3. In Focus

On progress made in drafting the 2012 budget

In the past three difficult years much has been achieved. While overcoming the crisis, it has become clear that, in terms of the budget, less means more:

– lower deficit means higher growth and it rebounds faster,
– lower deficit means higher competitiveness and more production,
– lower deficit means more jobs and higher export growth.

Latvia has already become one of the fastest growing and export-capable economies in the EU. This should be reinforced by completing the consolidation and achieving a balanced budget in 2013. Moreover, the lesson learned during the crisis, i.e. the rule to save when the economy is growing should be incorporated in the Constitution and the Law of Fiscal Discipline as well as real three-year budgeting should be introduced.

Given the short time that the new government has had at its disposal for drafting the budget, what has been accomplished is commendable. The government has been aware that it is not just a regular budget but one with far-reaching consequences: it will determine how we live for the next ten years and not just next year. It will likewise determine whether we live with the euro or without it.

We appreciate the fact that there is no longer any disagreement between the international donors and the government and that the consolidation amount is close to 150 million lats, a figure proposed by the central bank. Unfortunately, this contains no safety margin! We should take into account the fact that we are witnessing an exacerbation of the sovereign debt crisis in the world and particularly in Europe. The second wave of the crisis has already begun to roll, resulting in substantial downward revisions of the growth forecasts. New important developments are taking place every day, not just every week or month.

In November, the Vice-President of the European Commission for Economic and Monetary Affairs and the Euro, Olli Rehn, warned of a possibility of a "new recession", i.e. a renewed contraction in production and services output. The EC autumn forecasts also point to an expected growth deceleration. The latest statistics indicate a drop in industrial production already in the remaining months of this year. The recent ECB Survey of Professional Forecasters also suggests that the short-term euro area GDP growth will be low (0.8% in 2012). Moreover, it predicts slow growth for the next five years. The economies of many European countries, including the core economies, are stagnating.

Recent experience shows that under such circumstances it is the countries with sound public finances that are the most successful. There is still much to be done in improving Latvia's public finances: next year the state will continue to spend a million of borrowed lats a day and public expenditure remains at the level of 2007. Should the downturn risks in Europe materialise, Latvia may have to implement additional consolidation measures in the middle of next year.