



Independent Fiscal Institutions Review

# OECD Review of Latvia's Fiscal Discipline Council



## OECD Review of Latvia's Fiscal Discipline Council

This report presents the OECD review of the performance of Latvia's Fiscal Discipline Council on the basis of the OECD Recommendation of the Council on Principles for Independent Fiscal Institutions.

The European Commission's Structural Reform Support Programme (SRSP) provided funding for the review, and the review was organised in coordination with the European Commission's Directorate-General for Structural Reform Support.

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# Foreword

Independent fiscal institutions (IFIs) are publicly funded, independent bodies that provide non-partisan oversight and analysis of fiscal policy. They have grown in number in recent years as a cornerstone of budget scrutiny and oversight frameworks in OECD countries.

The Fiscal Discipline Council (FDC) supports Latvia's fiscal management by monitoring compliance with fiscal rules, scrutinising and endorsing macroeconomic forecasts, and assessing other financial risks and sustainability topics. The FDC requested the OECD to undertake this independent review of its performance on the basis of the OECD Recommendation of the Council on Principles for Independent Fiscal Institutions.

The OECD would like to thank the staff of the FDC and the stakeholders that were consulted for the preparation of the review, which included members of the Saeima (Parliament of the Republic of Latvia), staff of the Ministry of Finance, the Latvijas Bankas (Bank of Latvia) and other stakeholders in the public and private sector. A complete list of interviewees is provided in Annex A.

The OECD reviewers were Scott Cameron and Scherie Nichol from the OECD Secretariat's Public Management and Budgeting Division in the Directorate for Public Governance; Peter Fontaine, formerly of the U.S. Congressional Budget Office's Budget Analysis Division; Geert Langenus, National Bank of Belgium; Claire Murdoch, Scottish Fiscal Commission; Viktor Novyshedlak, Slovak Republic's Council for Budget Responsibility; and Irēna Emīlija Švilpe, Bank of Latvia and formerly of Latvia's Ministry of Finance.

The review also benefitted from feedback from staff of the OECD Secretariat, in particular, Jón Blöndal, Head of the Public Management and Budgeting Division.

The European Commission's Structural Reform Support Programme (SRSP) provided funding for this review, and the review was organised in coordination with the European Commission's Directorate-General for Structural Reform Support. It is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries or those of the European Commission.

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# Abbreviations and acronyms

EU	European Union
FDC	Fiscal Discipline Council
GDP	Gross Domestic Product
IFI	Independent Fiscal Institution
IMF	International Monetary Fund

# Executive summary and recommendations

Latvia's Fiscal Discipline Council (FDC) was established in 2013 by the *Fiscal Discipline Law* and began operating on 1 January 2014. Its mandate is to monitor the government's compliance with fiscal rules, endorse the macroeconomic forecasts that are used to prepare the budget, assess the adequacy of the fiscal security reserve and assess the sustainability of national fiscal policy, among other responsibilities.

The OECD's review concluded that the FDC is an effective fiscal monitoring body for Latvia and adheres closely to the OECD Principles for Independent Fiscal Institutions (IFIs). It can achieve even greater alignment to the OECD Principles and increase its impact by addressing the following areas with the associated recommendations:

- 1. Analytical underpinning of Council opinions.** Stakeholders perceive the FDC's opinions as being driven in large part by the expertise of the highly engaged and well-respected Chair. This contrasts with many of the FDC's European peers, whose formal opinions are viewed primarily as grounded in the analytical work of their secretariat.

*Recommendation:* Given that the FDC's secretariat does not currently have staff resources available to develop sophisticated internal models, the Council should seek external technical assistance to help build the capacity to support Council opinions with a clear and consistent analytical base that endures beyond the tenure of any specific Chair or Council members. The secretariat should focus first on developing modelling capabilities for fiscal analysis, which would most quickly align the FDC with its European peers. Since the start of this review and the provision of draft recommendations, the FDC has begun receiving such assistance through the European Commission's Directorate-General for Structural Reform Support.

- 2. Long-term fiscal sustainability analysis.** Stakeholders appreciated the FDC's Sustainability Report in 2017 and would like to see the report updated to reflect developments following the COVID-19 pandemic. Such a report would be best supported by internal tools developed by the secretariat, rather than those of temporary external consultants, to ensure consistency over time.

*Recommendation:* The FDC should commit to a regular schedule for publishing long-term fiscal sustainability analysis, with the goal of releasing an updated report within the next two years, when the economy and public finances have stabilised. The sustainability report should be made a regular publication every three years to ensure that at least one major update will occur within the terms of the Presidency and Saeima and under each Chair.

- 3. Resources devoted to economic and fiscal monitoring.** During the COVID-19 crisis, the FDC has justifiably focused its effort on monitoring monthly economic and fiscal developments, rather than more strategic analysis of Latvia's fiscal objectives. Its monthly monitoring reports during the crisis have been popular but have required much of the FDC's capacity.

*Recommendation:* As the immediate pandemic crisis subsides, the FDC should reduce the frequency of monitoring reports, for example to quarterly or twice annually. This will free staff resources to support a greater focus on strategic medium- and long-term fiscal issues and the development of the analytical underpinning of Council opinions.

- 4. Parliamentary engagement.** The frequency of the FDC's appearances before parliamentary committees has varied over its history, and there are no legislated requirements for engagement. Under current practice, the FDC participates in meetings of the Budget and Finance (Taxation) Committee and the European Affairs Committee when the annual budget law is reviewed, but has

little direct interaction with the Saeima outside of those occasions. Both the FDC and parliamentarians would like to see the FDC's research feature more prominently and routinely in committee hearings during the budget cycle.

*Recommendation:* The FDC should strengthen engagement with parliament, specifically with the Budget and Finance (Taxation) Committee and the European Affairs Committee. Engagement could be increased through formal channels, such as through a committee standing motion requiring the FDC to appear twice each year at fixed times in the fiscal year to share its views of the economy and public finances. Engagement could also be increased through informal channels, such as through one-on-one background briefings to committee members and committee analysts, provided the briefings are conducted transparently and with efforts to provide equal opportunities to members.

**5. Legal authority to hire secretariat staff and the balance between inside and outside expertise.**

The *Fiscal Discipline Law* provided legal authority for only Council members and a Secretary. The drafters of the law intended that Council members would do the majority of the analysis themselves with the support of outside consultants. However, the FDC's funding agreement sets an upper limit of 72 hours per year of direct remuneration for Council members. Further, as the FDC's mandate has expanded, stakeholders now view the use of outside consultants as suboptimal for responding quickly to emerging issues with evidence-based opinions that are consistent over time.

In recognition of these challenges, the government has granted the FDC the authority to hire analysts each year in the state budget. However, there is no permanent legislation authorising secretariat staff. The current secretariat of 2.5 analysts on a full-time equivalent basis is smaller than the average of four analysts in European Union (EU) IFIs with similar responsibilities. Further, the FDC's capacity-building programme to expand its internal modelling with the support of the European Commission's Directorate-General for Structural Reform will require additional permanent analytical capacity to implement and maintain for an enduring legacy.

*Recommendation:* The *Fiscal Discipline Law* should be amended at the next opportunity to explicitly authorise the FDC to be supported by "a Secretary and staff" instead of only a Secretary. The legislation should specify a minimum baseline level of funding for secretariat staff that provides greater flexibility to increase staff numbers toward the average analytical staff levels of EU IFIs with similar mandates. The secretariat's funding should be given multi-year protection in real terms in a similar manner as the existing remuneration of Council members and the Secretary. The limit on hours for which the Chair and Council members can be compensated should be raised to more closely reflect expectations for their analytical commitment.

**6. Communication.** The FDC's reports are well-written and concise, but many stakeholders view them as too technical. This contrasts with the media appearances and public statements of the Chair and Council members, which are widely considered to be accessible. The FDC also does not currently monitor in detail its public engagement statistics and media mentions to track the effectiveness of its reports and communications over time.

*Recommendation:* To an extent, this stakeholder feedback is expected, as a role of Council members is to communicate technical reports to the public. However, the FDC should nonetheless strive to increase the engagement of non-technical stakeholders through short summaries in plain language, infographics, and visuals with a distinct and consistent branding across reports and on social media. The FDC should also improve its monitoring of media mentions and public engagement so that it can track changes in engagement over time and adjust its approach to reports and communications accordingly.

# Chapter 1. Adherence to OECD Principles

## 1.1. Introduction

This review of Latvia's Fiscal Discipline Council (FDC) uses an evaluation framework anchored in the OECD Recommendation on Principles for Independent Fiscal Institutions, adopted by the OECD Council on 13 February 2014 (OECD, 2014<sub>[1]</sub>).<sup>1</sup>

The OECD Recommendation provides a set of Principles to assist Member countries in designing independent fiscal institution (IFIs) that are effective and viable over the long run. There are 22 Principles across nine headings:

- |                                      |                          |
|--------------------------------------|--------------------------|
| 1. Local ownership                   | 6. Access to information |
| 2. Independence and non-partisanship | 7. Transparency          |
| 3. Mandate                           | 8. Communications        |
| 4. Resources                         | 9. External evaluation   |
| 5. Relationship with the legislature |                          |

## 1.2. Results

Overall, the FDC's design, operations, and analysis satisfy all OECD Principles at least partially. On **local ownership**, the FDC was established largely in the context of requirements of the euro area surveillance framework; however, the reforms were also motivated by a domestic appetite for improving the management of the public finances and the *Fiscal Discipline Law* was designed with the Latvian context foremost in mind.

On **independence and non-partisanship**, the appointment process and term structure of Council members and the staffing procedures for the Secretary and outside consultants are protected from executive government influence; however, legal authority to hire analysts as a permanent secretariat is provided each year in the state budget through annual discussions with the Ministry of Finance and therefore relies on the goodwill of the government. The FDC's physical placement within the Ministry of Finance is a potential area of concern for its independence; however, it is not without precedent. A small number of IFIs such as the German Independent Advisory Board to the Stability Council and the Belgian High Council of Finance also use the facilities of their finance ministries. Further, stakeholders felt that the FDC is able to keep an arm's length relationship to the Ministry of Finance while benefiting from close proximity that grants the FDC easy access to information to complete its mandated tasks.

On **mandate**, the FDC's responsibilities are prescribed in detail in legislation. The FDC's initial focus on monitoring compliance with fiscal rules was decided by considering the institutional environment, specifically that the Bank of Latvia was already doing considerable fiscal analysis. Section 26 of the *Fiscal Discipline Law* grants the Chair the authority to produce reports and analysis at their own initiative and to represent the FDC without external authorisation. The mandate clearly links the FDC to the budget process by requiring the FDC's fiscal discipline surveillance report to be appended to the draft framework law before its submission to the Saeima. The FDC's role of endorsing the government's macroeconomic forecast was

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<sup>1</sup> Throughout, "FDC" will be used to indicate the institution that includes both council members and secretariat staff collectively. "Council" will be used when it is necessary to distinguish council members themselves, and "secretariat" will be used for the staff that support council members.

added after creation of the *Fiscal Discipline Law* and its timing is defined by memorandums and other unlegislated arrangements.

On **resources**, drafters of the *Fiscal Discipline Law* initially envisioned that Council members would do the majority of the analysis themselves, supported by only one staff member – the Secretary – for help with administration. Any additional support was to be provided from a budget for consultants on a project basis. Stakeholders, including some who played a lead role in drafting the original legislation, now see that this balance toward outside experts and away from permanent staff was ultimately suboptimal in ensuring that Council opinions had a strong evidence base and consistency over time. The FDC, legislators and the Ministry of Finance are working together to improve upon the status quo; however, the number of staff positions remains below the average of IFI peers with a similar mandate and presents challenges to delivering the IFI’s mandate on long-term sustainability analysis and maintaining its programme to expand its modelling capacity.

On **relationship with the legislature**, the FDC’s duties toward engaging with committees and legislators are not directly referenced in law. Under current practice, the FDC meets the Budget and Finance (Taxation) Committee when the annual budget law is reviewed but has little direct interaction with the Saeima outside of that.

On **access to information**, the *Fiscal Discipline Law* has a general catch-all clause prescribing that the FDC is entitled to the information that it requires to fulfil its mandate. The Law also has a clause granting the FDC the right to cooperate with government bodies, foreign institutions, and independent specialists to inform Council meetings.

On **transparency**, the FDC publishes all of its reports on its website and provides explanations of the underlying assumptions, including spreadsheets with fiscal rule calculations. It is transparent in its operations, publishing its procurement transactions and details of its contracts online. Detailed council meeting minutes are published on the FDC’s website.

On **communications**, the FDC engages an external media consultant to prepare press releases, post to social media, and organize press conferences for its reports. The decision to outsource many aspects of press releases and distribution is uncommon, but has proven to be effective.

On **external evaluation**, the FDC initiated this external OECD review. It also created an expert panel in March 2020 to provide feedback on its technical work. The panel includes the former FDC Chair and Secretary, an economist in the field of international finance, a director of a marketing and public opinion research centre, and an expert with a background in auditing.

A detailed assessment of the FDC’s adherence to the OECD Principles is given in Table 1.1. The remainder of this report expands on these discussions and provides recommendations for bringing the FDC into greater alignment with the OECD Principles and the best practices of peers. The recommendations are grouped into four areas:

- **Mandate and governance:** The FDC’s responsibilities, organisation and rights to information.
- **Reports and influence:** The FDC’s research products and how it communicates them to engage stakeholders and influence fiscal management practices.
- **Methods:** The FDC’s technical approaches, workflows and models for producing its reports.
- **Financial and human resources:** How the FDC has been empowered with a budget and staff to achieve its mandate.

**Table 1.1. Does the Fiscal Discipline Council adhere to the OECD Principles for Independent Fiscal Institutions?**

1. LOCAL OWNERSHIP	Key: ● = yes; ◐ = partially; ○ = no
<p><b>1.1 Broad national ownership, commitment, and consensus across the political spectrum. Models from abroad should not be artificially copied or imposed.</b></p> <p>Although partially motivated by euro zone entry, the reforms were at Latvia's urging, owing to existing issues with government spending pressure that Latvia's elected officials and public wanted to address. The drafters of the original law reported that they were not inspired by any international model.</p>	●
<p><b>1.2 Local needs and the local institutional environment should determine options for the role and structure of the IFI.</b></p> <p>The decision to locate the FDC in the Ministry of Finance was guided by its narrow mandate, small staff, and the availability of experts in Latvia. It was felt that an arm's length but physically close relationship with the Ministry would ensure that the FDC would have access to the data that they require to serve in their role. This has been borne out by experience. The FDC's focus on monitoring fiscal rules compliance was determined by considering the institutional environment, specifically that the Bank of Latvia was already doing considerable strategic fiscal analysis.</p>	●
2. INDEPENDENCE AND NON-PARTISANSHIP	
<p><b>2.1 Does not present its analysis from a political perspective; strives to demonstrate objectivity and professional excellence, while serving all parties. IFIs should be precluded from any normative policy-making responsibilities to avoid even the perception of partisanship.</b></p> <p>All stakeholders reported that they view the FDC's work as non-partisan. The FDC does not have policy-making responsibilities. It provides recommendations on the broad fiscal stance in line with the activities prescribed in its legislation.</p>	●
<p><b>2.2 The leadership of an IFI should be selected on the basis of merit and technical competence, without reference to political affiliation. The qualifications should be made explicit.</b></p> <p>The <i>Fiscal Discipline Law</i> requires that council members be "specialists of the field of finance and economics from Latvia or other Member State of the EU who have experience in fiscal policy issues." In practice they come from a wide range of skilled backgrounds in academia, central banks, the private sector, and international organisations. Three members are nominated by at least ten deputies of the Saeima and three members are nominated according to a joint proposal of the Minister of Finance and the Governor of the Bank of Latvia. Nominations are approved by parliament. In practice, the nominations are not made based on political association.</p>	●
<p><b>2.3 Term lengths and number of terms that the leadership of the IFI may serve should be clearly specified in legislation along with dismissal criteria and process.</b></p> <p>Members are appointed for six years, with the exception of three members who were nominated by Members of Parliament when the FDC was first established, in order to set up a staggering of the end of their terms. Conditions for dismissal of Council members are spelled out in legislation, relating to criminal offences or non-fulfilment of duties.</p>	●
<p><b>2.3 The leadership's term should optimally be independent of the electoral cycle.</b></p> <p>The FDC's leadership is appointed for 6 years (and may hold office for two successive terms) while the lower house political cycle is 4 years.</p>	●
<p><b>2.4 The position of head of the IFI should be a remunerated and preferably full-time position. Strict conflict-of-interest standards should be applied.</b></p> <p>The Council's Chair is a part time role. Chair and all council members are remunerated for their deliberations; however, the time invested by the Chair and Council members generally exceeds remunerated hours. The FDC has strict transparency requirements for contracts to allay conflict-of-interest concerns for Chairs or other part-time council members with outside employment. As with other part-time fiscal councils, members must be clear when they are speaking on policy matters in a council role and when they are speaking in the role of their other employment.</p>	◐
<p><b>2.5 The leadership of the IFI should have full freedom to hire and dismiss staff in accordance with applicable labour laws.</b></p> <p>Section 26 of the <i>Fiscal Discipline Law</i> empowers the Chair of the Council with complete control to hire and dismiss the Secretary and external experts invited by the Council. Leadership is somewhat constrained in staffing the secretariat, in that</p>	●

they must seek the Ministry of Finance's approval for adjusting the mix between consultants and secretariat analysts. They also face practical difficulties competing to attract talent against the compensation offered by other employers of economists in Latvia.

**2.6 Staff should be selected through open competition based on merit and technical competence, without reference to political affiliation, in line with civil service conditions.** ●

In practice staff are hired by the FDC through open competition based on merit, without political consideration or political influence. This requirement is not specified explicitly in law.

### 3. MANDATE

**3.1 The mandate should be defined in legislation, including types of reports and analysis they are to produce, who may request them and timelines for release.** ●

Section 28 (2) of the *Fiscal Discipline Law* defines the FDC's mandate, stating that "the Council shall examine the correctness of application of balance rule and expenditure growth rule, including when performing independent assessment of potential gross domestic product and nominal gross domestic product and structural balance calculation." The macro endorsement role is only prescribed in a memorandum of understanding with the Ministry of Finance.

**3.2 IFIs should have the scope to produce reports and analysis at their own initiative and autonomy to determine their own work programme within their mandate.** ●

Section 26 of the *Fiscal Discipline Law* grants the Chair the authority to manage the work of the FDC and to represent the Council without other authorisation.

**3.3. Clear links to the budget process should be established within the mandate.** ●

Legislation clearly links the FDC's surveillance reports to the medium-term budget framework: "The Council shall draw up a fiscal discipline surveillance report before submission of the draft framework law to the Saeima. The report shall be appended to the draft framework law and submitted to the Saeima." Endorsement timing and other budget engagement are clearly defined by memorandums and other arrangements.

### 4. RESOURCES

**4.1 The resources allocated to IFIs must be commensurate with their mandate.** ●

Drafters of the *Fiscal Discipline Law* envisioned Council members would do the majority of the analysis themselves and outsource any specific needs to consultants on a project basis. Stakeholders, including some who played a lead role in drafting the original legislation, now see that this balance toward outside experts is suboptimal. The FDC, legislators and the Ministry of Finance have been working together to shift the balance toward permanent staff.

**4.1 The appropriations for IFIs should be published and treated in the same manner as the budgets of other independent bodies.** ●

Remuneration of Council members and the Secretary and eligible expenses for Council meetings are prescribed with annual indexation in the *Fiscal Discipline Law*. These are paid from the budget of the Ministry of Finance. Since 2016, the Ministry of Finance has provided the FDC with resources to hire additional secretariat staff to fulfil the FDC's additional mandate to endorse macroeconomic forecasts. This top-up funding for secretariat staff does not have an ongoing legislated guarantee.

**4.1 Multiannual funding commitments may further enhance the IFI's independence and provide additional protection from political pressure.** ●

The Medium Term Budget Framework Law sets out funding level guidance for the Fiscal Discipline Council over the next three years, but the FDC's budget remains subject to annual approval.

### 5. RELATIONSHIP WITH LEGISLATURE

**5.1 Mechanisms should be put in place to encourage appropriate accountability to the legislature.** ●

The FDC may be called upon by committees of the Saeima to appear before them and Members of the Council may be terminated by the legislature under several conditions of non-performance. The National Audit Office audits the performance of duties and financial matters of the FDC and reports to the Saeima. The FDC is evaluated against performance indicators related to its Council meetings, reports and opinions under its budget provisions with the Ministry of Finance.

**5.1 The budgetary calendar should allow sufficient time for the IFI to carry out analysis necessary for parliamentary work.** ●

The FDC's surveillance reports are appended to the relevant draft laws and submitted to the Saeima. Parliamentarians

reported having sufficient time with the surveillance reports to carry out their duties. In producing the reports, the FDC is given little time to assess budget material.

**5.2 The role of the IFI vis-a-vis the parliament's budget committee (or equivalent), other committees, and individual members in terms of requests for analysis should be clearly established in legislation.**

Specific committee arrangements are not prescribed in legislation. There is some uncertainty over how to handle committee requests and individual requests from parliamentarians. In practice, the surveillance report is submitted to the Budget and Finance (Taxation) Committee every time a new draft budget is reviewed in parliament.

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## 6. ACCESS TO INFORMATION

**6.1 IFIs should have full access to all relevant information in a timely manner.**

The *Fiscal Discipline Law* prescribes that "The Council shall have the right to request and receive information from public authorities necessary for discharging the Council's duties."

**6.2 Any restrictions on access to government information should be clearly defined in legislation.**

The *Fiscal Discipline Law* grants the FDC the right to receive all information to fulfil its mandate and the FDC is not subject to restrictions on access to information.

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## 7. TRANSPARENCY

**7.1 The IFI should act as transparently as possible, including full transparency in their work and operations.**

Relevant expenses, consulting contracts and staffing decisions are disclosed on the web. Detailed council meeting minutes are published on the FDC's website.

**7.2 The IFI's reports and analysis (including underlying data and methodology) should be published, made freely available to all and sent to parliament.**

All reports are published online. Key reports are submitted to the legislature. The FDC provides spreadsheet files with calculations of the fiscal rules and calculations of the macroeconomic aggregates.

**7.3 The release dates of major reports and analysis should be formally established, especially in order to coordinate them with the release of relevant government reports and analysis.**

The release date of the FDC's Surveillance Report depends on the government's budget calendar and its exact timing is somewhat uncertain; however, it is formally established in that it must be published alongside the draft Medium-term Budget Framework Law and considered with the annual State Budget Law in the Saeima. The FDC's interim report is formally tied to the publication of the government's Stability Programme Update in April.

**7.4 IFIs should release their reports and analysis, on matters relating to their core mandate on economic and fiscal issues, in their own name.**

All reports are released under the FDC's own name and branding.

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## 8. COMMUNICATIONS

**8.1 IFIs should develop effective communication channels from the outset.**

The FDC has a strong media presence, driven by the voice of its Chair. It has well-developed research distribution channels, largely through the use of an external media consultant. This outsourcing has been successful but is uncommon. IFIs typically have more direct ownership of press releases and research distribution and invest more in tracking the impact of their communications.

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## 9. EXTERNAL EVALUATION

**9.1 IFIs should develop a mechanism for external evaluation of their work.**

The FDC enlisted the OECD to perform an external review in 2021 and created an expert panel to offer advice on technical matters related to analysis and reports.

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## Chapter 2. Mandate and governance

### Chapter findings

The creation of the Fiscal Discipline Council was motivated by domestic calls to improve the management of Latvia's public finances and by requirements of the EU's fiscal governance framework for adopting the euro. The FDC's mandate is clearly defined in legislation and memorandums with clear links to the budget cycle. It fulfils its responsibilities independently and impartially. That said, the following adjustments would bring the FDC closer in line with OECD Principles.

- The FDC currently appears before the Budget and Finance (Taxation) Committee when invited; however, the OECD Principles recommend that an IFI's duties to committees and individual legislators be defined in legislation. Greater certainty could be provided immediately through a motion by the Budget and Finance (Taxation) Committee that the FDC has an ongoing invitation to appear twice a year on a fixed date or date relative to the budget cycle to provide its views. When possible, the *Fiscal Discipline Law* should be revised to clarify the FDC's committee responsibilities and whether they have a defined role in responding to inquiries from individual legislators.
- The FDC has less than two weeks, or at times two days, to review key information to complete its Surveillance Report. The FDC should work with the Ministry of Finance to lengthen the time available to review budget information. This could include, where possible, meetings at intervals leading up to the budget to review draft plans as they are prepared.

### 2.1. Introduction

Latvia's economy suffered severe consequences from the 2008 global financial crises and was the hardest hit of the three Baltic states. The consequences of the crisis left the economy scarred and the public finances in a weakened position, with the 2010 deficit at 8.6% of Gross Domestic Product (GDP), up significantly from 0.6% in 2007. The deterioration of the fiscal position resulted in calls from domestic stakeholders to improve the management of the public finances. The government committed to implementing wide-ranging reforms to stabilise the economy and restore fiscal policy credibility.

The reforms culminated in the *Fiscal Discipline Law*, which Latvia's Saeima (Parliament of the Republic of Latvia) adopted on 31 January 2013. The Law set out fiscal policy principles and fiscal rules for managing the public finances and established the Fiscal Discipline Council, an independent fiscal authority to monitor fiscal discipline and compliance with the law. The Law and the creation of the FDC also fulfilled Latvia's requirements under the EU's fiscal governance framework for its plans to adopt the euro officially in 2014.

The new fiscal framework, supported by the FDC's voice, has turned around Latvia's public finances. The deficit was brought back down to pre-crisis levels by 2019. The COVID-19 pandemic has created new challenges, but Latvia's fiscal management framework and the FDC are prepared to confront them.

## 2.2. The FDC's mandate

The responsibilities given to the FDC include:

- Verifying whether Latvia's four fiscal rules (three-year spending ceilings, a structural deficit no greater than 0.5% of GDP, and criteria for expenditure growth and general government debt that are in line with or more restrictive than EU surveillance guidelines) have been properly applied, including an independent assessment of the assumptions for potential GDP and nominal GDP;
- Monitoring whether the implementation of the annual state budget law conforms to its plan, for indicators of the consolidated budget of local governments and budgets of public persons;
- Preparing an opinion on whether conditions to suspend the budget balance target have been met during a severe economic downturn;
- Preparing an opinion on whether the Fiscal Stability Reserve (an upward adjustment to planned expenditure as a safety cushion) is set at an appropriate level to counter fiscal risks;
- Preparing a surveillance report on fiscal discipline and, if necessary, a non-conformity report that identifies departures from the *Fiscal Discipline Law*;
- Endorsing the Ministry of Finance's macroeconomic forecasts twice a year – once for preparing the Stability Programme, and once for preparing the annual state budget and the medium-term budget framework (presented simultaneously). This function was added in 2016 and fulfils Latvia's commitments under Regulation (EU) No 473/2013 of the two-pack of reforms to the Stability and Growth Pact requiring independent production or endorsement of forecasts (Box 2.1);
- Preparing an interim opinion on the Stability Programme; and
- Assessing and analysing the sustainability of fiscal policy.

The *Fiscal Discipline Law* also gives the FDC the freedom to provide self-initiated opinions about any fiscal issue that the Council deems to be important to ensure overall compliance with the *Fiscal Discipline Law*:

*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 (Section 28(7)).*

Under this provision, the FDC has undertaken research such as assessing tax reforms and conducting surveys of political parties on issues related to fiscal discipline. These activities have helped to raise awareness of important issues and the work of the FDC.

The obligations of the FDC and Ministry of Finance to one another were unclear at first. When the FDC's responsibilities were expanded in February 2016 to include endorsing the official macroeconomic forecasts, the FDC and the Ministry of Finance clarified their interactions by signing a memorandum of understanding, which has been updated several times – most recently in 2018 (Fiscal Discipline Council, 2018<sup>[3]</sup>). The memorandum also improved the information exchange between the two, describing in detail the kind of data needed by the FDC to carry out its evaluation of the macroeconomic forecasts and fiscal policy. After the memorandum was signed, the government formally recognised the FDC's additional endorsement function by including a specific provision in the state budget law each year authorising the FDC to hire additional staff to carry out the responsibility.

The FDC is given less than two weeks, or at times two days, to assess key budget material for its Surveillance Report. The Ministry of Finance and FDC should coordinate to lengthen this time by arranging earlier meetings to discuss decisions and planning assumptions in draft form, while recognising that decisions may not be finalised. As a model they can look to the practice in the United Kingdom (UK), where the Office for Budget Responsibility has signed a memorandum with key departments to form a liaison group that meets several times in the run-up to budgets to discuss the evolution of the economic and fiscal forecasts (Office for Budget Responsibility, 2017<sup>[4]</sup>).

### Box 2.1. IFIs in the framework for EU coordination and surveillance of budgetary processes for euro area members

The “two-pack” of reforms in 2013 (Regulation 472/2013 and Regulation 473/2013) added a new budget coordination and surveillance process to the Stability and Growth Pact to help restore confidence in the fiscal sustainability of Member States in the euro area following sovereign debt crises and contagion effects of the shared currency in the wake of the global financial crisis.

Chapter III Article 4 of Regulation (EU) No 473/2013 gives a Member State the option of either having an IFI produce its macroeconomic forecast or endorse its macroeconomic forecast. Latvia has chosen the latter, in line with most Member States. Formally, the FDC is designated as the independent monitoring body for the purposes of the regulation in a memorandum of understanding between Latvia’s Ministry of Finance and the FDC.

Independent fiscal institutions fulfilling the monitoring role in the EU surveillance framework are expected to publish twice-annual endorsement statements corresponding to the Stability Programme Update and the Draft Budgetary Plans of the European Semester.

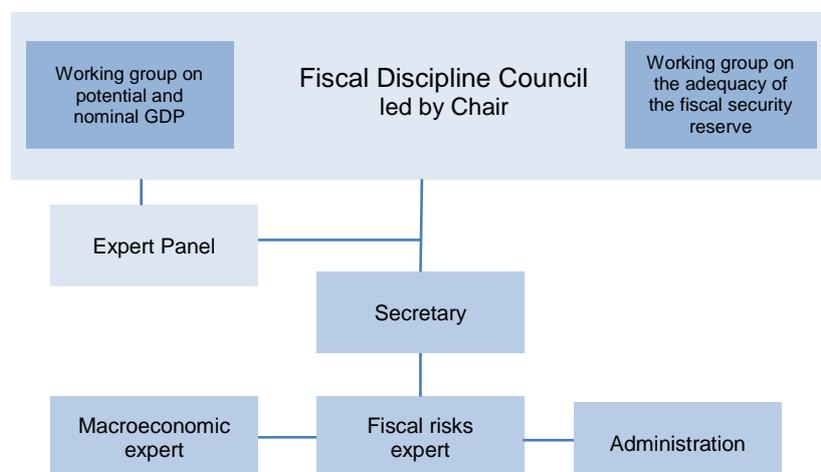
## 2.3. The FDC’s organisation and governance

Given the small population of Latvia and its limited fiscal capacity at the time, drafters of the *Fiscal Discipline Law* felt that it would be politically challenging to establish a new public entity for its monitoring. To pre-empt opposition, policymakers designed a small institution that would not require significant funding. The resulting FDC had six appointed council members supported by a sole secretary to handle administration. The Council held its first meeting on 25 February 2014.

When the FDC’s mandate was expanded in 2016 to include endorsing the official macroeconomic outlook, the Ministry of Finance re-assessed the Council’s analytical support and agreed to approve three staff positions under the FDC’s Secretary, filled by two economists and an administrative professional, bringing the secretariat to four.

The organisational structure of the secretariat is lean, with staff reporting directly to the Secretary, who is accountable to the Council for the performance of all support tasks (Figure 2.1).

Figure 2.1. The FDC’s current organisational structure



Note: Working groups are formed by Council members.

### ***The Council***

Among the Council's six members, three are nominated by the Saeima, which must be put forward by at least ten Members of Parliament, and three are nominated jointly by the Governor of the Bank of Latvia and the Minister of Finance. All nominations must be approved by a simple majority of the Saeima. Under the *Fiscal Discipline Law*, candidates must be specialists in the field of finance and economics from the EU and cannot be associated with a political party. Members serve for six years and a maximum of two terms. Appointments are staggered (three members were initially appointed for three-year terms) so that tenures do not all expire at the same time.

Although Council members are selected based on their technical competence, without explicit ties to a political party, the selection process should be more transparent. A public hearing in the Saeima with the nominees ahead of their endorsement could bring more clarity about their non-partisanship and professional background.

The law does not specify any time limit within which the nomination of a new Council member must be submitted once a Council member's term expires. The law is also silent about situations in which the FDC is not functional by merely not having enough Council members in place. The Council must have at least four members to have a quorum. It would be appropriate to consider an arrangement whereby Council members remain in office until their replacements have been elected or, alternatively, only when the expiration of a Council member's term of office might render the FDC unable to function. An example may be found in legislation for Slovakia's Council for Budget Responsibility.

Members of the Council elect a Chair among them for the term of three years. The Chair cannot hold the office for more than two such terms (six years) in succession. The Chair appoints a head of secretariat (the Secretary) who then hires additional staff to provide the Council with analytical support.

All reports, decisions, and opinions of the FDC are approved by the Council during its meetings. Council members also approve the FDC's three-year work plan and adjust it as necessary on a year-to-year basis.

Council members generally meet six times a year, but if necessary can schedule additional meetings. Decisions of the Council and meeting minutes are published on the FDC's website. Issues for discussion during FDC meetings can be proposed by any Council member. The secretariat staff generally also attend meetings. Decisions of the Council are made by voting with a majority rule. If the vote on a decision is evenly split, the Chair's vote determines the outcome. Council opinions are usually presented by the Chair. In cases of disagreement, Council members may ask for their opinion to be included in minutes.

### ***Working Groups***

The Council is empowered under the *Fiscal Discipline Act* to establish specific standing or temporary working groups within the Council to carry out specific areas of its mandate. In 2014, the FDC established two such groups:

- (1) The working group for the evaluation of potential GDP and nominal GDP, and
- (2) The working group for the assessment of adequacy of the fiscal security reserve.

All six Council members participate in the working groups. Currently, they are divided into two groups of three. Each group is led by a Council member and meets twice a year.

### ***Expert Panel***

In 2020, the FDC established a five-member expert panel of former Council members, employees, and other experts. The expert panel contributes to the Council's analytical accountability by discussing and exchanging views on technical matters. The panel includes the former FDC Chair and Secretary, an economist in the field of international finance, a director of a marketing and public opinion research centre,

and an expert with a background in auditing. Panel membership is not remunerated. Thus far, communication between the panel and the FDC has not been routine; however, the FDC Chair has approached panel experts for consultations on several one-off issues.

## 2.4. The FDC's accountability

The FDC is classified as a “budget institution” for purposes of Latvia’s *Law on Budget and Financial Management*. This means its funding is allocated under the procedures and supervision of the Cabinet of Ministers (the body exercising executive functions in Latvia’s traditional parliamentary system). As a budget institution, the FDC is required to prepare annual financial statements according to procedures set by Cabinet. The procedures require the FDC to undergo an audit by the State Audit Office every five years, which the State Audit Office presents to the Saeima.

Two such audits have been completed thus far. In 2016, the Audit Office raised a concern that the *Fiscal Discipline Law* did not entitle the FDC to be considered a “budget institution” at the time. In addition, the Audit Office highlighted that the law only allowed the FDC to hire experts on a project basis, whereas the FDC secretariat consisted of four full-time employees at the time, through its agreement with the Ministry of Finance. The Audit Office recommended amending legislation to address these issues. Both issues were resolved by introducing provisions on a year-to-year basis in annual budget laws that classify the FDC as a budget institution and authorise it to hire full-time employees. These provisions list performance indicators related to the preparation of Surveillance Reports, the number of Council meetings held and other objective measurements of fulfilling the FDC’s mandate.

The FDC is also directly accountable to the Saeima, in that Council members are approved by the Saeima and may be dismissed by the legislature under a set of prescribed conditions of non-performance. The Council’s *Surveillance Report* is submitted to the Budget and Finance (Taxation) Committee each year.

Specific committee arrangements are not prescribed in legislation and there is some uncertainty over how the Council should treat requests from committees and individual legislators. Engagement with the Saeima largely depends on the interest of parliamentarians. The FDC has been invited to participate during hearings of the Saeima’s Budget and Finance (Taxation) Committee and hearings on the Stability Programme in the European Affairs Committee. For example, the FDC participated in meetings for both of those two committees in 2020, presenting Council opinions on the Stability programme and on the 2021 Budget.

Physically, the FDC sits in the building of the Ministry of Finance and the Ministry is required to support it with general administration activities such as human resources and information technology. While its physical location and shared services could be perceived as a risk to its independence, its legal status as a separate and independent body is well understood and recognised by stakeholders, who view the office as operating separately and independently from the Ministry.

## 2.5. Access to information

Timely access to comprehensive and reliable information is the most important prerequisite for an IFI’s ability to deliver its mandate to a high standard. Information an IFI requires includes financial data and forecasts and the underlying methods and models used to produce them. The importance of access to information is highlighted in Principle 6.1 of the OECD Principles for IFIs, which recommends explicit legal guarantees to access information, supplemented by protocols or memoranda of understanding.

According to Section 28 of the Council’s enabling legislation, the FDC has the right to request and receive information from public institutions as necessary for the performance of its tasks. Public entities are expected to provide advice and necessary assistance upon request.

To manage the expectations regarding the processing of information requests, timeframes, and treatment of confidential data, the Council's access to information is supported by a memorandum of understanding signed between the Ministry of Finance and the FDC in 2016. It lists a detailed set of tables with macroeconomic and fiscal indicators which are the subject of information exchange. The memorandum was amended in the course of 2016 and again in 2018 as needs evolved. The FDC's use of both legislation and a memorandum of understanding is in-line with OECD Principles and the most common practice of OECD IFIs, 42% of which use both.

The Ministry of Finance is the main source of information for the FDC but the secretariat can also approach other relevant institutions such as the State Treasury and the Central Statistical Bureau. On 1 January 2021 the State Revenue Service introduced a unified account for reporting tax data that has made it more difficult for the FDC to obtain timely information on revenues collected by the type of tax assessed; however, this is expected to improve with time.

In general, the FDC and other stakeholders confirmed that there have been no major issues for gathering information in recent years, other than the difficulties in 2021 securing tax data noted above. The Ministry of Finance and other institutions have been supportive and have provided all the information requested by the Council.

In addition to the legal framework underpinning the FDC's access to information, good personal relations between the secretariat and government staff have played a key role in ensuring smooth access to information. The secretariat estimates that around 80% of the information is gathered via informal protocols or analyst-to-analyst contacts. The FDC should nevertheless be cautious about over-relying on good personal relations and should ensure that formal memoranda are maintained to ensure that access to information from all key actors is secured over the longer term.

Unlike some of its peers, the FDC does not publish statistics on the number of its information requests, nor on whether the responses were complete and received on time. The FDC may wish to consider tracking such metrics in the future. For example, the Slovak Council for Budget Responsibility attaches an annex to its main reports listing information requests used in its preparation and the responses received. This approach provides transparency and an opportunity to communicate any cases where information was withheld.

# Chapter 3. Reports and influence

## Chapter findings

The FDC has achieved a high level of positive influence on fiscal policy since its inception. This is owed in large part to the adaptability of its reports in response to developing issues, for example, the new monthly monitoring reports that staff developed to inform decision makers during the COVID-19 crisis. To increase its influence further and have greater alignment to the OECD Principles, the FDC should make the following adjustments:

- The FDC should commit to a regular schedule for publishing long-term fiscal sustainability analysis. A frequency of every three years would be roughly in line with the average practices of other OECD IFIs that publish long-term sustainability analysis and would ensure that at least one major update is likely to occur within each Chair's term (3 years) and each term of the presidency and Saeima (four years).
- As the immediate pandemic crisis subsides, the FDC should reduce the frequency of its monitoring reports. This will free staff resources to support a greater focus on strategic medium- and long-term fiscal sustainability issues.
- The FDC should improve the accessibility of its reports for non-technical stakeholders. This may include developing one-page summaries, infographics and visuals with an easily recognisable FDC branding to be used across the FDC's reports and on social media. As the secretariat builds modelling capacity and experience, it should aim to keep its reports concise.
- The FDC should strengthen its engagement with the Saeima, specifically with the Budget and Finance (Taxation) Committee and the European Affairs Committee. More engagement could be both formal, such as with scheduled appearances at committees after publishing major reports, and informal, such as through briefings to individual parliamentarians and parliamentary analysts.
- The FDC should improve the tracking of its web and media presence, along with other communications-related performance indicators to monitor the effectiveness of its communications approach. The FDC should also monitor its impact in parliament and how often its work is mentioned in parliamentary debate.

### 3.1. Introduction

The Latvian FDC has established itself as a credible and effective voice in the fiscal landscape in Latvia. It has developed influential reports and stakeholders reported that it has had an impact on several key fiscal issues (Box 3.1).

The FDC has fulfilled its statutory role while also responding in an agile way to emerging issues. For example, the FDC's commentary on the government's tax reforms in 2020 were noted by stakeholders as a significant contribution to the public debate at the time, and more recently the FDC introduced monthly COVID-19 crisis monitoring reports, which have been well-received by parliamentarians, journalists, academics and civil servants.

This chapter assesses the FDC's reports and the impact on the public debate that they achieve through different communication channels.

### Box 3.1. The FDC has made a positive impact on fiscal issues

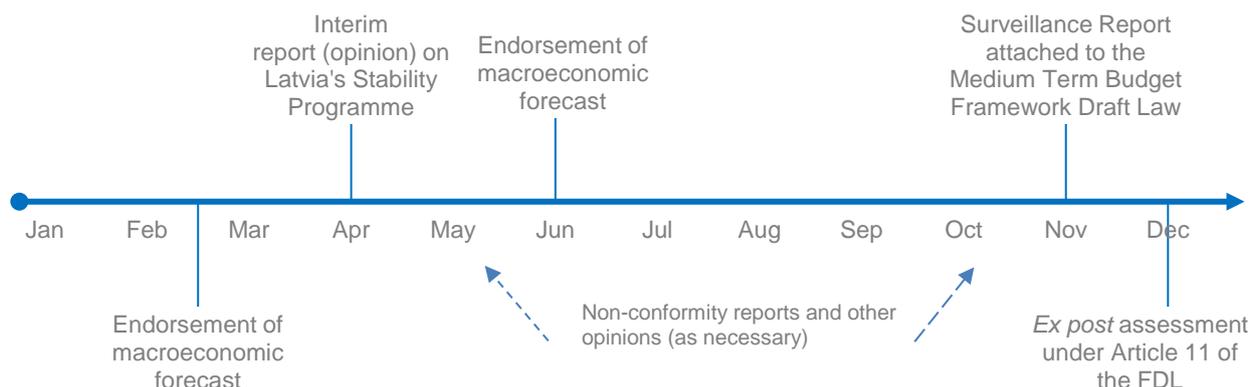
Stakeholders noted several specific areas where the FDC has raised the level of debate on fiscal policy through its work:

- The FDC's scrutiny of macroeconomic forecasts produced by the government of Latvia has improved the analytical rigour of the forecasts internally and the credibility of the forecasts externally.
- In 2017, the FDC contributed to debates on planned corporate tax and personal income tax reforms with an influential commentary on broader aspects of the distributional and economic effects of the reforms.
- In 2020, the FDC published a commentary on the progress of tax reforms along with recommendations for criteria that observers should use to assess the reforms (thereby avoiding specific policy recommendations). Stakeholders appreciated that approach and viewed the FDC as filling a gap in Latvia where few think tanks comment on public finance topics.
- The Ministry of Finance uses the FDC's commentary on fiscal space to challenge proposals from departments across government that might risk violating the *Fiscal Discipline Law*.
- The Council's views are sought by rating agencies and the EU bodies as an impartial opinion on the state of the government's fiscal plans.

### 3.2. The FDC's publications and their timing

The FDC's core publications are anchored to the main tasks in their mandate. Endorsements of the macroeconomic projections used by the Ministry of Finance typically take the form of Council Opinion letters ahead of the Stability Update in mid-February and again at the end of the second quarter of the calendar year (Figure 3.1).

Figure 3.1. Core publication calendar

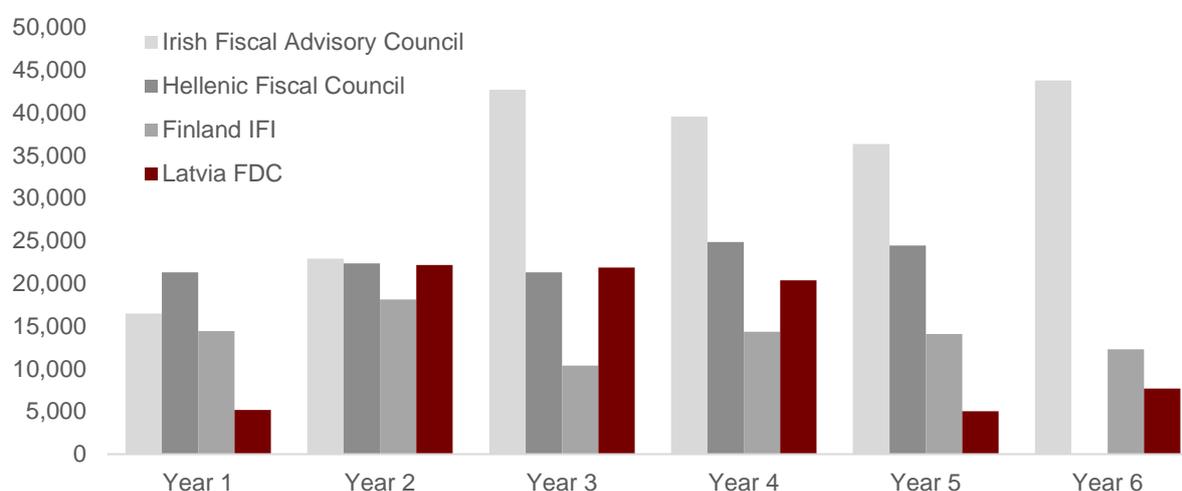


The FDC's assessment of the government's compliance with the *Fiscal Discipline Law* is laid out in Surveillance Reports typically in the fourth quarter and, if necessary, in non-conformity reports as issues arise. The *Fiscal Discipline Law* explicitly requires Surveillance Reports in the context of the draft Medium-term Budget Framework Law (which is considered at the same time as the annual State Budget Law in the Saeima). The FDC also prepares an interim report on the Stability Programme Update in April. The FDC's reports are appended to the relevant draft laws and submitted to the Saeima. The timing of reports depends

on the government's budget calendar and is therefore somewhat uncertain. In total, six Surveillance Reports and six interim reports have been prepared by the FDC since its creation.

The FDC's Surveillance Report is currently brief compared to its past reports and to peers with a similar institutional maturity (Figure 3.2). The report has averaged around 6,000 words in recent years, but contained as many as 20,000 words in earlier years. That partly reflects the recent turnover of staff and resetting of analytical capacity. Brevity is a positive attribute to which IFIs should aspire. As the FDC deepens its analytical capacity, it should aim to preserve the brevity of its reports. Further, it should monitor the readability of its reports using objective criteria based on sentence length, average syllables per word, and average characters per word. A useful discussion of these criteria and a cross-IFI comparison of the readability of reports may be found in Box 3.2 of OECD (2021<sup>[4]</sup>). The discussion concludes that the reports of the Portuguese Public Finance Council and the Irish Fiscal Advisory Council are good-practice examples.

Figure 3.2. Word count of main annual analytical report compared to peers



Note: The Hellenic Fiscal Council publishes in Greek; differences in average word count per language were controlled for using European Commission document translation averages.

Source: Main annual analytical reports of each IFI in the comparison.

The Council's Opinion letters on the Ministry of Finance's macroeconomic forecasts are even more concise documents, typically consisting of fewer than 2,000 words. They are drawn up whenever the Ministry of Finance releases new macroeconomic projections for budgetary planning. This typically happens twice a year, at the time of the Medium Term Budget Framework Law and the Stability Programme. In 2020, the FDC produced three opinions, as the Ministry of Finance had to substantially revise its macroeconomic forecasts to reflect the impact of the COVID-19 pandemic.

Non-conformity reports are prepared by the FDC if it observes violations of the *Fiscal Discipline Law*. The reports are to be drawn up immediately after the detection of an infringement and are to be submitted to the Cabinet and the Saeima. Non-conformity reports contain recommendations for the government to rectify the observed infringement. The FDC prepared 17 such non-conformity reports over 2014 to 2020. The reports typically pointed to expenditure ceilings being breached without adequate measures to compensate with additional revenue or spending cuts elsewhere.

In addition to the above regular publications, the FDC has published other documents under its broader mandate to assess compliance with the domestic fiscal framework. These range from comments on specific measures or reforms (for example, issues related to corporate or personal income tax reforms) to discussions on the appropriate use of certain windfall revenues. Taken together, these reports promote

the role of the FDC as a fiscal watchdog that advocates prudent budgetary policies. Three reports merit a specific mention:

- In 2017, the FDC published a report on fiscal sustainability. In this highly insightful *Fiscal Sustainability Report*, the FDC reviewed long-term macroeconomic and budgetary trends up to 2037 and warned against a rapid increase in government debt, taking into account the ambitions of policymakers to bring health care and social protection standards better in line with the EU average (Fiscal Discipline Council, 2017<sup>[3]</sup>). The FDC also called for productivity-enhancing labour market reforms to improve potential growth.
- In the run-up to the October 2018 national election, the FDC provided a service estimating the impact of political party platforms on fiscal rule compliance and produced a report summarising the results. To carry out the work, the FDC surveyed interested political parties on their priority revenue and expenditure intentions. The FDC then aggregated the self-reported measures into broad public finance projections and determined whether they were likely to be at odds with the *Fiscal Discipline Law*. This increased the transparency of the budgetary impact of the different electoral promises to the public.
- Since the onset of the COVID-19 pandemic, the FDC has published a monthly monitoring report that provides an update of the economic and fiscal situation using short-term indicators. These reports have been well-received by stakeholders as they cater to the need for detailed information on macroeconomic and budgetary developments in highly uncertain times. While the reports are in principle mostly descriptive, the Council also uses them to present its views on budgetary policy against the backdrop of the pandemic.

Finally, the FDC regularly monitors infra-annual fiscal and macroeconomic developments and publishes useful tabulations and summaries on their website. For example, the FDC publishes monthly statistics of government revenue and expenditure (based on data from the State Revenue Service and the Treasury). Economic monitoring on the Council's website includes an overview of quarterly statistics as well as a heatmap of a broad range of macroeconomic indicators.

### 3.3. The FDC's influence on decisions and the public debate

#### ***Influence on Cabinet decisions***

The FDC is invited on an ad hoc basis to participate in Cabinet meetings during budget discussions, where it provides opinions on fiscal discipline issues. In particular, the Chair is usually invited to be an observer of the meetings and is sometimes given the opportunity to present opinions of the Council about fiscal policies being considered by the Cabinet.

Prior to a Cabinet meeting, the FDC receives the agenda for an upcoming discussion and has a chance to consider whether any proposed fiscal actions might violate the rules under the *Fiscal Discipline Law*, which would trigger a non-conformity report by the FDC. The FDC can also simply provide its expert opinion about whether Cabinet plans constitute sound fiscal policy or not.

The Chair of the Council has been asked to provide input into Cabinet discussions on responses to the COVID-19 crisis and the FDC has been a key player in arguing for a more nuanced view of fiscal prudence – one that recognises the importance of public spending in propping up households and firms to avoid greater damage to the public finances over the longer term. Stakeholders reported that the message encouraged the government to be bolder in its emergency response. The FDC has also urged the Cabinet to be more transparent on pandemic expenditures.

### ***Influence on parliamentary debate***

Perhaps the most important channel through which an IFI can strengthen fiscal outcomes is by directly supporting the legislature's ability to hold the government to account – that is, by empowering the representatives of the public who have been elected for the full-time job of scrutinising the executive with quality information to do so. This can be accomplished by submitting reports to the legislature, participating in committee hearings, and providing background briefings to parliamentarians and their staff.

The FDC's appearances before parliamentary committees have varied over its history. Recent practice is to appear at the Budget and Finance (Taxation) Committee in the Saeima twice a year, once for the interim report on the stability programme in the spring and once for the Surveillance Report for the budget law in the autumn. The Council also occasionally appears before the European Affairs Committee (which directly considers the interim report). There are no formal requirements to appear in committee hearings.

Stakeholders reported that the Saeima recognises the independence of the FDC and that the FDC has had an influence over committee deliberations, albeit limited. A key challenge at the Saeima is a lack of capacity and support for budget analysis. In part, these challenges arise because a high turnover of members of parliament during elections means that the economic and fiscal expertise accumulated by members is lost. Moreover, there is limited analytical support available within the parliament. For the FDC to maximise its impact with the Saeima, its reports must be accessible and well-presented so that members without economics or financial backgrounds can understand and make use of the reports.

No statistics are available on how often the FDC is mentioned in parliamentary debate or how many times the FDC has appeared before the Budget and Finance (Taxation) Committee. A search of the Saeima website shows several recent references included in discussions on the budget and policy changes with fiscal costs. That said, the FDC and other stakeholders would like to see engagement with the parliament increased.

There is scope for increasing the interactions of the FDC with the Saeima by formalising them. For example, the Budget and Finance (Taxation) Committee could consent to a motion to have the FDC appear at a fixed time twice a year to present its views of the economy and public finances, either related to its main surveillance reports or not. This is the practice at the Parliament of Canada's Finance Committee, which adopted a standing motion for the Parliamentary Budget Officer to appear twice a year (Box 3.2). The FDC should also consider engaging more with other committees in the Parliament and parliamentary committee research support staff. These improvements may take time. Importantly, there may be an opportunity for the FDC to establish new terms of engagement with the Saeima after the next election in 2022 introduces a new cohort of representatives. To facilitate these discussions, the FDC could provide an induction program to new Members of Parliament to explain Latvia's fiscal policy framework and the FDC's role in supporting it.

### Box 3.2. The Finance Committee of Canada’s motion for the Parliamentary Budget Officer to appear twice a year

The Canadian Parliamentary Budget Officer’s duties to respond to committee requests are prescribed clearly in the *Parliament of Canada Act*; however, regular annual appearances before the committee are not. After early years of providing evidence to the Finance Committee on an ad-hoc basis, the committee formalised the relationship by adopting a standing motion for the Parliamentary Budget Officer to appear twice a year at fixed points annually going forward:

Consistent with the Parliamentary Budget Office (PBO) mandate to provide independent analysis about the state of Canada’s finances and trends in the national economy (as outlined in section 79.2 of the Parliament of Canada Act), that the PBO provide an economic and fiscal outlook to the Committee the fourth week of October and April of every calendar year and be available to appear before the Committee to discuss its findings shortly thereafter.

Source: Minutes of Meeting No. 11 of the 1st Session of the 41st Parliament for the Standing Committee of Finance on 29 September 2011. Available at: <https://www.ourcommons.ca/DocumentViewer/en/41-1/FINA/meeting-11/minutes>.

#### ***Influence with other public-sector stakeholders***

The FDC has developed effective two-way working relationships with several key partners, including the Treasury (a distinct entity subordinate to the Ministry of Finance that is responsible for Latvia’s cash and debt management and other public finance administration functions), the Bank of Latvia, and the State Audit Office. For example, the FDC relies on high-frequency spending data from the Treasury, while the Treasury considers the monitoring notes and commentary of the FDC for its cash and liquidity reserve management.

The FDC holds meetings with the Bank of Latvia at least twice a year and collaborates on specific policy analysis issues. For example, a Bank of Latvia expert was recently brought in for the FDC’s discussions on output gap modelling, and that effort subsequently helped the FDC to form an objection to the Ministry of Finance’s macroeconomic forecast resulting in changes to the estimated output gap underlying the official budget.

The FDC also enjoys good relationships with the State Audit Office, and the two assist each other in overlapping areas of interest. For example, in 2018, the Audit Office awarded a record of commendation to the FDC for its cooperation in the audit of the budget planning system in Latvia.

#### ***Influence through the “comply-or-explain” principle***

Comply or explain provisions in the EU surveillance framework create an obligation for a country’s government to either immediately enact the advice of an IFI or publicly explain the reasons for deviating from it. Although the principle of comply or explain was not ultimately recognised in the EU’s two pack of reforms on budget surveillance in 2013, it is a core tenet of the common principles for fiscal councils that the Commission developed under the authorisation of the Fiscal Compact.

Latvia’s national structural balance rule is currently more stringent than the European rules. Therefore, when the FDC draws attention to the risk of a rule being violated, it is usually the case that the European rules will still be met. Therefore, the comply-or-explain principle has not been properly tested in the context of the EU fiscal framework. For compliance with the *Fiscal Discipline Act*, the government has chosen to “explain” when replying to the FDC’s non-conformity reports. That said, stakeholders noted how the FDC’s

non-conformity reports have nonetheless been an incentive for the government to avoid non-compliance with domestic requirements and an eventual non-compliance with the EU fiscal governance framework.

### ***Influence through traditional media***

For many reports, the FDC uses an outside communications consultant to prepare press releases that are sent to mass media. The FDC also tweets and holds press conferences for reports. In a typical year, the FDC will hold four regular press conferences: two conferences covering its opinion on the Ministry of Finance's macroeconomic forecasts, and two conferences covering its Surveillance Report and interim report. These press conferences are typically attended by between 10 and 15 representatives from print, TV and radio.

In general, the FDC has strong interest from media outlets and most of its public impact is achieved through these traditional channels. Journalists typically approach Council members and the Chair directly for follow-up questions.

The FDC commissioned a documentary film on Latvia's fiscal policy and the history of the FDC which is nearing completion. Having such a documentary will help with further outreach, providing more people with a better understanding of the FDC's role in the consideration of Latvia's fiscal policy.

Although the FDC does not track the level of press coverage, it was noted by several stakeholders that they had received significantly increased media coverage since the beginning of the COVID-19 pandemic, with the Chair appearing on TV, radio, internet news portals and in print. Google searches of news stories referring to the FDC in 2020 and 2021 show regular news coverage of the FDC's monthly monitoring, its opinion on the Ministry of Finance's macroeconomic forecasts and its regular Surveillance Reports and interim reports.

### ***Influence through social media***

The FDC has increasingly used Twitter as a channel to disseminate the FDC's work. Although the FDC does not have a formal policy for social media, it uses tweets mainly to promote new reports and circulate media mentions of the Chair and other Council members in the news. Compared to other IFIs, the FDC has a large number of followers relative to the size of Latvia's population, in line with the Irish Fiscal Advisory Council, which is an active Twitter user (Table 3.1). The FDC's followers on Twitter have increased from 480 in June 2019 to 577 in April 2021.

**Table 3.1. Twitter followers of selected IFIs, by country**

<b>Institution</b>	<b>Numbers of followers on Twitter</b>	<b>Followers per million population</b>
PFC (Portugal)	646	63
CBO (USA)	30,600	94
OBR (United Kingdom)	13,200	199
UNRR (Czech Republic)	2,473	233
SFC (Scotland)	1,403	258
IFAC (Ireland)	1,452	299
FDC (Latvia)	577	299
CPB (Netherlands)	10,300	598

Note: Comparisons are total number of Twitter followers and may include some international followers.

Source: Authors' calculations based on Twitter followers in April 2021 and 2018 population data from OECD and National Records of Scotland.

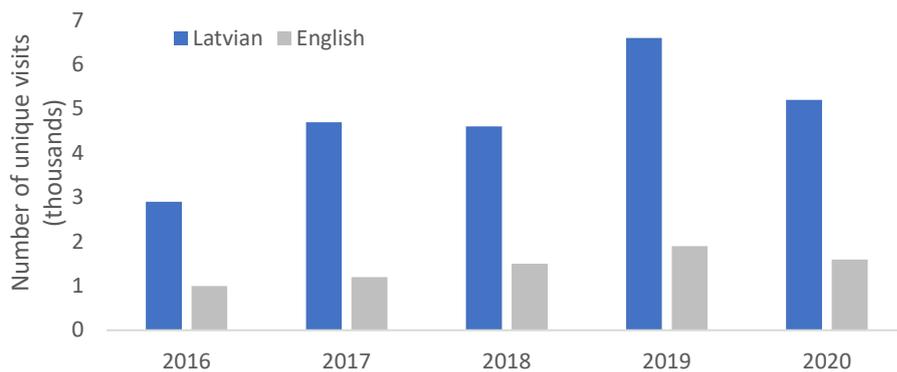
**Influence through the web**

The FDC publishes all opinions and reports on its website. The website is straightforward in its design and available in both Latvian and English. The FDC aims to act transparently and publishes a wide range of information on its activities including minutes of all FDC meetings, minutes of meetings of the fiscal risks and GDP working groups, and information on procurement activities. The FDC is currently redeveloping its website to improve accessibility and functionality, as well as the ability to monitor usage by visitors to the site, such as identifying which reports are downloaded the most and which parts of the website are accessed most frequently.

The number of visits to the FDC’s website has increased since 2016 (the first year for which data are available). Despite media coverage and stakeholder take-up of monthly crisis monitoring reports, website usage fell between 2019 and 2020 (Figure 3.3).

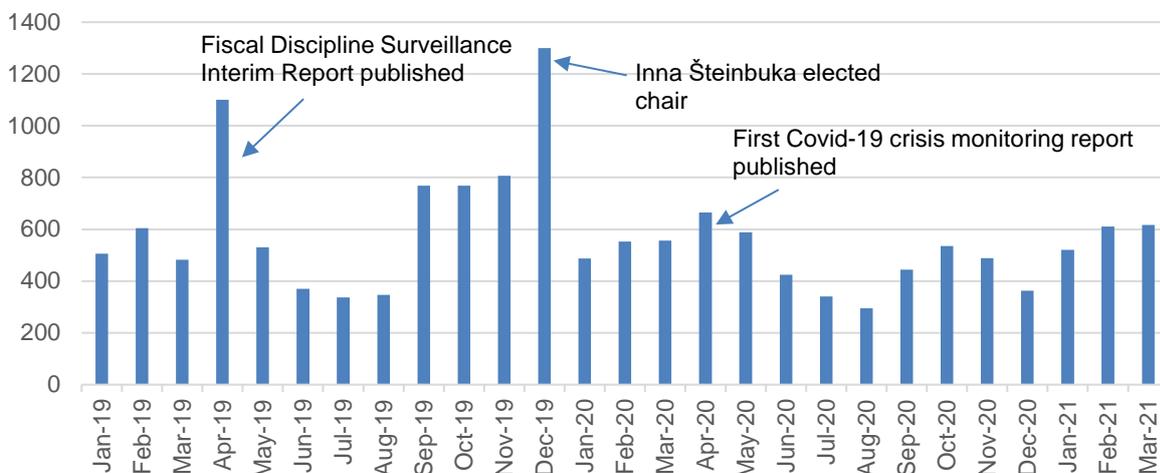
Information on monthly website usage is available since January 2019 and during this period only two months experienced more than 1,000 hits per month. The first was in April, when the Fiscal Discipline Surveillance Interim Report was published, and the second coincided with the appointment of Inna Šteinbuka as Chair of the Council in December 2019 (Figure 3.4). The publication of the FDC’s first monthly crisis monitoring report in April 2020 coincided with the largest number of monthly hits in 2020.

**Figure 3.3. Visits to the Fiscal Discipline Council’s website have grown, but peaked in 2019**



Source: Statistics provided by the FDC.

**Figure 3.4. Visits to the FDC website in 2019 and 2020 (site hits per month)**



Source: Statistics provided by the FDC.

# Chapter 4. Methods

## Chapter findings

The FDC's small staff and high turnover have prevented it from building and maintaining significant internal modelling capacity. It has instead pursued an approach of scrutinising official forecasts and comparing them to forecasts produced by other institutions. While this approach has met the requirements of the FDC's mandate, as it matures as an IFI it should strive to find staffing solutions that allow it to move to an approach where it does more independent modelling of its own. The following changes would bring the FDC's methods more in line with the practices of peers.

- The FDC should add more capacity for in-house forecasting. It has an agenda to do so and has begun receiving technical assistance through the European Commission's Directorate-General for Structural Reform Support.
- For macroeconomic assessments, any expansion should focus on simple output gap scrutiny tools, such as creating a composite index from its heatmap, as peers in Finland's National Audit Office have done. The FDC's macroeconomic assessment should also expand to cover demand and income components and subcomponents of GDP such as personal consumption expenditure and corporate profits.
- For fiscal assessments, expansion should focus on internal modelling capacity for the main tax and spending aggregates using simple spreadsheet-based revenue elasticity models, effective rates models, structural econometric models and univariate time-series models. More sophisticated techniques may be contingent on analytical capacity.
- Until that capacity is built, the FDC's current practice of scrutinising assumptions and comparing official forecasts to external GDP forecasts could be improved by including a wider source of think tanks and private banks, testing the performance of different procedures to combine them, and using that average as the basis for determining the government's probability of complying with fiscal rules, including confidence intervals based on past forecast errors and visualisations of the amount of uncertainty.

### 4.1. Introduction

This chapter assesses the tools that the FDC uses to carry out its mandate. It includes a technical assessment of the tools in comparison to the ones used by peer institutions, and also highlights key issues for the FDC's research, such as addressing the question of how the FDC's effectiveness can be further strengthened taking into account its analytical constraints.

### 4.2. Assessing the IFI Team's overall approach and workflow

For its *ex post* surveillance activities and monitoring, the FDC secretariat uses an annual monitoring model built in R software that conveniently compiles statistics from the Central Statistical Bureau of Latvia. Staff also use a fiscal rules assessment spreadsheet that is updated in coordination with the Ministry of Finance to independently confirm the calculations of the fiscal rules with outturn data.

For its *ex ante* functions, FDC staff do not produce macroeconomic and fiscal projections of their own. Instead, staff use an audit and external benchmarking approach. That is, they scrutinise the Ministry of Finance's forecasts for unreasonable assumptions and compare them to benchmark forecasts of other institutions such as the Bank of Latvia, European Commission, the OECD and the International Monetary Fund (IMF). The audit and benchmarking approach was largely a necessity for the FDC, as most staff (other than the FDC's first Secretary) did not have direct experience modelling Latvia's economy and public finances.

Aside from the *Fiscal Sustainability Report* produced in 2017 with the assistance of consultants, the audit approach is also used for long-term fiscal sustainability analysis, which currently involves requesting the government's analysis of new policy measures that affect long-term sustainability and ensuring that the analysis has been prepared under prudent assumptions.

As a step toward producing independent benchmarks, the FDC has developed a heatmap indicator of the business cycle, which it uses to assess the reasonableness of the EU's commonly agreed methodology for the output gap. Stakeholders find this product to be a useful check on the EU's methodology.

Table 4.1 compares the FDC's methodology to EU peers with similar mandates. The FDC's reliance on scrutiny and external benchmarks is in-line with its peers in Finland and Sweden; however, Finland's IFI plans to implement in-house forecasting in the near future and many of the forecasts underlying Sweden's budget are supplied directly by independent agencies. The Irish Fiscal Advisory Council and Slovak Republic Council for Budget Responsibility produce in-house economic and fiscal forecasts.

Table 4.1. Comparison of methods to peer institutions

	Endorsing or assessing official macroeconomic forecasts	Assessing the government's fiscal forecasts	Assessing compliance with fiscal rules and fiscal stance	Assessing long-term sustainability
Latvia FDC	Largely qualitative, compares against external forecasts from other institutions and monitors recent outturn data.	Mostly monitors recent outturn data and compares with external forecasts from other institutions.	Scrutiny of government calculations in fiscal rules spreadsheets with largely replicate EU calculations. Compares to an in-house heat map.	Scrutinising government analysis of impact. Commissioned a report prepared by consultants in 2017.
IFI Team of the National Audit Office of Finland	Largely qualitative, compares against external forecasts from other institutions and monitors recent outturn data.	Mostly monitors recent outturn data and compares with external forecasts from other institutions.	Scrutinises government calculations and uses analysis from other institutions. Replicates EU methodologies and domestic calculations. Compares to an in-house heat map and composite indicator.	Not currently in work plan.
Swedish Fiscal Policy Council	Largely qualitative, compares to benchmark external forecasts from other institutions and monitors recent data.	Mostly monitors recent data and compares to benchmark external forecasts from other institutions.	Scrutinises government calculations and analysis from other institutions.	Relies on work of other research agencies such as the National Institute of Economic Research and European Commission's scenarios and analysis.

	Endorsing or assessing official macroeconomic forecasts	Assessing the government's fiscal forecasts	Assessing compliance with fiscal rules and fiscal stance	Assessing long-term sustainability
Irish Fiscal Advisory Council	Produces in-house benchmarks with a suite of supply-side macro forecasting models and output gap models.	Produces in-house benchmark fiscal forecasts using high-level error-correction models for short- and long-run elasticities applied to tax bases. Fiscal and economic interaction (fiscal feedback) model. Suite of output gap models.	Replicates EU and methodology and domestic calculations and also using its own in-house "Principles-based approach" which uses alternative estimates of potential output rather than the commonly agree methodology potential output and budget elasticities used for EU fiscal surveillance.	In-house long-run projections (30 years), alternative scenarios, sensitivity analyses.
Slovak Republic Council for Budget Responsibility	Mandate only for ex-post forecast evaluations. However, prepares own macro forecasts. Large-scale structural macro model, error-correction equations. Nowcasting models for short-term. Dynamic stochastic general equilibrium model for simulations.	Produces in-house benchmarks with a mix of elasticity and structural econometric models, microsimulation bottom-up public finance revenue and expenditure projections for longer run. In-year estimates using seasonality. Traffic light system of risks.	Replicates EU methodology. Produces in-house output gap estimations, careful identification of one-offs, Expenditure Benchmark analysis.	In-house long-run projections, fiscal gap calculation over 50 years. Detailed scenarios. Published annually.

### 4.3. Individual model assessments

The OECD also assessed the appropriateness of each of the FDC's individual tools along six academic and practical criteria (Table 4.2). Some criteria are complementary, while others conflict. For example, a structural model grounded in economic theory may score highly in its ability to provide an intuitive narrative to stakeholders but may have higher forecast errors than a simple univariate time series model that relies only on its own history. Analysts at IFIs must consider these trade-offs and strike a balance when choosing models. For this reason, the review cannot provide a total score or pronouncement on whether a model is the best tool for the analysis. Instead, reviewers weighed the assessment criteria to form an opinion on whether the FDC chose a tool that is appropriate or inappropriate for delivering the FDC's mandate in Latvia's context.

Table 4.2. Summary of OECD model assessment criteria

Theory	Does peer-reviewed literature support (or not provide a strong argument against) this tool for the analysis, given the context and available data?
Accuracy	Is this tool likely to give the most accurate results (or avoid the most systematic bias) if applied to this problem?
Communication	Can the tool's outputs provide a coherent and intuitive narrative to stakeholders?
Transparency	Can the tool's methodology and assumptions be provided to the IFI's stakeholders in a manner that will satisfy its requirements for transparency and accountability?
Resources and business continuity	Does the tool require a level of resources and expertise that is appropriate to expect from the IFI's analysts to avoid analytical disruptions from staff turnover?
Precedent	Is the approach used widely at other IFIs and public finance institutions?

The technical assessment concluded that, although the FDC has few formal models to produce in-house research and needs to build capacity, the tools it currently has are appropriate for their specific use in the FDC's audit approach workflow. A summary list of the FDC's tools and the review team's assessment is provided in Table 4.3.

Table 4.3. The FDC's methodology is appropriate but could be improved to meet best practices

Model	Description	Opinion
Annual R model	Economic monitoring tool, with some time series statistical forecasting for consumer prices.	Appropriate, unqualified
Heatmap economic cycle indicator	Heat map for monitoring sectoral imbalances and the business cycle.	Appropriate, unqualified
Fiscal rules assessment spreadsheet	Spreadsheet calculations of <i>ex post</i> and <i>ex ante</i> fiscal rule compliance.	Appropriate, but room for improvement

The Annual R model is suited to compiling and reshaping historical data and for limited forecasting of consumer prices. The heatmap has widespread adoption among peer IFIs and is an excellent tool for the FDC and other stakeholders to quickly understand the state of the economy relative to its trend and to use it as a sense check against the output gap as measured by the EU commonly agreed methodology.

The FDC's fiscal rules assessment spreadsheet is appropriate for its role in delivering the IFI's mandate to a basic standard. However, the FDC should further develop this approach. The calculations are technically accurate and the exercise has some benefit as an audit approach to oversight; however, the lack of an internally produced benchmark against which to assess the reasonableness of official forecasts should be addressed in the future to bring the practice more in line with peers. The FDC has a workplan to do so.

Overall, the FDC's audit approach has had considerable success in identifying irregularities and breaches of Latvia's fiscal discipline framework. However, without direct access to the Ministry of Finance's models, and with less than two weeks to review the outlook, the audit approach is suboptimal as a long-term solution for independent oversight. The FDC should strive (and is striving) to move to an approach where it prepares more independent forecasts using its own fiscal models, and eventually, to some extent, simple macroeconomic benchmarks for aggregates such as potential GDP.

The FDC has entered into a modelling development project, funded by the Directorate-General for Structural Reform Support at the European Commission to bring its modelling practices in line with peers with similar functions. There are few examples of other IFIs with four staff or fewer that maintain in-house models. If a shift to in-house modelling is to succeed with the FDC's current resources, it is likely to require

considerable technical support with an eye toward using simple techniques. To sustain any sophisticated modelling capacity in the absence of regular technical support is likely to require additional financial and staff resources and a strong documentation and training plan to retain institutional memory.

#### 4.4. Key issues for the FDC's workflows and models

While the FDC's work was praised by stakeholders as being well-written, balanced and impartial, it is perceived as being driven by the expertise of the Council Members and especially of the highly engaged and well-respected Chair. Even though Council Members indicated that they are well supported by the small secretariat, this Council-driven approach contrasts with many of the FDC's European peers, whose formal opinions are grounded in the evidence and modelling of their staff and voiced under a more concrete institutional identity. It is therefore important for the secretariat to strengthen its analytical capacity to ensure that all Council opinions are underpinned with a concrete and consistent technical base that endures beyond the tenure of any specific Council members. It should do so in the following areas.

##### ***Strengthening macroeconomic analysis***

For its macroeconomic analysis, the FDC's key focus should be on potential output or output gap estimates. While uncertainty around these concepts has increased during the pandemic, the output gap remains a crucial indicator for both the domestic and the EU fiscal governance. The FDC can improve its scrutiny by using the EU's tools to replicate potential output under different assumptions and by taking its heat map a step further by calculating composite indices for an alternative measure of the business cycle, as peers in the National Audit Office of Finland have done. Over a longer capacity development horizon, the FDC can build its own simple short-run GDP benchmark forecast using nowcasting libraries in R software to extend its current monitoring tool. This approach is used by peers facing similar data environments such as the Scottish Fiscal Commission.

Given the FDC's current resource constraints, developing an in-house medium-term macroeconomic forecasting model should not be a key priority. Instead, it could develop a more formal approach for its assessment of the official macroeconomic projections, for example, by determining 'tolerance margins' around the median of a set of alternative projections (candidates include the Bank of Latvia, EC, OECD, IMF, and private banks). Such margins can be anchored to past forecast errors and confidence intervals, allowing the FDC to flag cases where the official projections appear to be too optimistic or pessimistic.

The FDC's assessment of the economic outlook should also be expanded beyond real and nominal GDP, inflation and the output gap. An evaluation of the government's revenue projections requires a view of the building blocks of GDP (demand or income components, as proxies for the tax bases for key revenue items). The FDC's opinions on the official macro projections should be broadened to encompass the relevant demand and income components of GDP. In addition, a more detailed view of macro aggregates is necessary if the FDC wants to develop its fiscal forecasting capacity (see below). In the absence of a fully-fledged macroeconomic forecasting model, the FDC can form a view on the key macro aggregates using alternative scenario tests or with simple decomposition models that project GDP components according to an aggregate GDP constraint.

##### ***Deepening fiscal analysis***

Efforts to strengthen the FDC's analytical tools should mostly focus on fiscal topics. An increased focus on in-depth fiscal analysis could align the FDC to many of its European peers such as the Slovak Republic Council for Budget Responsibility, the Irish Fiscal Advisory Council and the Portuguese Public Finance Council and would add the most value in the Latvian context.

The FDC should develop its own fiscal forecasting platform for the period covered by the EU stability programme. Such a platform could consist of a disaggregated framework covering the most important government revenue and expenditure items. Key revenue categories can be linked to macroeconomic proxy tax bases in spreadsheet models using revenue elasticities, effective rates, structural econometric models, or other simple time series statistical forecasting methods. Expenditure projections can be anchored to the projections in the Stability Programme or by exploring different population and inflation growth scenarios and comparing those to a “no policy change” scenario. Liaising with the Bank of Latvia, which operates a fiscal projection model, would be useful for exchanging views on the appropriate granularity of the model, specific forecasting rules and key parameters.

The key advantage of having such a model is that the FDC could then move beyond its assessment of the aggregate structural budget balance (which is highly uncertain since it is linked to the output gap that tends to be revised frequently) to include assessments of individual fiscal projections. A fiscal projection model could also be used for scenario analysis of fiscal developments under different macroeconomic and policy options.

### ***Deepening scrutiny of fiscal risks and the adequacy of the fiscal security reserve***

The FDC’s working group for assessing the adequacy of the fiscal security reserve meets several times a year to form its view and draft a chapter on fiscal risks for the Surveillance Report. The working group’s discussion consists mostly of qualitative observations of the comprehensiveness of the Ministry of Finance’s declaration of fiscal risks, along with recommendations to the Ministry to expand its analysis and quantify risks it has not considered. In the most recent assessment, the working group accepted the planned margin for 2021 but postponed its opinion for the planned margins for 2022 and 2023 given the unusually high degree of unknowns brought about by the COVID-19 crisis.

The Ministry of Finance’s declaration of fiscal risks is a detailed, well-produced document. The FDC would be unable to create comparable independent analysis of its own, which requires detailed administrative data and considerable staff resources. The working group’s qualitative discussions and application of members’ own judgment to determine gaps in the Ministry’s quantitative assessments has been appropriate. However, if the FDC secretariat builds internal forecasting capacity, it will open up new potential for expanding the risk assessments – an area that the FDC would like to explore in greater detail.

To refine its risk analysis, the FDC could consider the following list of options for developing its risk assessment capacity. The options are drawn from discussions with peer IFIs that have similar mandates for risk assessment reports, such as the Office for Budget Responsibility in the UK, and discussion papers and best practices from international organisations.

- **Scenario analysis and sensitivity tables.** The secretariat could support the working group by using its new fiscal forecasting capacity to provide scenario analysis and sensitivity tables that estimate the consequences of specific or general economic and fiscal developments on the budget balance. Of particular use would be scenarios with alternative assumptions for risks that the Ministry’s declaration assumes to be symmetric (and thus do not need to be accounted for in the fiscal security reserve). For example, interest rates have a zero (or slightly negative) lower bound but considerable upside risk. The FDC’s fiscal forecasting model can be expanded to include a detailed model for public sector debt, capturing outstanding maturity structures and effective interest rates on government bonds to assess the sensitivity of borrowing costs to interest rate developments, or to assess liquidity and refinancing risks with approaching debt rollover events.
- To support the scenario and sensitivity analysis, the FDC can **maintain a database of historical vintages of the Ministry’s risk assessments**, including a central registry of estimates of loans and guarantees over their life. Using this database, the FDC can calculate summary statistics of past risk estimates such as the mean and mode and any bias in revisions. These statistics may show that supposedly symmetric risks are in fact evolving over time asymmetrically. The FDC can then

apply these statistics at a high level to the Medium Term Framework Law to arrive at alternative projections of how much of the budget balance is at stake to determine a more appropriate fiscal safety margin if necessary.

- The FDC can also use historical forecast errors of the official budget forecasts to apply a probability distribution to the projections in the Medium Term Framework Law to **create fan charts that illustrate confidence intervals for achieving medium-term budget objectives**. These fan charts will give a sense to the adequacy of the fiscal security reserve for guarding against both known and unknown risks. This technique requires little data other than past budgeted and implemented amounts, which are publicly available. Fan charts of this type were used in the early days of the Portuguese Public Finance Council and Canadian PBO before they developed in-house modelling capacity and signed data access agreements.
- The fiscal forecasting capacity the FDC is developing will have demographic-based drivers for social insurance and social benefits that can be used to **simulate unforeseen demographic risks**, including changes to immigration rates, which tend to be the most sensitive driver of demographics. Currently, the government treats demographic risks as symmetric, but it is unlikely that the immigration rate and birth rates are of equal risk of unexpected increases and decreases. Demographically sensitive expenditure categories can be easily extended beyond the three-year framework law for long-term risk analysis and the FDC can eventually complement these projections with detailed cohort models, which are under development at some of the FDC's peer IFIs and could be part of wider capacity development cooperation.
- The secretariat could provide **quantitative assessments of high-level structural risks** that are not currently captured by the declaration, such as the impact of changes in “growth-corrected interest rates” (the difference between the interest rate and the growth rate) on long-term debt sustainability calculations. Such calculations were provided in the UK Office for Budget Responsibility's first Fiscal Risks Report (OBR, 2017<sup>[5]</sup>).
- The secretariat could **review the annual corporate plans and financial statements of state-owned companies** for any risks that have not been reflected in the fiscal risks declaration.
- If the FDC has a different opinion on the likelihood of a risk crystallising under the Ministry's probability scale, the FDC could **establish an agreement with the Ministry of Finance for the Ministry to provide alternative estimates under the FDC's preferred assumption**. The FDC could then publish the alternative estimate in its Surveillance Report. The OBR in the UK has a long-standing practice of requesting departments to re-estimate results with their alternative assumptions and then presenting them as scenarios in OBR reports.
- The FDC could **create a public consultation process and put out a request for expert assistance on evaluating risks that it believes are inadequately covered in the declaration**. For example, the OBR in the UK recently put out a public consultation to find experts on assessing the ongoing risks of the pandemic (looking for experts in the nascent field of macroeconomic epidemiology – the study of the interaction between the economy and pandemic control measures like lockdowns) and for assessing the risk of climate change on the public finances (OBR, 2021<sup>[7]</sup>). Through these requests for expertise, the FDC may be able to form a partnership with a university or policy school and serve as a platform of public influence for that research.
- As part of ongoing discussions about reforms to European fiscal rules, one proposal that could be a lead option is to set standards according to a probability-based risk management approach that uses **stochastic debt sustainability analysis** (Blanchard, Leandro and Zettelmeyer, 2021<sup>[7]</sup>). These standards are intended to be a more holistic measure of debt sustainability that balances risks for fiscal sustainability against risks to the macro economy if governments withdraw fiscal support too abruptly. The FDC could offer to serve as a contact point for testing risk-based approaches to fiscal rules for the EU surveillance framework and apply the techniques in its risk declaration assessment.

# Chapter 5. Financial and human resources

## Chapter findings

Stakeholders universally reported that they perceive Council members as having few secretariat resources to support them. This is confirmed with cross-country comparisons against peer IFIs. Further, legal authority to hire permanent secretariat analysts is granted each year in the state budget through annual discussions with the Ministry of Finance and therefore relies on the goodwill of the government.

The FDC's sufficiency of resources and its staff funding independence should be reviewed to align closer to the OECD Principles for IFIs. Specifically:

- The *Fiscal Discipline Law* should be amended to explicitly authorise the FDC to be supported by “a secretary and staff” instead of only mentioning the Secretary. This would provide greater certainty and protection for ongoing secretariat support. The secretariat's funding should be protected in real terms in a similar manner as the existing remuneration of Council members and the Secretary.
- The compensation of the Chair and Council members should be reviewed and adjusted to adequately reflect the commitment of the positions.

### 5.1. Introduction

According to the OECD Principles, an IFI must have resources commensurate with its mandate to fulfil it in a credible manner (Principle 4.1). This chapter assesses the extent to which the Fiscal Discipline Council has sufficient human and financial resources, as well as whether those resources are predictable and sustainable.

### 5.2. Financial resources

The budget for the FDC is determined by the rules laid out in the *Fiscal Discipline Law* that set minimum levels for:

- Remuneration of Council members
- Remuneration for one Secretary
- Expenses for external expert consultants
- Reimbursement of travel expenses incurred by Council members to attend FDC meetings.

To protect the budget across time, the Law also defines automatic indexation of remuneration, tying it to inflation of wages and expenditures in the public sector. Of note, the *Fiscal Discipline Law* does not provide for staffing beyond the sole Secretary in charge of administration.

The minimum funding for the FDC prescribed by the *Fiscal Discipline Law* is paid from the budget of the Ministry of Finance, which separates and protects the expenditure of the FDC as a separate line, or “budget

institution". Since 2016, the Ministry of Finance has also provided the FDC with resources for additional staff above the funding prescribed by the Law. This amount is the result of an agreement between the FDC and the Ministry of Finance, initiated by the former Chairman of the Budget and Finance (Taxation) Committee of the Saeima, in response to the need to increase analytical resources of the secretariat to fulfil the broadening of the FDC's mandate to include endorsing macroeconomic forecasts. The agreement is authorised each year in the annual budget law. In total, the agreement with the Ministry of Finance currently provides for four staff members: the Secretary, a macroeconomic expert, a fiscal risks expert, and an administrative professional.

The funding for the FDC is approved on a year-to-year basis, but stems from three-year plans within the Medium Term Budget Framework Law. This multi-year plan provides a form of commitment to the FDC's budget. That said, as the authorisation for any staff beyond the Secretary does not have a permanent legislated basis, the secretariat's existence ultimately relies on the goodwill of the government to provide for it in the annual budget law. The State Audit Office flagged this risk as part of its 2016 audit of the FDC and recommended that a more permanent solution for funding the FDC's secretariat be found. To achieve a more permanent solution, the *Fiscal Discipline Law* should be amended to specify that the Council is to be supported by an adequate secretariat with a minimum baseline of funding that is indexed to inflation. For example, the legislation of the Irish Fiscal Advisory Council sets a baseline level of funding that provides for several secretariat analysts (with the exact number left for the Council to manage within the budget) and a growth factor to ensure that the baseline is preserved in real terms (Box 5.1).

#### Box 5.1. The Irish Fiscal Advisory Council is given funding for a robust secretariat in legislation

The Irish Fiscal Advisory Council's budget is set in legislation under the *Fiscal Responsibility Act 2012* and paid directly out of the state's central fund. Section 6 of the Act specifies that the Council's budget is capped at a maximum of €800,000 per year in 2013 prices, which is then indexed to increase each year with inflation (specifically the Harmonised Index of Consumer Prices). The Act prescribes that the Council may "appoint such and so many persons to be members of staff of the Fiscal Council, and on such terms, as may be determined by the Fiscal Council" and that staff "shall be paid out of the moneys at the disposal of the Fiscal Council."

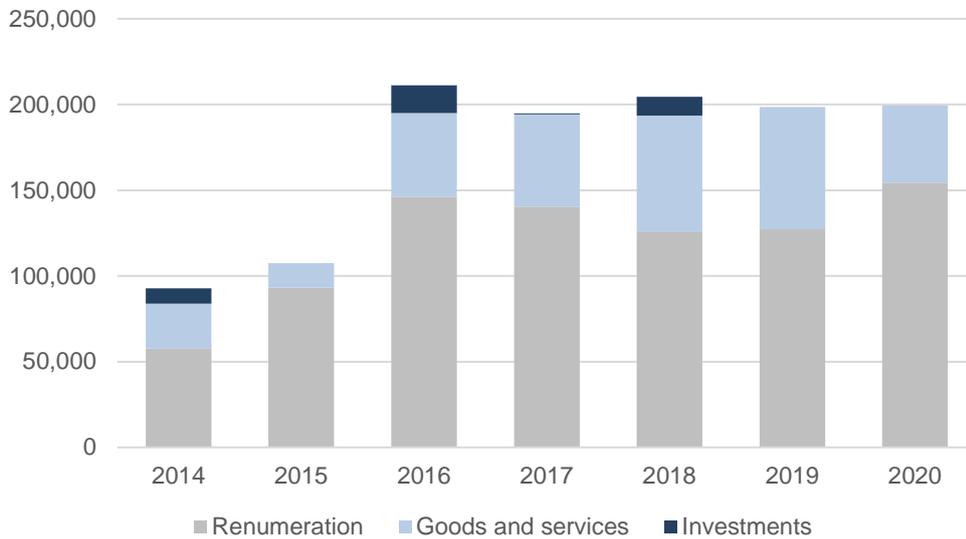
This arrangement protects the Council's independence, as it is not subject to annual decisions by either the government or Oireachtas (national parliament of Ireland), and it guarantees multi-annual stability of funding in line with the OECD Principles.

Since the mandate to endorse the official macroeconomic forecast was added in 2016, the FDC's annual budget has totalled approximately €200,000 (Figure 5.1). The budget is regularly set in three main categories: salaries, goods and services, and investments such as computers and office equipment. Within these categories, the FDC has flexibility to determine how the funding is used, provided the rules of remuneration in the *Fiscal Discipline Law* are followed.

In 2020, remuneration accounted for approximately 80% of total expenses, of which around 16% (€25,500) was for compensating Council members to attend meetings. During periods of understaffing, spending on consulting services rose and remuneration fell. If needed, the FDC may ask the Ministry of Finance to reallocate resources and use potential savings in services to increase remuneration, or vice versa. As an example, an expert consultant for a tax report was paid out of the remuneration category instead of the services category in 2020. The Ministry of Finance has generally accommodated the FDC's requests for resource reallocations in the past. To preserve the FDC's operating independence, the Ministry of Finance should continue to accommodate the FDC's internal resource management decisions in line with Principle

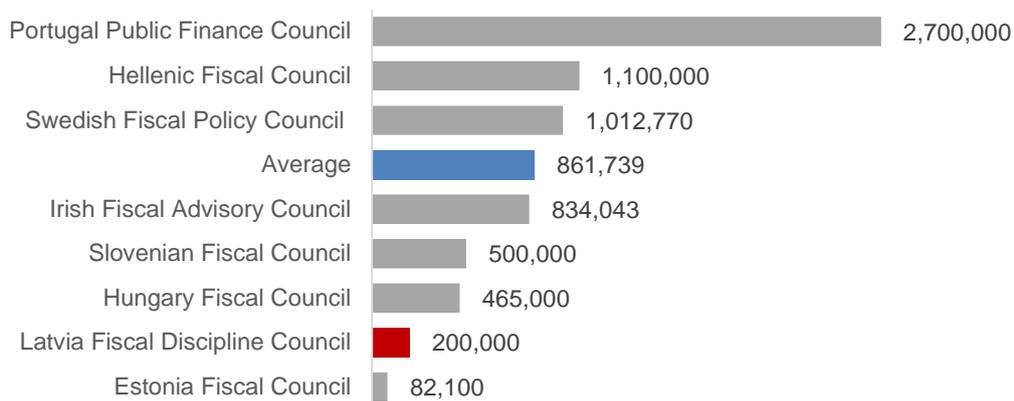
2.5 of the OECD Principles for IFIs, which says that leadership should have full freedom to hire and dismiss staff in accordance with applicable labour laws.

Figure 5.1. The FDC’s budget was increased in 2016 to endorse the macroeconomic forecast (euros)



Compared to other fiscal councils with similar makeups and mandates, the FDC’s financial resources are among the lowest (Figure 5.2). Only the Estonian Fiscal Council has a smaller budget; however, the Estonian Fiscal Council receives considerable support from the Bank of Estonia in which it sits and this assistance is not included in its budget total. This cross-country comparison is limited, as it does not adjust for country-specific differences in salaries and the cost of living.

Figure 5.2. Financial resources of EU IFIs with similar functions to the FDC (euros)



Note: Exchange rate conversion: one Swedish Krona is 0.099 euro.  
 Source: OECD IFI Database 2021 (Forthcoming).

### 5.3. Human resources

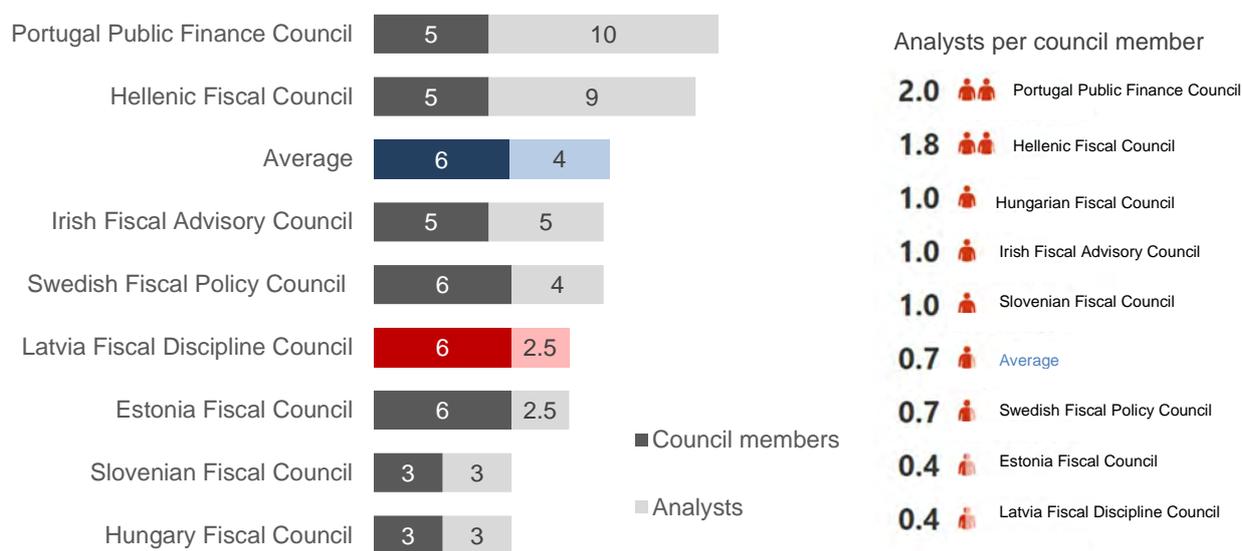
When the FDC was established, the designers of the *Fiscal Discipline Law* had in mind that the analytical work and drafting of reports would be carried out by Council members themselves without the need for analytical staff (only one Secretary for handling general administration was envisioned). At the same time,

compensation for Council members was capped at low levels, for example 72 hours per year under recent practice. The lack of research staff or incentives for Council members to invest a significant amount of their own time meant that initially the FDC was unable to maintain a strong analytical underpinning for the Council's opinions to ensure that they were consistent and applied under a well-documented framework across time.

That shortfall was partially addressed by increasing the number of approved staff by three in 2016 and increasing the FDC's budget to remunerate them. In total, the FDC now has the Secretary, two analysts, and an administrative position within the secretariat to support the Council. With the Secretary devoting roughly half of their time to administration tasks this leaves roughly 2.5 full-time equivalent employees responsible for analysis at the FDC. This places the FDC's secretariat staff resources among the lowest of EU IFI's with similar mandates (Figure 5.3).

The secretariat has gender balance amongst employees: half are women and half are men. The Council, on the other hand, has only one female member out of the six, the Chair. The nomination procedure for future Council members should pay special attention to this aspect of the Council's composition.

Figure 5.3. Council and analysts compared to peers (full-time equivalent)



Source: OECD IFI Database 2021 (forthcoming).

## 5.4. Key issues for financial and human resources

### ***Sufficiency of secretariat support and fiscal expertise***

The level of resources provided to the FDC after 2016 are sufficient to deliver its basic mandated tasks of monitoring the government's compliance with the *Fiscal Discipline Law* and endorsing macroeconomic forecasts. However, the FDC's resources are insufficient to support it in pursuing its wider mandate to give "an opinion about any fiscal issue that the Council deems to be important to ensure overall compliance with that law" and the provision requiring that "the Council shall assess and analyse the sustainability of the State fiscal policy." Conducting the activities that are typical for independent fiscal councils in delivering such responsibilities is likely to require additional permanent staff positions.

Providing greater flexibility for the FDC's leadership to determine their own balance between outside consulting services and permanent staff positions and to increase the number of secretariat analysts closer

to the average of its peers would significantly aid the FDC's efforts to build capacity and support the sustainability of its current technical assistance programme.

### ***Remuneration of Council members***

The members of the Council receive remuneration in conformity with the *Law on Remuneration of Officials and Employees of State and Local Government Authorities* and in proportion to the length of time worked, subject to a limit. The hourly wage rate of Council members is tied to the national average monthly wage (lagged by two years) published by the Central Statistical Bureau and should not exceed 50% of the monthly average wage in the country.

The hourly remuneration of Council members is relatively competitive (€56.22 in 2020, based on the 2018 average monthly wage of €1,004). However, the hours of work that are compensated are limited and do not reflect the time that Council members invest. The *Fiscal Discipline Law* sets a level of remuneration that assumes only six Council meetings per year, with eight hours of preparation for each meeting. Since 2016, the Ministry of Finance has provided funding for an additional two meeting days for the working groups. In total, the compensated effort related to the preparation of Council meetings, including the work of the working groups, is limited to 72 hours per year. The compensation for Council members in 2020 varied between €3,500 and €4,300. This is below the compensation offered at other peer IFIs. For example, the Chair of the Irish Fiscal Advisory Council is provided with a set rate of €20,520 per year and other Council members are provided with €11,970 (OECD, 2021<sup>[9]</sup>). Although average wages and the cost of living in Ireland are considerably greater than Latvia, a gap remains. The limit on annual compensated hours for Council members should be raised to better reflect the analytical commitment that is expected of them and the Council should be provided with funding in a manner that allows it to determine its own activities such as working group meetings, without detailed discussions with the Ministry of Finance.

As it stands, the ability of the Fiscal Discipline Council to fulfil its mandate depends on the Chair devoting considerable uncompensated time to Council work. Stakeholders noted that the Chair must be available at all times to communicate the FDC's outputs and that they must be deeply involved in the preparation of material for Council meetings. The OECD Principles recommend that the position of an IFI head should preferably be a full-time position. In the case of smaller institutions like the FDC, it is not unusual that, given the overall financial resources available, such an arrangement is impractical. Nevertheless, the total available hours of compensation for the FDC's Chair should be raised to attract a wider range of candidates who will not be discouraged by the considerable voluntary time commitment required of them to keep the FDC operating successfully.

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