

## Verification of compliance with the requirements of article 11 of the fiscal discipline law

### Council opinion

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<sup>1</sup> (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 includes 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 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.

#### **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 1<sup>st</sup> of December.

At the meeting on 16<sup>th</sup> of December 2021, 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.

<sup>1</sup> Regulation 473/2013 available: [EUR-Lex - 32013R0473 - EN - EUR-Lex \(europa.eu\)](#)

<sup>2</sup> [FDP\\_1\\_09\\_849\\_20180619\\_MoU\\_FDC\\_MoF\\_consolidated.pdf \(fiscalcouncil.lv\)](#)

**Table 1 Verification of compliance with the requirements of Article 11 of the FDL**

Item/year	2013	2014	2015	2016	2017	2018	2019	2020
(1) GDP, at current prices	22 749	23 626	24 572	25 371	26 984	29 154	30 647	29 511
(2) Actual structural general government budget balance, % of GDP	-1,4	-1,6	-2,0	-0,4	-1,4	-1,7	-0,7	-2,8
(3) Actual structural general government budget balance	-314,8	-384,8	-480,2	-106,2	-374,6	-493,2	-205,3	-820,8
(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>	-1.2 <sup>8</sup>	-0.6 <sup>9</sup>	-0.5 <sup>10</sup>
(5) Minimum planned structural general government budget balance	-295,7	-236,3	-245,7	-228,3	-269,8	-349,8	-173,6	-137,2
(6) Deviation from plan for the year	-19,1	-148,5	-234,5	122,2	-104,8	-143,4	-31,7	-683,6
(7) Deviation from plan for the year, % of GDP	-0,1	-0,6	-1,0	0,5	-0,4	-0,5	-0,1	-2,3
(8) Accrued deviation from plan for all years starting with 2013	-19,1	-167,6	-402,1	-280,0	-384,7	-528,1	-559,8	-1 243,4
(9) Accrued deviation from plan for all years starting with 2013, % of GDP	-0,1	-0,7	-1,6	-1,1	-1,4	-1,8	-1,8	-4,2
(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	-0,5
(11) Correction necessary if 9.< 10.	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Source: MoF and Council calculations

At the end of 2020, the accumulated actual deviations from the structural balance rule for all years, starting from 2013 as a percentage of GDP, reached -4.2% and mathematically such an accumulated difference strongly stipulates to enforce correction mechanism to ensure a balanced budget in the coming years.

However, in 2020 and 2021, the Latvian economy faced a severe economic downturn caused by the Covid-19 pandemic. As well as performance of economic in 2021 and coming years are projected below of its potential and the output gap will be negative<sup>11</sup> (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

<sup>3</sup> No longer in force - Par vidēja termiņa budžeta ietvaru 2013., 2014. un 2015.gadam (likumi.lv)

<sup>4</sup> No longer in force - Par vidēja termiņa budžeta ietvaru 2014., 2015. un 2016.gadam (likumi.lv)

<sup>5</sup> No longer in force - Par vidēja termiņa budžeta ietvaru 2015., 2016. un 2017.gadam (likumi.lv)

<sup>6</sup> No longer in force - Par vidēja termiņa budžeta ietvaru 2016., 2017. un 2018.gadam (likumi.lv)

<sup>7</sup> No longer in force - Par vidēja termiņa budžeta ietvaru 2017., 2018. un 2019. gadam (likumi.lv)

<sup>8</sup> No longer in force - Par vidēja termiņa budžeta ietvaru 2018., 2019. un 2020. gadam (likumi.lv)

<sup>9</sup> No longer in force - Par vidēja termiņa budžeta ietvaru 2018., 2019. un 2020. gadam (likumi.lv)

<sup>10</sup> No longer in force - Par vidēja termiņa budžeta ietvaru 2020., 2021. un 2022. gadam (likumi.lv)

<sup>11</sup> 14.06.2021. Endorsement of the Ministry of Finance macroeconomic forecasts for the medium-term budgetary framework 2022/24 | Fiskālās disciplīnas padome (fdp.gov.lv)

constant prices is negative. The correction shall be carried out in the year when the abovementioned difference is positive. According to latest macroeconomic forecasts, it may happen at 2024.

**Table 2. Output gap (%) and real GDP (mil. EUR)**

<b>Item/year</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>
IKP Real GDP	26 555	27 532	28 898	29 898	30 903
Potential GDP	27 693	28 275	29 049	29 918	30 845
Output gap % GDP	-4.1	-2.6	-0.5	-0.1	0.2

Source: MoF

**Given the set of conditions of Article 11 of the FDL and the economic situation reality during the Covid crisis 2020-2021, 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 states that correction mechanism is already in force and should be applied when the output gap reach positive rates.**