

# VERIFICATION OF COMPLIANCE WITH THE REQUIREMENTS OF ARTICLE 11 OF THE FISCAL DISCIPLINE LAW

According to Article 28 Part 7 of the Fiscal Discipline Law (hereinafter – FDL), the Fiscal Discipline Council (hereinafter – 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.

According to the Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (Regulation 473/2013<sup>1</sup>) Article 5 Part 2(a) an independent body shall provide public assessment related to the occurrence of circumstances leading to the activation of the correction mechanism. Article 11 of the FDL stipulates the requirements regarding the correction mechanism in the national legislation.

According to the Memorandum of Understanding<sup>2</sup> (hereinafter – MoU), the Council shall assess whether adjustment to the general government structural balance (hereinafter – the structural balance), shall be made according to Article 11 of the FDL through triggering the automatic correction mechanism to make adjustments and the future periods to which the correction applies.

## 1 Structural balance rule assessment (2013-2016)

In accordance with Article 11 of FDL the Ministry of Finance (hereinafter – MoF) has calculated the difference of the actual structural balance and the minimum planned general government structural balance by 1 December 2017, and, according to the request, supplied the calculations to the Council (see Table 1). **During the Council meeting that took place on 6 December 2017, the Council took note of the information provided by the MoF regarding compliance with Article 11 of the FDL.**

**Table 1. Verifying compliance with the requirements of Article 11 of the Fiscal discipline law according to the structural balance rule**

		2013	2014	2015	2016	2017
		actual				forecast
1.	Nominal GDP*, million euro	22 831.5	23 681.5	24 353.1	24 926.7	26 676.2
2.	Actual structural general government budget balance, % of GDP	-0.8	-0.9	-0.9	0.2	-0.9
3.	Actual structural general government budget balance, million euro	-172.1	-212.4	-231.2	45.1	-230.8
4.	Minimum planned structural general government budget, % of GDP	-1.3 <sup>3</sup>	-1.0 <sup>4</sup>	-1.0 <sup>5</sup>	-0.9 <sup>6</sup>	-1.0 <sup>7</sup>

<sup>1</sup> Regulation 473/2013 available at <http://eur-lex.europa.eu/legal-content/LV-EN/TXT/?qid=1446562236138&uri=CELEX:32013R0473&from=LV>, accessed on 06.12.2017.

<sup>2</sup> Paragraph 5.14.1. The Memorandum of Understanding available at [http://fiscalcouncil.lv/files/uploaded/FDP\\_1\\_09\\_969\\_20160729\\_MoU\\_FDC\\_MoF\\_consolidated.pdf](http://fiscalcouncil.lv/files/uploaded/FDP_1_09_969_20160729_MoU_FDC_MoF_consolidated.pdf), accessed on 06.12.2017.

<sup>3</sup> On medium-term budget framework 2013, 2014 and 2015, available in Latvian at <https://www.vestnesis.lv/op/2012/192.2?search=on>, accessed on 06.12.2017.

<sup>4</sup> On medium-term budget framework 2014, 2015 and 2016, available in Latvian at <https://www.vestnesis.lv/index.php?menu=doc&id=262267>, accessed in Latvian on 06.12.2017.

<sup>5</sup> On medium-term budget framework 2015, 2016 and 2017, available in Latvian at <https://www.vestnesis.lv/op/2014/257.25>, accessed on 06.12.2017.

<sup>6</sup> On medium-term budget framework 2016, 2017 and 2018, available in Latvian at <https://www.vestnesis.lv/op/2015/248.2>, accessed on 06.12.2017.

<sup>7</sup> On medium-term budget framework 2017, 2018 and 2019, available in Latvian at: <https://www.vestnesis.lv/op/2016/241.2>, accessed on 06.12.2017.

		2013	2014	2015	2016	2017
		actual				forecast
5.	Minimum planned structural general government budget balance, million euro	-308.0	-247.4	-248.5	-224.3	-266.8
6.	Deviation from plan for the year, million euro (3-5)	135.8	35.0	17.3	269.4	35.9
7.	Deviation from plan for the year, % of GDP	0.6	0.1	0.1	1.1	0.1
8.	Accrued deviation from plan for all years starting with 2013, million euro	135.8	170.8	188.2	457.6	493.5
9.	<b>Accrued deviation from plan for all years starting with 2013, % of GDP</b>	<b>0.6</b>	<b>0.7</b>	<b>0.8</b>	<b>1.8</b>	<b>1.8</b>
10.	Rule in accordance with Article 11 of the FDL, % of GDP	-0.5	-0.5	-0.5	-0.5	-0.5
11.	<b>Correction necessary if the limit - 0,5% stated by the FDL is violated</b>	<b>No correction</b>				

Source: for 2013-2016: MoF assessment of the general government structural balance performance for the criteria of Article 11 of the FDL. For 2017 – Notes to the draft Law on Medium-term budget framework for 2018, 2019, and 2020, page 77.

\* 2013-2016 data are updated regarding latest CSB revisions on 29.09.2017 and 02.10.2017.

Article 11 of the FDL stipulates the automatic upward adjustment of the structural balance in the amount of 0.5% of GDP in the third year of the next Medium-term budget framework law (hereinafter – MTBFL) after establishing that accumulated actual deviation from the structural balance in excess of 0.5% of GDP. According to the MoF's estimate, the structural balances adjustment does not apply, as accumulated deviations of the actual structural balance from the planned balance are above the threshold stipulated in Article 11 (-0.5% of GDP). **The total accumulated difference between the balances at the end of 2017 amounted to 1.8% of GDP. After examining the information provided, the Council concludes that it is not necessary to make the adjustment according to Article 11 of the FDL.**

When examining the implementation of Article 11 of the FDL in December 2017, the Council made a comparison with the assessment carried out last year (December 2016) (see Table 1). Much like last year, there was a degree of uncertainty surrounding the cyclical component, which was affected by revision of potential GDP and the GDP revisions of the Central Statistical Bureau. Since December 2016, the accumulated structural balance deviations have deteriorated by 0.3% of GDP in 2013, 0.6% of GDP in 2014, 0.7% of GDP, but remain unchanged for 2015 and 2016.

When comparing the estimates of the annual deviations with the changes in the cyclical component (see Table 2), it can be concluded that adjustments to better reflect the business cycle are one of the main reasons for the changes between the assessments of December 2016 and December 2017.

**Table2. Comparison of Article 11 of the FDL compliance at end-2017 and end-2016**

		2013	2014	2015	2016
		actual			
1.	Annual deviation in percent of GDP as assessed at end-2016	0.9	0.4	0.2	0.4
2.	Annual deviation in percent of GDP as assessed at end-2017	0.6	0.1	0.1	1.1
3.	<i>Change in the assessment from 2016 to 2017 (2-1)</i>	-0.3	-0.3	-0.1	+0.7
4.	<i>change due to the shift in the cyclical component</i>	-0.3	-0.2	-0.2	-0.1
5.	<i>Accumulated deviation from the structural balance target</i>	-0.3	-0.6	-0.7	0.0

Source. Calculations of the Council.

## 2 Expenditure growth rule assessment 2013-2016

In addition to the structural balance rule, the Council has also applied the expenditure growth rule to determine the deviations of actual state budget expenditures from the plans<sup>8</sup>. Such an evaluation has been performed by analogy with the structural balance rule assessment in the context of Article 11.

It would be useful to assess the fiscal discipline of the previous year's budget execution with regard to all fiscal numerical rules, assessing the various budget components and identifying possible planning defects. The Council is gradually implementing this approach.

**Table 3. Verifying compliance with the requirements of Article 11 of the Fiscal discipline law in accordance with the expenditure rule**

		2013.	2014.	2015.	2016.
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1.	GDP, at current prices	22 831.5	23 681.5	24 353.1	24 926.7
2.	State budget expenditures (budget law) (maximum)	6 853.8	7 187.5	7 472.4	7 688.4
3.	State budget expenditures (actual)	6 835.2	7 254.1	7 476.7	7 502.4
4.	Deviation from plan for the year	18.5	-66.6	-4.3	185.9
5.	Deviation from plan for the year, % of GDP	0.1	-0.3	0.0	0.7
6.	Accrued deviation from plan for all years starting with 2013	18.5	-48.1	-52.5	133.4
7.	<b>Accrued deviation from plan for all years starting with 2013, % of GDP</b>	<b>0.1</b>	<b>-0.2</b>	<b>-0.2</b>	<b>0.5</b>
8.	Rule in accordance with Article 11 of the FDL, % of GDP	-0.5	-0.5	-0.5	-0.5
9.	<b>Correction necessary if the limit -0,5% stated by the FDL is violated</b>	<b>No correction</b>	<b>No correction</b>	<b>No correction</b>	<b>No correction</b>

Source: Council calculations.

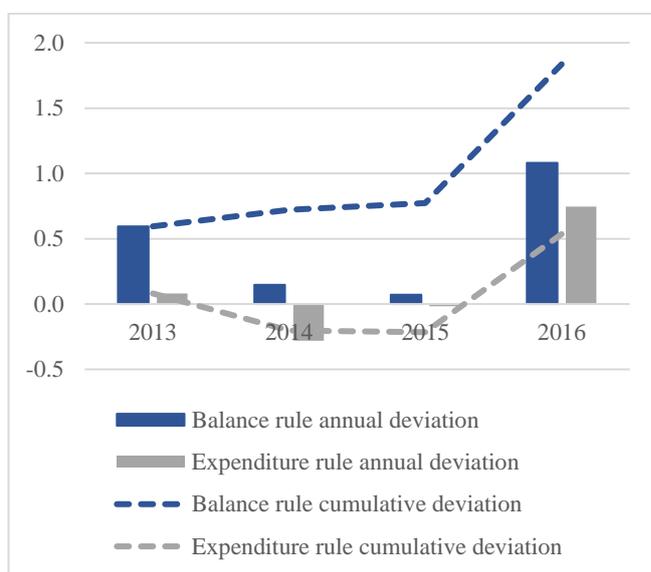


Chart 1. Ex post balance rule and expenditure rule. Source: Council calculations.

Similarly to the structural balance rule, the expenditure rule is also used in the planning of the MTBF and requires that general government expenditure be commensurate with the 10-year average potential GDP growth rate<sup>9</sup>.

In accordance with the expenditure growth rule, deviations are comparatively more significant than in the case of the structural balance rule (see Table 3). However, deviations from planned budget expenditures do not lead to significant violations of fiscal discipline, even though there were slight deviations from the expenditure ceilings for two years (2014 and 2015). The accumulated deviation reaches 0.5% of GDP. In general, the

<sup>8</sup> Council calculations in MS Excel format available at Annex 1:

[/files/uploaded/FDP\\_1\\_08\\_1757\\_20171206\\_FDL\\_11parts.xlsx](#), accessed on 06.12.2017.

<sup>9</sup> It should be noted that resulting from the financial crisis potential GDP experienced negative growth and hence it also requires reduction of the estimates for the next few years, requiring very conservative pace for the State budget expenditure growth.

expenditure growth rule of 2013-2016 does not require the start of the corrective mechanism provided for in Article 11 of the FDL.

The Council confirms that, in accordance with Article 11 of the FDL, no adjustment to the structural balance is necessary. The structural balance rule and the expenditure growth rule calculations for 2013-2016 indicate that a positive deviation buffer has been accumulated (see Chart 1). However, the considerable impact of the cyclical component on the assessment of the structural balance and the impact of the GDP deflator's estimates on the calculation of the expenditure growth rule suggests the need for conservative fiscal policy.

The Council notes that, based on the expenditure growth rule, the positive execution results in 2016 have improved the balance of accrued deviations.

**The Council contends that, to further improve the FDL framework, it would be useful to include all the fiscal numerical rules outlined in the FDL in the correction mechanism assessment, including the expenditure growth rule.**