# 3. In Focus

## Latvia to set constitutional limits on public deficit and debt

In Europe and elsewhere in the world investors, lenders and businessmen are preoccupied with the issue of growing debt. If Latvia manages to cure this illness faster and better than others, it will fare much better – this has been the reasoning guiding Latvia's economic policy makers in recent years. The correctness of this approach is confirmed by the data on growing gross domestic product, exports, manufacturing and dropping unemployment.

Similarly, setting **constitutional limits on the country's public deficit and debt** should also assist us both in the near future as the country gears up for the euro introduction in 2014 and in the longer run, remaining a lesson learned or legacy of sorts left by the current financial crisis to the future Latvian policy makers. **This month** the relevant amendments to the Constitution and an accompanying ancillary law were **submitted to the Parliament** for scrutiny and approval.

When to expect the entry of the new provisions into force and what is the content of the proposed legislative amendments? Most probably the new legislation will be in place in time for the passing of the 2013 budget next autumn. This does not rule out the possibility of a speedier passing of the new provisions stipulating a counter-cyclical fiscal policy which represents the only stable strategy towards sustainable growth: thriftiness in good times in order to be able to stimulate growth when the going gets tougher.

During the growth years following the EU accession in 2004, the pro-cyclical fiscal expansion acted to step up the overheating of the Latvian economy, dealing a devastating blow to the export competitiveness of the economy. The competitiveness has now been regained but only through painful budget cuts and structural reforms. To begin with, the proposed changes suggest sticking to medium-term budgeting covering a period of three years, which should help both planners and investors get a better sense of perspective.

The draft ancillary law accompanying the amendments to the constitution states: when the year-on-year growth of gross domestic product at constant prices does not exceed 2%, the general government consolidated budget (i.e. including local governments) has to be balanced or in surplus, whereas deficit is acceptable only during the years of economic decline. It also sets a ceiling for the general government debt at 60% of GDP.

While these principles of good economic governance are turned into statutory provisions in this country, a step-by-step compressing of the deficit from 7.7% of GDP in 2010 to 4.5% planned for 2011 and then to 2.5% of GDP in 2012 will already mean a gradual return to income-based spending. For the improved resilience of Latvia to any potential second wave of the global crisis and the euro changeover in 2014, the 2012 budget remains decisive: passed in a timely manner this year (despite the extraordinary elections on 17 September) without increasing taxes and keeping the budget deficit safely below the Maastricht criterion of 3%.