



LATVIJAS REPUBLIKAS FISKĀLĀS DISCIPLĪNAS PADOME

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RĪGĀ

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Prime Minister
Republic of Latvia
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Chairman of the Budget and Finance (Tax) Committee
Saeima of the Republic of Latvia
Jānis Vucāns
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Minister of Finance
Republic of Latvia
Dana Reizniece-Ozola
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Dear Messrs Kučinskis and Vucāns,
Dear Madam Reizniece-Ozola,

On health care reform deviation

According to Article 28 Part 7 of the Fiscal Discipline Law (hereafter – FDL), the Fiscal Discipline Council (hereafter – Council) shall prepare and submit to the Saeima and the Cabinet's attention of fiscal policy matters, where it finds them important to comply with the FDL terms.

Council Regulation 1466/97 stipulates that the medium-term objective (hereafter – MTO) can be revised if a country is undertaking major structural reforms¹. The deviation from the MTO should not exceed 0.5% of GDP so as to allow an appropriate safety margin with respect to the 3% deficit rule. The cap on the deviation is required in view of the significant uncertainty attached to estimating the impact of such reform efforts².

¹ Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1997R1466:20111213:EN:PDF>, accessed on 8/02/2017.

² Vade Mecum on the Stability and Growth Pact, 2016 edition, available at: http://ec.europa.eu/info/publications/vade-mecum-stability-and-growth-pact-2016-edition_en, accessed on 8/02/2017.

Council Regulation 1466/97 specifies that structural reforms should have direct long-term positive budgetary effects, including raising potential sustainable growth. Reform proposals should contain a cost-benefit analysis and the country should establish that the proposed measures will have a verifiable impact on the long-term sustainability of public finances.

The government of Latvia received permission from the European Commission to deviate from the MTO in 2017 and, contingent upon the implementation of the proposed reforms, for the remainder of the Medium-term budget framework (hereafter – MTBF) 2017/19 to continue implementing structural reforms in health care³. In the assessment of the European Commission, the positive impact on growth and the long-term sustainability of public finances is plausible.

The health care reform is being implemented from 2014 in accordance with the *Public Health Guidelines for 2014-2020*. The reform was independently evaluated by the University of Latvia, and it is estimated to significantly improve the health of the working-age population⁴. Furthermore, *Latvia's Stability Programme 2016-2019* noted that

[a]dditional expenditure for healthcare will have a positive long-term effect on public finances, and the use of the SGP⁵ flexibility mechanisms at present will also create the necessary motivation to make a transition to the mandatory health insurance mechanism after the SGP flexibility deviation would come to an end.⁶

Low public funding, inequality and a high number of premature deaths are listed as weaknesses of the Latvian health care system and provide further justification for the invocation of the flexibility clause. Furthermore, reference is made to the European Council's recommendations that Latvia should consider improving the availability, cost-effectiveness and quality of the health care system to provide additional support for the proposed reforms.

In addition, *Latvia's Stability Programme 2016-2019* indicates that a cost-benefit exercise was carried out and argues "that additional estimated amount of expenditure from 2013 to 2020 exceeds the economic benefits of the respective period"⁷.

The economic benefits are estimated from the productive return of labour and the reduction of the potential years of life lost (hereafter – PYLL). In other words, GDP growth will be improved by a higher number of healthy and productive inhabitants. The economic gains that will accrue as a result of the structural reforms amount to 823.5 million euro. However, the estimate for the period 2013-2020 is only 254.9 million euro and assumes the realistically optimistic scenario (see below). The costs in the period 2013-2020 amount to 577 million euro.

³ Council Recommendation of 12 July 2016 on the 2016 National Reform Programme of Latvia and delivering a Council opinion on the 2016 Stability Programme of Latvia, available at: [http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016H0818\(20\)&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016H0818(20)&from=EN), accessed on 8/02/2017.

⁴ Assessment of the 2016 Stability Programme for Latvia, available at: http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/20_scps/2016/14_lv_scp_en.pdf, accessed on 8/02/2017.

⁵ Stability and growth pact

⁶ Latvia's Stability Programme for 2016-2019, available at: http://ec.europa.eu/europe2020/pdf/csr2016/sp2016_latvia_en.pdf, accessed on 8/02/2017.

⁷ Ibid.

	Economic benefit (million euro)		Costs (million euro)
	2013 - 2020	2013 - 2040	2013 - 2020
Realistically optimistic scenario	254.9	823.5	577
Pessimistic scenario	137.4	443.8	

Source: Ministry of Finance

Latvia's Stability Programme 2016-2019 notes that funds allocated for the implementation of the health care reform between 2014 and 2016 exceeded the required amount that would ensure the achievement of the PYLL target. No clear future reform plans are outlined, even though a list of all previous reform efforts are listed. Measures for reforms in the health care sector will be outlined in annual budget documents, based on the *Health strategy for 2014-2020*⁸.

In the letter received by the Council from the Ministry of Health on 19 September 2016, representatives outline the activities that will be funded with the additional funds made available by deviating from the MTO. The list includes (i) improving the availability of oncological services, (ii) additional funds for diagnostic and rehabilitation services and (iii) increasing the number of patients entitled to compensated medication.

The Council has a number of concerns regarding the use of deficit financing and expenditure planning in the health care sector, which should be addressed in the process of devising and implementing structural reforms.

The permission to revise the MTO in order to finance the implementation of reforms in the health care sector applies to 2017-2019, while expenditure needs will persist beyond the horizon period. In view of this, the Council has previously suggested that the government develop a fiscally sustainable long-term framework for the provision of public health care. Consequently, the Council reiterates the need to develop reforms in the health care sector that can be financed without relying on deficit increases.

	2017	2018	2019
Deficit increase (million euro)	34.3	111.6	148.1
Deficit increase (% of GDP)	0.1	0.4	0.5

Source: Ministry of Finance

In addition, the Council has also argued that the overall efficiency 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. In view of this, recent reliance on the reallocation of funds from other budgetary sources (e.g. receiving funds from other ministries or the budget programme "Funds for Unforeseen Events") requires attention.

Information provided by the Ministry of Finance shows that in both 2015 and 2016 the expenditure plan of the Ministry of Health was revised upwards.

2015			2016		
Plan	Revised plan	Change	Plan	Revised plan	Change
751.95	765.11	13.16	770.77	804.90	34.14

Source: Ministry of Finance (million euro)

⁸ Assessment of the 2016 Stability Programme for Latvia, available at: http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/20_scps/2016/14_lv_scp_en.pdf, accessed on 8/02/2017.

Furthermore, in both 2015 and 2016 a significant portion of the increase is attributable to funds received from other ministries' expenditure savings or the budget programme "Funds for Unforeseen Events".

	Reallocation from other ministries	Reallocation from "Funds for Unforeseen Events"	Total
2015	5.72	3.05	8.77
2016	15.59	2.39	17.98

Source: Ministry of Finance (million euro)

Concurrently, at the meeting of the Cabinet of Ministers, which took place on 8 November 2016, 16.06 million euro were reallocated from the budget of the Ministry of Finance to the sub-programme of the Ministry of Health *VSIĀ "Paula Stradiņa klīniskā universitātes slimnīca" jaunā korpusa būvniecība un iekārtošana*.

Consequently, recent experience suggests that the Ministry of Health relies on appropriation increases, using funds from other ministries and the budget programme "Funds for Unforeseen Events". This points to a need for improved expenditure planning to finance health care related expenses and satisfy the financial requirements of state-owned enterprises overseen by the Ministry of Health.

In view of the above and in order to establish that the proposed measures and expenditures are in compliance with principles of fiscal discipline, the Council requests that the Ministry of Finance:

1. Establish a clear link between the funds granted for the implementation of health care reforms and specific measures, and clearly define and monitor results that have to be achieved;
2. Clarify how deficit financed expenditure needs in the health care sector will be funded after 2019 when the deviation from the MTO will no longer be permitted;
3. Inform how expenditure planning will be revised to ensure the functioning of state-owned enterprises in the health care sector with the resources allocated in the budget.

Council Deputy Chairman

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