Fiscal developments and projections in Latvia 2013–2016

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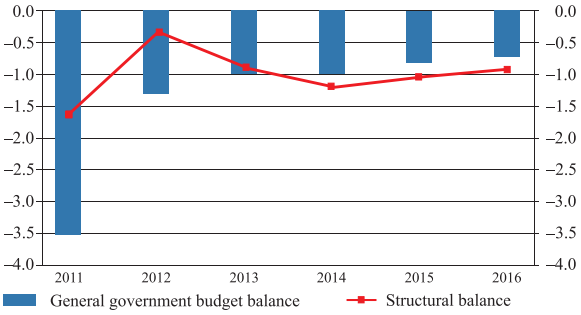
The budget deficit of Latvia in 2013 declined to 1.0% of GDP according to the Eurostat notification on General Government Budget Deficit and Debt published on 23 April 2014. This marks another milestone on the track to fiscal sustainability for Latvia. Putting a stop to the era of irresponsible spending when hit hard by the world financial crisis in 2008, Latvia has made certain steps towards achieving fiscal balance and creating a culture of fiscal discipline. First, the massive fiscal consolidation effort of around 16% of GDP in three years brought the budget deficit to slightly above 3% of GDP in 2011. The new direction of the fiscal policy and improvement of the macroeconomic outlook compressed the deficit further in 2012 achieving the structural deficit target set at 0.5% of GDP.

Subsequently, the dedication to fiscal discipline was reaffirmed by signing the Fiscal Compact even before becoming bound by its requirements as a member of the euro zone as of 1 January 2014.

Following the signing of the Fiscal Compact, a Fiscal Discipline Law was adopted in 2013 and applied to the budget 2014 already. The Law focuses on medium-term budgeting, numerical budget rules and independent surveillance.

General government budget balance
(% of GDP)



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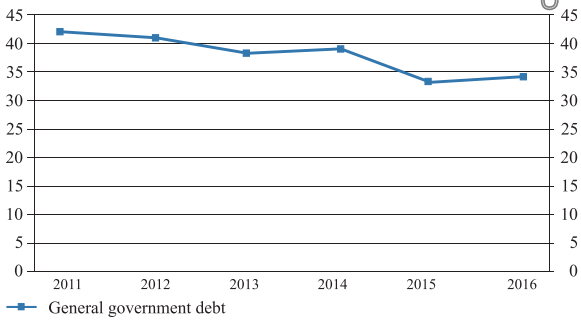
General government debt
(% of GDP)



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Another important step towards creating a framework to promote the culture of fiscal discipline was the establishment of an independent Fiscal Discipline Council in accordance with the Fiscal Compact and the Latvian Fiscal Discipline Law. The Fiscal Discipline Council will monitor the implementation of the Fiscal Discipline Law and provide an independent assessment of adherence to the numerical rules of the law and underlying macroeconomic assumptions.

Notwithstanding the sharp rise in government debt in the wake of the financial crisis, the debt level remained relatively low. After successfully re-establishing Latvia on the sovereign credit market as a high quality borrower, the debt is on the track of gradual reduction as the stability programme loans are being repaid as planned.

The ability of the Latvian government to shift the fiscal course towards sustainability has been deservedly praised internationally; however, even after reducing the deficit further in 2013 a few points of caution should be noted. First of all, the macroeconomic forecasts on which the budget 2014 as well as the medium term framework for 2014–2016 was based were finalised in autumn 2013. That means that the macroeconomic assumptions will need to be reassessed in preparation of the budget 2015. The adverse geopolitical events that have taken place recently in Ukraine will most likely have a downward effect on the economic outlook implying a lower revenue base.

The recent success in achieving fiscal discipline cannot be taken for granted, regardless of the commitment to financial discipline embedded in the national law. Stakeholders, led by the newly-formed Fiscal Discipline Council, should closely monitor the budget preparation process both leading up to and after the Parliamentary election in autumn.

There are further considerations on the income side: the overall tax level in Latvia is low by European standards and the current policies are aimed to keep it that way. However, specifically labour is taxed comparatively more heavily and policies have been set up and implemented to reduce this burden. On top of the social security contribution reduction in 2014 and the personal income tax reduction in 2013, two more subsequent 1-percentage-point cuts in personal income tax are scheduled for 2015 and 2016. Moreover, personal income tax allowances have been increased. The tax rate reduction will surely cut into budget revenue. Hence, probably the only way to bolster tax income remains to continue with efforts to improve tax compliance. This is recognised in the budget by allocating funds for measures to fight both grey economy and tax evasion.