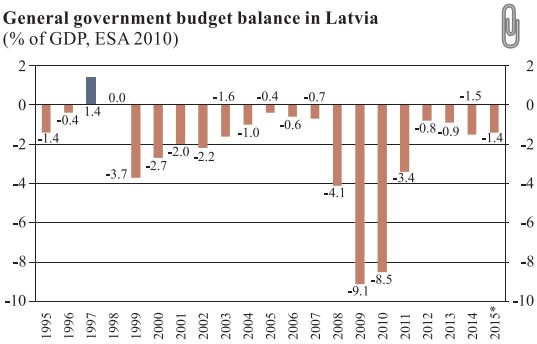
The right moment to put the budget in order

Press conference of the Governor of Latvijas Banka (summary)

Ilmārs Rimšēvičs
President
Latvijas Banka

This is a crucial moment for establishing a reasonable fiscal policy and putting the budget in order, said Ilmārs Rimšēvičs, the Governor of Latvijas Banka, at his regular press conference in December. For 2017, a budget ensuring a solid foundation for Latvia's future economic growth should be adopted. This should be achieved based on several principles: stability, balanced budget, and careful revision of budgetary expenses (zero-based budgeting).



* Assessment by the Ministry of Finance
Source: Eurostat

The 2016 budget has been adopted despite all the shortcomings so much discussed by entrepreneurs, and we will have to live with it. So right now it is important to not lose time and review the budget drafting process, so that we could adopt the kind of budget for 2017 that would create a stable foundation for the development of Latvian economy in the future.

Stability is essential for the Latvian business environment, for attracting investment and for resuming lending. Latvijas Banka supports the proposal of auditing the tax system, at the same time urging to make it clear once and for all: as soon as the taxation system is put in order, we are not going to manipulate it for at least one general election cycle. Thus a practice of a stable and transparent tax system would be established – a system that, instead of being changed every year, is maintained stable for at least four years.

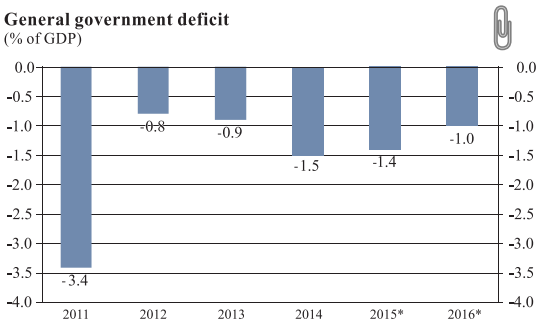
The tendency of the last twenty years is worrisome: we have had a budget surplus for only one year; the rest of the time we have lived on debt, increasing the external debt. Still the simple equation is valid: **budget deficit = higher public debt = higher taxes**. In other words, living with a budget deficit we enter a vicious circle: the public debt is growing and to service it greater funds are needed, but, to find these funds, taxes have to be raised. The raising of taxes has a negative influence on the business environment, it is an obstacle to investment and creates uncertainty about the future both for businesses and households, thus having a negative impact both on economic growth and the budget itself.

> **"Still the simple equation is valid: budget deficit = higher public debt = higher taxes."**

The promise of **establishing a working group for zero budget** should be kept, irrespective of what is happening with the coalitions, governments, etc. Any budget activity must be evaluated from the beginning – by assessing the relevance of positions rather than increasing the base for the next years without carefully reviewing the expenditure of previous years. In this work, there should be no red lines: the budget base should be evaluated in all ministries, including the priority ones, whose expenditure was not curtailed for 2016.

The current lack of discipline has consequences for the future. Regarding 2016, no prior commitments were honoured, which means that for 2017, a greater fiscal reserve will have to be built. In view of the optimistic forecasts, which have been included in the budget but which may have to be corrected – because of lower inflation, among other things – **building the fiscal reserve will be very important**.

Under the current circumstances, s**tructural reforms in education and healthcare systems are of growing importance**. We do hope that in 2016 serious reforms will take place in both of these areas, in order to improve Latvia's competitiveness, and that measures will concurrently bet taken to explain to the general public why such reforms are necessary and what positive effect they will have on our economy in the future.



* Assessment by the Ministry of Finance
Sources: Eurostat, Law on the state budget for 2016

Why are we discussing budget matters already now? We have at least six months till the drafting of the next budget begins and we hope that the Ministry of Finance and the Government will launch a serious discussion for us to see what the Government is spending overall and whether the only way to improve the budget situation is to continue brutally raising the taxes. That's not the way it should be.