The new school bag of the 2017 budget contains homework

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The preparation process of the next year's budget is currently in full swing. Several positive signs can be observed in planning of public finances, e.g. the review of expenditure base, more cautious growth forecasts and the provision of a risk reserve. However, it is necessary to put greater focus on budget sustainability by balancing expenditure with revenue.

The review of the effectiveness of the use of the budget base expenditure finished in spring 2016 should be mentioned as one of the completed homework assignments. Thus, funds were released for financing more topical state needs before adding new funding. The review process of the current expenditure has yielded first results and should be continued. Certainly, there is the potential to find more than the approximately 60 million euro, less than 1% of the budget, released in the first expenditure review exercise.

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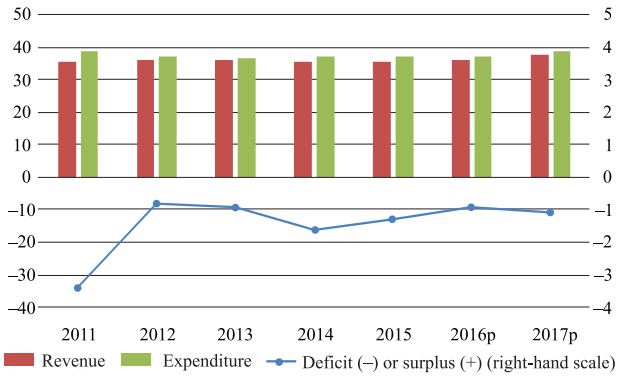
General revision of the tax system has been commenced this year involving World Bank experts. They point out that Latvia collects less taxes than the European Union (EU) countries on average or countries similar to Latvia, and that the key improvements should be made in tax administration and combating the grey economy. Efforts made in recent years to strengthen capacity of the State Revenue Service, improve tax collection, e.g. the introduction of the reverse value added tax in individual sectors, as well as the planned regulatory adjustments of the construction sector are steps in the right direction. It is expected that recommendations made by the World Bank will have a positive long-term impact on competitiveness of the tax system.

Government finances
(% to GDP)



Source: CSB.

Tireless calls by the Fiscal Discipline Council (FDC) for greater focus on sustainability in planning public finances have born fruit. Taking into account the opinion of the FDC, the degree of optimism in macroeconomic forecasts underlying the budget was reduced. Moreover, the 2017 budget will see an overdue introduction of the fiscal security reserve. It is a significant instrument to reduce risks of budget deficit exceeding the planned amount.

Improvements in the budget preparation process should be greatly appreciated. However, work to be done and "the old diseases" cannot be disregarded. The recent decreasing trend observed in economic growth forecast adjustments in Latvia and the EU requires us to be as cautious as possible when spending public finances. The approval of the aforementioned fiscal security reserve for 2017 can help in this regard. At the same time, the approach to look for revenue possibilities to satisfy appetite for spending survives. In order to cover new recurring expenditure items, including wages and salaries, short-term sources of revenue have been mainly used. The highest share of additional resources has been provided by postponing the planned changes to the procedure of vehicle exploitation tax payment which would make it possible to pay the tax for the actual exploitation period only; the share payable in dividends by state capital companies has remained high (85% in 2017); and significant resources have been allocated for new expenditure, foreseeing one-off revenue of 20 million euro generated from confiscation of proceeds from criminal activity.

Budgetary needs are, of course, acute and require hundreds of millions of euro to satisfy them. This is not a finding of today requiring a sudden search for funding. Although currently resources for covering new expenditure have been found in the budget, a more structured approach to balancing expenditure with revenue is necessary in the future. The flow of homework assignments in the budget school bag will continue tomorrow and beyond with the living standard of future pensioners, healthcare, education and other essential needs of the country's population in mind.