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Approved
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Minutes No 1-04/353, §4.3

FISCAL DISCIPLINE SURVEILANCE INTERIM REPORT

ON LATVIA'S STABILITY PROGRAMME 2019-2022

Rīga, 2019

Saturs

EXECUTIVE SUMMARY

The Council notes fiscal easing in 2018 and 2019. Proposed Latvia's Stability Program 2019-2022 (SP2019/22) does not indicate that the Government intends to improvement while preparing a medium-term budgetary framework for 2020-2022. Although both the nominal and the structural balance are expected to improve compared to the previous plans, these efforts cannot be considered sufficient given the deficit in Latvia compared to the budgets of the Baltic neighboring countries over several years. The Council notes that the Government is setting up a fiscal reserve for 2020-2022 years meeting the minimum requirements of the FDL. The Council calls for the reserve to be set for all years in the medium term budget framework law (MTBFL) with no caveats, that the risks stipulated for the reserve have arisen and that the reserve would be used in the context of contradictory statements in SP2019/22.

According to the CSB data, the nominal balance of the 2018 state budget reached the objective established in the budget law[1]. However, the Council notes a significant deterioration in the structural balance, reflecting the rapid economic growth, which has not been followed by a positive change in the budget balance. Meanwhile, Latvia's government budget balance in 2019 and 2020 is largely determined by the deviation from the medium term structural balance objective European Commission agreed to support to structural reforms in health care expiring in 2020. The Council notes that the deviations from the medium-term budget balance target for the implementation of the health reform and the approach to the use of fiscal reform in the calculation of fiscal indicators lead to a difference in the budget balance results for Latvia with other Baltic States resulting into a deficit in Latvia and a surplus in Lithuania and Estonia.

The tax reform has introduced at least two effects on the fiscal policy of Latvia. One is a real reduction in the tax burden, which is moving away from the initial target of collecting tax revenues of 1/3 of GDP. The reform implies that some revenue cuts might be temporary. The second is the method of calculating fiscal rules, considering the impact of the tax reform as a one-off measure, which , the Council does not recognize as FDL compliant. Instead of compensating for the reduced revenue through reduced budget expenditure as a result of the tax reform, SP2019/22 envisages expenditure to increase. It establishes a dangerous precedent, because an equally large one-off effect could be attributed to additional spending on education, research and infrastructure. The Council invites the Government to rectify this approach and to build a baseline scenario for MTBFL for 2020/22 without the adjustments for the tax reform. The Council estimates that in this case, the negative fiscal space in 2020 is 112.2 million euro, instead of the negative fiscal space estimated by the Ministry of Finance in the amount of 11.9 million euro.

There is a conflict between the FDL and the Budget and Financial Management Law regarding the regulation for the reallocation of appropriations and their impact on the state budget expenditure ceilings leading to numerous of Council non-compliance reports. The Council calls eliminating the conflicting provisions of the Fiscal Discipline Law and the Law on Budget and Financial Management to clarify the reallocation of appropriations and changes in the expenditure ceilings.

The Council notes that from 2020 onwards, expires deficit funding for health, which will limit increase in spending for other priorities, including the increased expectations for wage growth in budgetary institutions. The Council also examined an information prepared by the Ministry of Health, which provides detailed information on the measures taken within the framework of the permitted deviation permitting deficit financing.

Public finance sustainability studies indicate a significant reduction in public sector impact in pension and health care funding in the long run, in line with a baseline scenario, while this may prove politically difficult to sustain.

[1] This information was published by CSB on 18 April – after the preparation and approval of the Stability Programme by the Cabinet of Ministers on April 15 *https://www.csb.gov.lv/en/statistics/statistics-by-theme/economy/government-finance/search-in-theme/2613-provisional-results-general-government*, accessed on 23/04/2019

The calculations of the Council based on updated macroeconomic and fiscal data for 2013-2018 indicate significant accummulated deviations from the fiscal rules stipulated in FDL. Applying all three numerical fiscal rules in the assessment provides improved and objective evaluation of the compliance of the execution of the state budget with the changing macroeconomic and fiscal outcomes. The Council finds the accumulated deviation from the fiscal objectives amounting to 2.6% of GDP after the ex-post recalculation according to all three fiscal rules.

The Council identifies insufficient focus to the objectives of sovereign debt policy and repeatedly recommends the Government to establish a specific debt control mechanism to ensure the integration of sovereign debt management into overall fiscal policy governance.

The Council draws attention to the fact that both its independence and the quality of its functions are undermined by restrictions on the proper functioning of the Council Secretariat. The Council calls on the legislator to make the necessary amendments to the legislative acts in order to prevent the interpretation of the current legislation of the MoF and the Supreme audit office from leading to a complete paralysis of the Council, as it is not possible to provide independent analytical support for Council decisions.

ABBREVIATIONS *TBC*

CSB	Central statistical bureau
BoL	Bank of Latvia
Council	Fiscal Discipline Council
EC	European Commission
ESA	European system of accounts
EU	European Union
FDL	Fiscal discipline law
FSR	Fiscal safety reserve
IMF	International monetary fund
LRVK	State audit office
Surveillance report	Fiscal Discipline Surveillance Report 2019
MoF	Ministry of Finance
MoU	Memorandum of Understanding
MTBF	Medium term budget framework
MTBFL 2020/22	Medium term budget framework law for 2020-2022
MTO	medium term objective
GDP	Gross domestic product
-	Not applicable / not available
SGP	Stability and growth pact
SP	Latvia's Stability Programme
SP 2019/22	Latvia's Stability Programme for 2019-2022

MANDATE OF THE COUNCIL

According to the FDL (FDL Chapter III Fiscal Discipline Surveillance) the Council is an independent collegial institution which has been established to monitor compliance with the FDL. The Council's core competence is related to the assessment of fiscal discipline, and assess fiscal policy and issues related to macroeconomic developments.

Specifically the Council is responsible for:

1. monitoring compliance with FDL provisions in the annual state budget law and the MTBFL during their preparation, execution, and amendment;

2. verifying whether the fiscal balance and the expenditure growth provisions have been properly applied, including an independent assessment of the potential GDP and nominal GDP, and the calculation of the structural balance;

3. supervising the observance of FDL provisions in the implementation of the annual state budget law, conformity of total fiscal indicators of the consolidated budget of local governments and budgets of derived public persons with the forecasted values.

4. preparing opinions regarding major permitted departures from the balance condition during a severe economic downturn;

5. preparing an opinion on whether the FSR is set at an appropriate level to counter extant fiscal risks

6. preparing a surveillance report on fiscal discipline and, if necessary, a non-conformity report;

7. preparing and submitting to the Saeima and the Government opinions regarding issues of fiscal policy and macroeconomic development if they pertain to compliance with the terms set out in the FDL;

8. endorsing the MoF macroeconomic forecasts twice a year – while preparing the SP, and the annual state budget and while preparing the MTBF (according to the Memorandum of Understanding (hereafter – MoU)[2], signed on 8 February 2016);

9. preparing interim report (opinion) on SP (according to the MoU);

10. assessing and analysing the sustainability of fiscal policy for the purposes of preparing the reports stipulated by the FDL.

[2] Memorandum of Understanding, available: *http://fiscalcouncil.lv/files/uploaded/FDP_1_09_849_20180619_MoU_FDC_MoF_consolidated.pdf*, accessed on: 23/04/2019

1 FISCAL POLICY CHALLENGES

1.1 FISCAL STANCE

The Council positively assesses that SP 2019/22 includes a fiscal safety reserve for all three years of the Stability programme, including decision to provide a fiscal reserve for the State Budget Law 2019. The government was unable to set up a fiscal safery reserve (FSR) in 2016, i.e. in the first year, as foreseen by the third paragraph of the FDL transitional provisions, but the budget for the next three years (2017-2019) included a reserve in the minimum amount of 0.1% of GDP. The amount of FSR derives from the assessment made in the Fiscal risk statement (Appendix 1 to the Development of Fiscal risks statement since its first publication in 2014) which has been substantially improved since 2014. The Council notes that the FSR plays an important role in stabilizing public finances and mitigating the negative effects of the economic cycle by creating provisions to offset deviations.

In 2018, the consolidated budget balance was better than expected, i.e. instead of the deficit of 265.3 mill. euro, the year ended with 215.5 mill. euro deficit (see Table 1.1 below). In 2018, the implementation of the consolidated general budget was significantly worsened by the local government consolidated budget balance, which, in contrast to the planned 31.6 mill. euro surplus closed with 150.5 mill. euro deficit. As one of the reasons for SP2019/22 the significant increase of municipal capital expenditures is mentioned, as opposed to the planned amount.

	2013	2014	2015	2016	2017	2018
Consolidated government budget balance (estimate at the moment of the state budget approval)	-160.0	-175.2	-286.6	-341.9	-301.4	-265.3
Consolidated government budget balance (actual)	-127.6	-397.3	-373.5	-100.3	-221.9	-215.5
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Special budget balance (estimate at the moment of the state budget approval)	-56.3	132.4	162.9	104.6	65.3	125.9
Special budget balance (actual)	-57.9	100.4	91.1	47.8	113.8	202.2
Consolidated local government budget balance (estimate at the moment of the state budget approval)	-27.1	-22.3	-55.4	-52.7	0.0	31.6
Consolidated local government budget balance (actual)	-119.3	-85.0	-26.2	57.4	-14.4	-150.5

Table 1.1. Budget plan outcomes 2013-2018, mill. euro (cash basis). Source: MoF and Treasury.

SP2019/22 the forecasts maintain the deficit plans, as opposed to the other Baltic States. Lithuania has managed to conclude a year with a surplus budget of three years, which has also helped to reduce the total public debt in 2018 to 34.2% of GDP (see Charts 1.1 and 1.2 below). Latvia's budget deficit deficit planning for 2019 and 2020 is heavily influenced not by the economic cycle, which would create a budget with surplus, but by tax reform derogations, which allow for further spending increases.

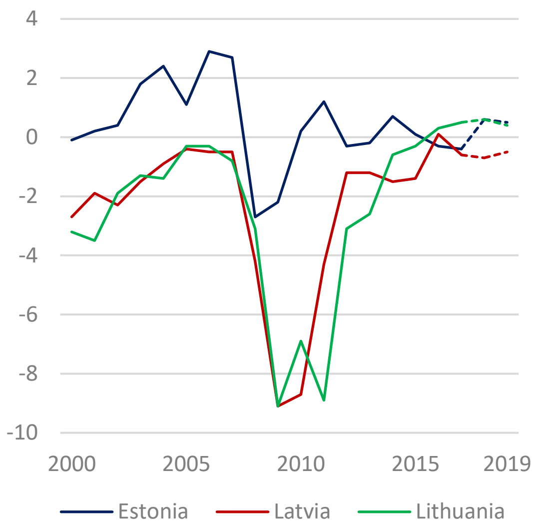


Chart 1.1 Baltic States general government budget balances 2000-2019, % of GDP. Source: Eurostat, EC DBP.

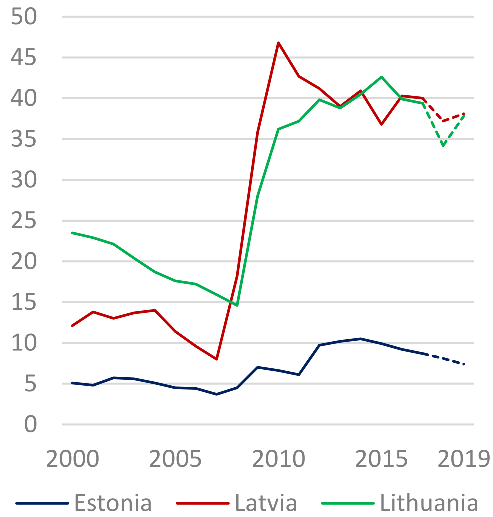


Chart 1.1 Baltic States general government budget balances 2000-2019, % of GDP. Source: Eurostat, EC DBP.

Latvia lags behind the EU average change in primary balance in 2015-2020. Overall, the European Union retains the ability to balance its primary budget balance, even though the median for 2015-2017 was 0.26% of GDP and for 2018-2020 0.23% of GDP, which shows only a small expansion of fiscal policy (see Chart 1.3 below). Compared to Chart 1.1 showing the weak general government balance, Chart 1.3 we can see that from Baltic States Latvia is the one with better fiscal tightening plans for the period of 2015-2020. This can be assessed positively, but also remembering that the additional difference between the two indicators is that Chart 1.3 shows a primary balance that removes debt servicing costs.

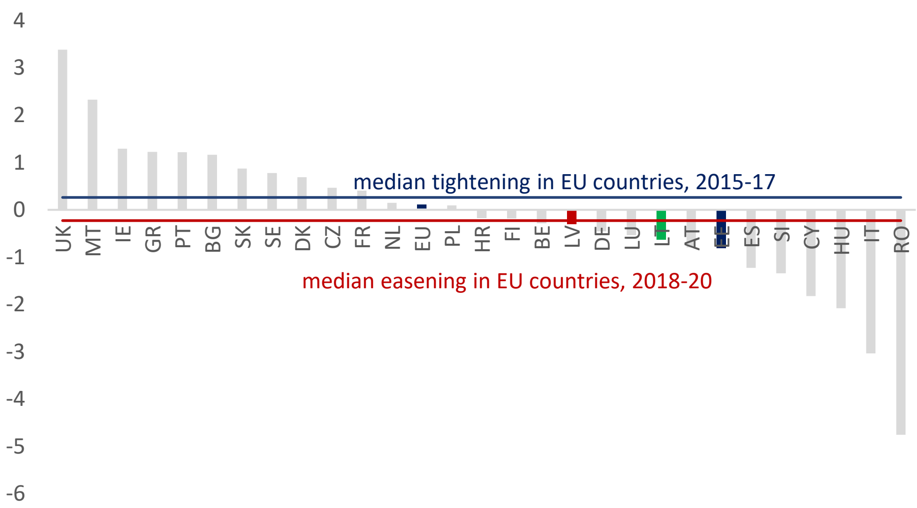


Chart 1.3. The fiscal stance in EU countries. Change between 2015 and 2020 in the underlying primary balance, in % of potential GDP. Source: Ameco, European Commission database.

1.2 Tax reform impact assessment

> **FDL inaccuracy**
> The Council does not recognize the impact of the tax reform as a one-off measure in the development of a fiscal framework in line with the legal framework of Latvia and the European Union.

The Council considers that the impact of the tax reform in the preparation of the fiscal framework is not properly reflected. As a result of the tax reform, budget revenue decreases compared to the baseline scenario leading to a decline in tax revenue to GDP ratio (see Table 1.2).

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Tax revenues, mill. euro	6 740.0	7 078.6	7 392.3	7 870.6	8 477.6	9 025.0	9 497.5	10 110.9	10 620.9	11 128.9
Tax-to-GDP, %	29.6	30.0	30.4	31.4	31.4	30.7	30.4	30.5	30.4	30.2

Table 1.2. Tax revenues, Source: Eurostat 2013-2017, Ministry of Finance 2018-2022.

Although the State Revenue Service reports on the implementation of the 2019 tax revenue plan for the first three months, tax-to-GDP revenues have fallen, creating a significant constraint on budget expenditures.

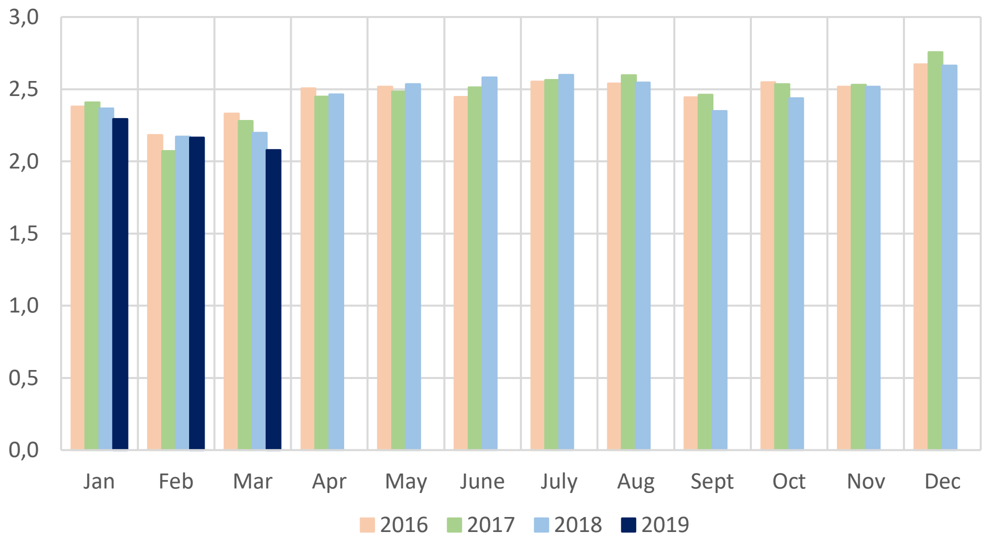
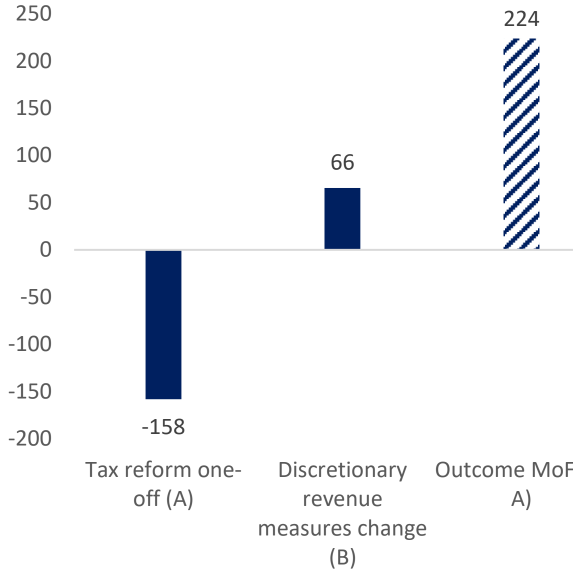


Chart 1.4. Tax revenue, incl. social contributions, monthly, % of GDP. Source: Treasury.

The Council calls on the Government to rectify this approach and on MTBFL 2020/22 to create a baseline scenario where the artificial incentive to increase expenditure in tax reform is removed. The tax reform was a set of concrete government decisions that were already identified in the planning process as a set of budget cuts in 2019 and 2020. However, tax reform measures have been used to further stimulate expenditure growth, called one-off measures. Establishing a precedent with this, as an additional one-off effect can be additional spending on education, research, infrastructure.



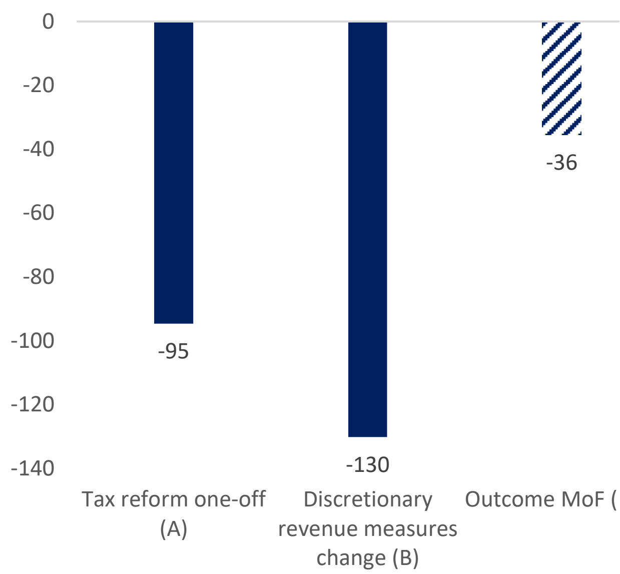


Chart 1.5. Tax reform impact assessment in budget revenue plans, the MoF calculations, mill. euro, in 2019.

Chart 1.6. Tax reform impact assessment in budget revenue plans, the MoF calculations, mill. euro, in 2020.

The Government decides annually on discretionary (with the Government decision) revenue measures. They tend to have a positive impact (e.g. 66 mill. euro in 2019) (see Chart 1.5), and they tend to have a revenue-reducing effect (e.g. -130 mill. euro in 2020) (see Chart 1.6). However, it is not clear why the tax reform is not adequately reflected as discretionary measures in both years, as it has a revenue-reducing effect respectively for -158 mill. euro in 2019 and for -95 mill. euro in 2020.

The Council rejects such an approach as an appropriate FDL. The FDL does not foresee the calculation of such one-off expenses and is a dangerous precedent for the future, when the Law on Fiscal Discipline has an extended interpretation. Since the beginning of 2017, the Council notes the cost of tax reform and the need for adequate compensatory measures. In the spring of 2017, the Council, in cooperation with ECRL, organised a seminar[3], and in the summer of 2017 submitted a non-compliance report[4]. However, the MoF hold no promises and no appropriate compensatory measures were found, but instead received a creative approach to the calculations. Instead of reducing tax expenditures or reducing them to tax revenue, the tax reform was proclaimed as a one-off measure and booked as an amount for which the Government may further increase expenditure.

[3] Expert discussion on Latvia's tax policy reform strategy on 30 March 2017 in cooperation with European Commission Representation in Latvia. Materials are available: *http://fiscalcouncil.lv/discussion-on-tax-reform*, accessed on 23/04/2019

[4] 17.07.2017 Non-compliance report regardingthe draft legislation of the tax reform available: *http://fiscalcouncil.lv/files/uploaded/FDP_1_08_1124_20170717_NZ_nodoklu_reforma_EN.pdf*; and *http://fiscalcouncil.lv/17072017-irregularity-report*, accessed on 23/04/2019

1.3 Irregularities in the budget execution

FDL inaccuracy
There is a conflict between the FDL and the Budget and financial management law due to the redistribution of appropriations and their impact on the maximum allowable national budget expenditure leading to a number of Council non-compliance reports.

The government continues to annually re-allocate appropriations, which reduces the maximum expenditure laid down in the budget law without appropriate compensatory measures. In general, since the Council, i.e. since 1 January 2014, the Government has used this legal loophole between two laws – the Fiscal Discipline Law and the Budget and Financial Management Law (see Table 1.3).

			2014	2015	2016	2017	2018	2019	2020	2021
1.	07.03.2014	State pensions special budget increase	1.6	50.7	105.6					
2.	24.11.2015	Redistribution of the Payments to the budget of the European Community			10.0	10.0	10.0			
3.	11.11.2016	Redistribution of the Payments to the budget of the European Community			13.4					
4.	17.07.2017	Tax reform law package					75.8	118.5	233.5	
5.	06.09.2017	Redistribution of the Payments to the budget of the European Community				19.0				
6.	15.09.2017	Redistribution of the Payments to the budget of the European Community				16.4				
7.	20.09.2017	Redistribution of the Payments to the budget of the European Community				4.0				
		Redistribution from the State debt management				0.1				
8.	04.10.2017	Redistribution of the Payments to the budget of the European Community				3.4				
9.	18.10.2017	Redistribution of the Payments to the budget of the European Community				1.0				
10.	23.11.2017	Redistribution from the State debt management				0.9				
11.	05.02.2018	*Demogrāfisko lietu centrs*						81.7	87.7	87.7
12.	29.08.2018	Redistribution of State social benefits programme					1.3			
13.	23.10.2018	Redistribution of State social benefits programme					5.6			
14.	01.11.2018	Redistribution from the State debt management					5.5			
15.	19.12.2018	Health sector remuneration increase without compensatory measures						116.4	110.7	28.5
16.	12.02.2019	Redistribution of State social benefits programme						52.0	24.3	23.6

Table 1.3. Council irregularity reports summary 2014-2019, mill. euro. Source: http://fiscalcouncil.lv/reports

The Council calls on the Saeima to resolve and eliminate these discrepancies between the two laws, so that the automatic principle established by the FDL operates at both the maximum expenditure level, both in the case of increased spending and in reducing the maximum amount of expenditure in these programs, if there is a residue in these programs. The Council welcomes the amendments to the Budget and Financial Management Law, which were adopted together with the package of laws accompanying the 2019 national budget, improving the regulation of transfers of appropriations. However, the Council considers that the contradictions between the FDL and the Budget and Financial Management Law have not been completely eliminated.

1.4 Health reform deviation

With the approval of the European Commission there was permission in the state budget, from 2017 to 2019, a derogation from the medium-term objective, allowing for a series of reform measures financed by additional government debt.

The Council assessed information provided by the Ministry of Health on the deficit deviation of 2018 in the amount of 113.4 million euro executed at 112.3 million euro (see details in Annex 4[5]). The Council recalls that 2019 is the final year for the deviation from the deficit target for structural reform, and that the Government should be able to maintain the level of spending in the future using its own financial resources without using additional loans.

1.5 Sustainability of public finances

Increasing the demographic burden poses significant risks to social security and health care. Long-term demographic indicators point to an increasing demographic burden. In 2070, 72 seniors per 100 employees[6] are estimated to be compared to 67 seniors on average in EU Member States. Unsolicited savings and limited state involvement in social protection and health care create significant social and political risks in the future, when people do not have adequate guarantees for quality living and protection against social risks.

It is important to take care of the second level of pensions and also to make savings, because the first level of pensions will have a shrinking value, as well as the weak level of pension replacement as opposed to the current salary in the market. Reasons that SP2019/22 maintains that pension expenditure is sustainable, unfortunately, mainly due to the sharp decline in the benefit ratio for the period 2016-2070; year. Changes are estimated at -3.9%, which is the most important part of the decline in total pension expenditure in GDP. On average, public pensions are decreasing by 8.9%[7] per year. Understanding the indicator is critical because it essentially shows the decreasing importance of the average salary when retiring and the fact that the dependency on the second pension level increases significantly, or the importance of the first level of pension that is directly related to the size of the workers decreases (and with that the reduction of wage bill) retirement.

The labor market is already, and will be, in the near future to a large extent supported by the retention of older workers, who are even more critical of the adequacy and sufficiency of the health system. As is rightly mentioned in SP2019/22, the number of workers aged 65-74 was already increasing by 9.1% in 2018. The EC estimates that it will rise to 21% in 2070[8] from 16.1% of

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[5] Health reform deviation monitoring 2017-2018, please see more details in Annex 4: *http://fdp.gov.lv/files/uploaded/FDP_1_08_393_20190423_Starpzinojums_Piel4.xls*, accessed on 23/04/2019

[6] The 2018 Ageing Report: Underlying Assumptions and Projection Methodologies. Data file available: *https://ec.europa.eu/info/sites/info/files/economy-finance/country_fiches_2018_ar_uapm_10years.xlsx*, accessed on 23.04.2019. LV and EU pages.

[7] The 2018 Ageing Report: Economic and Budgetary Projections for the EU Member States (2016-2070). Country Fiche on public pensions for the Ageing Report 2018 – Latvia available: *https://ec.europa.eu/info/sites/info/files/economy-finance/final_country_fiche_lv.pdf,* accessed on 23.04.2019. page 2 about -8.9% and page 30 about -3.9%.

[8] Ibid, page 11.

employment in this age group in 2016, and this also largely explains how the overall employment rate in Latvia (seniors in the labor market) will grow.

The health care system remains critical of the level of patient out-of-pocket payments in total health costs (Chart 1.7), which is also likely to help sustain fiscal sustainability in relation to public health funding, which is considered fiscally sustainable but certainly not socially sustainable to society.

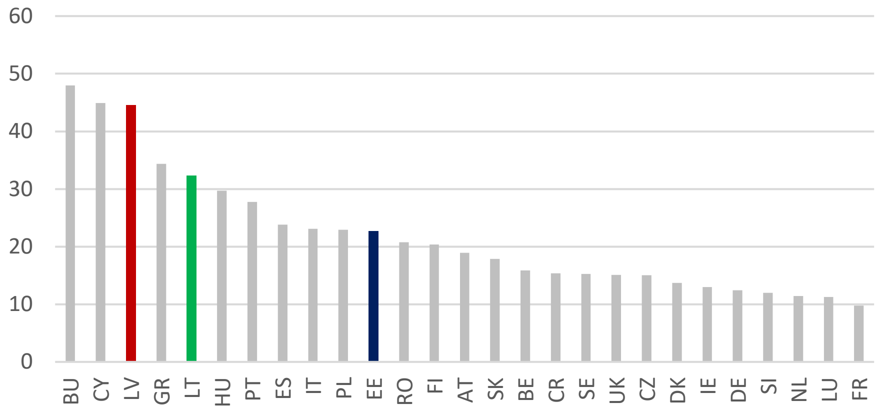


Chart 1.7. Out-of-pocket payments, % from health expenditures, in 2016. Source: Eurostat.

Recommendation:
In order to improve the long-term assessment of the sustainability of fiscal policy, including a realistic assessment of labor market developments based on demographic trends, it is necessary to improve the discussion about the changes in the structure of the labor market, the ratio of public pensions to average wage changes, etc.

2 MACROECONOMIC DATA UPDATES PROCEDURE

Thanks
The Council welcomes the Ministry of Finance's responsiveness to follow-up procedures in cases where CSB restores data related to the approval of macroeconomic forecasts.

The Council thanks the Ministry of Finance for its reply and responsibility for the follow-up procedure in cases where the Central Statistical Bureau updates data related to the approval of macroeconomic indicators. In the March 2019 correspondence, it was agreed that in the future, when CSB restores data, the FM will restore the entire table[9], allowing formulas to calculate output differences that affect the size of the cyclical component of the government budget balance. After the table has been updated, it will be sent to the Council for information, which will take note of it. It ensures the transparency of macroeconomic data changes.

The Council endorsed MoF's macroeconomic forecast on 15 February 2019, according to the MoU. Within the early review and endorsement of the MoF's macroeconomic projections, the Council has agreed to support the efforts by the Government in preparation of annual documents - the Stability Programme and the Medium-term Budget Framework. The Council assessed the forecast as a whole, and provided an endorsement of the key macroeconomic indicators (Table 2.1). Full endorsement text is available in the Annex 2.

	2019	2020	2021	2022
Real GDP growth	**3.2**	**3.0**	**2.9**	**2.9**
Nominal GDP growth	**6.4**	**5.9**	**5.5**	**5.5**
Inflation	**2.5**	**2.2**	**2.1**	**2.0**
GDP deflator	**3.1**	**2.8**	**2.5**	**2.5**
Potential GDP growth	**3.5**	**3.4**	**3.2**	**3.2**
Output gap	**1.4**	**1.0**	**0.7**	**0.4**

Table 2.1 Macroeconomic indicators forecast endorsed by the Council on 15 February 2019, %

At the same time, the Council calls for the use of additional instruments (e.g. Annex 3 for the heat map of Latvia's economy[10]) and models that would allow a more accurate assessment of the economic cycle and, consequently, of output gap.

The Council notes positively SP2019/22 sensitivity analysis, incl. the information about the capacity of the Latvian economy to reorganize the financial sector in 2018 with less negative impact than expected. Positive assessment relates also to the fact that the analysis of both the optimistic and the pessimistic scenario is detailed till the general government budget balance level. The sensitivity analysis, among other things, highlights key tax revenue scenarios, non-tax revenues, interest expenditure, as well as calculations to budget balance and government debt levels. In SP2019/22 the MoF has described in detail the legal and procedural framework that exists in the case of a pessimistic scenario, the Council also recommends including a specific commitment from the Government or a procedure to reduce the debt in a positive scenario, as indicated in the optimistic scenario analysis table.

[9] Example of macroeconomic indicators table available here: *http://fdp.gov.lv/files/uploaded/FDP_1_08_215_20190215_makroekonomikas_prognozes_viedoklis_Piel2.xlsx*, accessed on 23/04/2019

[10] Latvian economy cycle heatmap for 2000-2018 available here: *http://fiscalcouncil.lv/cycle-heatmap*, accessed on 23/04/2019

3 ASSESSMENT OF COMPLIANCE WITH NUMERICAL FISCAL RULES

3.1 EX-POST ASSESSMENT OF FISCAL RULES 2013-2018

FDL inaccuracy
The Council notes that the requirements of Article 11 of the FDL on the application of the correction mechanism and the assessment of budget implementation should be implemented using updated data in all the numerical fiscal conditions mentioned in the FDL. It is not enough to apply only the condition of a structural balance.

The Council recalculated the maximum expenditure after three FDL quantitative conditions using the updated data for 2013-2018. , leading to a budget balance adjustment of 2.6% of GDP (Chart 3.1). In the conversion process, the following components were updated for each condition –

(i) under the condition of the structural balance, the adjustment of local government budget balances, public budget balances, EKS, government budget revenue and cyclical component;
(ii) the cost increase condition for interest payments, EU program expenditure, investment amount, employment budget programs data, unemployment rate, natural unemployment rate, GDP deflator, potential GDP change data;
(iii) the recalculation of the inheritance condition after changes in the basic budget and special budget beneficiries of the Ministry of Welfare, changes in paid services, changes in current EU budget payments and changes in government debt service costs.

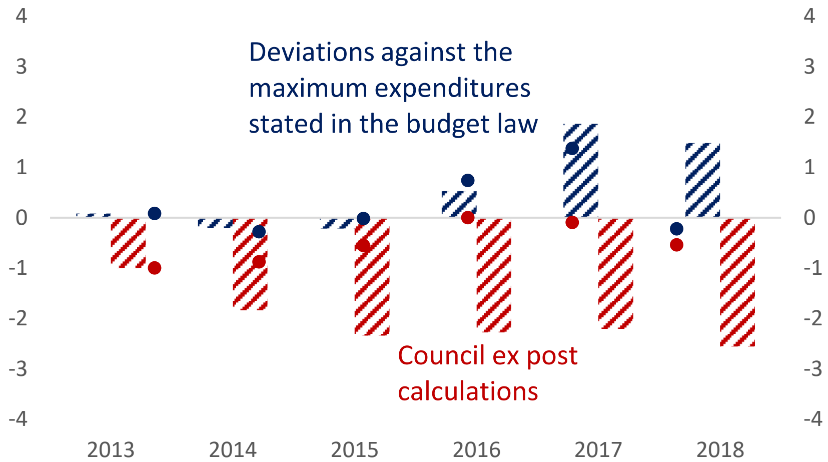


Chart 3.1. Ex post assessment of maximum ceilings according to all 3 rules, % of GDP, yearly and accrued deviation, 2013-2018. Source: Council calculations[11]

[11] Calculations available in Annex 5: *http://fdp.gov.lv/files/uploaded/FDP_1_08_393_20190423_Starpzinojums_Piel5.xls*, accessed on 23/04/2019

3.2. EX-ANTE ASSESSMENT OF FISCAL RULES 2020-2022

FDL inaccuracy
The FDL does not provide for the imposition of one-off measures in the calculation of fiscal conditions, so it is necessary to correct the baseline scenario in such a way that the tax reform is considered similar to other government revenue-reducing measures.

The Council carried out an assessment of alternative numerical fiscal conditions in 2020-2022 adopted by the Council on 5 April 2019.

The Council estimates the maximum spending for 2020 at 9831.2 mill. euro that is for 100.3 mill. euro (continuity rule) less than the maximum spending rate set by the MoF. For 2021 the Council's calculations differ from the MoF expenditure condition, making it tighter due to the one-off removal of the tax reform, but, like the MoF calculations, the stricter structural balance condition is 10 251.3 mill. euro. For the year 2022, the calculation of numerical conditions does not differ and the Council agrees with the MoF about 10 671.4 mill. euro (Chart 3.2).

Summarising the fiscal space estimate for 2020, the Council calls for the addition of a deviation of 100.3 million euro thus the fiscal space for 2020 is not -11.9 million euros but adding till -112.2 million euro. The aforementioned assessment of the use of fiscal rules affects the maximum permissible amount of government budget expenditures, but the fiscal space is determined by a set of decisions made by the government, which affects the budget revenue and the calculation of expenditure liabilities.

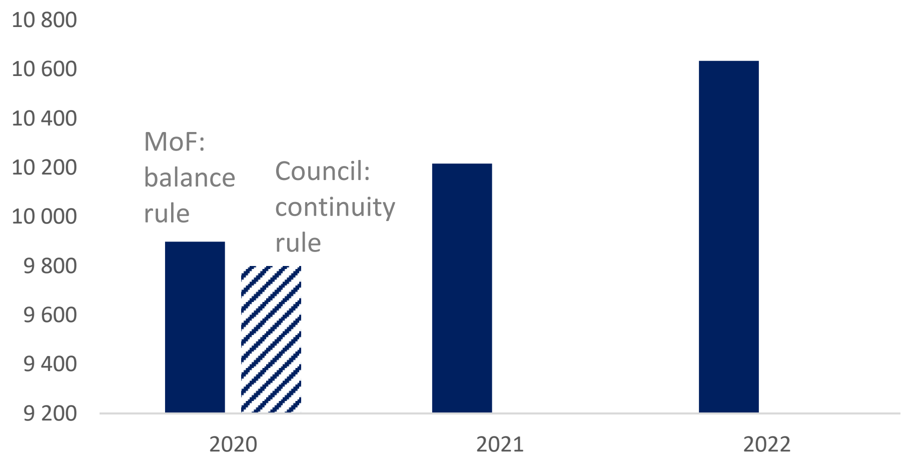


Chart. 3.2. Summary of numerical fiscal rules, mill. euro. 2020-2022. Source: MoF and Council calculations[12]

The Council took note of the main proposals of the MoF concerning deviations from the MTO and adopted the following decisions:
(1) **opposes tax reform expenditure as discretionary government measures with a negative impact on the budget balance** of 0.5% of GDP in 2019 and -0.3% of GDP in 2020. For more information on tax reform, see: 1.2. chapter;
(2) **underlines the importance of creating a fiscal reserve of at least 0.1% of GDP by 2020 and 2021**.

The Council opposes the calculation of Fiscal fiscal conditions for the year 2020. As a result of calculations of numerical conditions of the MoF, the ceilings of government expenditure for 2020 were set at 9 931.5 mill. euro (structural balance condition); 20 671.4 mill. euro (condition of structural

[12] Calculations available in Annex 5: *http://fdp.gov.lv/files/uploaded/FDP_1_08_393_20190423_Starpzinojums_Piel5.xls*, accessed on 23/04/2019

bialnces) and 20 671.4 mill. euro for 2022 (structural balance condition) (Chart 3.3). For example, the maximum spending planned for 2020 has increased by 485.0 mill euro since SP 2017.-2020 for years.

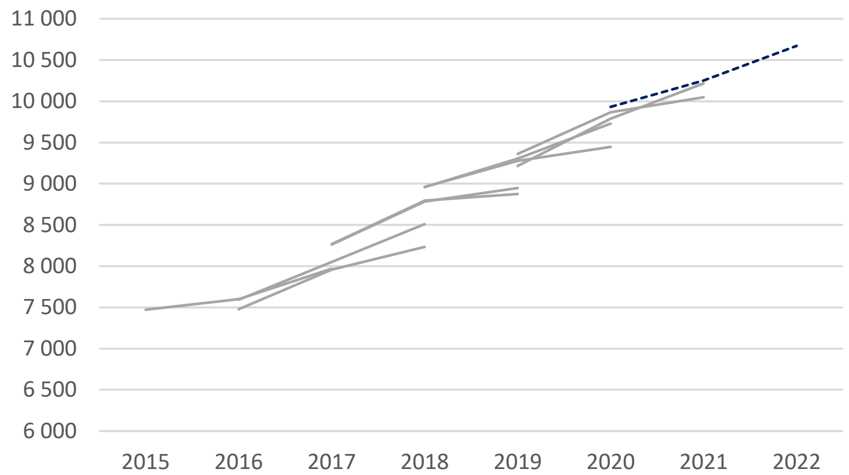


Chart 3.3. Expenditure ceilings, mill. euro. 2015-2022 Source: MoF[13]

Bulk increase in editions 2021-2022 provides the ESA corrections planned by the Ministry of Finance for the years 2021-2022, respectively 330.2 mill. euro for 2021 and 419.6 mill. euro for 2023 (Chart 3.4), the ESA corrections are planned with a expenditure consolidation effect of -14.7 mill. euro.

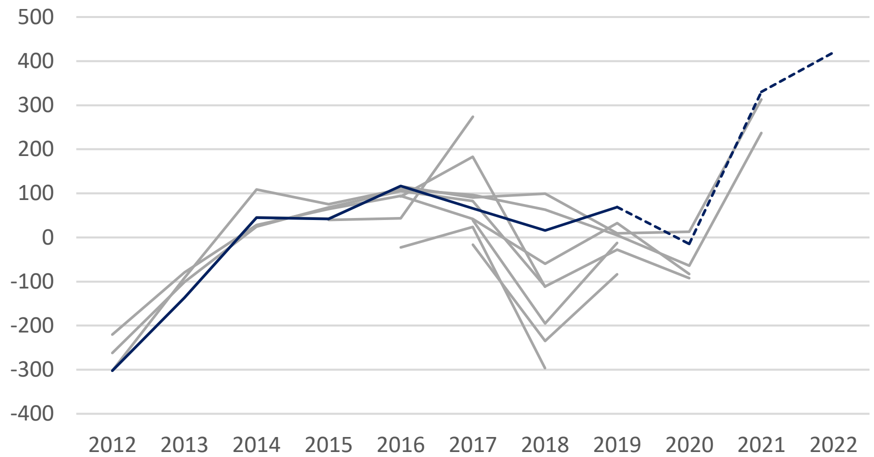


Chart 3.4. European System of Accounts corrections, mill. euro, 2012-2022. Source: MoF[14]

The general government structural balance is estimated by the Ministry of Finance at 0.5% by 2020-2022 (Chart 3.5) while the general government nominal balance is estimated by the FM to be between -0.4% of GDP in 2020, -0.2% of GDP in 2021 and -0.3% of GDP in 2022 (Chart 3.6). The Council notes positively SP2019/22 the expected improvement in the structural balance compared to the actual level in 2018, which is largely determined by the expiry of the EC harmonized derogation from the medium-term objective (in the context of health care reforms). The EU legal framework allows such derogations from the medium-term objective over a three-year period.

[13] Calculations available in Annex 6: *http://fdp.gov.lv/files/uploaded/FDP_1_08_393_20190423_Starpzinojums_Piel6.xls*, skatīts: 23.04.2019.
[14] Ibid.

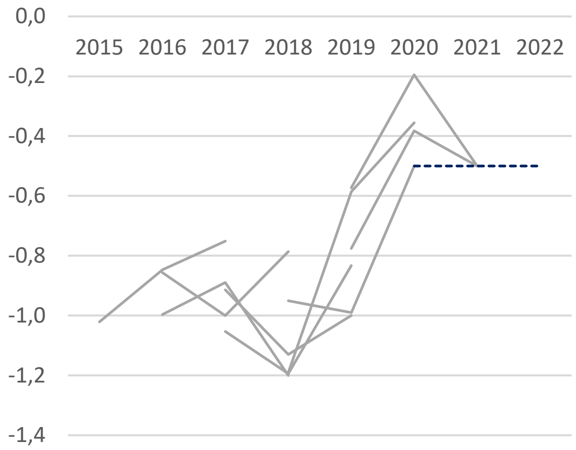


Chart 3.5. General government structural balance, % of GDP, Source: MoF

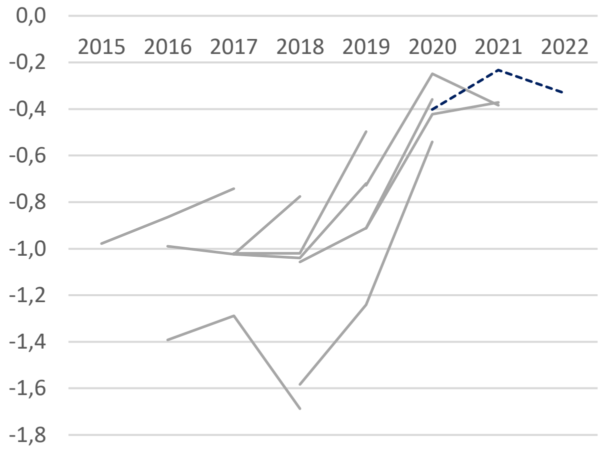


Chart 3.5. General government headline balance, % of GDP, Source: MoF

3.3 State debt rule and debt sensitivity analysis

The Council negatively assesses the government's work on reducing the public debt burden, as the medium-term fiscal planning targets are not being met (see Chart 3.7). The current target set by the FDL is to prevent government debt level above 60% of GDP. Although government debt cannot be regarded as disproportionately high, its level of rapid growth during the economic crisis has not been adequately reduced to create an adequate reserve under conditions of rapid economic growth. The improvement in government debt to GDP over the past years is mainly due to a further acceleration in the underlying debt growth of the economy, mainly to finance the budget deficit.

The Council recommends annually to the Government to establish a specific debt control mechanism to ensure the integration of sovereign debt management into overall fiscal policy governance. There are a number of countries that include sovereign debt not as a subordinate fiscal condition but as a self-measurable and controllable one. In addition, they are countries where debt has not exceeded 60% of GDP. The inability of governments to reduce debt levels during the economic upturn does not indicate responsible and sustainable public finance management.

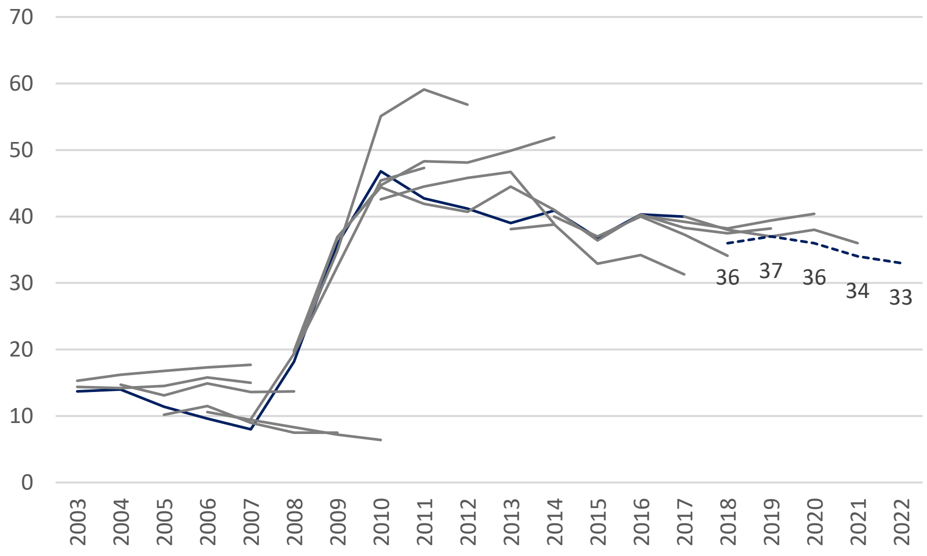


Chart 3.7. General government debt: forecasts and outcome, % of GDP. Source: Eurostat, 2003-2017, Treasury: 2018-2022

The Council, using the publicly available sovereign debt assessment model developed by the IMF[15], updated its data, to provide an equivalent assessment of sovereign debt. Similarly to the IMF[16], the Council's assessment also suggests that the government's ability to maintain a no-policy-change, including the optimistic general government revenue and expenditure projections are an opportunity to significantly reduce the debt level in the medium term (see Table 3.1). The ability to reduce debt also includes SP2019/22 that the planned repayments of debt in 2022 and 2023 are significantly lower.

	2018	2019	2020	2021	2022	2023
Council	37.1	35.4	33.5	32.1	29.9	27.9
IMF	35.1	34.1	32.9	31.9	30.9	29.9
Difference	*2.0*	*1.3*	*0.6*	*0.2*	*-1.0*	*-2.0*

Table 3.1. General government debt, % of GDP, Source: IMF and Council calculations.

At the same time, thanks to the IMF model, it was possible to use sensitivity analysis for the revenue side of the budget. This is in line with the current situation in Latvia when tax reform has a negative impact on revenue. The primary balance is worsened by 2019 and by 1.6% of GDP in 2020. As a result of the simulation it can be stated that despite the favorable economic conditions, the decrease in revenue generates an additional impulse for debt increase (Table 3.2).

	2018	2019	2020	2021	2022	2023
Baseline	37.1	35.4	33.5	32.1	29.9	27.9
Revenue reduction	37.1	38.2	38.9	37.6	36.5	35.4
Difference	*0.0*	*+2.8*	*+5.4*	*+5.5*	*+6.6*	*+7.5*

Table 3.2. General government debt sensitivity analysis, by changing primary balance level, % of GDP. Source: Council calculations.

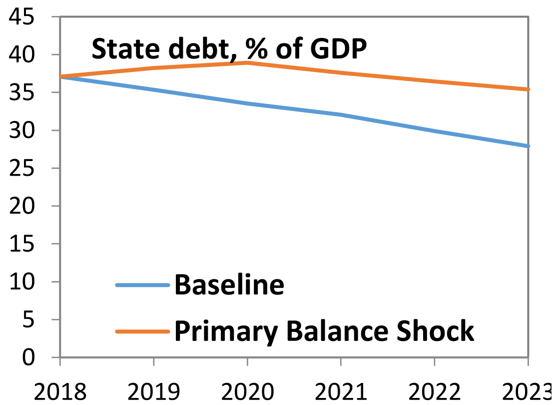


Chart 3.8. General government debt, % of GDP, changes against baseline. Source: Council calculations

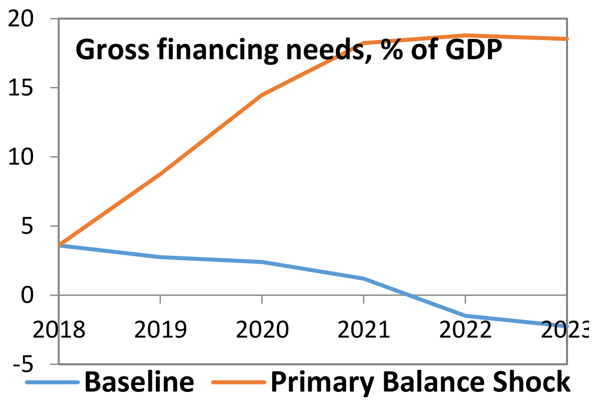


Chart 3.9. Gross financing needs, % of GDP, changes against baseline. Source: Council calculations

Recommendation:
1. The debt rule should provide a specific enforcement mechanism necessary to ensure the inclusion of sovereign debt management in overall fiscal policy governance.
2. The Council calls for an expert discussion on the inclusion of the sovereign debt indicator in the management of fiscal policy.

[15] International monetary fund MAC DSA model available: *https://www.imf.org/external/pubs/ft/dsa/mac.htm*, accessed on 23/04/2019
[16] 2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF LATVIA International monetary fund (2018) Article IV consulation. Report for the Republic of Latvia available: *https://www.imf.org/~/media/Files/Publications/CR/2018/cr18266.ashx*, page 44. accessed on 23/04/2019

4 PROVISION OF COUNCIL ACTIVITIES

FDL inaccuracy
Non-compliance is formed by the MoF by not providing the Council with adequate legal and administrative facilities and resources to enable the Council to perform its functions in accordance with the requirements of the FDL, including by not giving the Council legal authority to recruit permanent staff.

Technical support. The Council has not reached an agreement with the Ministry of Finance on technical support in the following areas of administrative activity: (i) the Treasury provides accounting services. However, the Council asks the Ministry of Finance to provide invoice and other accounting document scanning and entry into the Treasury's accounting systems, as well as the introduction of annual financing plans into the Treasury's e-plāni and e-tāmes systems. The Council also invites the Ministry of Finance to keep the Council's stock records and the annual inventory process, incl. provision of inventory documentation. The Council would be pleased to transfer the original accounting records to the Treasury or the Ministry of Finance; (ii) The Ministry of Finance provides information technology in the daily work of the Council. However, the Council asks the Ministry of Finance also to ensure compliance with the requirements of the Data Protection Regulation in the work of the Council; (iii) lack of assistance in the organization of staff matters, including recruitment, leaving the final decision to the Council. The Council also requests that staff records be entered into the Treasury system and that monthly data be submitted to the State Chancellery; (iv) handing over to the Ministry of Finance the preparation of the 2nd instruction of the Cabinet of Ministers and, if necessary, the transfer of appropriations; (v) lack of assistance in the organization of business trips, including also in matters of transportation services of foreign council members; (vi) lack of assistance in procurement, incl. in the documentation organization, information enter into the Procurement Monitoring Bureau Public Procurement Management System, perform technical procurement (paper, water sessions, stationery, etc.) in the Electronic Procurement System, if necessary, the auction organization; (vii) organization of records and archives, incl. maintenance of the content of the account at the Unified state archive information system, storage of files until archiving; (viii) providing a fire and safety service at Smilšu Street 1 building; (ix) assistance in the project of the receiving and reviewing alert builder messages.

The Ministry of Finance has reached an agreement on the issues of information technology, meeting rooms and pass booking, as well as access to the record-keeping system for those internal rules of the MoF, which are related to the Council's technical location in Smilšu Street 1 building.

The Council would maintain the administrative workload on the following issues: (i) the right of final decision-making in the recruitment process and in research procurements; (ii) prepare the Council's operational strategy and communication strategy; (iii) prepare an annual work plan; (iv) assess the Council and risk management and benefit management issues; (v) the Council would also prepare a public annual report if necessary; (vi) providing independent communication, incl. maintenance of website and social networks.

Council experts recruitment. The Council's ability to involve experts in collecting and analyzing data is limited by the FDL rule, which only provides for the status of Secretary of the Council as the sole member of the Council's staff. This limitation has been temporarily resolved by a separate provision in the annual State Budget Law, which is incorporated from 2018, but actually limits the duration of the employment contract and reduces the social guarantees of part-time experts. The involvement of short-term experts is limited by the lack of administrative resources for the Council to carry out procurement procedures in accordance with the Public Procurement Law. The Council has not been able to reach an agreement with the Finance Ministry on receiving adequate technical support on these issues.

The disproportionate administrative burden on the Council as part of its current resources makes it difficult to perform the functions assigned to it by the FDL and the cooperation agreements with the Ministries of Finance.

ANNEX 1. DEVELOPMENT OF THE FISCAL RISK STATEMENT

	2014	2015	2016	2017	2018
Quantifiable fiscal risks					
State guarantees	• Precisely defined fiscal impact (0,01% of GDP)	• Additional description of risk calculation • More detailed description of the risk monitoring process • The fiscal impact has decreased comparing with FRD 2014	• More detailed explanation of the nature of state guarantees • More detailed description of the risk monitoring process	• No significant changes	• Precisely defined fiscal safety reserve (0.001% of GDP in 2019), however it is not included in total FSR
State loans	• Precisely defined fiscal safety reserve (0,003% of GDP)	• Additional description of risk calculation • Estimated FSR has decreased • New regulations of the Cabinet of Ministers, which contribute to risk monitoring and reduction, come into force	• More detailed explanation of the nature of state loans • More detailed description of the risk monitoring process	• No significant changes	• No significant changes
Risks to the welfare industry	• There are four groups of fiscal risks and one	• A risk group has been taken away which was related	• A risk group has been taken away which was related with an inflation,	• No significant changes	• The fiscal risk of welfare are accompanied by information on

	additional risk (liquidity risk)	with an increase in social contributions	which may lead to an increase in social expenditure • More detailed recent year statistics analysis • Risk asymmetry mistake is noted, but it is concluded that asymmetry exists in the long run period		decisions taken by the Saeima regarding welfare sector and their fiscal impact
Current payments to the EU budget	• Includes both planned and paid payments to the EU budget	• Detailed explanation why the execution of payments may be higher or lower than projected (depends on GDP)	• No significant changes	• Additional two factors which affects contributions to the EU budget (approving EU budget amendments and Latvia's growth rates)	• The risk is accompanied by up-to-date information on the impact factors of the EU budget contribution
Assistance from EU financial instruments	• Exactly reflected both planned and paid payments to the EU budget	• No significant changes	• The State Treasury has not released data for 2015 • No significant changes	• The State Treasury has not released data for 2016 • No significant changes	• The Treasury has released the latest data on EU policy instruments expenditure
State guarantee for study loans	• Fiscal safety reserve for this risk is not created	• No significant changes	• More detailed explanation of the guarantee statistics	• No significant changes	• No significant changes

Capital on demand	• Capital presented on demand broken down by international institutions	• Detailed explanation of the risk occurrence • The total demand for capital in 2015 has increased	• No significant changes	• No significant changes	• No significant changes
Public Energy Trader	–	–	–	–	• The FRS adds a risk to the Public Energy Trader (PET). Irrespective of the fact that the risk is included in the quantifiable risks, it is not included in the FNR calculation because the analysis is not completed and the risk is considered to be symmetrical

State corporations (non-quantifiable risk until 2017, risk quantifiable from 2018)	• The FRS emphasizes that the responsible shareholder body has to analyse the risks affecting the financial result • Detailed risk description	• The FRS emphasizes that the responsible shareholder body has to analyse the risks affecting the financial result • In the absence of history, it is not possible to carry out a fiscal risk assessment • Difference from FRS 2014, there is no timetable for forecast estimation	• The MoF intends to make amendments to the FDL due to the agreement on borrowing • The numerical impact on the budget balance is reflected, but actual, not predicted one	• No significant changes • Minor changes to numerical values, including changes in indicators for 2015	• For the first time, public corporation risk is part of the quantifiable risk; however, the risk is not included in the FSR calculation, as it has historically been symmetric. Similarly, this risk has been the subject of an in-depth analysis of the deviations of the balance sheets of general government classified health companies, but the final conclusion is that the risk is symmetric
Non-quantifiable fiscal risks					
PPP	• Fiscal impact cannot be determined • No PPP projects mentioned • It is mentioned that it is necessary to establish a responsible institution that	• The benefits of PPP projects are explained in more detail • Fiscal impact can be set only partially • A nursery PPP project comes up • It is mentioned that it is necessary to	• Information on PPP, which in 2015 increased the deficit by 0.3% of GDP, is mentioned • The Ķekava PPP project is mentioned	• No significant changes	• Additional information is given on the fiscal impact for the PPP risk and the probability is set to be close to zero, therefore it is not quantified and

	would manage the risk of PPP projects	establish a responsible institution that would manage the risk of PPP projects			included in the FSR calculation.
The execution of the International Court of Justice and the Constitutional Court	• One of the possible risks related to litigation is related to airBaltic and RIX	• Planned court decisions regarding RIX and airBaltic case are not taken into account, preparing this risk assessment	• More detailed description of the EU Court and the Constitutional Court in essence and more detailed description of their impact on the state budget • It is mentioned that low-cost risks are covered by FUE • Higher cost risk are usually included in the annual budget	• No significant changes	• There is no sub-section on the salaries of judges which is mentioned in content
Financial Sector	–	–	• First time financial risk is included in FRS • It is mentioned that the risk is low and there is no need for the quantification, however it can be concluded that risk quantification is possible • More detailed description of Parex case	• No significant changes • Additional Reverta is mentioned	• Additional information on the Latvian Deposit Guarantee Fund and its impact on the general government sector are added (changes are foreseen in the EKS methodology)

Tax reform	–	–	–	• Actual fiscal risk that is included in the FRS	–
Additional information		• A section on risk management improvement is coming up in FRS 2015 • It is mentioned that consideration should be given to the inclusion of macroeconomic risks in the FRS	• In FRS 2016 there is explanation for the symmetrical fiscal risks and why fiscal safety reserve for these risk is not created • FRS has become more extensive and more detailed • A detailed macroeconomic review is presented		• Chapter 1 explains that the symmetry of risks should be at least the medium term (3 to 5 years), while if it is not practically possible to identify symmetric signs of fiscal risk during the relevant period, the observation period should be extended to 7 years, which could be considered as long term

ANNEX 2. COUNCIL'S ENDORSEMENT OF MOF MACROECONOMIC PROJECTIONS (15 FEBRUARY 2019)

This document presents the opinion of the Fiscal Discipline Council (hereafter - the Council) on the macroeconomic forecast prepared by the Ministry of Finance (hereafter – MoF) that will be used for drafting Latvia's Stability Programme (hereafter – SP) 2019/22, which is scheduled to be submitted to the Cabinet of Ministers on mid-April 2019. An early review and endorsement of the MoF's macroeconomic projections by the Council has been agreed upon to support the efforts of the Government during the preparation of the annual SP and the medium term budget framework (hereafter – MTBF).

According to the Memorandum of Understanding, signed on 8 February 2016, the Council has a responsibility to endorse MoF's macroeconomic forecast. The Council assessed the forecast as a whole, and provides an endorsement of the key macroeconomic indicators, which are outlined below. During the endorsement process the Council was presented with detailed information on MoF's forecast, such as the gross domestic product (hereafter – GDP) structure and development scenarios of GDP components. The Council has consulted with external experts to gain a comprehensive understanding of the developments in Latvia's economy.

The Council has a mandate to endorse the forecast of macroeconomic indicators according to the scope of Article 20 of the Fiscal discipline law (indicators are summarised in Table 2 at the end of this document).

	2019	2020	2021	2022
Real GDP growth				
MoF (Feb 2019)	**3.2**	**3.0**	**2.9**	**2.9**
BoL (Dec 2018)	3.5	3.1	–	–
EC (Jan 2019)[17]	3.1	2.6	–	–
EC (Oct 2018)[2]	3.2	2.9	–	–
IMF (Oct 2018)	3.3	3.1	3.0	3.0
Nominal GDP growth				
MoF (Feb 2019)	**6.4**	**5.9**	**5.5**	**5.5**
BoL (Dec 2018)	–	–	–	–
EC (Oct 2018)[2]	5.4	5.7	–	–
IMF (Oct 2018)	5.8	5.7	5.5	5.3
Inflation				
MoF (Feb 2019)	**2.5**	**2.2**	**2.1**	**2.0**
BoL (Dec 2018)	2.9	2.5	–	–
EC (Jan 2019)[1]	2.7	2.1	–	–
EC (Oct 2018)[2]	2.7	2.4	–	–
IMF (Oct 2018)	2.4	2.4	2.4	2.3
GDP deflator				
MoF (Feb 2019)	**3.1**	**2.8**	**2.5**	**2.5**
BoL (Dec 2018)	–	–	–	–
EC (Oct 2018)[2]	2.1	2.7	–	–
IMF (Oct 2018)	2.9	3.2	3.1	3.0
Output gap				
MoF (Feb 2019)	**1.4**	**1.0**	**0.7**	**0.4**
BoL (Dec 2018)	–	–	–	–
EC (Oct 2018)[2]	2.1	1.3	–	–
IMF (Oct 2018)	–	–	–	–

Table 1 Key macroeconomic indicator forecasts by various institutions, % y-o-y. Data sources: MoF, BoL, EC, IMF.

The MoF macroeconomic forecast is largely in line with the forecasts of the European Commission (hereafter – EC), the International Monetary Fund (hereafter – IMF) and the Bank of Latvia's (hereafter – BoL) (Table 1). However, the inflation rate is forecasted lower (in comparison to forecasts by BoL, and EC[1] for 2019) but the nominal GDP growth – higher (even by 1,0 percentage points in comparison to EC).

Although the output gap estimate is increased for the whole-time horizon in comparison to the previous forecast by MoF, it remains below the EC forecast. Both forecasts indicate a likely decline in real GDP growth below potential growth.

In 2018, the financial and transport sectors performed better than expected, we also saw high confidence indicators (above the long-term average) and investments

[17] European Commission Winter 2019 Economic Forecast. Available at: *https://ec.europa.eu/info/sites/info/files/economy-finance/ip096_en.pdf*, accessed on 07.02.2019.

(especially in construction sector, financed by the European Funds). However, in addition to historically low unemployment (since 2009) pushing up wages, **risks of weaker external trade and lower external demand are emerging**[18], together with warnings of reputation crisis in banking sector if prevention of money laundering will not be introduced at the level recommended by the MONEYVAL[19].

The Council endorses the nominal and real GDP growth forecast for SP 2019/22 with comments. Compared to the previous forecast in October 2018, which was prepared for the MTBF 2019/21, the real GDP growth rate has been raised by 0.2 percentage points for 2019 with no changes for upcoming years (Chart 1). However, negative risks at global extent have increased, resulting in weaker external trade and lower external demand; it could slow down the real economic growth below the forecasted level for 2019.

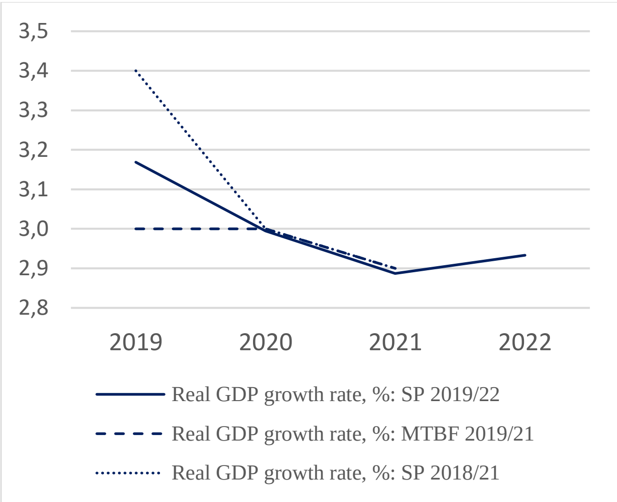


Chart 1 Forecast for real GDP growth, y-o-y. Data source: MoF.

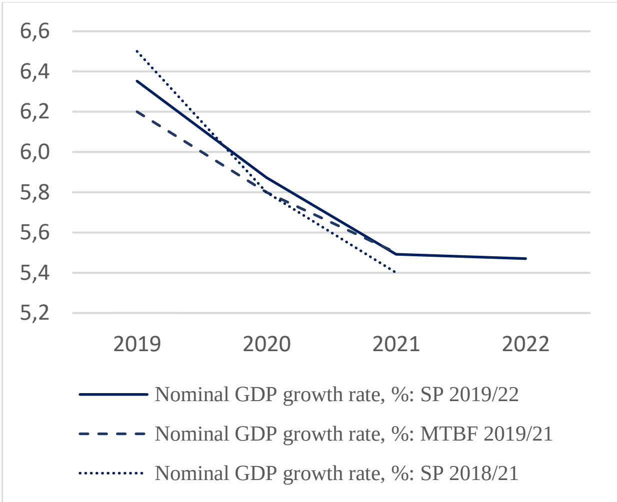


Chart 2 Forecast for nominal GDP growth, y-o-y. Data source: MoF.

The Council endorses the GDP deflator and the change in the consumer price index (hereafter – CPI) (inflation) forecast for the SP 2019/22 with comments. Since October 2018, there are no changes made to the inflation forecast (Chart 3), however, as already in previous endorsements, the Council emphasizes that the pressure on the wage growth from the labour market remains high and therefore inflation outcome might be above the current forecast, particularly for years 2020 and 2021. The CPI forecasts by the EC (2019) and Bank of Latvia are higher for both 2019 and 2020.

[18] European Commission Autumn 2018 Economic Forecast. Available at: *https://ec.europa.eu/info/sites/info/files/economy-finance/ip089_en_0.pdf* , accessed on 07.02.2019.

[19] The Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism - MONEYVAL, July 2018. Anti-money laundering and counter-terrorist financing measures. Available at: *https://rm.coe.int/moneyval-2018-8-5th-round-mer-latvia/16808ce61b*, accessed on 07.02.2019.

"After the peak in 2017 of the economic growth in European Union (hereafter – EU), growth has moderated with emerging external demand risks and weaker external trade (domestic demand remains strong)."

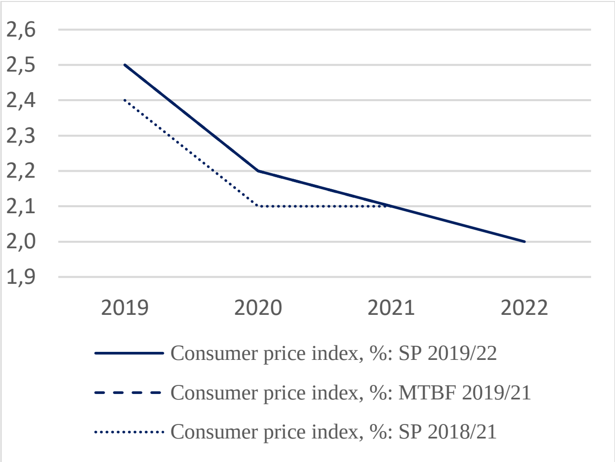


Chart 3 Forecast for inflation, y-o-y.
Data source: MoF.

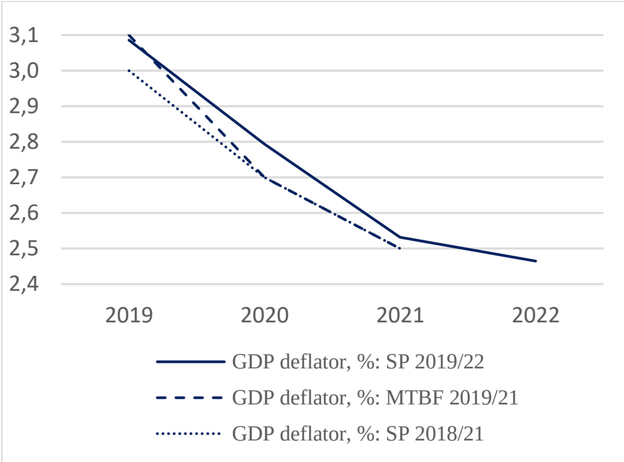


Chart 4 Forecast for GDP deflator, y-o-y.
Data source: MoF.

The Council endorses the potential GDP growth and output gap forecasts for the SP 2019/22 with comments. Potential GDP growth has been revised upwards by 0.1 percentage points for 2019 and 2020, and for 0.2 percentage points for 2022. A 3.0% growth rate has been set for 2023, 2.9% for 2024, 2025 and 2026 (the expanded time horizon is necessary for further calculations of the expenditure benchmark). The Council agrees that the current output gap is larger-positive than previously forecasted, in fact, it could be even larger, knowing the risks of, e.g., price acceleration above the inflation rate currently forecasted by MoF that would deteriorate the productivity and result in lower economic growth potential as well as widening positive output gap. While MoF argues that there are positive structural changes in the labour market, the Council points out that the structural unemployment is high, therefore labour market continues to restrict the potential GDP growth.

Latvia's economic growth currently is in upswing of economic cycle close to its maximum growth level. Although, in 2019, the slowdown of economic growth is probable because of raising risks, the economy will continue to growth in upcoming years. During this time, the Government should implement a restrictive fiscal policy and create a buffer for next – turning downwards – phase in the economic cycle.

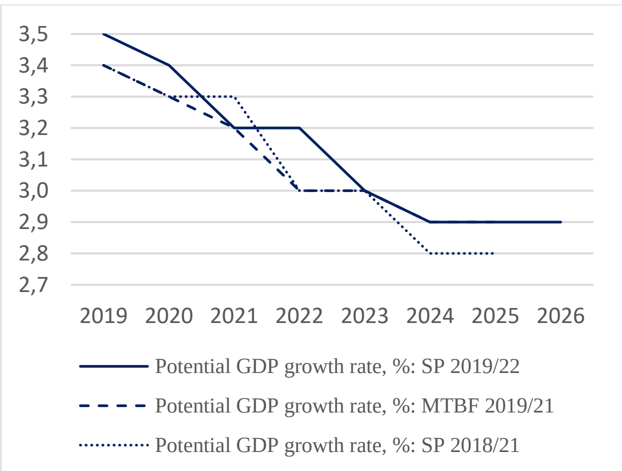


Chart 5 Potential GDP growth, %, y-o-y.
Data source: MoF.

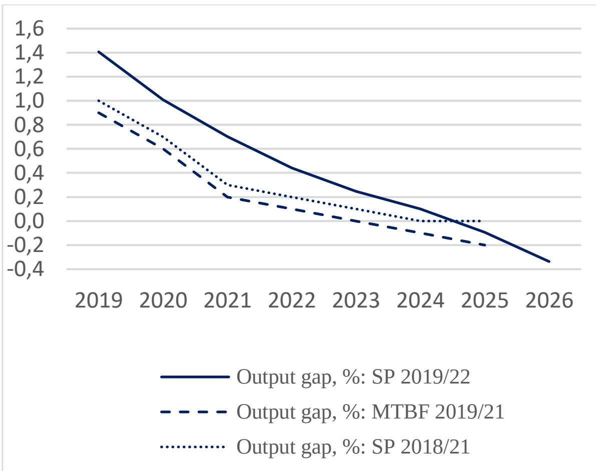


Chart 6 Output gap, % of potential GDP.
Data source: MoF.

	2019	2020	2021	2022
Real GDP growth	**3.2**	**3.0**	**2.9**	**2.9**
Nominal GDP growth	**6.4**	**5.9**	**5.5**	**5.5**
Inflation (consumer prices)	**2.5**	**2.2**	**2.1**	**2.0**
GDP deflator	**3.1**	**2.8**	**2.5**	**2.5**
Potential GDP growth	**3.5**	**3.4**	**3.2**	**3.2**
Output gap	**1.4**	**1.0**	**0.7**	**0.4**

Table 2 Macroeconomic forecast indicators endorsed by the Council. Data available also in MS Excel[20].

Broadly, the Council considers the MoF's macroeconomic forecasts to be realistic and endorses them.

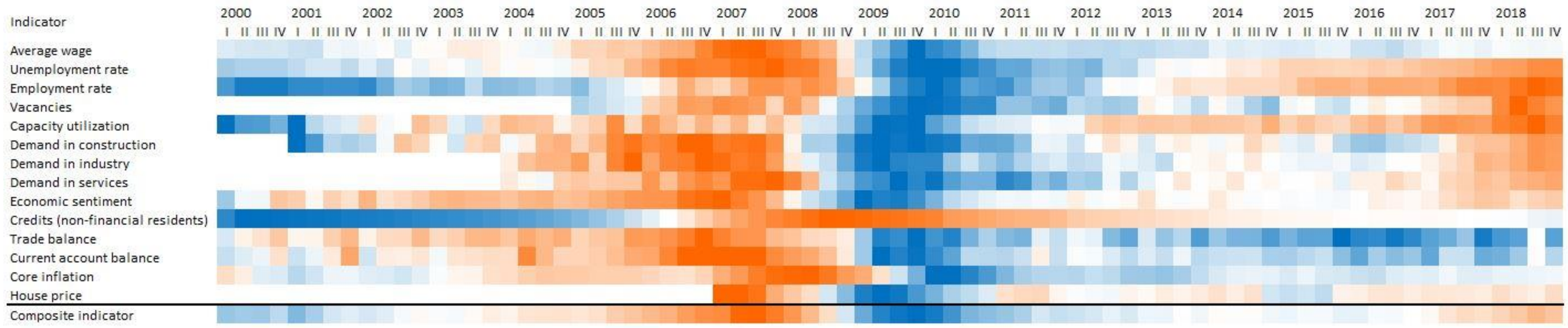
The Council would like to point out that the SP2019/22 should include the sensitivity analysis, where following negative risks are assessed: decreasing unemployment contributing to wage growth and inflation, unfavourable external circumstance for external trade and lower external demand, effect of Brexit; as well as reputation risks in banking sector. As in the spring forecast last year, the Council has attached an evaluation of yearly macroeconomic forecasts (in MS Excel[21]). The Council encourages the MoF to continue to improve both the sensitivity analysis and the evaluation of previous forecast's deviations.

The Council is also looking forward to MoF's assessment (that is going to be prepared in May 2019) of tax-reform started in 2017 results, incl. effect on economic cycle.

In addition, the Council has introduced a new monitoring tool – the heatmap (available online: http://fiscalcouncil.lv/cycle-heatmap), to follow on changes of main indicators characterizing the economic cycle. From the analysis it is possible to observe a clear "heating" of the composite index since beginning of 2017, and especially in 2018Q2 and 2018Q3, which is characterized by tension in labour market, historically high capacity utilization in manufacturing industries, high demand in construction, industry and services, as well as above the long term average house price index and economic sentiment (see Annex[22]).

[20] Macroeconomic indicators. Available: *http://fdp.gov.lv/files/uploaded/FDP_1_08_215_20190215_macroeconomic_forecasts_opinion_Ann2.xlsx*, accessed on 15.02.2019.
[21] Evaluation of the annual macroeconomic forecasts. Available: *http://fdp.gov.lv/files/uploaded/FDP_1_08_215_20190215_macroeconomic_forecasts_opinion_Ann3.xlsx*, accessed on 15.02.2019.
[22] Heatmap and recognition of economic cycles. Available: *http://fdp.gov.lv/files/uploaded/FDP_1_08_215_20190215_macroeconomic_forecasts_opinion_Ann4.pdf*, accessed on 15.02.2019.

ANNEX 3. LATVIAN ECONOMY HEATMAP 2000-2018 (MS EXCEL TABLES)



Latvian economy heatmap 2000-2018 available in MS Excel here: *http://fiscalcouncil.lv/cycle-heatmap*

ANNEX 4. HEALTH CARE REFORM PERFORMANCE INDICATIOS: DEVIATION USE (MS EXCEL TABLES)

4. pielikums. Veselības aprūpes sistēmas reformas progresa rādītāji: atkāpes izlietojums (MS Excel tabulas)

#	Rādītājs	2018I						Item
		Finansējums, eiro Financing, euro		Papildu skaits, pacienti Additional volume, patients		Rindu garums, dienās Waiting list, days		
		Plāns Planned	Faktiskā izpilde Actual outcome	Plāns Planned	Faktiskā izpilde Actual outcome	Pirms reformas Before reform	Faktiskā izpilde Actual outcome	
1.	*Onkoloģija*	*37 163 269*	*38 756 386*	*63 538*	*107 072*	*x*	*x*	*Oncology*
	Primārā diagnostika	1 499 520	1 245 866	22 000	33 518	x	x	Primary diagnostics
	Speciālistu konsultācijas	650 320	905 831	11 000	35 666	x	x	Expert consultations
	Sekundārā diagnostika un izmeklējumi	2 332 540	3 112 735	14 659	21 461	x	x	Secondary diagnostics and examinations
	Ambulatorā ārstēšana	1 177 895	1 170 486	3 306	2 126	x	x	Ambulatory treatment
	Stacionārā ārstēšana	2 462 176	2 660 515	5 998	6 481	x	x	Hospital treatment
	Kompensējamie medikamenti	12 709 164	13 478 477	6 094	7 275	x	x	Reimbursable drugs
	Pozitronu emisijas tomogrāfija/datortomogrāfija	235 473	128 045	217	118	x	x	Positron emission tomography / computer tomography
	Staru terapijas un ķīmijterapijas efektivitātes uzlabošana	8 974 871	8 974 871	4	3	x	x	Improving the effectiveness of radiation therapy and chemotherapy
	Valsts patoloģijas centra izveide	965 660	965 660			x	x	Establishment of a national pathology center
	Vēža skrīninga programmas reforma	390 000	348 250	260	424	x	x	Reform of Cancer Screening Program
	Priekšdziedzera un urīnpūšļa vēža ārstēšana un diagnostika. Iekārtu iegāde	3 224 650	3 224 650	3	3	x	x	Treatment and diagnosis of prostate and bladder cancer. Purchase of equipment
	Datortomogrāfija. Iekārtu iegāde	2 541 000	2 541 000	3	3	x	x	Computer tomography. Purchase of equipment
2.	*Infekcijas slimību izplatības mazināšana*	*16 740 741*	*16 740 741*	*63 437*	*64 780*	*x*	*x*	*Reducing the spread of infectious diseases*

#	Rādītājs	2018						Item
		Finansējums, eiro Financing, euro		Papildu skaits, pacienti Additional volume, patients		Rindu garums, dienās Waiting list, days		
		Plāns Planned	Faktiskā izpilde Actual outcome	Plāns Planned	Faktiskā izpilde Actual outcome	Pirms reformas Before reform	Faktiskā izpilde Actual outcome	
	Kompensējamie medikamenti	11 174 882	11 174 882	407	1 000	x	x	Reimbursable drugs
	References laboratorijas izmeklējumi VHC hepatīta pacientu terapijas uzsākšanai un terapijas monitoringam saistībā ar pacientu skaita pieaugumu	783 203	783 203	6 530	7 568	x	x	Reference laboratory tests for the initiation of treatment for VHC patients with hepatitis
	Vīrusu molekulārās izmeklēšanas analītiskās jutības rādītāju uzlabošana	579 656	579 656	55 000	55 000	x	x	Improvement of analytical sensitivity of viral molecular investigations
	HIV/AIDS medikamentozā ārstēšana	4 203 000	4 203 000	1 500	1 212	x	x	HIV / AIDS medication
3.	*Veselības aprūpes pakalpojumu pieejamība*	*38 373 824*	*37 353 637*	*1 158 531*	*1 024 930*	*22 239*	*17 078*	*Access to health care services*
	Speciālistu konsultācijas	5 425 824	5 425 824	378 911	316 337	100	72	Expert consultations
	Ambulatorie izmeklējumi un terapija	12 698 580	12 698 580	535 232	551 264	40	36	Ambulatory examinations and therapy
	Dienas stacionārs	9 613 310	9 613 311	97 561	64 326	407	148	Daily hospital treatment
	Ambulatorā rehabilitācija	889 879	889 879	99 554	72 174	500	345	Ambulatory rehabilitation
	Diabēta apmācības kabinetu izveide	139 912	116 859	11	11	x	x	Diabetic training cabinets
	Endoprotezēšanas operācijas stacionārā	2 614 685	2 614 685	891	1 136	21 191	16 477	Endoprosthetic surgery in a hospital
	Darbnespējas saīsināšana un pasākumi prognozējamās invaliditātes novēršanai ar mērķi novērst ilgstošu slimošanu personām darbspējīgā vecumā	2 563 917	2 562 084	1 667	1 556	x	x	Reducing incapacity for work and measures to prevent predictable disability
	Aknu transplantācijas	500 001	220 482	7	5	x	x	Liver transplantation
	Bioloģiskās terapijas nodrošināšana Krona slimībai, čūlainajam kolītam un psoriāzei	1 208 748	1 125 295	11 697	12 940	x	x	Providing biological therapy for Crohn's disease, ulcerative colitis and psoriasis

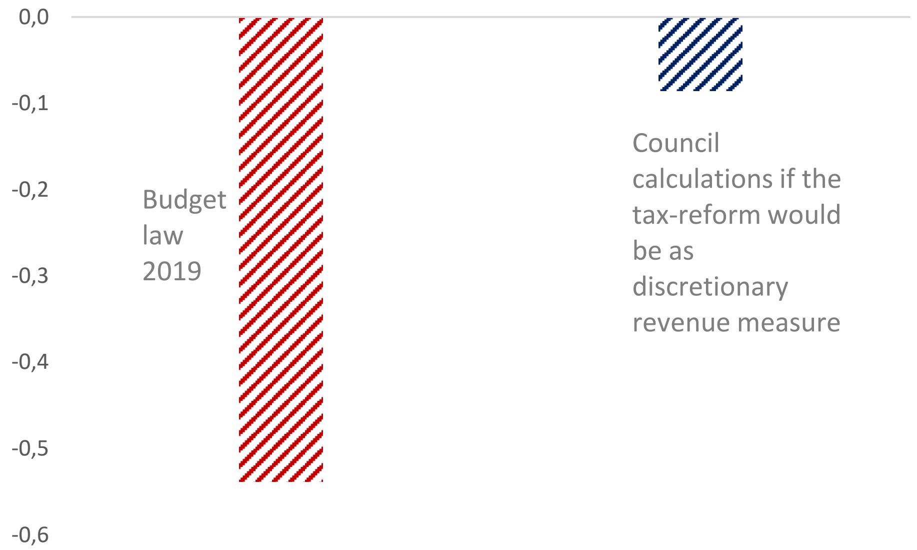
#	Rādītājs	2018						Item
		Finansējums, eiro Financing, euro		Papildu skaits, pacienti Additional volume, patients		Rindu garums, dienās Waiting list, days		
		Plāns Planned	Faktiskā izpilde Actual outcome	Plāns Planned	Faktiskā izpilde Actual outcome	Pirms reformas Before reform	Faktiskā izpilde Actual outcome	
	Hronisko pacientu aprūpes reforma	2 718 968	2 086 638	33 000	5 181	x	x	Chronic Patient Care Reform
4.	*Primārā veselības aprūpe*	*9 664 036*	*10 058 853*	*1 082 448*	*2 260 011*	*x*	*x*	*Primary health care*
	Mērķa kritēriju izpildes iekļaušana kapitācijas naudā	3 131 715	3 123 263	1 303	1 269	x	x	Inclusion of the fulfillment of the target criteria in the capital's money
	Ģimenes ārstu kvalitātes maksājumu sistēmas reforma	2 797 022	1 851 835	1 322	1 284	x	x	Family doctors' quality payment system reform
	Bērnu zobārstniecības tarifu pārskatīšana	3 735 299	5 083 755	1 079 823	2 257 458	x	x	Child dentistry tariff review
5.	*Sirds un asinsvadu programma*	*11 458 130*	*9 382 962*	*17 210*	*27 399*	*x*	*x*	*Cardiovascular program*
	Kardiovaskulārā riska izvērtēšana un algoritmu ieviešana	1 706 257	254 254	11 926	14 245	x	x	Cardiovascular risk assessment and implementation of algorithms
	Aortālā vārstuļa transkatetrāla implantācija (TAVI) pakalpojuma ieviešana	1 875 000	1 875 000	75	75	x	x	Implantation of the Aortic Valve Transcattal Implantation (TAVI) service
	Angiogrāfu iegāde	4 500 000	4 498 881	4	4	x	x	Purchase of angiographs
	SAS medikamenti	3 376 873	2 754 827	5 205	13 075	x	x	SAS medication
∑	**Kopā atkāpe no vidēja termiņa budžeta mērķa**	**113 400 000**	**112 292 579**	**2 385 164**	**3 484 192**	**22 239**	**17 078**	**Total deviation from medium-term budget objective**

Avots: Veselības ministrija, Fiskālās disciplīnas padomes aprēķini *Source: Ministry of Health, Fiscal Discipline Council calculations*

Annex 4 in its full amount available in MS Excel here: *http://fdp.gov.lv/files/uploaded/FDP_1_08_393_20190423_Starpzinojums_Piel4.xls*.

ANNEX 5. NUMERICAL FISCAL RULES 2013-2022, EX POST ANTE (MS EXCEL TABLES)

Example of calculations from Annex 5

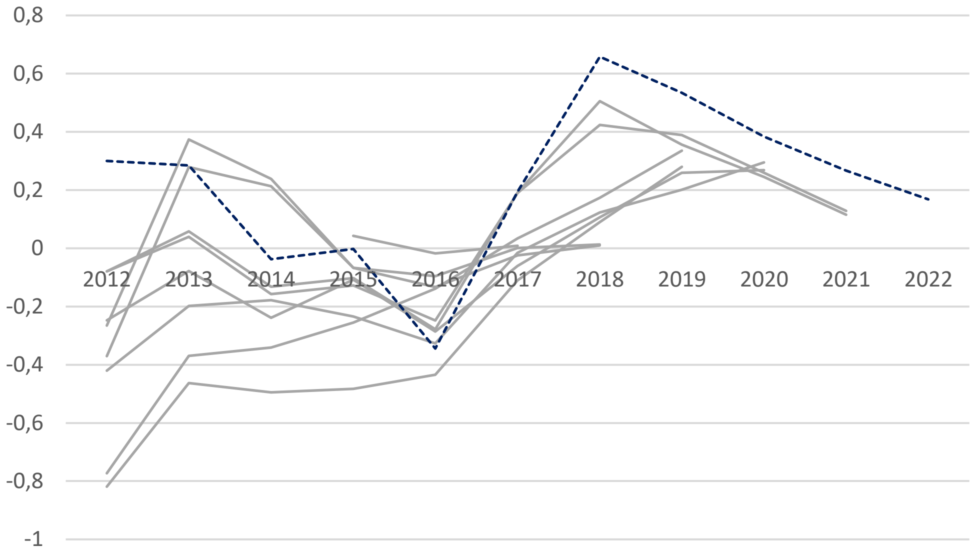


General government budget balance 2019: budget law 2019 and Council calculations, % of GDP. Source: https://likumi.lv/ta/id/306232-par-valsts-budzetu-2019-gadam and Council calculations.

Annex 5 in its full amount available in MS Excel here: *http://fdp.gov.lv/files/uploaded/FDP_1_08_393_20190423_Starpzinojums_Piel5.xls*.

ANNEX 6. NUMERICAL FISCAL RULES 2013-2022 EX ANTE VINTAGES (MS EXCEL TABLES)

Example of calculations from Annex 6:



Budget cyclical component ex ante vintages 2013-2022, % of GDP. Source: Council calculations.

Annex 6 in its full amount available in MS Excel here:
http://fdp.gov.lv/files/uploaded/FDP_1_08_393_20190423_Starpzinojums_Piel6.xls.

ANNEX 7. INTERNATIONAL MONETARY FUND'S MAC DSA MODEL FOR LATVIA (MS EXCEL TABLES)

Latvia Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

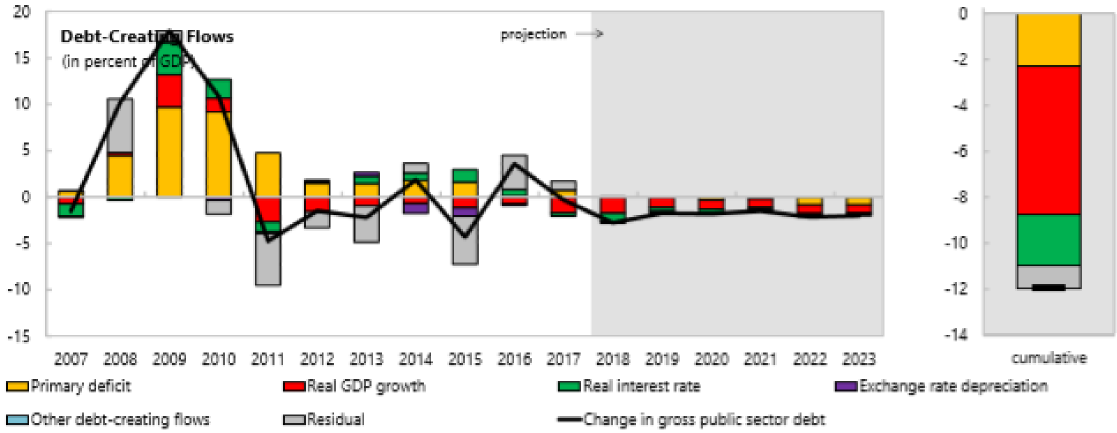
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of marts 25, 2019		
	2007-2015 [2/]	2016	2017	2018	2019	2020	2021	2022	2023	Sovereign Spreads		
Nominal gross public debt	34,6	40,2	39,8	37,1	35,4	33,5	32,1	29,9	27,9	Bond Spread (bp) 3/		57
Public gross financing needs	4,9	1,0	1,5	3,6	2,7	2,4	1,2	-1,5	-2,3	5Y CDS (bp)		35
Public debt (in percent of potential GDP)												
Real GDP growth (in percent)	0,6	2,1	4,6	4,8	3,2	3,0	2,9	2,9	2,8	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	3,9	0,9	3,2	4,2	3,1	2,8	2,5	2,5	2,5	Moody's	A3	A3
Nominal GDP growth (in percent)	4,9	2,9	8,0	9,2	6,4	5,9	5,5	5,5	5,4	S&Ps	A	A
Effective interest rate (in percent) [4/]	4,7	2,9	2,5	2,0	2,0	1,9	2,0	1,8	1,9	Fitch	A-	A-

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	3,0	3,6	-0,3	-2,8	-1,7	-1,8	-1,5	-2,1	-2,0	-11,9	
Identified debt-creating flows	4,1	-0,1	-1,3	-2,6	-1,6	-1,6	-1,3	-2,0	-1,9	-11,0	
Primary deficit	3,9	0,1	0,7	0,1	0,0	-0,3	-0,2	-0,9	-0,9	-2,3	-1,0
Primary (noninterest) revenue and g	35,4	36,8	37,1	36,8	35,9	35,7	35,1	34,6	34,6	212,6	
Primary (noninterest) expenditure	39,3	37,0	37,8	36,8	35,9	35,4	34,9	33,7	33,7	210,4	
Automatic debt dynamics [5/]	0,2	-0,2	-2,0	-2,6	-1,5	-1,3	-1,1	-1,1	-1,0	-8,7	
Interest rate/growth differential [6/]	0,4	0,0	-2,1	-2,6	-1,5	-1,3	-1,1	-1,1	-1,0	-8,7	
Of which: real interest rate	0,7	0,7	-0,3	-0,9	-0,4	-0,3	-0,2	-0,2	-0,2	-2,2	
Of which: real GDP growth	-0,3	-0,7	-1,7	-1,7	-1,1	-1,0	-0,9	-0,9	-0,8	-6,4	
Exchange rate depreciation [7/]	-0,2	-0,2	0,0	...	...	...	...	...	...	...	
Other identified debt-creating flows	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	
Please specify (1) (e.g., privatizatic	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	
Contingent liabilities	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	
Please specify (2) (e.g., other debt	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	
Residual, including asset changes [8/]	-1,1	3,7	1,0	-0,2	-0,2	-0,2	-0,2	-0,2	-0,2	-1,0	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds (bp).

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ) times previous period debt ratio, with r = effective nominal interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Annex 7 in its full amount in MS Excel available here: *http://fdp.gov.lv/files/uploaded/MAC_DSA_IMF_LV_dsatemp_june18.xlsm.*