

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 Council shall draw up and submit to the Saeima and Cabinet an opinion in other fiscal policy and macroeconomic development issues, if it considers them as substantial for the complying with the norms set out in this Law.

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 area¹ (Regulation 473/2013) 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. The rule stipulates an adjustment of the general government minimum allowable budget balance in the medium-term budgetary plan to ensure that the actual deviation from the structural balance rule does not impede the establishment of a balanced budget. The transitional provisions of the FDL stipulate that 2013 is the reference year from which the requirements of the adjustment mechanism under Article 11 of the FDL are assessed.

According to the Memorandum of Understanding² (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.

Ex-post assessment of the structural balance rule

According to Article 11 of the FDL, the Ministry of Finance (hereinafter - the MoF) calculated the actual structural balances and the difference between the minimum projected structural balance, and submitted calculations to the Council on 27th of November.

At the meeting on 17th of December 2020, the Council examined the data provided by the MoF on compliance with Article 11 of the FDL. Verification of compliance with the provisions of Article 11 of the FDL is included in Table 1.

Table 1

Verification of compliance with the requirements of Article 11 of the FDL

Item	2013	2014	2015	2016	2017	2018	2019
(1) GDP, at current prices	22 923.7	23 613.9	24 560.9	25 360.3	26 962.3	29 142.5	30 463.3
(2) Actual structural general government budget balance, % of GDP	-1.4	-1.5	-1.8	-0.3	-1.3	-1.7	-0.7
(3) Actual structural general government budget balance	-323.0	-364.0	-453.1	-69.2	-346.8	-494.6	-221.5
(4) Minimum planned structural general government budget, % of GDP	-1.3 ³	-1.0 ⁴	-1.0 ⁵	-0.9 ⁶	-1.0 ⁷	-1.2 ⁸	-0.6 ⁹

¹ Regulation 473/2013 available: [EUR-Lex - 32013R0473 - EN - EUR-Lex \(europa.eu\)](https://eur-lex.europa.eu/eli/reg/2013/473/oj)

² FDP_1_09_849_20180619_MoU_FDC_MoF_consolidated.pdf ([fiscalcouncil.lv](https://www.fiscalcouncil.lv/))

³ Zaudējis spēku - Par vidēja termiņa budžeta ietvaru 2013., 2014. un 2015. gadam (likumi.lv)

⁴ Zaudējis spēku - Par vidēja termiņa budžeta ietvaru 2014., 2015. un 2016. gadam (likumi.lv)

⁵ Zaudējis spēku - Par vidēja termiņa budžeta ietvaru 2015., 2016. un 2017. gadam (likumi.lv)

⁶ Zaudējis spēku - Par vidēja termiņa budžeta ietvaru 2016., 2017. un 2018. gadam (likumi.lv)

⁷ Zaudējis spēku - Par vidēja termiņa budžeta ietvaru 2017., 2018. un 2019. gadam (likumi.lv)

⁸ Zaudējis spēku - Par vidēja termiņa budžeta ietvaru 2018., 2019. un 2020. gadam (likumi.lv)

⁹ Zaudējis spēku - Par vidēja termiņa budžeta ietvaru 2018., 2019. un 2020. gadam (likumi.lv)

Continuation of table 1

(5) Minimum planned structural general government budget balance	-298.0	-236.1	-245.6	-228.2	-269.6	-349.7	-172.6
(6) Deviation from plan for the year	-25.0	-127.9	-207.5	159.0	-77.2	-144.9	-48.9
(7) Deviation from plan for the year, % of GDP	-0.1	-0.5	-0.8	0.6	-0.3	-0.5	-0.2
(8) Accrued deviation from plan for all years starting with 2013	-25.0	-152.9	-360.4	-201.4	-278.6	-423.5	-472.4
(9) Accrued deviation from plan for all years starting with 2013, % of GDP	-0.1	-0.6	-1.5	-0.8	-1.0	-1.5	-1.6
(10) Rule in accordance with Article 11 of the FDL, % of GDP	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
(11) Correction necessary if 9.< 10.	No	Yes	Yes	Yes	Yes	Yes	Yes

Source: MoF and Council calculations

At the end of 2019, the accumulated actual deviations from the structural balance rule for all years, starting from 2013 as a percentage of GDP, reached -1.6%. Mathematically, such an accumulated difference stipulates to enforce correction mechanism to ensure a balanced budget in the coming years.

However, in 2020, the Latvian economy faced a severe economic downturn caused by the Covid-19 pandemic. Performance of economy in 2020 and coming years are projected below of its potential and the output gap will be negative (see Table 2).

According to article 11, part (6) of FDL, correction shall not be carried out, if the forecasted difference between the gross domestic product and potential gross domestic product in constant prices is negative. The correction shall be carried out in the year when the above mentioned difference is positive.

Table 2

Output gap (%) and real GDP (mlj. EUR)

Item/year	2019	2020	2021	2022	2023
Real GDP	27561	25631	26939	27787	28655
Potential GDP	27130	27774	28469	29180	29890
Output gap % GDP	1.6	-7.7	-5.4	-4.8	-4.1

Source MoF

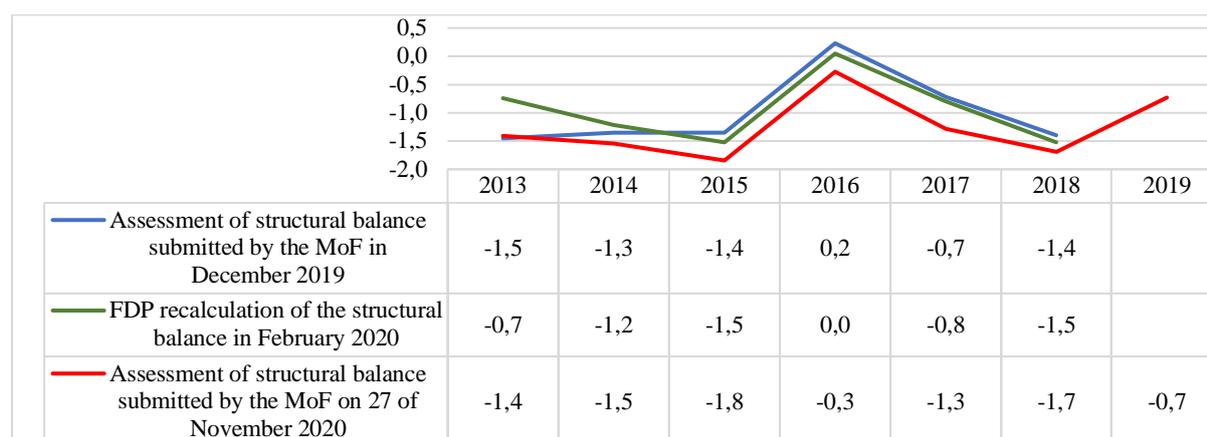
Given the set of conditions of Article 11 of the FDL and the economic situation reality in 2020, as well economic forecasts for the coming years, the Council acknowledges that the corrective mechanism is not applicable at a time when the economy operating below its potential. At the same time, the Council points to the need to balance real economic performance with planned expenditures, whereas it will be necessary to return to balanced budget practices in the coming years.

The Council notes that in a year when economic growth will return and the output gap will reach positive values, the corrective mechanism may be enforced which means that in the draft framework law for the third year, the minimum planned structural balance of the general government budget shall be determined greater for 0.5 per cent of the gross domestic product than that allowed by the structural balance deficit mentioned in Article 10 of the FDL (-0.5% of GDP).

Changes of the structural balance in period 2013-2020

The value of the output gap is an integral part of the structural balance and, as it changes, the structural balance has changed accordingly over the years. Assessment of 2019 shows deterioration of the structural balance values. Changes in the output gap affect both the CSB 's revisions of GDP data and

recalculation of potential GDP due to the Covid-19 crisis. In the period 2019-2020 output gap value has changed several times (see Figure 1).



Source: MoF and Council calculations

Fig. 1 Changes in the assessment of the structural balance in period 2013-2020

On 7th of February 2020, updated estimates of potential GDP were received from the MoF, which are included in the macroeconomic forecasts of the Stability Program (baseline scenario) for 2020/2023¹⁰. Using updated estimates of potential GDP, the FDP recalculated the level of the structural balance, finding that in 2015, it deteriorated by 0.2% p. at 2016 by 0.1% p, at 2017 by 0.4%p. and in 2018 by 0.1%p. At the same time, assessing extraordinary (CoV) macroeconomic forecasts for the Stability Program 2020/2023 the Council noted the necessity for adjustment of potential GDP values¹¹.

On 15th of June 2020, the FDP approved macroeconomic forecasts for the medium-term budgetary framework 2020/2023¹².

The Ministry of Finance had taken into account the Council's recommendations on the Stability Program 2020/2023 and adjusted the estimate of potential GDP, which also affected the estimate of the output gap.

On 27th of November 2020, the Council received an assessment from the Ministry of Finance on the fulfilment of the condition of Article 11 of the FDL from 2013 to 2019. The calculations included the revisions of GDP data by CSB made in 30th of September 2020, which also resulted in an adjustment of the potential GDP and output-output gap, leading to a deterioration in structural balance values for the period from 2013 to 2018.

¹⁰ [OPINION ON THE MINISTRY OF FINANCE'S EXTRAORDINARY REVISED MACROECONOMIC FORECAST 14.04.2020. OPINION ON THE MINISTRY OF FINANCE'S EXTRAORDINARY REVISED MACROECONOMIC FORECAST \(fiscalcouncil.lv\)](#)

¹¹ [INTERIM REPORT ON LATVIA 'S STABILITY PROGRAM 2020-2023 YEAR Microsoft Word - FDP_1_08_213_20200429_FDP_viedoklis_par_Latvijas_Stabilitates_programmu_2020.-2023.gadam_PIELIKUMS](#)

¹² [FDC OPINION ON THE MINISTRY OF FINANCE'S MACROECONOMIC FORECAST FOR 2020 AND 2021-2023 15.06.2020. FDC OPINION ON THE MINISTRY OF FINANCE'S MACROECONOMIC FORECAST FOR 2020 AND 2021-2023 \(fiscalcouncil.lv\)](#)