

ANNEX 4. SURVEY ON BUDGET DISCIPLINE

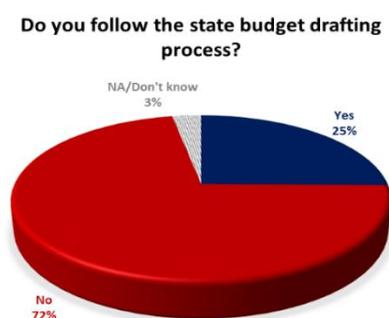
IMF¹ and OECD² contend that independent fiscal institutions (IFIs) should foster public discussions and improve the public's understanding of issues pertaining to fiscal policy. Due to the fact that such institutions do not possess specific legally defined tools for influencing fiscal policy, one of 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.

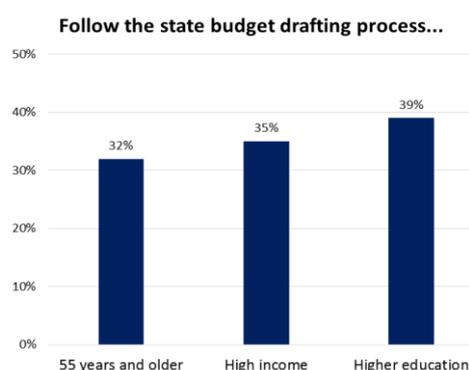
The results of several studies indicate that the public's knowledge of political processes and questions pertaining to governance is incomplete³. Studies conducted in USA and Europe show that people have mediocre or poor knowledge on political and economic matters. In the case of USA it has been established 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

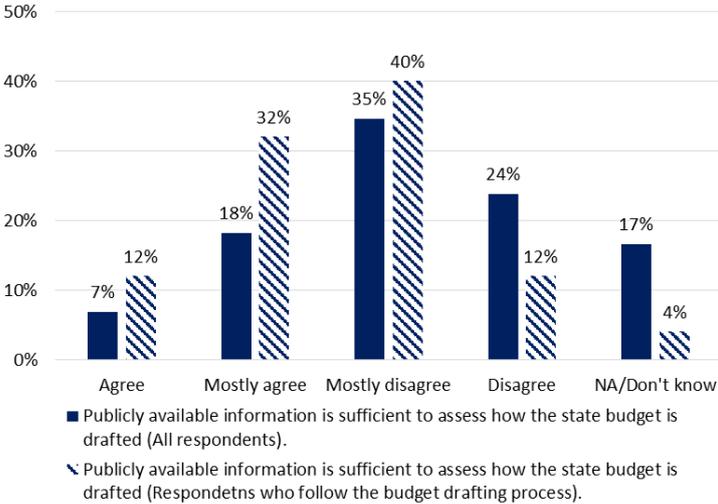
¹ Debrun, X., Kinda, T., Curristine, T., Eyraud, L., Harris, J. and Seiwald J. (2013) *The Functions and Impact of Fiscal Councils*, available at: <http://www.imf.org/external/np/pp/eng/2013/071613.pdf>, accessed on: 03/03/2016.

² OECD Council (2014) *Recommendation of the Council on Principles for Independent Fiscal Institutions*, available at: <http://www.oecd.org/gov/budgeting/recommendation-on-principles-for-independent-fiscal-institutions.htm>, accessed on 03/03/2016.

³ Somin, I. (2013) *Democracy and Political Ignorance: Why Smaller Government is Smarter*, Stanford: Stanford University Press.

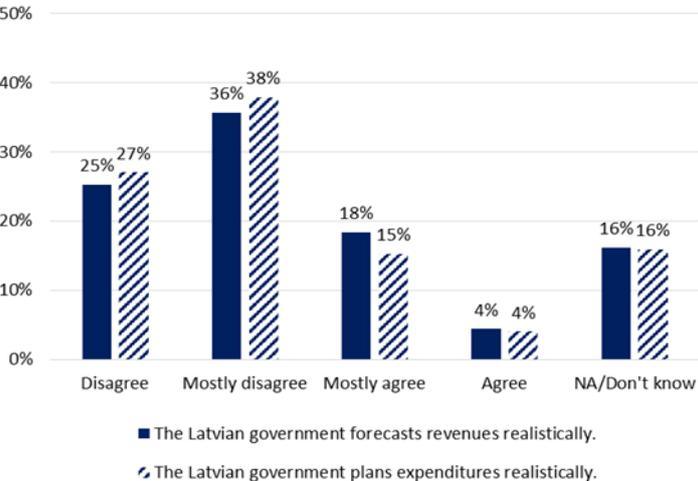
Approximately a quarter of the population follow the budget drafting process. The results of the survey show that 25% of respondents follow how the state budget is drafted (A4.1), mainly relying upon information available on the internet and television. Interest increases with the respondent’s level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

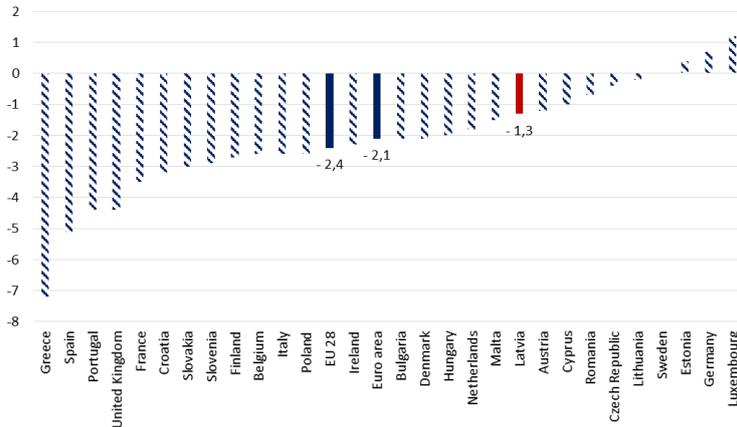
It is believed that revenues and expenditures are not planned realistically, even though revenue forecasts are consistently fulfilled. People mostly disagree that expenditures are planned realistically and revenue forecasts are realistic. In the case of revenues, public perception differs from State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



A4.4 Source: Council survey

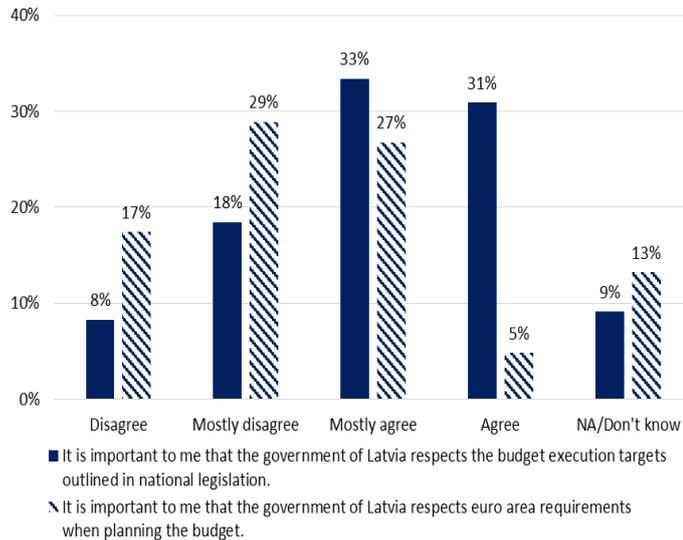
Respondents believe that Latvia is worse than other euro area states at meeting budgetary requirements, even though official statistics show that Latvia’s results are among the best. Euro area countries have to observe certain requirements, such as expenditure ceilings and permissible budget deficit 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.



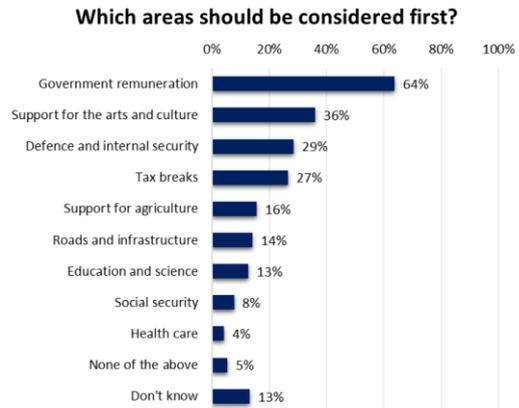
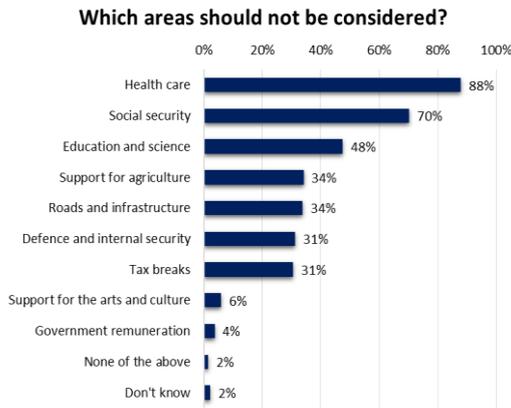
A4.5 General government budget balance in 2015 (% of GDP)
Source: Eurostat

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.



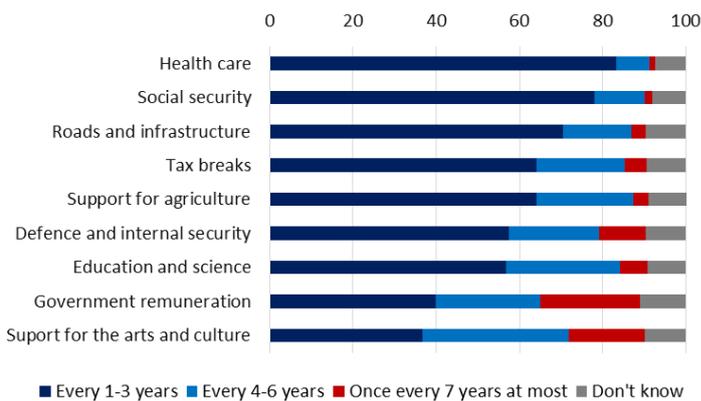
A4.6 Source: Council survey

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

How often should expenditure utility assessments be carried out for these areas?

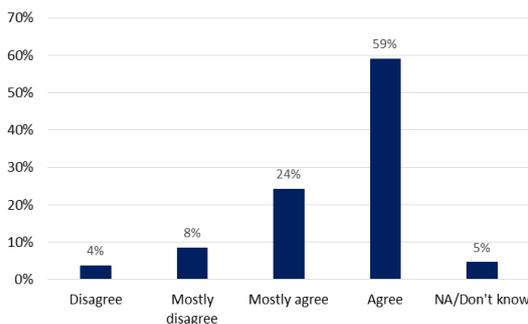


A4.8 Source: Council survey

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.

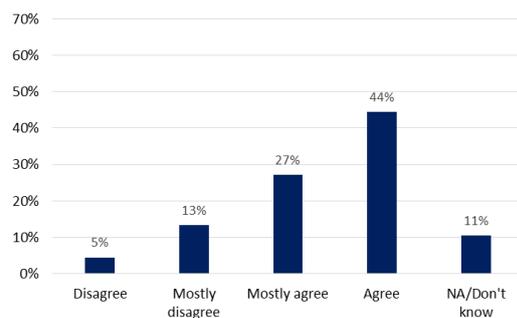
Respondents agree with the principles of counter-cyclical fiscal policy. 81% of respondents agreed or mostly agreed that expenditure plans should be based on revenue possibilities. Crucially, the survey also asked questions regarding building savings and increasing public debt in times of growth. In 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.

Savings must be made for leaner times during periods of economic growth.



A4.9 Source: Council survey

During periods of economic growth, public debt can only be increased to invest in areas and projects whose positive impact will also be felt by future generations.



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.