

## Addendum to the Fiscal discipline surveillance interim report on Latvia's Stability Programme 2019-2022

With this addendum, the Fiscal Discipline Council (the Council) responds to the press release issued by the Ministry of Finance (MoF) on 24 April 2019, where the MoF insists that Latvia's Stability Programme 2019-2022 (SP 2019/22) is fully compliant with the Fiscal Discipline Law (FDL). The MoF incorrectly interprets that the Council objects the treatment of the tax reform as a one-off measure. Actually, the Council does not find the adjustment of the fiscal rules for the effects of the tax reform consistent with the FDL.

In the Fiscal discipline surveillance interim report on the SP 2019/22 released on 23 April 2019 the Council identified a number of deviations from the FDL.

SP 2019/22 applies for the assessment of the fiscal rules according to the FDL by treating the impact of the tax reform as one-off measure, which for 2019-2020 increases government expenditure ceilings. The Council objects this treatment on the grounds as the following:

- FDL does not stipulate the use of one-off measures to make adjustment to the expenditure ceilings;
- One-off measures as adjustor for the assessment of the fiscal rules are permitted by the regulations pertaining to the EU Stability and Growth Pact;
- Tax reform implemented in Latvia based on a set of laws passed in 2017 has been a discretionary act by the authorities of the Government and should be treated as such in the assessment of the fiscal rules.

The MoF in the SP 2019/22 acknowledges that the one-off measure because of the deterioration in tax revenues does not meet the criteria of the EU Stability and Growth Pact to be applied as adjustment in the medium term scenario<sup>1</sup>. In the absence of explicit regulation adopted under the FDL, the Council cannot accept the use of the one-off measure related to deterioration of tax revenues resulting from the tax reform as compliant with the FDL. These circumstances have not changed since the assessment by the Council of the explanation provided by the MoF in March 2019<sup>2</sup>.

The Council is looking forward to a comprehensive assessment of the effects of the tax reform, including segregation of one-off impact from long-term impact on the government fiscal position.

The Council does not agree with the interpretation of the fiscal rules assessment in both fiscal criteria – in regard to the context of the structural balance and expenditure growth rule. The Council reiterates that an extended interpretation of the FDL creates a critical undesirable precedent in the framework of Latvia's fiscal policy.

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<sup>1</sup> Latvia's Stability programme 2019-2022. Available [here](#). Page 39, page 82, accessed on 08/05/2019.

<sup>2</sup> The Council does not consider the explanation provided by the MoF sufficient because it does not justify an extended interpretation of the FDL. FM response is available here: [http://fiscalcouncil.lv/files/uploaded/FDP\\_1\\_08\\_288\\_20190305\\_FDSR\\_Ann1.pdf](http://fiscalcouncil.lv/files/uploaded/FDP_1_08_288_20190305_FDSR_Ann1.pdf), accessed on 08/05/2019.

The Council's opinion anthology on the impact of tax reform:	
<i>Council</i>	<i>MoF reply</i>
On 30 March 2017 <sup>3</sup> , in cooperation with the European Commission Representation in Latvia, Council organised an expert discussion on Latvia's tax policy reform strategy. The Council expressed its concern that (i) the tax reform has been devised without a long-term view of the government requirements; (ii) some of the proposed changes involve significant high short-term risks of reduced tax revenues; (iii) the government has not defined any of sectors to reduce their funding, and even for some areas, there are plans even to increase expenditures. Achieving such goals and at the same time ensuring fiscal discipline would require rapid, unprecedented growth in tax revenues.	–
On 17 July 2017 <sup>4</sup> , the Council issued a non-comformity report on draft legislation of the tax reform to the Government, the Saeima and the Minister of Finance. The Council pointed to a non-compliance with Article 9 of the FDL, as the Government, when submitting package of the tax reform draft laws to the Saeima, did not add sufficient legislative proposals that compensate the revenue shortfall.	On 21 July 2017, the MoF replied that the next medium-term budget framework would be prepared according to the FDL.
On 4 October 2017 <sup>5</sup> , the Council issued a Fiscal discipline surveillance report on Latvia's medium-term budget framework, pointing to significant differences in the calculation of fiscal rules. The Council declined support for the inclusion of discretionary measures (the tax reform) in expenditure rule calculation according to the proposed calculation algorithm (as one-off measures with the opposite sign).	–
On 6 April 2018 <sup>6</sup> , the Council issued interim Fiscal discipline surveillance report on the Latvia's Stability Programme 2018-2021. Despite the positive assessment, the Council expressed concerns that the basic budget balance projections indicated a pro-cyclical fiscal policy and the structural balance projections do not reflect the tax reform correctly.	On 10 April 2018, the MoF replied that the tax shortfall resulting from the tax reform should be excluded from the structural balance as one-off effect, despite the fact that the European Commission would

<sup>3</sup> Expert discussion on Latvia's tax policy reform strategy. 30 March 2017. Available here: <http://fiscalcouncil.lv/discussion-on-tax-reform>, accessed on 08/05/2019.

<sup>4</sup> Irregularity report regarding the draft legislation of the tax reform. 17 July 2017. Available here: [http://fiscalcouncil.lv/files/uploaded/FDP\\_1\\_08\\_1124\\_20170717\\_NZ\\_nodoklu\\_reforma\\_EN.pdf](http://fiscalcouncil.lv/files/uploaded/FDP_1_08_1124_20170717_NZ_nodoklu_reforma_EN.pdf) or together with the MoF reply: <http://fiscalcouncil.lv/17072017-irregularity-report>, accessed on 08/05/2019.

<sup>5</sup> Fiscal discipline surveillance report on Latvia's medium-term budget framework 2018-2020. 4 October 2017. Available here: [http://fiscalcouncil.lv/files/uploaded/FDP\\_1\\_08\\_1499\\_20171004\\_FDSR\\_without\\_annexes.pdf](http://fiscalcouncil.lv/files/uploaded/FDP_1_08_1499_20171004_FDSR_without_annexes.pdf). Page 19, accessed on 08/05/2019.

<sup>6</sup> Fiscal discipline surveillance interim report on Latvia's Stability programme 2018-2021. 6 April 2018. Available here:

[http://fiscalcouncil.lv/files/uploaded/FDP\\_1\\_08\\_409\\_20180406\\_Interim\\_report\\_without\\_annexes.pdf](http://fiscalcouncil.lv/files/uploaded/FDP_1_08_409_20180406_Interim_report_without_annexes.pdf). Page 21 or together with the MoF reply: <http://fiscalcouncil.lv/06042018-interim-report-opinion>, accessed on 08/05/2019.

The Council's opinion anthology on the impact of tax reform:	
<i>Council</i>	<i>MoF reply</i>
	not recognize it as a one-off measure in the context of the EU Stability and Growth Pact.
On 28 December 2018 <sup>7</sup> , the Council issued the Fiscal discipline surveillance report on interim budget for 2019. The Council advised to exclude the tax reform impact as an expenditures-increasing effect in the calculation of fiscal rules.	–
On 5 March 2019 <sup>8</sup> the Council issued a Fiscal discipline surveillance report on budget for 2019. The Council refused to recognise the treatment for the impact of the tax reform in the assessment of the structural balance for the budget prepared by the MoF being consistent with the FDL <sup>9</sup> and advised to make appropriate adjustments in the preparation of the fiscal framework for 2020.	The Council attached the MoF's position, which was requested before the issuing of the Council's report.
On 23 April 2019 <sup>10</sup> , the Council issued an interim Fiscal discipline surveillance report on the Latvia's Stability programme 2019-2022. The Council repeated the opinion that tax reform should be categorized similar to other government revenue-reducing measures, and that the baseline scenario needs to be adjusted accordingly.	On 24 April 2019, the MoF published a press release <sup>11</sup> in which it continued to insist that the SP 2019/22 the complies with the FDL of the tax reform impact calculations.

<sup>7</sup> Fiscal discipline surveillance report on interim budget for 2019. 28 December 2018. Available here: [http://fiscalcouncil.lv/files/uploaded/FDP\\_1\\_08\\_1589\\_20181228\\_FDSR.pdf](http://fiscalcouncil.lv/files/uploaded/FDP_1_08_1589_20181228_FDSR.pdf), pages 3-4, accessed on 08/05/2019.

<sup>8</sup> Fiscal discipline surveillance report on budget for 2019. 5 March 2019. Available here: [http://fiscalcouncil.lv/files/uploaded/FDP\\_1\\_08\\_288\\_20190305\\_FDSR.pdf](http://fiscalcouncil.lv/files/uploaded/FDP_1_08_288_20190305_FDSR.pdf), page 11, accessed on 08/05/2019.

<sup>9</sup> The Council does not consider the explanation provided by the MoF sufficient because it does not justify an extended interpretation of the FDL. FM response is available here: [http://fiscalcouncil.lv/files/uploaded/FDP\\_1\\_08\\_288\\_20190305\\_FDSR\\_Ann1.pdf](http://fiscalcouncil.lv/files/uploaded/FDP_1_08_288_20190305_FDSR_Ann1.pdf), accessed on 08/05/2019.

<sup>10</sup> Fiscal discipline surveillance interim report on the Latvia's Stability programme 2019-2022. 23 April 2019. Available here: [http://fiscalcouncil.lv/files/uploaded/FDP\\_1\\_08\\_393\\_20190423\\_Interim\\_report.pdf](http://fiscalcouncil.lv/files/uploaded/FDP_1_08_393_20190423_Interim_report.pdf), page 16, accessed on 08/05/2019.

<sup>11</sup> MoF: Stability programme is fully compliant with the Fiscal discipline law. 24 April 2019. Press release in Latvian available here: <http://fm.gov.lv/lv/aktualitates/jaunumi/60431-fm-stabilitates-programma-pilniba-atbilst-fiskalas-disciplinas-likumam>, accessed on 08/05/2019.