



Main Principles of Fiscal Policy in Latvia

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Content



- Achievements towards budget balancing
- Fiscal discipline in legislation
- Long term sustainability of Public Finances

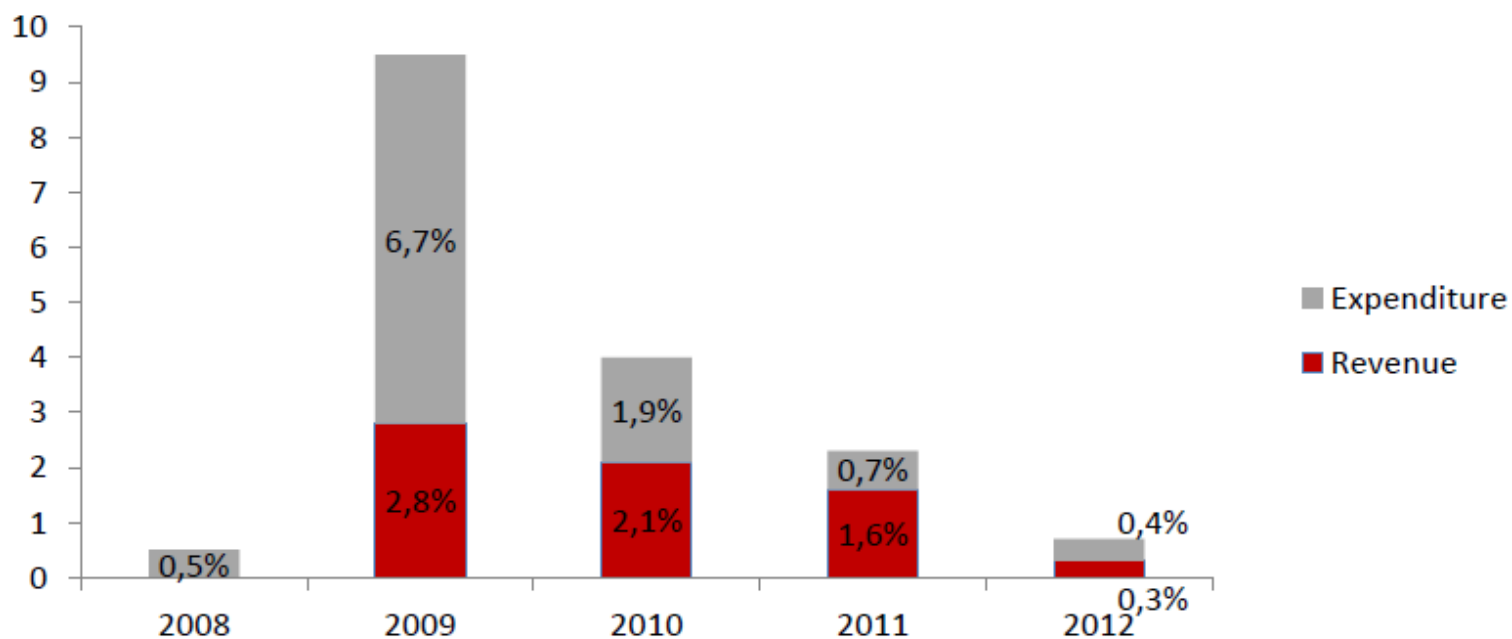


ACHIEVEMENTS TOWARDS BUDGET BALANCING

Fiscal consolidation



In total during the time period from 2008 until 2012 the fiscal consolidation measures have been performed with fiscal impact of 16.9% of GDP, from which approximately 6.7% of GDP are measures taken on the revenue side, while measures on the expenditure side in total constitute approximately 10.2% of GDP).
On average during the year in the time period from 2008 until 2012 Latvia has performed the fiscal consolidation measures in the amount of 3.4% of GDP.



Post – crises challenges

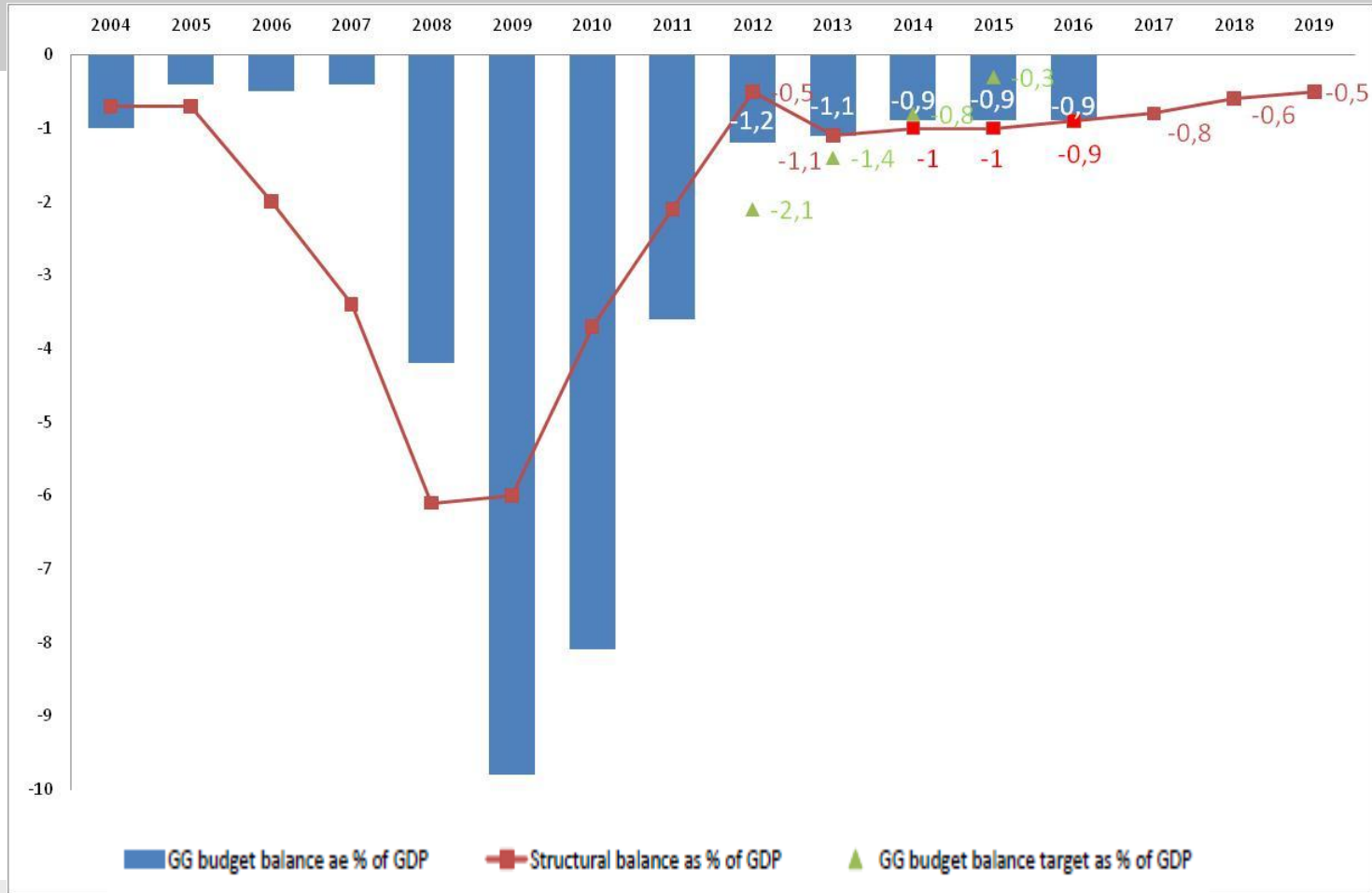


Fiscal consolidation affected also the amount and quality of public services provided by the State. Insufficiency of funding has accumulated problems that currently have become urgent and not solving of which may further create irreversible processes, for example, deterioration of roads.

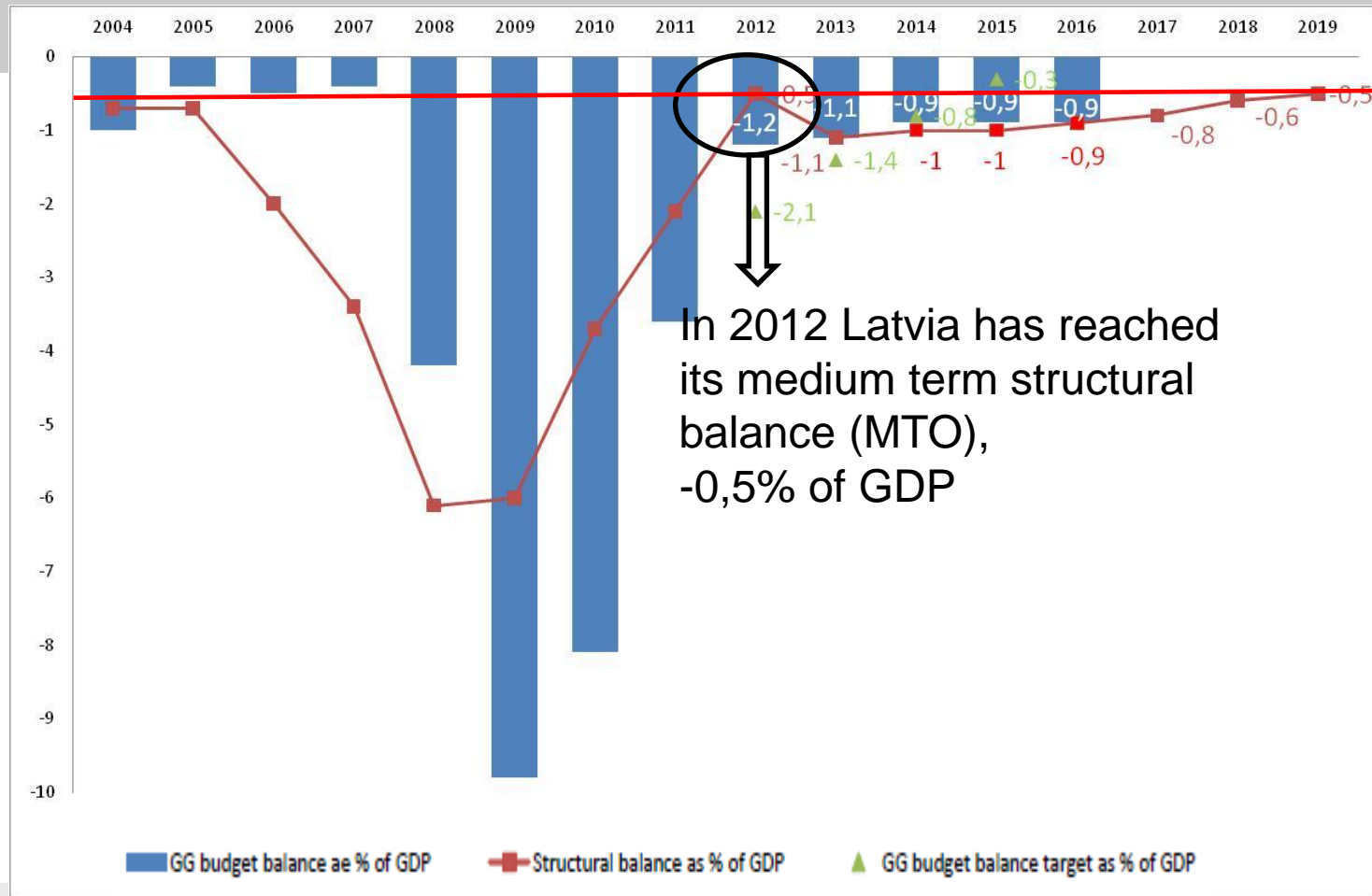
Therefore the years 2013- 2016 are marked as an **post-crisis period**, during which the State shall restore adequate funding for the implementation of the States' functions, completely respecting the conditions of the fiscal discipline.

This period has been already marked in 2012, which is characterized by considerable increase in revenue in the State budget, providing an opportunity to improve the fiscal position better than it was planned and increase expenditure, **making amendments** to the budget of 2012.

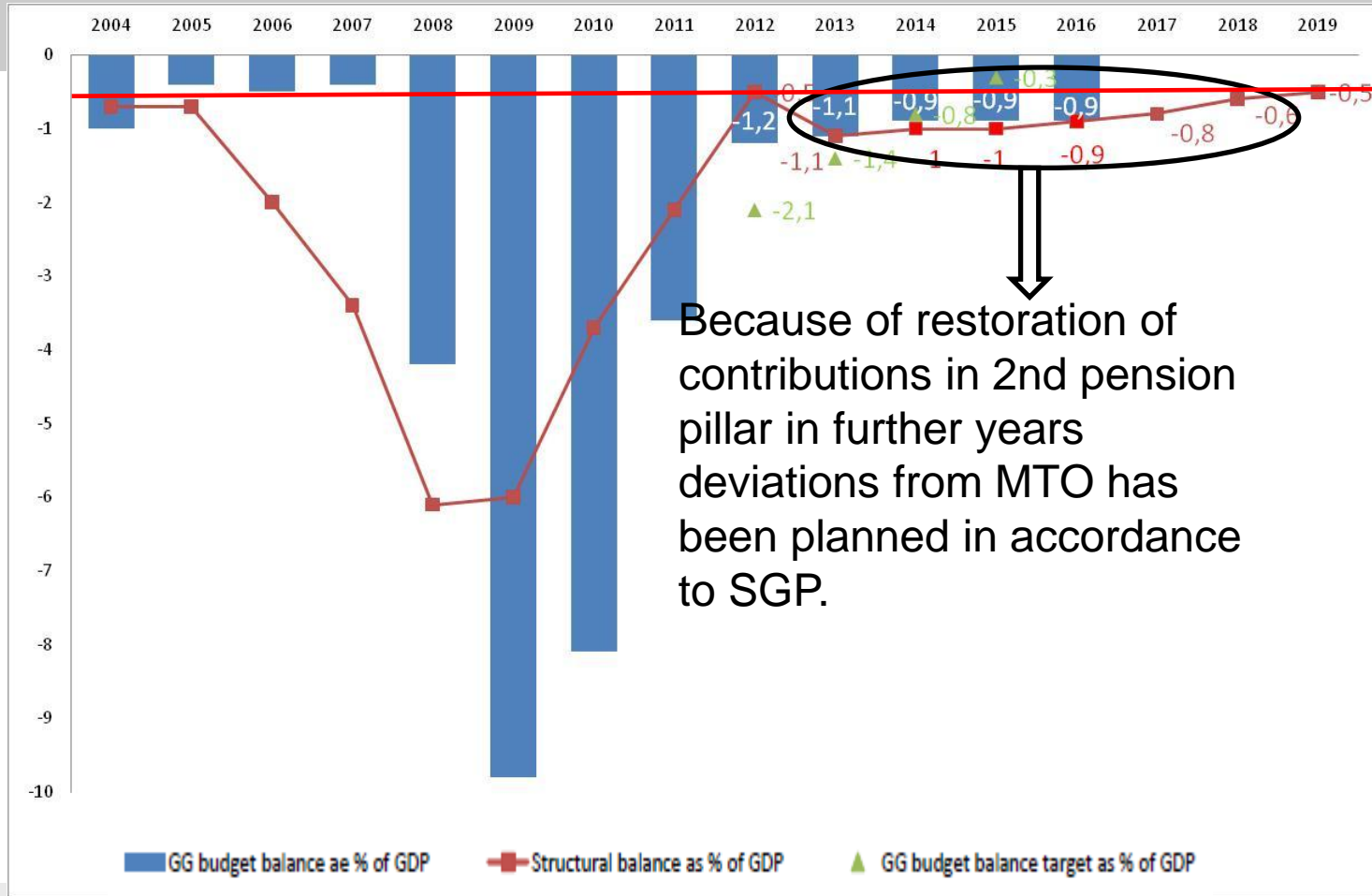
Headline and Structural balance



Headline and Structural balance



Headline and Structural balance





FISCAL DISCIPLINE IN LEGISLATION

Fiscal discipline in legislation



- 31.05.2012 Latvia ratified EU Fiscal Compact.
- 06.03.2013 Fiscal Discipline Law entered into force.

Main elements of Fiscal Discipline Law



- Numerical Fiscal Rules;
- Fiscal Risks;
- Fiscal Council.

3 Numerical Fiscal Rules



Balance rule

=

Cyclical part

+

Structural balance

+

One-off measures

$$b_p = \alpha \cdot \left(\frac{Y_p - Y_p^{pot}}{Y_p^{pot}} \right) + b_p^{str} + b_p^{vien}$$

Expenditure growth rule

Expenditure growth (net GDP deflator): not more than the average potential GDP growth.

Expenditure ceiling

Fixed in MTBFL for each of next 3 years. Operational tool for preparation of Budget Law (stabilization, equalization, exceptions).

Main characteristics of FDL

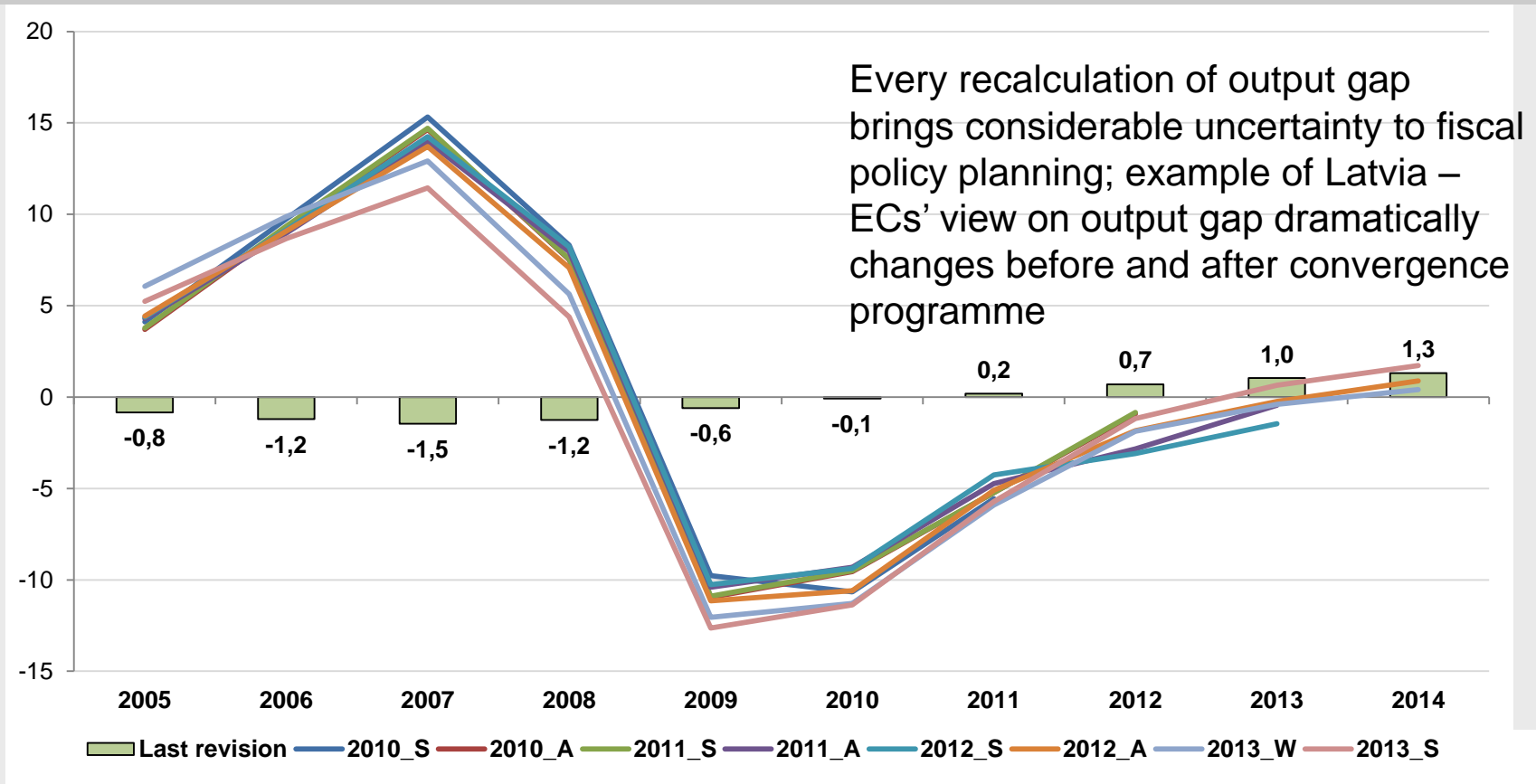


- Structural deficit not higher than 0,5% GDP.
- Specific convergence rule towards MTO (0,5% adjustment path);
- Automatic correction mechanism: (based on Swiss debt break rules) notional account registering deviations of actual structural balance (+/-) from its planned targets. If cumulative deviation is negative and higher than 0,5%, correction is triggered automatically by improving structural balance in next MTBF by extra 0,5% until deviation is fully compensated.

Output Gap– shaky cornerstone of Fiscal Policy?



Output gap, as % of potential GDP, vintages of European Commission calculations



Note on abbreviations – W/S/A stand for winter, spring and autumn forecasting rounds of European Commission

Escape clauses



1. Natural catastrophes, disasters and other material losses caused by natural or social processes. ($>0,1\%$ GDP);
2. In case of thret to national security according to article 62 of Latvian Constitution;
3. In case of severe economic downturn (recession).

Fiscal risk management



- Fiscal risk management:
 - Regular identification, disclosure and mitigation;
 - Declaration of fiscal risks annexed to MTBFL;
 - Fiscal safety reserve: (expenditure ceiling in MTBFL – expenditure in Budget Law) depending of fiscal risks, at least 0,1% of GDP.



- Fiscal Council: main task - monitoring implementation of fiscal rules.

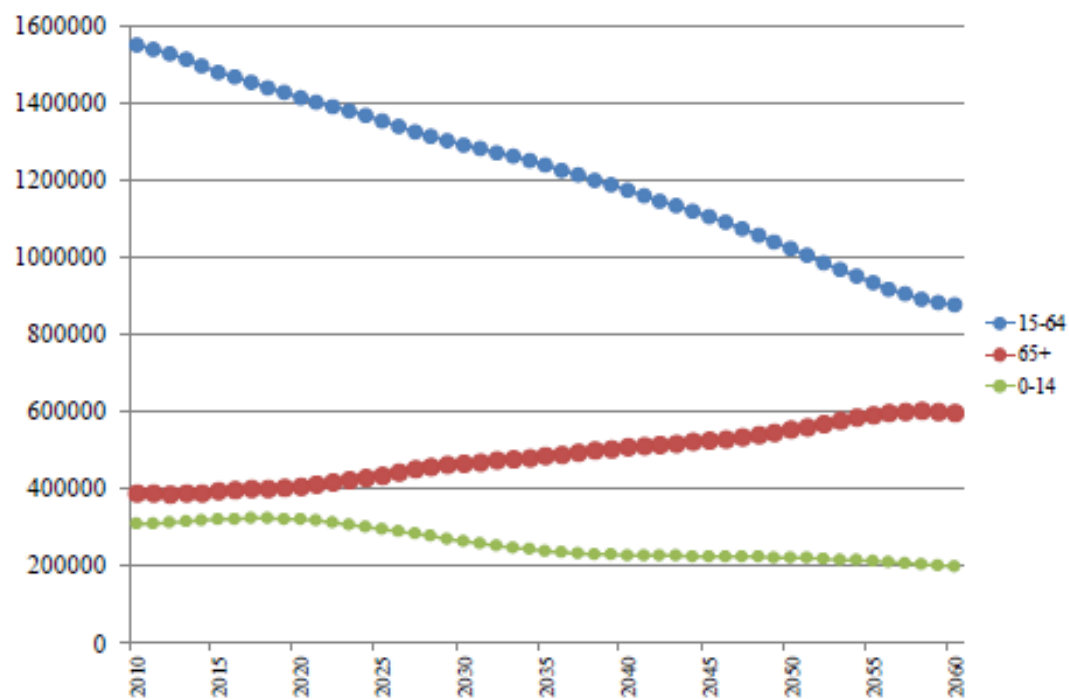
No direct mandate for independent macroeconomic forecasts, (in meaning of producing or endorsing macroeconomic forecasts), however will provide its opinion, which is not binding.

- issuing annual report and irregularity reports;
- Government response: comply or explain;
- 6 members;
- independence safeguards (removal from office, financing).



LONG TERM SUSTAINABILITY OF PUBLIC FINANCES

Long term sustainability of Public Finances



Long term sustainability of Public Finances (2)



% of GDP	2010	2020	2030	2040	2050	2060
Total expenditure						
Of which: age-related expenditure	18.5	15.4	14.4	14.4	14.9	15.1
Pension expenditure	9.7	6.8	6.0	6.1	6.2	6.0
Social security pensions	9.7	6.8	6.0	6.1	6.2	6.0
Old-age and early pensions	8.7	6.1	5.4	5.6	5.8	5.6
Other pensions (disability, survivors)	1.0	0.7	0.6	0.5	0.5	0.4
Occupational pensions						
Health care expenditure	3.7	3.9	4.1	4.3	4.4	4.4
Long-term care expenditure	0.7	0.7	0.7	0.8	0.9	1.0
Education expenditure	4.4	4.0	3.6	3.2	3.4	3.7

Assessing the expenditure of public sector related to ageing population, uncertainty in assumptions should be taken into account. Due to certain negative factors, especially in the health and long-term care sectors, the total amount of expenditure in the long term could increase from 3 to 4 percentage points.

Source- AWG –Working Group on Ageing Population and Public Finances’ Sustainability of the European Council Economic Policy Committee.

Long term sustainability of Public Finances (3)



In 2012 the following changes were made (approved by the Saeima) in the Latvian pension system:

- ✓ gradual increase in retirement age from the year 2014 by 3 months each year until in 2025 there are 65 years reached
- ✓ possibility to accept early retirement 2 years before the normal retirement age, if the insurance period is at least 30 years
- ✓ increase of the minimum insurance period up to 15 years, starting from 2014, and up to 20 years, starting from 2025.
- ✓ gradual increase of contribution rate in the 2nd pension systems' level, i.e., in 2012 by 2%, in 2013-2014 by 4%, in 2015 by 5% and in 2016 by 6%



Thank you!