reforms-an-12, accessed on 03/10/2016.

Assessment of the Declaration of Fiscal Risks

Recommendations

1. Accept the SFR approved by the Government, while reiterating the need for the fiscal security reserve and stressing the need to survey all possible sources of fiscal risk.

2. Include risks arising from the financial sector in the SFR since these have been significant in the past. Risks related to possible capital calls from the European Stability Mechanism and their future impact should also be carefully assessed.

   Limited progress. *Risks arising from the financial sector have been included in the SFR, but the analysis is incomplete.*

3. Improve the quality of risk assessment by collecting information pertaining to all fiscal risks and, if possible, quantify them in order to have a reliable estimate of their potential fiscal impact.
   See section on the Assessment of the Statement of Fiscal Risks.

4. Provide a more detailed description of how probabilities are assigned to particular risks to facilitate the review process for independent institutions.
   See section on the Assessment of the Statement of Fiscal Risks.

5. Ensure collection and exchange of information to improve risk management and develop procedures to prevent sudden impacts on the fiscal balance.
   See section on the Assessment of the Statement of Fiscal Risks.

2 Macroeconomic outlook and output gap

Recommendations

1. While the Council generally approves the MoF's macroeconomic forecast as a basis for drafting the state budget for 2016 and setting the budget framework for 2017/18, it strongly encourages the MoF
   a) to provide a more profound sensitivity analysis of the macroeconomic scenario;
   b) to develop, based on the sensitivity analysis, a back-up plan for the realistic case of budget revenues falling short of the estimates.

   No progress.

2. Regarding medium and long term development, structural reforms in order to boost potential GDP growth should be implemented, addressing the issues of a decreasing labour force, a rigid investment sector and the mismatch of the economically active population's skills and abilities with the labour market's requirements.
   No progress.

3 Assessment of compliance with numerical fiscal rules

Recommendations

1. The Council recommends to treat the allocation for the fiscal security reserve as an activity related to the determination of the numerical fiscal targets and to determine the expenditure ceilings starting from 2017 including the allocation for the fiscal security reserve.
   Recommendation taken. *the fiscal security reserve adopted together with the fiscal space decisions.*

2. The MoF should develop a procedure for ex post of the structural balance and correction mechanism, preferably in consultation with the Council.
   Limited progress. *The SFR covers ex post assessment of MTO execution, as well as the numerical fiscal rules are recalculated with the updated information provided by the MoF. There is still room for improvements regarding comparison of national and EC methodology of fiscal rules assessment and correction mechanisms.*

ANNEX 2. COUNCIL'S OPINION ON THE MINISTRY OF FINANCE'S MACROECONOMIC FORECAST (16 JUNE 2016)

This document presents the opinion of the Fiscal Discipline Council (hereafter - the Council) on the macroeconomic forecast prepared by the Ministry of Finance (hereafter – MoF) that will be used for drafting Latvia's medium term budget framework (hereafter – MTBF) 2017/19, which is scheduled to be submitted to the Saeima on 15 October 2016. An early review and endorsement of the MoF's macroeconomic projections by the Council has been agreed upon to support the efforts of the Government during the preparation of the annual Stability Programme and the MTBF.

According to the Memorandum of Understanding (hereafter – MoU), signed on 8 February 2016, the Council has a responsibility to endorse MoF's macroeconomic forecast. The Council assessed the forecast as a whole, and provides an endorsement of the key macroeconomic indicators, which are outlined below. During the endorsement process the Council was presented with detailed information on MoF's forecast, such as the gross domestic product (hereafter – GDP) structure and development scenarios of GDP components. The Council has consulted with external experts to gain an understanding of the current status and developments in the labour market as well as economy as a whole. The Council endorses the forecast for the indicators according to the scope of Article 20 of the Fiscal discipline law. The endorsed indicators are summarised in the Table 2 at the end of this document.

	2016	2017	2018	2019
Real GDP growth				
MoF	**2.5**	**3.5**	**3.4**	**3.4**
BoL	2.0	3.0	-	-
EC	2.8	3.1	-	-
IMF	2.5	3.6	3.8	3.8
Nominal GDP growth				
MoF	**2.8**	**5.3**	**5.7**	**6.1**
BoL	-	-	-	-
EC	-	-	-	-
IMF	3.0	5.2	5.8	5.9
Inflation				
MoF	**0.0**	**1.6**	**2.0**	**2.5**
BoL	-0.4	1.3	-	-
EC	0.2	2.0	-	-
IMF	0.2	1.7	2.0	2.0
GDP deflator				
MoF	**0.3**	**1.7**	**2.2**	**2.7**
BoL	-	-	-	-
EC	1.0	2.2	-	-
IMF	0.5	1.5	1.9	1.9
Output gap				
MoF	**-1.1**	**-0.3**	**0.2**	**0.7**
BoL	-	-	-	-
EC	1.8	1.8	-	-
IMF	-	-	-	-

Table 1 Key macroeconomic indicator forecasts by various institutions, % y-o-y. (MoF forecast from 8 June 2016; BoL forecast from 10 June 2016; EC forecast from May 2016; IMF forecast from May 2016). Data sources: MoF, BoL, EC, IMF.

The MoF macroeconomic forecasts are largely in line with those of the European Commission (hereafter – EC) and International Monetary Fund (hereafter – IMF), but more optimistic than the Bank of Latvia's (hereafter – BoL) forecast. (Table 1). The divergence of views between MoF and EC on the output gap persists: while EC sees Latvia's economy as currently performing slightly above its potential, MoF foresees a small negative output gap for 2016 and 2017.

Latvia continues to experience a general trend of downward revisions of the forecasts for both real and nominal GDP growth compared to the forecasts in the Stability Programme 2016/19 and MTBF 2016/18. It must be noted that the majority of the countries worldwide, including most of Latvia's main trading partners, experience a decline in forecasted economic growth. High uncertainty persists regarding both the current macroeconomic conditions and future growth prospects. EC expects moderate European economic growth to be still mainly supported by domestic demand, slightly balanced by increasingly active investment sector due to the expected pick up of the Investment Plan for Europe, however, economic growth is not expected to accelerate significantly in Europe as a whole[28].

The Council endorses the real GDP growth forecast for the horizon period. Compared to the previous forecast prepared for the Stability programme 2016/19, the real GDP growth rate has been reduced by 0.5 percentage points to 2.5% for 2016, but raised by 0.2 percentage points to 3.5% for 2017 and broadly unchanged for the other years of the horizon period, namely 2018 and 2019 at 3.4% annually (Chart 1).

Data for the first quarter of 2016 suggest that the economy is developing at a considerably slower pace than was expected at the beginning of 2016 when the previous macroeconomic projections were being developed by the MoF. The main reason for the sharp reduction is the protracted stagnation in the investment sector, explained by the delay in the inflow of EU funds into the economy, which strongly affects the construction sector, which experienced a 19% drop in the first quarter of 2016, compared to the first quarter of 2015. Similarly, slow-down in retail growth, decreasing wholesale turnover and cargo turnover in Latvia's ports contributed to slower GDP growth compared to the earlier forecasts.

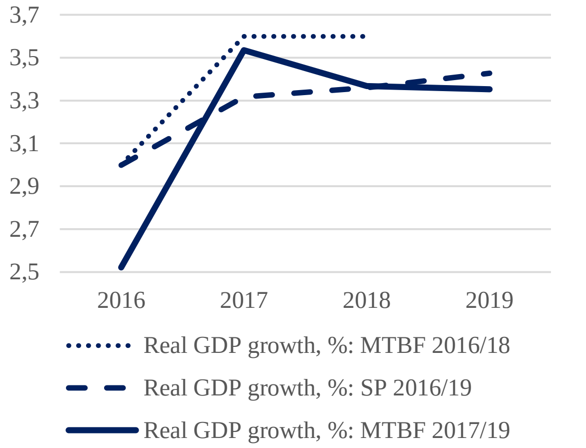


Chart 1 Forecast for real GDP growth, y-o-y. Data source: MoF.

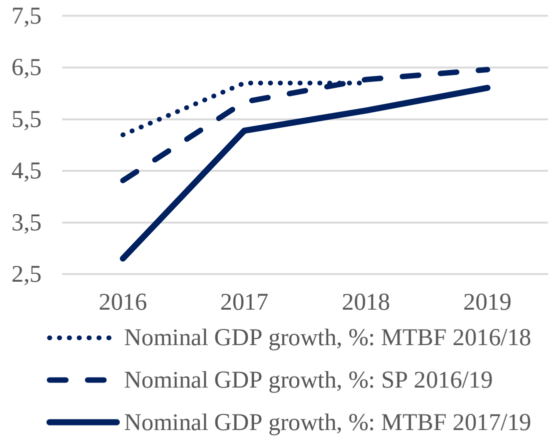


Chart 2 Forecast for nominal GDP growth, y-o-y. Data source: MoF.

One of the assumptions underlying the current real GDP growth forecast is related to the investment sector growing rapidly in 2017 due to the expected inflow of EU funds into the economy. The Council points at a risk of slower investment pickup than MoF projects, considering the historic trends, which show that most of the payments to contractors will take place towards the end of seven year planning period, which corresponds to 2018-2022 in the current period.

The Council considers the current real GDP growth forecast by MoF to be broadly realistic. High wage growth and still low energy prices provide for moderate real GDP growth.

The Council endorses the nominal GDP growth forecast for the horizon period. The MoF has lowered the nominal GDP growth forecast for the horizon period (Chart 2). The nominal GDP forecast for 2016 has experienced the sharpest decline by 1.5 percentage points down to 2.8%; for the other years the decline being 0.5, 0.6 and 0.3 percentage points respectively compared to the Stability Programme 2016/19. Real GDP growth being revised downwards just slightly, the downward revision of nominal GDP forecast decline is mainly related to considerable downward revisions of inflation and GDP deflator forecasts.

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[28] European Economic Forecast. Spring 2016. Available: *http://ec.europa.eu/economy_finance/publications/eeip/pdf/ip025_en.pdf*. Last assessed on 9 June 2016.

The Council endorses the change in consumer price index (hereafter – CPI) (inflation) forecast for the horizon period. The Council supports the downward revision in the inflation forecast from 0.4% in the Stability Programme 2016/19 to 0.0% currently for 2016, from 2.0% to 1.6% for 2017 and from 2.5% to 2.0% for 2018 (Chart 3). The forecast for 2017 and 2018 is slightly higher than what the European Central Bank projects for Europe as a whole (1.3% for 2017 and 1.6% for 2018)[29], which can be explained by ongoing price convergence.

The Council endorses the GDP deflator forecast for the horizon period. The Council notes the GDP deflator revision for 2016 to more realistic levels compared to earlier MoF's forecasts, namely, from 1.3% to 0.3% in 2016, and from 2.4% to 1.7% for 2017 (Chart 4). This has been caused by the reduction of forecasted changes in price levels for all GDP components – reduced forecasts for both private and public consumption deflators, as well as switching the deflators for gross capital formation and exports from positive to negative numbers, which is partly off-set by a negative projected imports deflator.

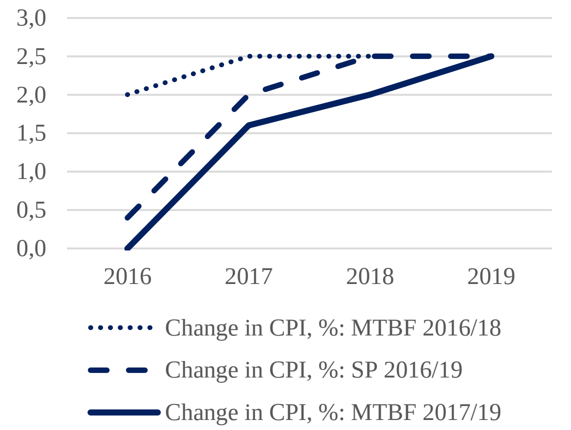

Chart 3 Forecast for inflation, y-o-y. Data source: MoF.

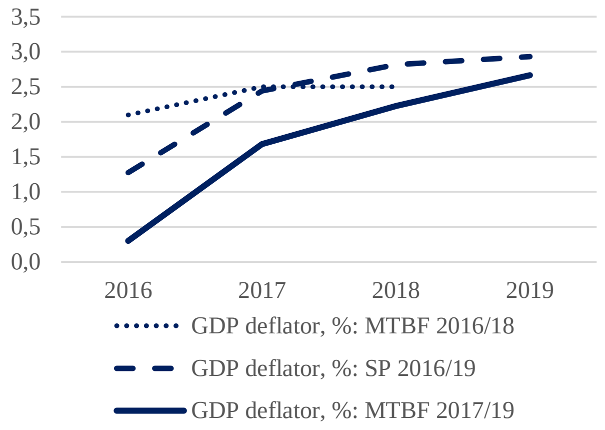

Chart 4 Forecast for GDP deflator, y-o-y. Data source: MoF.

The Council endorses the potential GDP growth and output gap forecast for the horizon period. The Council notes that the MoF's forecasts of the potential GDP growth result into increasingly negative output gaps for 2016 and 2017 and less positive output gaps for 2018 and 2019 than forecasted previously (Charts 5 and 6).

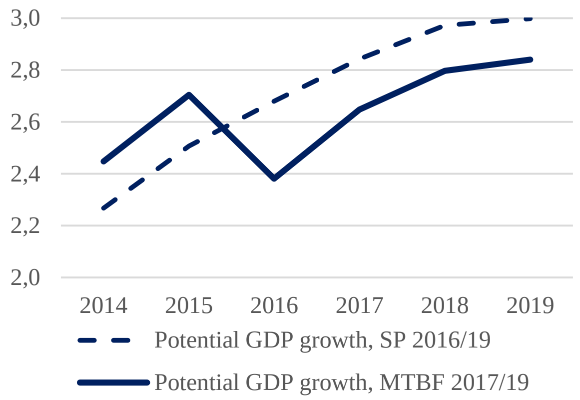

Chart 5 Potential GDP growth, %, y-o-y. Data source: MoF.

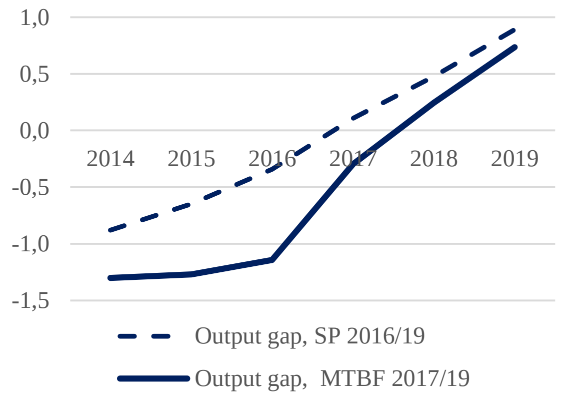

Chart 6 Output gap, % of potential GDP. Data source: MoF.

[29] European Central Bank. June 2016 Eurosystem staff macroeconomic projections for the euro area. June 2016. Available: *https://www.ecb.europa.eu/pub/pdf/other/eurosystemstaffprojections201606.lv.pdf?b5b8e2d20d82a0ff9ec84aef99e767c4* Last assessed on 9 June 2016.

The Council notes MoF's explanation that the 0.3 percentage point reduction in the potential GDP growth for 2016 is related to the persistent idleness in the investment sector. According to the production function, this translates into lower potential capital level than previously estimated. The reduced forecast for potential GDP growth for the other years by 0.2 percentage points annually is explained by the base effect of the downward revision of potential GDP growth for 2016.

	2016	2017	2018	2019
Real GDP growth	**2.5**	**3.5**	**3.4**	**3.4**
Nominal GDP growth	**2.8**	**5.3**	**5.7**	**6.1**
Inflation	**0.0**	**1.6**	**2.0**	**2.5**
GDP deflator	**0.3**	**1.7**	**2.2**	**2.7**
Potential GDP growth	**2.4**	**2.6**	**2.8**	**2.8**
Output gap	**-1.1**	**-0.3**	**0.2**	**0.7**

Table 2 Macroeconomic forecast indicators endorsed by the Council.

ANNEX 3. SURVEY ON TAX MORALE

The government of Latvia has declared[30] that it plans to increase Latvia's tax-to-GDP ratio by 2020, primarily by limiting the shadow economy. While the government of Latvia has previously expressed an intention to increase the tax-to-GDP ratio to 1/3, the current government has declared that it plans to reach this tax-to-GDP ratio by 2020**.** To this end, the World Bank was commissioned to do a review of the current tax system, which could assist the government in developing a new approach to tax policy. However, the government's plan to increase tax revenues will primarily be directed at limiting the shadow economy and improving tax collection.

Both local[31] and international[32] studies have indicated that Latvia has a considerable shadow economy, which significantly impacts tax revenues. The estimates vary, but the consensus is that economic activities taking place outside the formal economy account for a comparatively large part of Latvia's GDP. This has a serious impact on tax revenues, as a significant portion of income in Latvia goes untaxed. This further compounds the fact that Latvia's tax revenues compare unfavourably to those of other members states of the EU (see Section 1).

In addition to changes in tax administration, revenues may be increased by gaining a better understanding of why people avoid paying taxes. Adjustments to the operation of revenue bodies and the development of effective enforcement and deterrence strategies are of great importance. However, addressing the causes of why people participate in the shadow economy also requires insight into compliance behaviour and the reasons for non-compliance and tax evasion.

Taxpayer behaviour should be understood as a result of his/her personal norms and the social and economic environment in which he/she operates[33]. Recent research on tax evasion and compliance with tax law has given considerable attention to social and psychological factors, and the role that norms and questions of justice and fairness play in determining compliance behaviour. It has been argued that deterrence and punitive measures play a role when norms and convictions fail. Research suggests that there is a need to study the motivation of taxpayers from a perspective that is attuned to the social and economic context, and does not see people's choices as solely being determined by the desire to maximise pay-off.

Tax morale can broadly be defined as the intrinsic motivation to pay taxes and provides a way of explaining tax evasion. The social and psychological aspects of tax evasion have begun to attract the attention of academics and policy analysts, and the prominence of tax morale has increased. Even though its effect is difficult to quantify, the role of norms and personal convictions provides a potential way of explaining the variation between the levels of compliance with tax laws in different countries.

Tax morale is influenced by trust in state institutions and the tax system, **and overall financial satisfaction[34].** Studies have identified that tax morale is influenced by various factors, such as education, employment status and marital status. However, trust in the government and the revenue collecting body play a crucial role in determining whether individuals will decide to comply with tax laws. What is more, higher financial satisfaction is associated with higher tax morale.

The Fiscal Discipline Council commissioned a survey on tax morale in Latvia. The survey was conducted in April 2016, and the sample consisted of 1029 respondents. 53% of respondents were female, and 47% were male.

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[30] http://www.pkc.gov.lv/vald%C4%ABbas-priorit%C4%81tes-2014

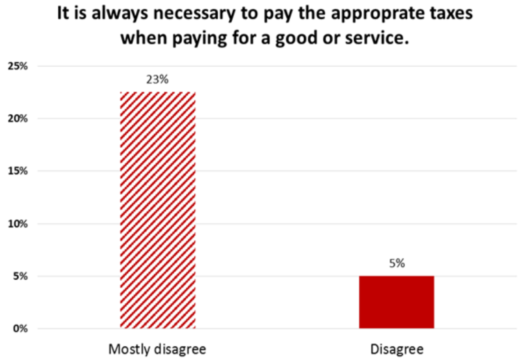
[31] http://www.sseriga.edu/en/centres/csb/shadow-economy-index-for-baltic-countires-2009-1015/

[32] Schneider, F (2015) *Size and Development of the Shadow Economy of 31 European and 5 other OECD Countries from 2003 to 2015*: *Different Developments*, available at: http://www.econ.jku.at/members/Schneider/files/publications/2015/ShadEcEurope31.pdf,accessed on: 03/10/2016.

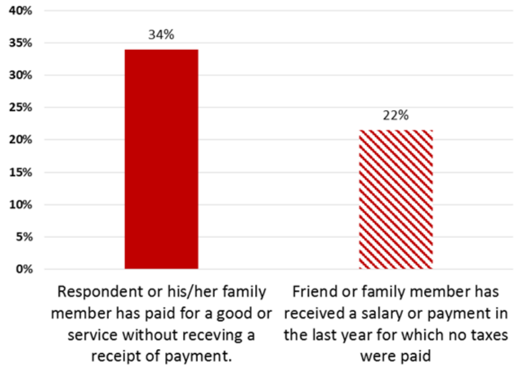
[33] OECD (2010) *Understanding and Influencing Taxpayers' Compliance Behaviour*, available at: https://www.oecd.org/tax/administration/46274793.pdf, accessed on 03/10/2016.

[34] Torgler, B. (2007) *Tax Compliance and Tax Morale*, Cheltenham: Edward Elgar Publishing.

The results of the survey suggest that Latvia's inhabitants are lenient towards not paying taxes. The results of the survey commissioned by the Fiscal Discipline Council indicated that the majority of Latvia's population thinks that tax evasion is not justifiable, but a considerable part of Latvia's society is lenient towards tax evasion, does not think that paying taxes is mandatory and has experience of tax evasion.

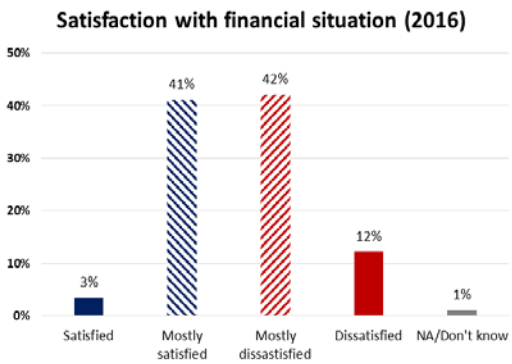


A3.1 *Source: Council survey*

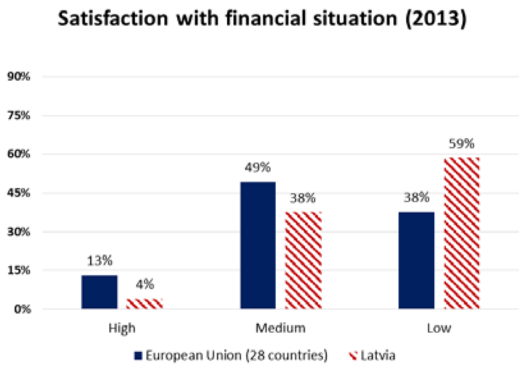


A3.2 *Source: Council survey*

The survey shows that people's satisfaction with their financial situation is low. Eurostat data from 2013 indicate that satisfaction with one's financial situation in Latvia is below the EU average. The results of the Council's survey confirm this, as the average level of financial satisfaction is comparable to data from 2013.

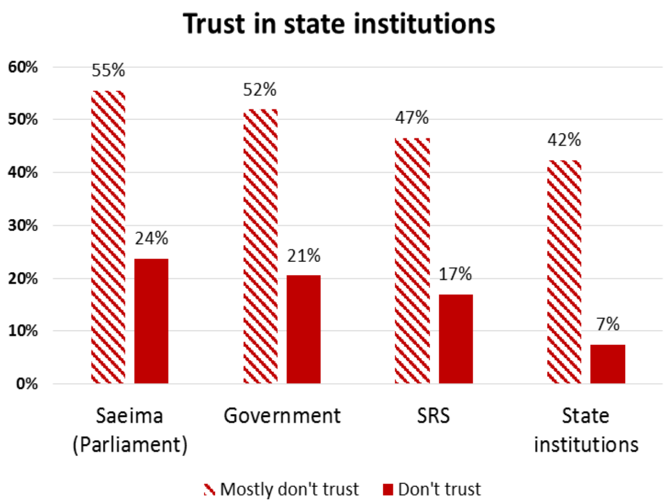


A3.3 *Source: Council survey*

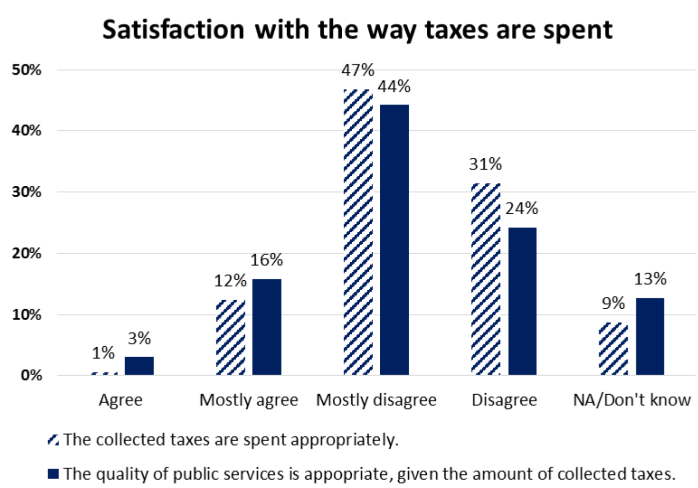


A3.4 *Source: Eurostat*

The results of the survey indicate that people in Latvia have low trust in state institutions, and trust in the State Revenue Service (SRS) is below average. The results show that people's trust in the parliament, the government and the State Revenue Service is low. Even though trust in the tax collecting agency was higher than the parliament or government, the State Revenue Service score was lower than the score for state institutions in general.



A3.5 *Source: Council survey*

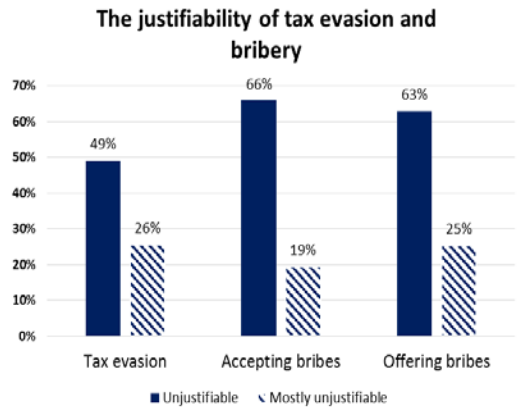


A3.6 Source: Council survey

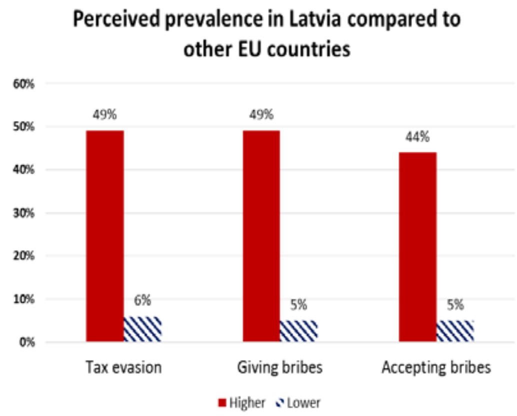
The population of Latvia is critical of the way tax revenues are spent and the quality of public services, even though paying taxes is believed to be a duty. The results of the survey show that people think that the Latvian government does not use tax revenues appropriately. Furthermore, the quality of public services is deemed unsatisfactory (infrastructure and health care in particular) and inadequate, given how much revenue the government collects. Nonetheless, the vast majority believe that paying taxes is a duty.

The tax system in Latvia is believed to be unfair. Whether or not citizens perceive the distribution of income and exchange of taxes for public services to be fair influences their willingness to pay taxes. Our survey shows that 74% of all respondents believe that the tax system in Latvia is not fair.

People are dismissive of tax evasion and corruption, but believe that these are widespread in Latvia. The survey shows that the majority of respondents believe that giving and accepting bribes and evading taxes are not justifiable acts. However, a large part of respondents believe that such practices are much more widespread in Latvia than they are on average in the EU.



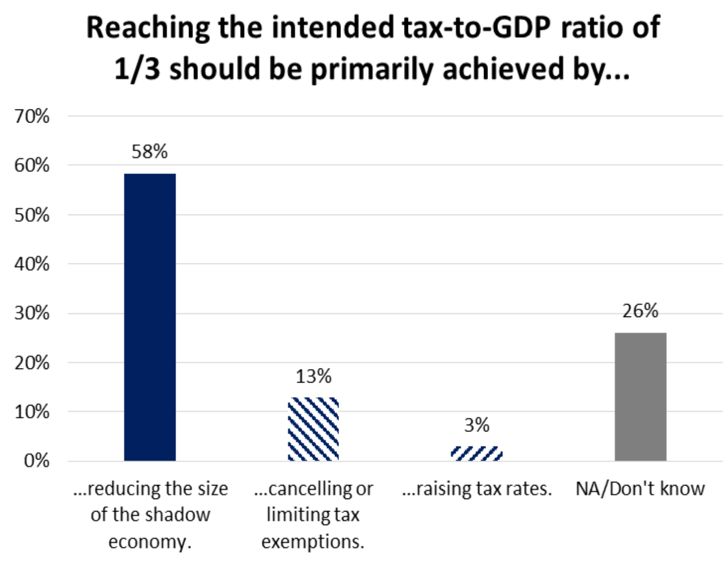
A3.7 Source: Council survey



A3.8 Source: Council survey

The majority thinks that the state should provide more services, but this preference is offset by an unwillingness to pay higher taxes. The majority of respondents agreed or mostly that the state should take greater care that everyone is provided for (64%) and fund health care to a greater extent (81). This would suggest a preference for a welfare state. Nonetheless, the results of another recent survey[35] show that the preference for state-funded services decreases once it is made explicit that increasing the range of public services would mean higher taxes.

[35] *Baltic International Bank Latvijas Barometrs*, June 2016, available at: http://www.bib.eu/wrapper/fileviewcounter?rid=1869, accessed on 03/10/2016.



A3.9 Source: Council survey

The majority thinks that tax revenues should be increased by reducing the size of the shadow economy. When presented with different alternatives to raising government revenues, 58% of respondents said that this should be done by limiting tax evasion. This would be preferable to raising tax rates or reviewing tax breaks.

In conclusion, the survey shows that Latvia performs poorly on questions that can be used as proxies for tax morale. While many think that tax evasion is unjustifiable and tax revenues should be increased by reducing the shadow economy, a significant part of Latvia's society is tolerant towards tax evasion and has experience of tax evasion. What is more, questions concerning financial satisfaction, trust in state institutions, the quality of public services, the prevalence of corruption and tax evasion, and perceptions of the tax system indicate widespread dissatisfaction and mistrust.

The Council suggests strengthening tax morale as a way of improving compliance with tax law. This can be achieved by building trust in the tax system and State Revenue Service. Furthermore, by strengthening and clarifying the link between the amount of taxes paid and the quality and scope of public services, faith in the fairness of the fiscal exchange may be increased.

ANNEX 4. SURVEY ON BUDGET DISCIPLINE

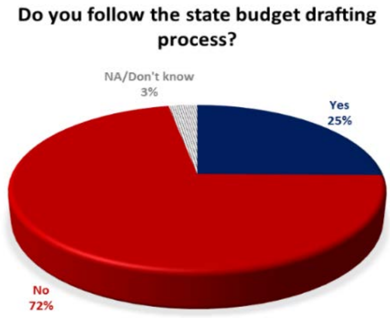
IMF[36] and OECD[37] contend that independent fiscal institutions (IFIs) should foster public discussions and improve the public's understanding of issues pertaining to fiscal policy. Due to the fact that such institutions do not possess specific legally defined tools for influencing fiscal policy, one of the ways in which IFIs can encourage fiscal discipline is the quality of public discussions. This would allow voters to assess whether budgetary outcomes are the result of luck or competent policy-making.

Fiscal policy is characterised by a significant informational asymmetry, which can be rectified by IFI activities. Due to the complexity and technical nature of the information, the public and government employees have disparate levels of knowledge regarding fiscal policy. The public often has an incomplete understanding of the flow of public finances, and the costs of certain services and decisions. In these circumstances it is easy to under- or overestimate the costs and long-term burden of a policy proposal (e.g. tax break) on budget expenditures. By improving the public's understanding and encouraging transparency in public finance IFIs increase the voters' ability to critically evaluate the consequences of political parties' policies.

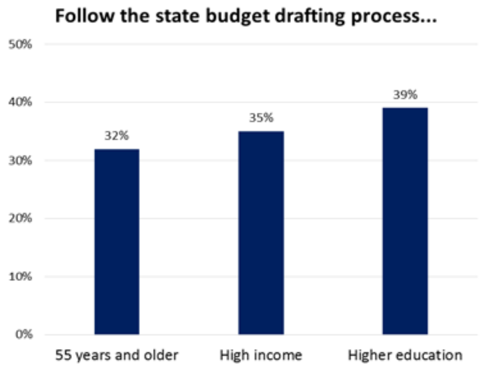
The results of several studies indicate that the public's knowledge of political processes and questions pertaining to governance is incomplete[38]. Studies conducted in USA and Europe show that people have mediocre or poor knowledge on political and economic matters. In the case of USA it has been established that knowledge has not significantly improved over the course of the 20th century. This means that improved access to education, the quality and activity of mass media, the availability of information online and the attempts of the government to be more transparent have not improved the results of surveys assessing people's knowledge on political and economic matters.

Rational ignorance is often invoked to explain people's lack of knowledge. Since the middle of the 20th century it has become common to maintain that people make a rational decision not to educate themselves on certain topics, because this knowledge has high costs. With regard to benefits, the situation is less clear. People's desire to competently participate in the democratic process can be regarded as a benefit, but for many this does not outweigh the required investments.

A survey was conducted in April 2016 to ascertain the views and understanding of Latvia's society on fiscal policy and budget discipline. The survey was conducted in cooperation with the social research centre SKDS. A total of 1005 people were surveyed.



A4.1 Source: Council survey



A4.2 Source: Council survey

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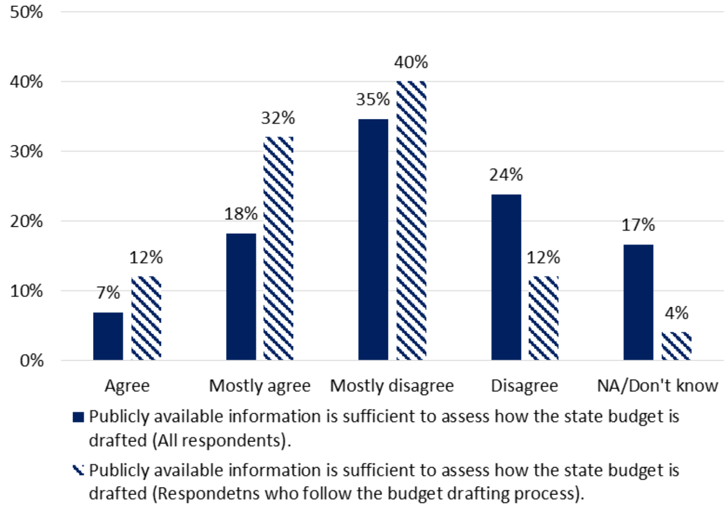
[36] Debrun, X., Kinda, T., Curristine, T., Eyraud, L., Harris, J. and Seiwald J. (2013) *The Functions and Impact of Fiscal Councils*, available at: http://www.imf.org/external/np/pp/eng/2013/071613.pdf, accessed on: 03/03/2016.

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

[38] Somin, I. (2013) *Democracy and Political Ignorance*: *Why Smaller Government is Smarter*, Stanford: Stanford University Press.

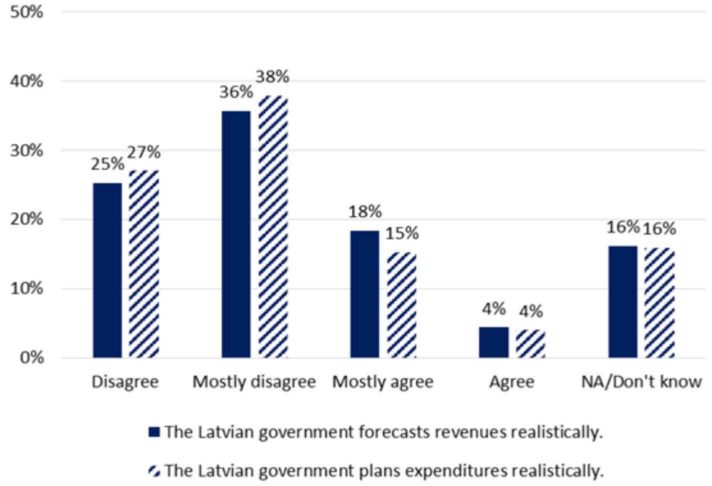
Approximately a quarter of the population follow the budget drafting process. The results of the survey show that 25% of respondents follow how the state budget is drafted (A4.1), mainly relying upon information available on the internet and television. Interest increases with the respondent's level of education, age and income level (A4.2).

Publicly available information is believed to be insufficient, but the assessment of respondents who are interested in the budget drafting process is more positive. People mostly disagree that the available information is sufficient to assess how the budget is drafted. It should be noted that people, who claimed that they follow the budget drafting process, were more positive in their assessment of the available information.



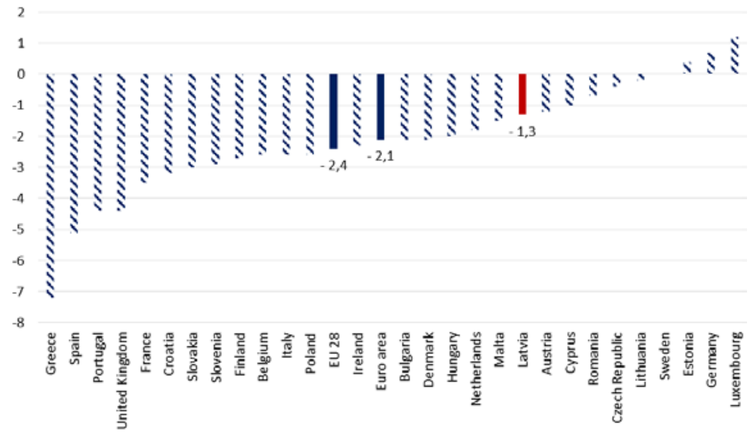
A4.3 Source: Council survey

It is believed that revenues and expenditures are not planned realistically, even though revenue forecasts are consistently fulfilled. People mostly disagree that expenditures are planned realistically and revenue forecasts are realistic. In the case of revenues, public perception differs from State Revenue Service summaries (see Section 1), which show that revenue forecasts are consistently met.



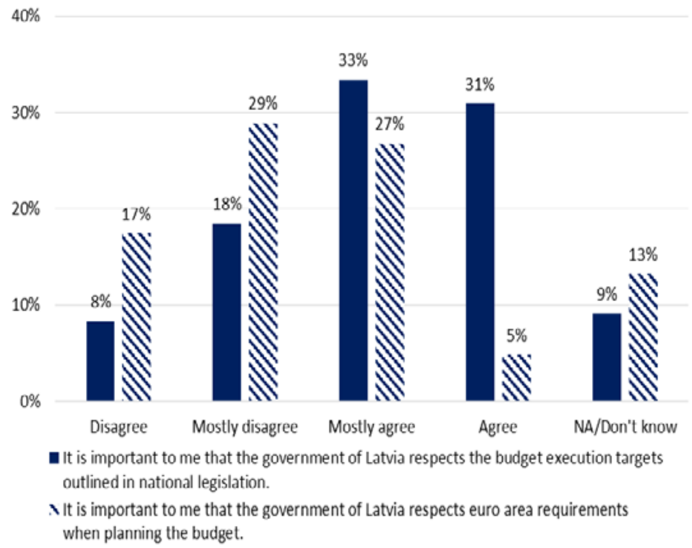
A4.4 Source: Council survey

Respondents believe that Latvia is worse than other euro area states at meeting budgetary requirements, even though official statistics show that Latvia's results are among the best. Euro area countries have to observe certain requirements, such as expenditure ceilings and permissible budget deficit levels, when drafting their budgets. The survey asked how Latvia's government compared to other euro area states with regard to respecting these requirements. According to the respondents, Latvia's results are similar (42%) or worse (30%), and only 18% thought that Latvia's performance is better. This opinion differs from official information, which shows that Latvia's performance is above the euro area average.



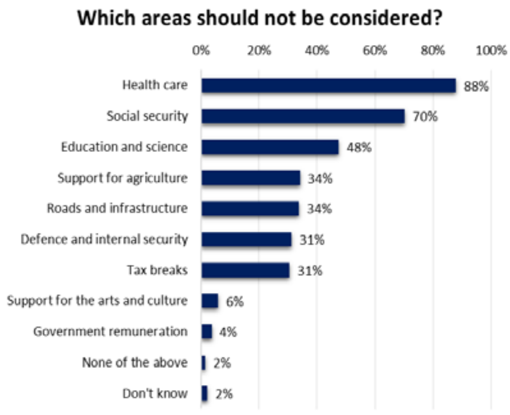
A4.5 General government budget balance in 2015 (% of GDP)
Source: Eurostat

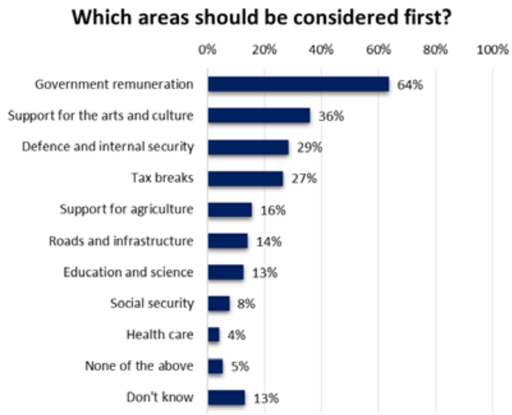
Targets defined in national legislation are more important to respondents than respecting euro area requirements. The survey contained two questions on respecting execution targets defined in national legislation and respecting euro area requirements when drafting the budget. The results indicate that the former is more important to Latvia's society.



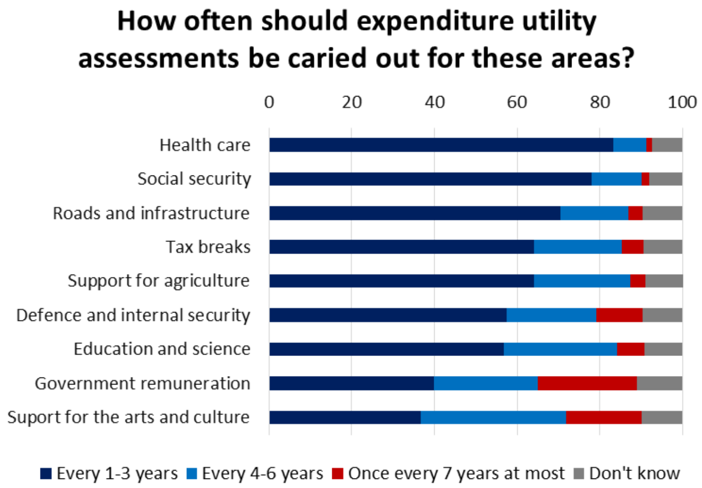
A4.6 Source: Council survey

It is believed that government remuneration should be decreased if expenditures have to be cut, but funding allocated for health care and social security should not be reduced. Respondents were offered a list of areas from which they could choose those where funding could be decreased in case of such a need - and other areas where it should not be decreased. 64% believed that remuneration of government employees could be reduced. Support for the arts and culture was in second place with 36%. Funding for health care (88%) and social security (70%) should not be decreased.





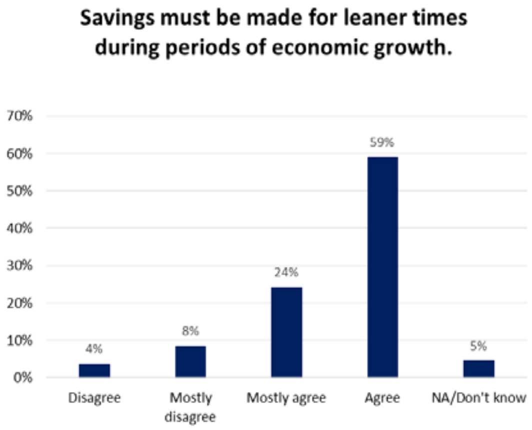
A4.7 Source: Council survey



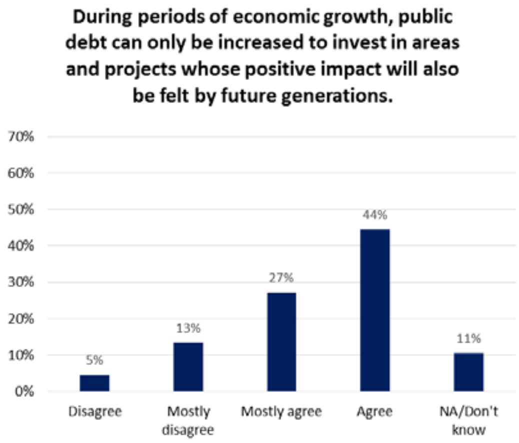
A4.8 Source: Council survey

In general, the opinion is that expenditure utility should be reviewed once every 1-3 years. The opinion regarding the frequency of expenditure reviews differed according to the area in question. With the exception of remuneration of government employees and support for the arts and culture, at least 57% of respondents believed that expenditure reviews should be carried out once every 1-3 years. 83% believed that expenditure on health care should be reviewed this often, but only 37% believed that expenditure on the arts and culture should be reviewed with the same frequency.

Respondents agree with the principles of counter-cyclical fiscal policy. 81% of respondents agreed or mostly agreed that expenditure plans should be based on revenue possibilities. Crucially, the survey also asked questions regarding building savings and increasing public debt in times of growth. In both cases the vast majority (84% and 71% respectively) responded that they agree or mostly agree with a course of action that corresponds with the principles of countercyclical fiscal policy.



A4.9 Source: Council survey



A4.10 Source: Council survey

The connection between the budget deficit and public debt is unclear. The survey contained a question whose purpose was to ascertain whether people were aware of the link between the budget deficit and the increase of public debt. Two almost identical options were provided, but 16% believed that one of the options was worse and 32% could not answer the question.

The results of the survey show that people want a cautious and responsible approach to the budget, but the responses indicate pessimism and insufficient knowledge. The respondents' answers indicate that Latvia's inhabitants approve of balancing expenditures with revenue possibilities, a responsible approach to the increase of public debt and saving during times of economic growth. This means that countercyclical fiscal policy and a disciplined approach to drafting the budget are seen as desirable when thinking of government finance. However, questions regarding Latvia's results indicate pessimism and insufficient knowledge regarding government finance.

The lack of knowledge and indifference should be approached from the perspective of civic rationality. An educated and informed electorate is a kind of public good, which contributes to responsible policy and the election of competent representatives, whose actions correspond with the interests of voters. The rational ignorance approach needs to be complemented with a perspective of civic rationality, which emphasises the public good and a critical engagement between the public and its representatives.

The Council suggests developing and improving upon measures of public education to ensure that members of the public have an appropriate understanding of the budget drafting process and considerations that have to be taken into account when implementing reforms and thinking of the sustainability of government finance.

Annex 5. Ernst&Young consultations

PROTOCOL[39]

Consultation on fiscal risk assessment

Participants of consultation: Jānis Platais (Fiscal discipline council (FDC), Latvia), Dace Kalsone (FDC, Latvia), Andžs Ūbelis (FDC, Latvia), Daniel R. Mullins (EY, USA), Renāte Strazdiņa (EY, Latvia), Zane Zilberga (EY, Latvia)

Dates of the consultations: 31.03.2016. and 11.05.2016.

1. **Overall Risk Management assessment of fiscal risks declaration attached to the medium-term budget framework law year 2015-2017 and 2016-2018** (Novērtēt vispārējo risku vadību Fiskālo risku deklarācijās, kuras pievienotas vidēja termiņa budžeta ietvara likumiem 2015.-2017.gadiem un 2016.-2018.gadiem)
3. **Capital sector related selection of the quantifiable fiscal risk indicators of state and municipalities** (Ar valsts un pašvaldību kapitālsabiedrību sektoru saistīto kvantificējamo fiskālo risku rādītāju atlase)

One of the most important elements in fiscal risks mitigation is intervention policy or practice. For example if county is moving in the budget year/circle to what risks are identified and then come to the actual numbers need for additional spending and reduction in revenues.

Regarding risks IMF and World Bank often measure the promoted fiscal transparency that is vehicle for mitigating risks. Not necessarily to quantify and precisely identify what the scale of the risk is, but to identify the fact that this may be the risk factor to open the policy debate. To measure the transparency information on the flows have to be available and often it is the best that can be achieved. Quantification of all risks may not be feasible and open acknowledgement (with some understanding of possible magnitude and probability of occurrence, high, medium, low) and discussion may be a very useful approach. Particularly if there is a requirement that a risk statement have to be approved.

For a general perspective one of the most important vehicles for the risk mitigation is agri risk forecast. Revenue and expenditure forecast need agri in order to be able to deal with risk. The next most important vehicle would be transparency with respect to how the budget execution stays within the scope of the year and after year closing. General tendency is to provide transparency in agreements between government and public/private partnership, as well as clear understanding on implicit and explicit guarantees which are provided by government on political perspective. It’s easier to provide the guarantee in future perspective than in actual spending. These guarantees which produce liabilities are growing, because of the political ease in doing so they create no direct real “pain” in involvement, but they produce future “pain”. Suggested is that the risk assessment and the processes for risk mitigation is shared between the agencies, spending units of the government and financial government institutions.

Probabilities have to be calculated to predict and act in case if risk materializes as well as resources necessary to recover from the effect. One way is keep contingency reserves.

[39] The protocol contains summary of the consultations that occurred during the project. Summary is based on the original consultations video (files attached in CD attached) and do not contain all the details discussed and recorded in video.

Normally those funds lapse in the end of the year because of the impropriations in the process.

In order to assure that the highest priority services can be met, common practice for state institutions is to spend conservatively in first to third quarter (mostly in later quarters and depends on the time period covered in the commitment) of the year and to push anything that is capital spending and funding to the operating budget in third to fourth quarter. Additional funds are used to meet the ongoing, institutional, operating maintenance services and other services that could be concerned as more discretionary spending. One of the interesting implications is that people have looked at the spending patterns of the agencies and discovered they spend more in the fourth quarter than any other quarter of the year. The agencies have to make this kind of risk mitigation claiming acceptable, because often people see it as irresponsible way of spending budget.

Allocation of responsibilities in case of materialized risk instead of formal risk assessment is opposite for risk management, that is responding to the risk that is already developed and emerged as oppose to savaging the strategy which is forward looking in anticipation to those risks.

In any situation when there is price regulation potential of corporations for additional risks appearing to enter the system, there have to be interference in ability to set prices which is at least at costs recovery and then normal economic returns.

Normal utility which is in a space of monopoly doesn't generally purpose much in the way of risks if the regulators are responsible for setting the tariff at the normal economic return to the entity that could be significantly discounted of the list. Regarding other risks associated in the local level infrastructure risks are not significant in the form of debt, but significant in the form of maintenance capital deterioration, capital stock deterioration.

Experience in other countries

USA experience:

For long period of time in USA local governments and states are essentially autonomous and independent of national government, they have their own budget systems and budget structure and national government has limited abilities to tell them what actions they should take and how to split the budget. State governments have their own constitutions which often also grant home rule to local jurisdictions allowing state's and local jurisdictions finance beyond expenditures and issue debt to finance capital projects.

One of the distinctions regarding local government is between operating expenditures and capital:

- operating expenditures has to be near balance;
- capital is entering debt market or finance capital projects - stays in local level to balance operating budgets.

Tendency is:

1) to assume a potential imbalance in any given year;
2) to budget what's after to refer to as a continuous;
3) to reserve which is essentially a fund balance that is carried over from year to year in a state and local government.

The states and local governments tend to carry positive balance any given year, which are used as a physical cushion in order to create stabilising resources.

The rule of thumb is that USA national and local governments previously have never really considered the specific implications of one form of potential liability versus another form. They are looking at the degree in which they have essentially set a target of 5%, 5% is included in the operating budget continues reserve and holds there. But with the physical downturn form the financial crisis it became obvious that 5% isn't sufficient. Therefore the government finance association in USA have recommended two month (~16%) as reserve, although for one jurisdiction 16% is much different than to another.

National perspective in USA is to ignore it entirely, because of the ability to enter the debt market and to issue additional debt. Recently government accountability office of national government undertake the risk assessments in order to determine what the most likely risk policy and program activity is. And these risk assessments are most likely used to inform future budget standings, but the critical process stands to significant impact in the actual risk mitigation assessments, they provide the information on transparency, but not clear how it actually impact expenditure on revenue client.
Recently USA states and local governments has been analysing the fluctual relations of the revenue and expenditure profile over time and executed equivalent to gap analysis. And have been individually now setting continues reserves which are consistent with the expected future fluctuation in 10 or 15 year shock.

One way how to look at the fiscal risks, risk assessment and risk mitigation is on the standing side. For example there are few jurisdictions in USA who are using a formal risk assessment of the implications of responding to fiscal risks. Presumption is that there are numerous ways to respond to generate more revenue and what are the economic consequences. You can issue the debt or cut spending. USA identifies a matrix setting which include:

- feasibility of the easiness at which the policy can be introduced;
- consequences of the introduction to the achievement of the government objectives.

Their risk mitigation strategy is an attempt to reduce spending in context in the areas which make the least negative consequences for the population.

Even though USA doesn't have a formal risk assessment in contentious place in budget, if you have contractual relationships which are likely to produce contingent liabilities, it must be appropriated in the budget to the degree to which there is expectation that particular liability is going to become due, while it doesn't have a process for mitigating risks as whole. As more of a micro process for mitigating risks by forcing agencies to actually budget out of their recourses an amount which is equivalent to the expected value to that risk.

In USA and Canada, jurisdictions can often choose to go to capital markets themselves or enter into bond market relationship with the state, and the state will issue which then can be pulled across all subnational jurisdictions and they will each pay their share of debt obligations.

During global recession, there were many states in USA that were under fairly significant distress. National government was bailing out banks, suffering the consequences of the economic conditions which created the need to bail out the banks and bank bailout was by the national government to the degree that it existed. But other jurisdictions were feeling distress very strongly, because of economic consequences.

Other country experience:

Australia and New Zealand are taking the formal process for the mitigation of risk. And New Zealand identifies as scheduled the status of the risk across the number of problematic areas on annual basis and then tries to determine if these risks are changed or unchanged over time for the preceding year. If they are changed and expectations are they will change, then they are doing analysis of what the potential impact is.
New Zealand, Australia, UK, Brazil and Sweden have risk assessment process, but there are significantly different elements than in USA.

Sweden and Australians has system which is similar to USA micro system described previously. It requires that when a liability is incurred that beneficiary of that liability pay some fee to the government which is consistent with the presumed risk at the time of entering into the agreement. Under those conditions it forces the actual beneficiary and agency to consider the potential cause. Have to be careful with this system because it also generates the revenue stream and it can be thought to go to a contingency reserve fund that cannot be touched by any kind of other actions.

New Zealand and Australia has the risks on their Ministry of Finance (MF) website. Some of them are much less engaged in contingent, they are more focused on direct liabilities. New Zealand is defining:

- labour market risks;
- specific elements of their revenue system;
- identify expectation of risks;
- expenditure risks;
- operating budget initiatives;
- housing and social involvement;
- science and innovations;
- etc.

They go through all the different departmental areas and identify the risks. And it is all supported by very detailed information from the individual programs. They are able to produce the contentious asset estimate for all of their contentious liabilities. It comes as part of the budgeting process. Swedish budget system goes through to identify the actual cause and assign them to the ministries and agencies.

New Zealand started preparing fiscal risk assessment 8 years ago, Australia - 9, UK – 7. Fiscally independent councils have been looking at forecast of revenues for longer period of time, earliest in Netherlands right after the war in 1945 But transition to formulate and trying to integrate the fiscal risks assessment in the budget is something that is not as nearly as wide spread. But it has been done and it’s been in a way which is aligned with medium term economic and expenditure framework in a way which is very supportive to the ability to plan.

Experience of Latvia:

FDC: Describes the situation of Latvia in EU, practice and challenges in Latvian retirement’s system and public health care system, as well as state guarantee issuing situation in the field of transportation, metallurgy etc.

FDC: A loan guaranteed for the major iron company here turned out sour at the early stage, while the risks assumed at the moment when the guarantee was issued were viewed as not very high. So certainly treasury protected themselves at the moment when issued guarantee, they assume that there are certain probabilities at this to go bad. Minister verified and signed the guarantee knowing that this was politically imposed. But later when everybody look back at this case it was not appropriate.

FDC: There is no specific contingent liability fund associated if those loan guarantees are present. It is more responsibilities allocation and this is responsibility for MF to budget for these things whenever they are not appropriate.

EY: There have to be clear demarcation who is responsible on what kind of risks of entities, so that the private sector partners experience the consequences of the failure to perform in the manner in which directly affects their economic well been. And at the same time the state has to have the protection for the social implications for the need of air travel and aircraft. This is really difficult aspect of risk mitigation to put finger on as when you have public-private partnership in which private entity is in such a critical role that they can't be subject to normal market conditions of failure.

FDC: At the moment Latvian government owns telecom companies and almost 80% of airline and not in a hurry to divest these assets. Most of the population supports the idea that government is controlling these companies including utilities, which are not operating poorly and are reasonably good market producers. In case of iron company in the beginning of the problems only relationship with government was the guarantee, but the airline was owned by Latvia (51%) at the beginning.

EY: The rational way of approaching this is:

1) to identify the inventory of risks (risks faced by government, contingent, direct, indirect risks etc.);
2) then rationally identify the economic value of these risks. That can include pension system risks, social safety risks which are associated with economic downturns and although those are often much broader, but certainly including risks associated with loan guarantees to private industry;
3) when there is the list, attempt to value the risks have to be separated from actual act of making the choice on whether or not to offer the support.

If it's major steal company or airline it's probably very difficult to separate evaluation process from the offer support. For example, if there is a program to support small business development and want to provide loan guarantee to small business enterprises that are making investments in equipment and you have potentially hundreds or more of enterprises, under that circumstances there is a risk that can be reasonably evaluated. There will be separated entities such as sub-parts of MF that would evaluate the actual economic consequences of the guarantee and expected revenue outflow. And then there should be a separate entity (for example, department of commerce) which would make a decision whether to offer this for. Also the private banking sector can be brought into the partnership. It can serve as a market test of the level of risk, assuming that the private bank assumes a share of risk proportionate to their investment and potential gain.

EY: That separation of evaluation from the decision to offer support means that there is at least some level of check on the process, therefore the entity that offers support should also have some budget for that expected outlay, so that guarantee demander do not recognise these as free resources that they can pursue the problematic objectives without consequences. That is mill type of experience, which is often difficult to handle for government, but it is far simpler than the concept of major airline or iron company, which makes a significant component to GDP of the nation. These issues impose both political and economic dimension in the same decision making structure.

FDC: In practice government didn't really look in matter of airline and iron company in detail. They just let it flow as part of price for passing the budget in that specific year (in case of iron company).
EY: As the expectation is that government will step in and support what otherwise would fail, if this is the concern and essentially a certainty, then risk mitigation becomes fairly large from macro perspective in any particular year. One suggestion would be to take the biggest employers and, assuming they are going down soon, prepare the risk assessment for all of them.

EY: Have to look at it in a sense of overall cycle or period in which the events have occurred and decide what to do at the similar events on similar cycle and similar magnitude of the proportion of GDP, what would that do to physical balance? If they were result of the past recession in global characteristics of that recession they most likely are periodic, the occurrence of that will be significant in the future, but that mean that should suggest evaluation process.

FDC: At the moment day to day risks are reasonably well covered and government is learning from the past mistakes. Compared with other countries here are relatively good fiscal rules related to operation to local government. Currently MF is not including explicit risks on the fiscal risk declaration.

EY: To the degree to which the actual benefits of industry are public, they serve the public purpose, then there should be an appropriate public sector risk sharing and that can be covered by the assets of the entity itself. Private risk has to be shouldered by effective management of the entity. However once there is management split (entity managed by private sector and supported by government) it is difficult to enforce that because of the incentives that exists and are somewhat problematic.

FDC: There are strong frameworks to manage risk assessments in the local government. They are independent with the budgetary decisions. Restrictions are related with solvency.

FDC: Local infrastructure is responsibility of local governments, but national government has to allocate EU convergence funds for local infrastructure/environment projects. Problem in this area is defined maintenance. Local government may easily exclude this from the budget telling we have other priorities, national government would say this is not their responsibility.

FDC: To guarantee state issued loan repayments from local governments, Treasury of Latvia has strict tools in their hand as it is responsible institution for sharing the tax revenues and risks have been reduced quite radically.

FDC: There is a general need for the improvement in procedures and the content to perform valuable risk assessment. The cabinet has passed the degree witch says that ministries has responsibility to come up with risk assessment, they have responsibility to communicate this to the MF, so that this would be included in the government statement and in the risk declaration. The problem is that government building safeguards in defining inconvenient risks therefore few banks goes down from time to time.

EY: To calculate the probabilities and assign resources is the way to recover faster in case of materialized risk. Just the way the recourses are spent it’s very difficult for the operating agencies to keep contingency reserves. Normally those funds lapse in the end of the year because of the impropriations in the process. Exception is EU budget that can be executed in seven years.

FDC: Local government have significant responsibility in setting prices of utility services and the price levels can be significantly different between municipalities. At the moment no information if regulator would impose much lower tariff because of social or other reasons at which the costs can’t be at the costs recovery level.
EY: In any situation when there is a price regulation potential, additional risks appear to enter the system, if there is interference in ability to set prices which is at least at costs recovery and then normal economic returns.

FDC: Currently nobody is specifically responsible for determining the probability of the risk occurring and fiscal consequences as well as there is a lack of competence and growing bureaucracy in field of risk in responsible institutions. MF concern is if they take the responsibility to prepare fiscal risk assessment in full scale, they won’t have time to do the everyday job and they are afraid to suggest minister extra calculation possibility as this other jobs won’t be done.

EY: This is an opportunity to MF to change the view. Have to explain the benefits of fiscal risk assessment in a manner how FM will understand it’s for their own good. Fiscal risk assessment has a potential to reduce their workload in another way, for example, if the ministries are taking the action to create future liabilities they are going to value those liabilities against other pursuits they are engaged in. Then will have to establish a method for prioritising and therefore split resources accordingly, some ministries will have to receive fewer resources and flexibility to work with, but form the government and MF perspective this being engaged by all ministries simultaneously would increase the flexibility of resource flow in their discretionary that will be possible to reallocated across the ministries by the MF.

FDC: There are many risks that are in field of MF itself, for example it is hard for them to fight risks in financial sector, because no one else will stand with them.

EY: There is a changing approach that can be used by MF which is to focus on issues that are less threatening to them or potentially corresponding to the MF mission. And then gradually move in to the financial sector of risks and quantifications when they feel the benefit. It has to be done in a way that segregates strategic objectives which allows making progress on those who are supportive from the perspective of MF; these are the ones that are more difficult. It takes multiyear timeframe, as this is a relatively new methodology in Latvia and it can’t be accomplished instantly.

FDC: At the moment there is at least risk assessment that include costs and it’s possible to agree on decent level of provisioning the risks and appropriate responsibilities. Problem for MF is that EU is overtaking the arrangements to assure the financial sector sustainability and as in this case the national level responsibility is minimised, therefore they do not want to take responsibility.
EY: In practice if there is a slightest probability then it should be calculated. To suggest that EU will be stabilization vehicle that’s useful position, but it doesn’t change the fact that risks are local and they have direct implications on revenue. And even if it is localised access to

funds of different source it doesn't change the fact that risk is there, the risk still exists. Still have to borrow and access funds externally. European stabilization mechanism has to intervene, but economy is still affected, meaning there is a reduction in local risk, but it still presents fiscal risks in the government itself.

FDC: MF has narrowed down actions related with fiscal risk assessment and generally is on quite narrow path. The discussion they are having is much broader than what is now defined in our current law. The challenge now is to improve the way how fiscal risk assessment is managed and how to make it more comprehensive and how to improve managing system.

EY: It is fairly complicated to manage full scale fiscal risk assessment at the moment, but most of these processes have started in relatively simple terms. They start by incremental process in sense of comprehensiveness and quality of the estimates. One step is that MF already has a risk matrix, that's incremental with respect to scope. Have to reach to use fiscal risk assessment continuously adding to that scope to enhance the quality of the estimates. Also someone has to take the ownership in making the estimates. The start of the fiscal risk assessment is good, have to continue improvement.

FDC: Department which is council closest counterpart in MF is fiscal policy department. They are supposed to be fully staffed for these tasks and are relatively small comparing to what you see in other countries and lacking experience in field of risks.

EY: If the physical department in the MF doesn't have a risk analysis unit itself dedicated to this they should face the difficulties in preparing the type of estimating needed to do. Other governments are dealing with this involving external audit entity that could be a vehicle to stimulate the development of the necessary capacity. FDC also suggests state auditors would agree to do it, but the problem is that for causing risks they can't take anybody into prosecution what is set as their KPI.

2. **Conformity assessment of the fiscal risk symmetric principle in the annual state budget and the medium-term budgetary framework preparation** (Fiskālo risku simetrijas principa lietojuma atbilstības izvērtēšana gadskārtējā valsts budžeta un vidēja termiņa budžeta ietvara sagatavošanā)

At the moment Latvian government face the challenges related with standing appropriation by other laws, but the major challenge is related with different implicit government liabilities which are coming from finance sector as well as there are other sectors where fiscal outflows are recognised. Government has an opinion that some of these risks could be symmetrical, which could be neglected in the fiscal framework (excluded out of impact assessment) because of good estimates, compensating these risks in time.

Symmetrical risks are assumed to be symmetrical over time and can be:

- Implicit liabilities that will have positives and negatives, which offset themselves over time;
- Offsets that occur simultaneously between different liabilities, where some liabilities will create positive budgetary impacts in this cycle as well as other liabilities creating negative liabilities.

In Latvia there are both cases.

Symmetrical risks are certainly not symmetrical in the economic downturn. They normally are symmetrical in terms till three years, but in order to understand the budget implications at any given time of the year have to be aware of them during the economic downturn as well.
Symmetrical risks are known and are associated with existing government relationship with entities not natural or other disasters. They are identifiable and should definitely be included in risk assessment.
If the government as well as state owned enterprises are publishing their budget on accrual basis, then normal liquidity issues, working capital issues, levels of equity would be normal measures to use for the public sector assessment to understand the risks and moreover to understand the pattern over time. Trends for the public entities are probably more important than actual number.
Symmetry should be annual symmetry. It can be symmetrical highest in scope of three year budget framework but not more. But then it depends on the nature of the risks and the conditions of the economy. It is possible to take offsetting hedge positions in the financial markets (with surplus funds), but that is not a usual governmental role. Government is to provide public services, not an investment bank.
Other country experience:
Australia and New Zealand have made huge effort trying to incorporate fiscal risks on budgeting process in consideration. The effort can't be valuated jet, but they have made an attempt.
USA has incorporated fiscal risks by executing special assessments of risks in the health care industry or transportation, but they are not incorporated in the budget in any direct fashion. USA local governments have probably done better job in trying to incorporate some of the risk assessments and following the accounting standards framework to identify long term liabilities. Some local governments have made an attempt to put fiscal risks into their accounting system for the annual financial reports. But that doesn't meet that they are well incorporated in the budget. Symmetrical risks in USA have been ignored. Not a practice that you would advise. In USA local governments are more conservative in budgeting practice than in national level. However that's not necessary the case depending on economic circumstances, meaning when have to go through the process of budget reductions minimising the risks of population and services. Claim of symmetry might be the vehicle of reducing the information content requirement.

Experience of Latvia:
Basis for fiscal policy are:

- balanced budget;
- precise estimates;
- good coverage of the budget.

This is a matter of discussion with Latvian Ministry of Finance (MF), because currently there are items that are not covered up, therefore outflows happening in financial sectors. MF recognise these as a symmetrical risks based on historical financial trends. Information on public sector entities finance situation can be allocated in two groups:

- entities that are monitored closely - corporations that are classified as part of the general covenant (100% included in statistical information);
- more commercial entities - no good summaries for this category available. Unfortunately sector ministries manage their own ministries and nobody is producing There is no centre to supervise these entities. As parliament coalition is fighting for the advantageous ministries, full information is not shared between them.

One of the generally symmetrical working arrangements is depositary scheme. The fund collects the money outside the budget, but the only thing is that MF and treasury is generally guaranteeing the sustainability of operations of that fund. And whenever they proceed the incoming money they come up with the bridge load which is stretching the payment. Initial contributions by banks haven't been sufficient causing the increase of the fee for all banks. Then banks start to contribute at increased rate against specific deposit amount levels to compensate for the past loses. If the economic situation is good they enjoy relatively low contribution rate and the fund is growing, so as soon as economic downfall appears fund is facing hard time. FM needs to come up with the loan to the fund so the banks will need to recover this through the contributions. It is Very important to convey the appropriate incentives to the private actors. Financial institutions will pursue their own self-interest. Experience in the US shows that unanticipated vehicles for private gain at the expense of public losses have been common and created serious risks for government (savings and loan scandal of the late 1980's, housing market sub-prime loans associated with the housing bubble and great recession etc.).

At the moment MF actually is not challenged to put numbers on all the risks because their perspective is that they are symmetrical. It is a very convenient assumption, unless they have taken specific steps to incorporate specific offsetting hedges, the assumption of symmetry is quite suspect. These are risks that may fluctuate around some level that include budget projections. MF is costing these risks as low probability (happening once in 10 years).

But if we look at the most recent 10 years Latvia have faced major problem with four to five financial institutions. Three of these cases caused damage to the fiscal balance. These are not the cases which MF says they are symmetrical. They admit that those risks actually materialized, but the argument is: since the EU system holds bank supervision and has changed, the risk is not our, it is related with EU.
Other case is that our exposure is limited. An example discuses recently regarding payments: payments recently were taken to EU budget, each year they are planed and each year they are wrong (ten years in the row). Because EU and Latvian MF use different formula to calculate the size of economy and respect to payments, economic projections change. For five years MF underestimated the payment and then for other five years – overestimated. In ten year period it is symmetrical, but in five years it's not.

This example is only symmetrical in the sense of long term debt position or long term budgetary outlay. But symmetry should be annual or in scope till three years. There is no good reason to consider this example as symmetrical as in such a long period the risk symmetric characteristics is changing significantly. As MF considering risks is analysing trends in different historical time periods (three till ten years) for all of the identified risks we can conclude it have been done in order to adjust the situation. In this case the example is symmetrical in ten year period and therefore could be neglected in the fiscal framework.

Last ten years have also include really problematic physical conditions during the world wide recession therefore including significant economic peaks, valleys and recovery relevant from the fiscal position and fiscal perspective affecting symmetrical characteristics as well.

Skaitlisko nosacījumu izpildes kopsavilkums[1]

Summary of numerical conditions fulfilment[1]

P6.1.tabula

Table P6.1

(milj. eiro)
(million euro)

	2017		2018		2019		
	MTBF 2017/19 (draft) MoF	MTBF 2017/19 (draft) Council	MTBF 2017/19 (draft) MoF	MTBF 2017/19 (draft) Council	MTBF 2017/19 (draft) MoF	MTBF 2017/19 (draft) Council	
(1) Bilances nosacījums	8 265,8	8 231,5	8 784,3	8 672,7	8 947,5	8 799,4	(1) Balance rule
(2) Izdevumu pieauguma nosacījums	8 411,2	8 411,2	8 792,4	8 745,7	9 093,5	8 967,7	(2) Expenditure growth rule
(3) Pārmantojamības nosacījums	8 261,6	8 283,6	8 888,5	8 910,5	x	x	(3) Continuity rule
(4) = MIN [(1);(2)]	8 265,8	8 231,5	8 784,3	8 672,7	8 947,5	8 799,4	(4) = MIN [(1);(2)]
(5) = (4) - (3)	4,2	-52,1	-102,7	-236,3	x	x	(5) = (4) - (3)
(6) = [5]	4,2	52,1	102,7	236,3	x	x	(6) = [5]
(7) Iekšzemes kopprodukts, faktiskajās cenās	26 403,4	26 403,4	27 905,1	27 905,1	29 614,7	29 614,7	(7) Gross domestic product, at current prices
(8) 0,1% no IKP, (8) = 0,1%* (7)	26,4	26,4	27,9	27,9	29,6	29,6	(8) 0,1% of GDP, (8) = 0,1%* (7)
(9) Valsts budžeta maksimālie izdevumi atbilstoši fiskālajiem nosacījumiem, (9) = IF [(6) > (8); (4); (3)]	8 261,6	8 231,5	8 784,3	8 672,7	8 947,5	8 799,4	(9) CG maximally permissible expenditure in accordance with fiscal rules, (9) = IF [(6) > (8); (4); (3)]
(10) Fiskālā nodrošinājuma rezerve	26,4	26,4	27,9	27,9	29,6	29,6	(10) Fiscal safety reserve
(11) Valsts budžeta izdevumi, ņemot vērā fiskālā nodrošinājuma rezervi, (11) = (9) - (10)	8 235,2	8 205,1	8 756,4	8 644,8	8 917,9	8 769,8	(11) CG expenditure, taking into account fiscal safety reserve, (11) = (9) - (10)

Avots: Finanšu ministrija, Fiskālās disciplīnas padomes aprēķini

Source: Ministry of Finance, Fiscal Discipline Council calculations

Bilances nosacījums
Balance rule
(milj. eiro)
(million euro)

P6.2. tabula
Table P6.2

	2017						**2018**				**2019**			
	MTBF 2015/17 (draft)	MTBF 2015/17 (law)	MTBF 2016/18 (draft)	MTBF 2016/18 (law)	MTBF 2017/19 (draft) MoF	MTBF 2017/19 (draft) Council	MTBF 2016/18 (draft)	MTBF 2016/18 (law)	MTBF 2017/19 (draft) MoF	MTBF 2017/19 (draft) Council	SP 2016/19	MTBF 2017/19 (draft) MoF	MTBF 2017/19 (draft) Council	
(1) Valsts budžeta ieņēmumi (naudas plūsmas metode)	7 483,5	7 488,8	7 664,8	7 870,6	7 952,5	7 952,5	8 335,7	8 709,7	8 742,2	8 742,2	8 871,1	8 804,8	8 804,8	(1) Central government budget revenue (cash-flow)
(2) Pašvaldību budžeta bilance	0,9	0,9	-15,8	-27,3	0,0	0,0	-33,6	-45,5	-49,8	-49,8	-56,3	-48,9	-48,9	(2) Local government budget balance
(3) No valsts budžeta daļēji atvasināto publisko personu un budžeta nefinansētu iestāžu budžeta bilance	-0,4	-0,4	-0,3	-3,3	-0,1	-0,1	-0,8	-3,8	-3,1	-3,1	-6,9	-9,0	-9,0	(3) Derived public persons budget balance
(4) EKS korekcijas	273,8	269,1	23,8	147,3	38,9	38,9	-296,4	-110,1	-195,1	-195,1	-83,9	-12,6	-12,6	(4) ESA corrections
(5) Minimāli atļautā strukturālā bilance, % no IKP	-0,75	-0,75	-1,00	-1,06	-0,93	-0,80	-0,79	-0,79	-1,13	-0,73	-0,83	-1,00	-0,50	(5) Minimal structural balance, % of GDP
(6) Vienreizējie pasākumi, % no IKP	x	x	x	x	x	x	x	x	x	x	x	x	x	(6) One-off, % of GDP
(7) Cikliskā komponente, % no IKP	0,0	0,0	0,0	0,0	-0,1	-0,1	0,0	0,0	0,1	0,1	0,3	0,3	0,3	(7) Cyclical component, % of GDP
(8) IKP, faktiskajās cenās	28 513,3	28 513,3	27 750,2	27 750,2	26 403,4	26 403,4	29 476,7	29 476,7	27 905,1	27 905,1	30 429,2	29 614,7	29 614,7	(8) GDP, at current prices
Kopā (1)+(2)+(3)+(4)-[(5)+(6)+(7)]*(8)	**7 969,3**	**7 970,1**	**7 956,8**	**8 288,2**	**8 265,8**	**8 231,5**	**8 233,7**	**8 780,1**	**8 784,3**	**8 672,7**	**8 926,1**	**8 947,5**	**8 799,4**	**Total** (1)+(2)+(3)+(4)-[(5)+(6)+(7)]*(8)

Avots: Finanšu ministrija, Fiskālās disciplīnas padomes aprēķini

Source: Ministry of Finance, Fiscal Discipline Council calculations

Izdevumu pieauguma nosacījums
Expenditure rule
(milj. eiro)
(million euro)

P6.3. tabula
Table P6.3

	2017		2018		2019		
	MTBF 2017/19 (draft) MoF	MTBF 2017/19 (draft) Council	MTBF 2017/19 (draft) MoF	MTBF 2017/19 (draft) Council	MTBF 2017/19 (draft) MoF	MTBF 2017/19 (draft) Council	
(1) Vispārējās valdības kopējie izdevumi, koriģēti atbilstoši izvēlētajam stingrākajam nosacījumam	9 840,3	9 796,3	10 490,1	10 378,4	10 786,3	10 638,3	(1) GG total expenditure, adjusted in accordance with the stricktest rule applied
(2) Procentu maksājumi, D.41	264,4	264,4	260,8	260,8	289,6	289,6	(2) Interest expenditure, D.41
(3) ES programmu izdevumi, kuriem ir atbilstoši ES fondu ieņēmumi	483,0	483,0	525,1	525,1	521,3	521,3	(3) Expenditure on EU programmes fully matched by EU funds revenue
(4.1) Bruto pamatkapitāla veidošana (BPKV), t-3, P.51	1 042,7	1 042,7	1 084,6	1 084,6	896,6	896,6	(4.1) Gross fixed capital formation (GFCF), t-3, P.51
(4.2) BPKV, t-2, P.51	1 084,6	1 084,6	896,6	896,6	1 150,7	1 150,7	(4.2) GFCF, t-2, P.51
(4.3) BPKV, t-1, P.51	896,6	896,6	1 150,7	1 150,7	1 286,4	1 286,4	(4.3) GFCF, t-1, P.51
(4.4) BPKV, t, P.51	1 150,7	1 150,7	1 286,4	1 286,4	1 308,1	1 308,1	(4.4) GFCF, t, P.51
(5) Nediskrecionāras bezdarba izmaiņas	-10,4	-10,4	-11,0	-11,0	-12,0	-12,0	(5) Non-discretionary change in unemployment
(6) Diskrecionāru ieņēmumu pasākumu izmaiņas	92,2	92,2	20,4	20,4	-35,1	-35,1	(6) Discretionary revenue measures change
(7) Izlīdzinātie kopējie izdevumi (nominālie), (7) = (1)-(2)-(3)-(4.4.)+[VID (4.1) (4.2) (4.3)]	8 985,9	8 941,8	9 522,4	9 410,7	9 827,7	9 679,7	(7) Smoothed total expenditures (TE) (nominal), (7) = (1)-(2)-(3)-(4.4.)+[AVE (4.1) (4.2) (4.3) (4.4)]
(8) Koriģētie kopējie izdevumi (nominālie), (8) = (7)-(5)-(6)	8 904,1	8 860,0	9 513,0	9 401,3	9 874,8	9 726,8	(8) Adjusted TE (nominal), (8) = (7)-(5)-(6)
(9) Nominālo koriģēto kopējo izdevumu pieaugums, %	2,9	2,4	5,9	5,1	3,7	3,4	(9) Growth of nominal adjusted expenditure, %
(10) IKP deflators, %	2,2	2,2	2,5	2,5	2,8	2,8	(10) GDP deflator, %
(11) Reālo koriģēto izdevumu pieaugums, %	0,7	0,2	3,3	2,6	0,9	0,5	(11) Growth of real adjusted expenditure, %
(12) Potenciālais izdevumu pieaugums, %	2,2	2,2	3,4	3,4	2,3	2,3	(12) Potential growth reference rate, %
(13) Vispārējās valdības kopējie izdevumi, ja kopējo izdevumu pieaugums = potenciālais izdevumu pieaugums	9 972,0	9 972,0	10 498,1	10 451,4	10 932,4	10 806,5	(13) GG total expenditure, if TE growth = potential growth
(14) Vispārējās valdības kopējie ieņēmumi	9 552,0	9 552,0	10 199,9	10 199,9	10 573,1	10 573,1	(14) GG total revenue
(15) Valsts budžeta ieņēmumi (naudas plūsmas metode)	7 952,5	7 952,5	8 742,2	8 742,2	8 804,8	8 804,8	(15) State budget revenue (cash-flow)
(16) Pašvaldību budžetu bilance	0,0	0,0	-49,8	-49,8	-48,9	-48,9	(16) Local government budget balance
(17) No valsts budžeta daļēji atvasināto publisko personu un budžeta nefinansētu budžeta iestāžu budžetu bilance	-0,1	-0,1	-3,1	-3,1	-9,0	-9,0	(17) Derived public persons budget balance
(18) EKS korekcijas	38,9	38,9	-195,1	-195,1	-12,6	-12,6	(18) ESA corrections
Kopā (15)-[(14)-(13)-(16)-(17)-(18)]	**8 411,2**	**8 411,2**	**8 792,4**	**8 745,7**	**9 093,5**	**8 967,7**	**Total** (15)-[(14)-(13)-(16)-(17)-(18)]

Avots: Finanšu ministrija, Fiskālās disciplīnas padomes aprēķini

Source: Ministry of Finance, Fiscal Discipline Council calculations

Pārmantojamības nosacījums
Continuity principle
(milj. eiro)
(million euro)

P6.4. tabula
Table P6.4

	2017		2018		
	MTBF 2017/19 (draft) MoF	MTBF 2017/19 (draft) Council	MTBF 2017/19 (draft) MoF	MTBF 2017/19 (draft) Council	
(1) Koriģētie maksimāli pieļaujamie valsts budžeta izdevumi (Vispārējās valdības budžeta plāns iepriekšējā gadā)	6 808,0	6 808,0	7 237,7	7 237,7	(1) Adjusted maximum permissible state budget expenditure (Draft budgetary plan of previous year)
koriģēto maksimāli pieļaujamo valsts budžeta izdevumu korekcijas saskaņā ar FDL 5.pantu, t.sk.:					*adjustments of maximum permissible state budget expenditure according to the FDL Article 5, incl.:*
1) pamatbudžeta izdevumos sakarā ar aktuālākām valsts sociālo pabalstu un pensiju saņēmēju kontingenta prognozēm;	-9,2	-9,2	-8,1	-8,1	1) state budget expenditure due to more actual forecasts in contingent receiving state social allowances and pensions;
Labklājības ministrijas pamatbudžeta programma 20.01.00 "Valsts sociālie pabalsti"	-2,4	-2,4	-0,5	-0,5	20.01.00 Programme of the Ministry of Welfare basic budget "State Social Benefits"
Labklājības ministrijas pamatbudžeta programma 20.02.00 "Izdienas pensijas"	-0,3	-0,3	1,0	1,0	20.02.00 Programme of the Ministry of Welfare basic budget "Work pensions"
Labklājības ministrijas budžeta apakšprogramma 20.03.00 "Piemaksas pie vecuma un invaliditātes pensijām"	-6,5	-6,5	-8,6	-8,6	20.03.00 Programme of the Ministry of Welfare basic budget "Supplement to the old age and disability pensions"
Aizsardzības ministrijas pamatbudžeta programma 31.00.00. "Militārpersonu pensiju fonds"	0,0	0,0	0,0	0,0	31.00.00 Programme of the Ministry of Defence basic budget "Military pension fund"
2) speciālā budžeta izdevumos sakarā ar aktuālākām sociālās apdrošināšanas pakalpojumu saņēmēju kontingenta, kā arī pensiju un pabalstu vidējā apmēra prognozēm;	111,4	111,4	163,1	163,1	2) state social security budget expenditure due to more actual forecasts in contingent receiving social security services, so as forecasts of average amount of pensions and allowances;
04.01.00 Valsts pensiju speciālais budžets	17,7	17,7	45,5	45,5	04.01.00 Special budget - State pensions
04.02.00 Nodarbinātības speciālais budžets	29,3	29,3	33,1	33,1	04.02.00 Special budget - Employment
04.03.00 Darba negadījumu speciālais budžets	2,9	2,9	4,0	4,0	04.03.00 Special budget - Occupational accidents
04.04.00 Invaliditātes, maternitātes un slimības speciālais budžets	61,5	61,5	80,5	80,5	04.04.00 Special budget - Disability, maternity, and sickness
3) izdevumos, kuri izriet no prognozēto maksas pakalpojumu un citu pašu ieņēmumu izmaiņām, kā arī no kārtējā gada sākumā fiksētās maksas pakalpojumu un citu pašu ieņēmumu atlikuma summas;	4,3	4,3	4,0	4,0	3) expenditure, which results from change in forecasted revenues from paid services and other self-earned revenues as well as fixed sum of remaining revenues from paid services and other self-earned revenues at the beginning of current year;
4) to izdevumu palielināšana, kuri nepieciešami Satversmes 62.pantā minētā apdraudējuma novēršanai, kā arī dabas katastrofu, avāriju un citu dabas vai sociālo procesu izraisītu materiālo zaudējumu novēršanai, — ievērojot FDL 12.panta otrās daļas nosacījumu;					4) increase of expenditure which is subject to the Constitution Article 62 as well as material losses arising from natural disasters, emergencies and natural or social processes complying with provision of second Paragraph of the FDL Article 12;
5) to izdevumu palielināšana, kuri nepieciešami, lai izpildītu starptautisko tiesu un Satversmes tiesas spriedumus;		22,0		22,0	5) increase of expenditure necessary for execution of verdicts of international courts and Constitutional court;
6) izdevumos saistībā ar Eiropas Savienības politiku instrumentu un pārējās ārvalstu finanšu palīdzības līdzekļu finansētiem projektiem un pasākumiem;	-53,7	-53,7	10,0	10,0	6) expenditure in relation with projects and measures financed from European Union policy instruments and other foreign financial assistance programmes;
7) izdevumos tās valsts parāda daļas apkalpošanai, kura ietilpst Valsts kases kompetencē;	-26,5	-26,5	-25,3	-25,3	7) expenditure for servicing that part of state debt falling under the competence of the Treasury;
8) kārtējos maksājumos Eiropas Savienības budžetā un starptautiskai sadarbībai;	-8,1	-8,1	-7,9	-7,9	8) regular payments in the budget of the European Union and for international co-operation;
9) FDL 16.panta piektajā daļā neminētu fiskālo risku izraisīto izdevumu palielināšana FDL 17.panta ceturtajā un piektajā daļā minētajos gadījumos, — ievērojot šo daļu nosacījumus;					9) increase of expenditure related to fiscal risks not mentioned in the fifth Paragraph of the FDL Article 16 in accordance with fourth and fifth Paragraphs of the FDL Article 17, by complying with provisions of these Paragraphs;
10) to izdevumu palielināšana, kuri izriet no normatīvā akta pieņemšanas saskaņā ar FDL 9.pantu, ja atbilstoši tā nosacījumiem pieņemts normatīvais akts, kas paredz palielināt valsts budžeta ieņēmumus, lai segtu attiecīgo izdevumu palielinājumu, vai izdevumu samazināšana apjomā, kas kompensē valsts budžeta ieņēmumu kritumu, ja tiek pieņemts normatīvais akts, kas paredz samazināt valsts budžeta ieņēmumus.					10) increase of expenditure resulting from adopting of normative act in accordance with the FDL Article 9, if according its provisions normative act is adopted which foresees to increase state budget revenues in order to cover respective increase of expenditure or reducing expenditure in amount compensating fall in state budget revenues, if normative act is adopted foreseeing to reduce state budget revenues.
(2) Faktiskie ES fondu izdevumi pozīcijās, kas pakļaujas izlīdzināšanai	1 168,1	1 168,1	1 254,4	1 254,4	(2) Expenditure of European Union structural funds, Cohesion fund, Common Agricultural Policy and Common Fisheries Policy as subject to the smoothing mechanism
(3) Valsts parāda vadības izdevumi pozīcijās, kas pakļaujas izlīdzināšanai	267,4	267,4	260,6	260,6	(3) Government debt service expenditure, what is in the Treasury's competence as subject to the smoothing mechanism
Kopā (1)+ [Summa no 1) līdz 10)]+(2)+(3)	**8 261,6**	**8 283,6**	**8 888,5**	**8 910,5**	**Total** (1)+ [Sum from 1) to 10)]+(2)+(3)

Avots: Finanšu ministrija, Fiskālās disciplīnas padomes aprēķini
Source: Ministry of Finance, Fiscal Discipline Council calculations