



On the Implementation of Part 11 of the Fiscal Discipline Law (Correction Mechanism)

Opinion of the Council

In accordance with Section 28, paragraph 7 of the Fiscal discipline law (hereinafter - FDL), the Fiscal discipline council (hereinafter - Council) shall prepare and submit an opinion to the Saeima and the Cabinet of Ministers regarding fiscal policy issues if they are recognized as essential for compliance with FDL norms.

According to the Regulation (EU) No 473/2013¹ 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) 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 correction 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 estimated according to Article 11 of the FDL through triggering the automatic correction mechanism to adjust and the future periods to which the correction applies.

In accordance with Section 11 of the FDL, until 1st of December of the next year (this year 2023) the Ministry of Finance (hereinafter - MoF) shall calculate a difference between actual structural balance of the general government budget and minimum planned structural balance of the general government budget for each financial year.

On September 29, 2023, the Central Statistics Bureau (CSB) carried out wide revisions of national accounts data, which affects the MoF calculations for FDL Article 11 rules as well. Considering these reasons MoF submitted calculations of FDL correction mechanism on 6th of December. MoF calculations included updated data on GDP and potential GDP dynamics since 2013.

Ex-post evaluation of the structural balance rule

Looking at the compliance of the conditions of Article 11 of the FDL in the context of structural balance rule (FDL Article 10), the Council would like to note that the deviations of the general government structural balance (hereinafter GGSB) from the minimum planned GGSB level and the accumulated amount of these deviations show that correction procedure is not applicable. The sum of GGSB deviations accumulated in all years exceeded the threshold value (-0.5 % of GDP) required for initiation of correction. In 2022, the difference between the actual structural balance of the general government budget and the minimal planned structural balance of the general government budget is 1.86 billion euros, but the accumulated amount of balance

¹ Regulation 473/2013 [EUR-Lex - 32013R0473 - EUR-Lex \(europa.eu\)](#)

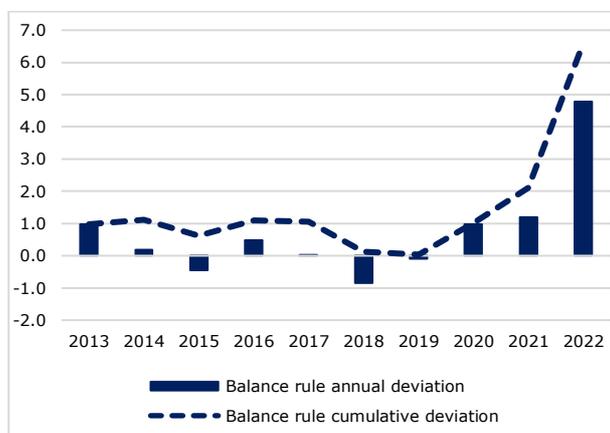
² Memorandum of understanding between MoF and Council [download \(fdp.gov.lv\)](#)

deviations for all years starting from 2013 is 2.56 billion euros, or 6.6% of GDP (see table 1 at the end of the document and figure 1)

In addition, it should be noted that:

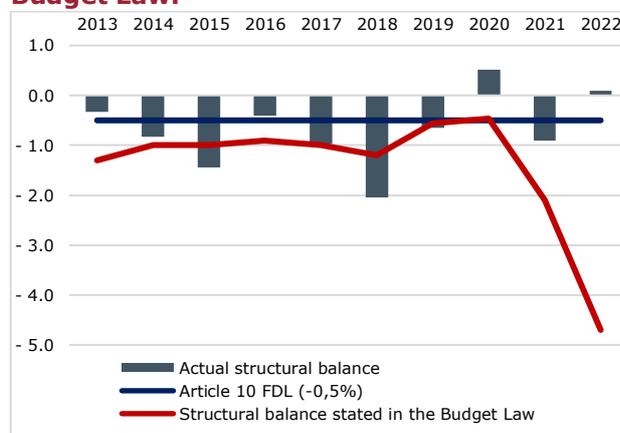
- In the period from 2013 to 2022, the actual GGSB was formed with a surplus in only two years. MoF data show that there were surpluses of GGSB in 2020 (0.5% of GDP) and in 2022 (0.1% of GDP).
- The restriction set in Article 10 of the FDL, or structural balance rule stipulates to plan GGSB not lower than (-0.5% of GDP). Compliance of this rule was observed only in four years - 2013 (-0.3% of GDP), 2016 (-0.4% of GDP) and in the already mentioned 2020 and 2022, (see figure 2).
- The most significant deviations from the marginal value of the structural balance were in 2015 (-1.4%), 2017 (-1% of GDP) and 2018 (-2% of GDP).
- In the period from 2021 to 2022, which related to Covid-19 pandemic, Russia's military aggression in Ukraine, and the operation of the escape clause of the Stability and Growth Pact, a sharp deterioration of the planned GGSB was observed. However, the actual GGSB value in these years has been close to or exceeded the FDL the marginal value sat for in Article 10, (see figure 2).

Figure 1. Ex-post assessment of the structural balance rule



Source: MoF and Council calculations [Table 3 of appendix 1]

Figure 2. The actual structural balance values compared to the balance rule (Article 10 of the FDL) and the minimum GGSB in Budget Law.



Source: MoF and Council calculations [Table 1 of appendix 1]

SB assessment approaches in the coming years

In its Surveillance reports^{3,4,5} the Council has repeatedly indicated that the planned defence and internal security expenditures in the following years, in the period from 2023 to 2026, do not meet the definition of one-off measures in the sense of the EU SGP. The amount of these expenses is significant - in 2023. 457 million EUR or 1.1% of GDP), in 2024. 810 million EUR or 1.8% of GDP), in 2025 881 million EUR or 1.8% of GDP and in 2026 596 million EUR or

³ Surveillance report on the MTBF 2024-2026 and the Budget for 2024 | Fiskālās disciplīnas padome (fdp.gov.lv)

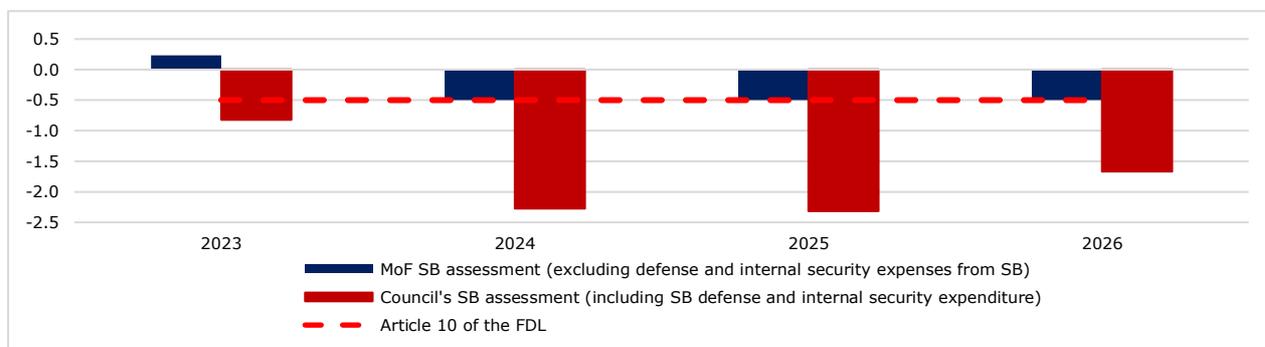
⁴ Interim report on Stability program 2023/26 | Fiskālās disciplīnas padome (fdp.gov.lv)

⁵ Surveillance report on MTBF 2023-25 and budget 2023 | Fiskālās disciplīnas padome (fdp.gov.lv)

1.2% of GDP - thus its inclusion or exclusion in the SB calculation can radically change the necessity of applying the correction mechanism. According to the data provided by the MoF, in the process of preparing the Medium-term budget framework 2023-2026, the planned structural balance from which defence and internal security expenses are excluded for the whole period is -0.5% of GDP and thus may be created the impression that the of the structural balance rule (paragraph 10 of the FDL) has been met.

However, according to the Council's calculations, in the case that defence and internal security expenses are included in the structural balance, it significantly worsens throughout the period and do not meet the (FDL p. 10) limit value (-0.5% of GDP) - indicative structural balance in 2023 can be reached (-0.8% of GDP), in 2024 and 2025 (-2.3% of GDP), but in 2026 (-1.7% of GDP). The differences in the assessment can be seen in Figure 3.

Figure 3. Estimated value of structural balance MoF and Council assessment



MoF and Council calculations [Table 5 of appendix 1]

Ex-post evaluation of the expenditure growth rule

In addition to the structural balance rule, the Council also applied an indicative ex-post assessment expenditure growth rule to verify the deviations of the state budget expenditures planned in Budget Law from the actual expenditures.

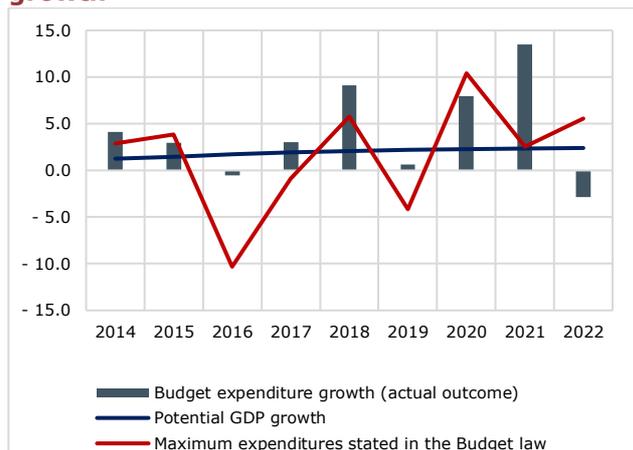
The Council considers that the ex-post assessment of the expenditure growth rule is not provided in the framework of Article 11 of the FDL, however, the Council believes that such approach allows to assess various components of the budget and identify possible risks of fiscal imbalances.

In the period from 2014 to 2021 observed a constant increase in actual state budget expenditures. The reduction of expenses observed only in 2016 by (0.5%) and in 2022 by (2.8%). The latest reduction is related to the termination of large-scale state support programs that were related to the mitigation of the consequences of Covid-19 and the Energy cost crisis.

As can be seen in Figure 4, correction is not necessary within the framework of Article 11 of the FDL, since the accumulated deviations from the planned structural balance are not lower than -0.5% of GDP. Conversely, the actual budget expenditures have exceeded the planned maximum allowed expenditures defined in the budget law, every year since 2015. Thus, over the years, a significant deviation of the accumulated actual expenses from the planned has been formed, which 2022 reached 12.8 billion, or 33% of GDP.

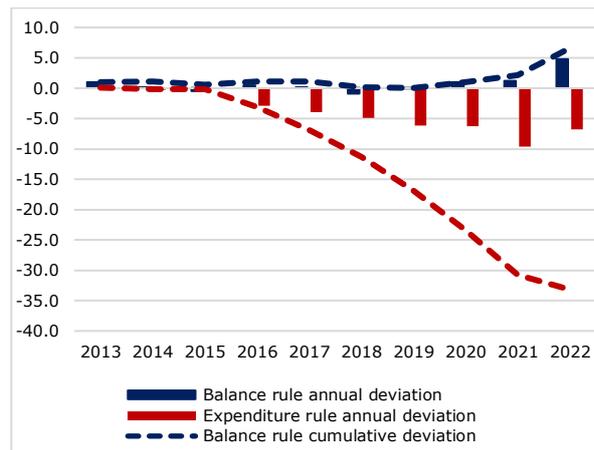
The increase in expenditures has also exceeded the growth of the 10-year average potential GDP in almost the entire observation period. In the period from 2014 to 2015, in 2018 and in the period from 2020 to 2022, the increase in state budget expenses more or less exceeded the growth of 10-year average potential GDP, (see figure 5).

Actual and planned expenditure growth compared to 10-year average potential GDP growth



Source: MoF and Council calculations [Table 2 of appendix 1]

Estimation of ex-post balance rule and expenditure growth rule



Source: MoF and Council calculations [Table 6 of appendix 1]

By comparing the 10-year average potential GDP growth rate with the preceding government expenditure growth rate, the Council indicates the risk of ending up with increasingly narrow fiscal options in the long term.

Decision of the Council

At the meeting on 20th of December 2023, 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 at the end of this document and attached in an Excel file in Appendix 1 of this document.

In the year 2022, the accumulated amount of balance deviations as % of GDP exceeds the amount stipulated by the FDL (-0.5), and the corrective mechanism does not need to be applied.

The Council draws attention to further assessments covering the periods 2023-2026, and suggests that the MoF in these years assess the structural balance according to the national methodology and, in addition, according to the EU SGP methodology, according to which, expenses for defence and internal security are not considered as one-off expenditures and therefore should be included in the SB calculation.

At the same time, the Council carefully observe the development of the political process for the practice of accounting the defence expenses of the EU⁶ and other EU countries and maintains flexibility in case the position of the EC on one-off expenses for national defence changes in the following years.

⁶ [Germany puts its troops in the line of fire if Putin attacks NATO - POLITICO](#)

Table 1

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

Indicator/year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
(1) GDP at current prices, EUR million	22 749	23 626	24 572	25 371	26 984	29 154	30 573	30 109	33 349	38 870
(2) Actual structural general government budget balance, % of GDP -	-0,3	-0,8	-1,4	-0,4	-1,0	-2,0	-0,7	0,5	-0,9	0,1
(3) Actual structural general government budget balance (mill. EUR)	-74,6	-194,7	-355,5	-104,0	-262,0	-597,0	-200,3	154,2	-303,1	35,3
(4) Minimum planned structural general government budget, % of GDP (Objectives of the structural balance set by the MTBF)	-1,3 ⁷	-1,0 ⁸	-1,0 ⁹	-0,9 ¹⁰	-1,0 ¹¹	-1,2 ¹²	-0,6 ¹³	-0,5 ¹⁴	-2,1 ¹⁵	-4,7 ¹⁶
(5) Minimum planned structural general government budget balance (mill. EUR)	-295,7	-236,3	-245,7	-228,3	-269,8	-349,8	-173,2	-140,0	-700,3	-1 826,9
(6) Deviation from plan for the year, million euro (3-5) (mill. EUR)	221,1	41,5	-109,8	124,4	7,8	-247,2	-27,1	294,1	397,2	1 862,2
(7) difference in balances for the financial year (% of GDP)	1,0	0,2	-0,4	0,5	0,0	-0,8	-0,1	1,0	1,2	4,8
(8) Accumulated balance deviations for all years starting from 2013 (mill. EUR)	221,1	262,6	152,8	277,2	285,1	37,9	10,8	304,9	702,1	2 564,3
(9) Accumulated balance deviations as % of GDP	1,0	1,1	0,6	1,1	1,1	0,1	0,0	1,0	2,1	6,6
(10) Rule in accordance with Article 11 of the FDL, as % of GDP	-0,5	-0,5	-0,5	-0,5	-0,5	-0,5	-0,5	-0,5	-0,5	-0,5
(11) Correction necessary if 9. < 10.	No need to correct									

Source: MoF and Council calculations

⁷Expired - on the medium-term budgetary framework for 2013, 2014 and 2015 (likumi.lv)

⁸Expired - on the medium-term budgetary framework for 2014, 2015 and 2016 (likumi.lv)

⁹Expired - on the medium-term budgetary framework for 2015, 2016 and 2017 (likumi.lv)

¹⁰Expired - on the medium-term budgetary framework for 2016, 2017 and 2018 (likumi.lv)

¹¹Expired - on the medium-term budgetary framework for 2017, 2018 and 2019 (likumi.lv)

¹²Expired - on the medium-term budgetary framework for 2018, 2019 and 2020 (likumi.lv)

¹³Expired - on the medium-term budgetary framework for 2018, 2019 and 2020 (likumi.lv)

¹⁴Expired - on the medium-term budgetary framework for 2020, 2021 and 2022 (likumi.lv)

¹⁵On the medium-term budgetary framework for 2021, 2022 and 2023 (likumi.lv)

¹⁶On the medium-term budgetary framework for 2022, 2023 and 2024 (likumi.lv)