

Annex 1 The Ministry of Finance's response to the Council's request to justify a derogation from the tax reform as a one-off measure in the context of the FDL

In accordance with the Article 2, second section of the Fiscal Discipline Law (FDL), shall apply to the budget institutions, institutions non-financed from the budget and derived persons partially financed from the State budget laid down in the Law On Budget and Financial Management. The fiscal policy principles laid down in this Law shall be applicable also to other institutions to be included in the general government sector [within the meaning of Paragraph 2.70 of Annex A of Council Regulation (EC) No 2223/96 of 25 June 1996 on the European system of national and regional accounts in the Community].

Therefore, these institutions apply the FDL rules. In fact, however, the content of the norms narrows the application of the norms to the Cabinet of Ministers and the Ministry of Finance, as the FDL norms define the conditions and restrictions for the preparation of the medium-term budget framework law and state budget draft laws until they are submitted to the Saeima. Thereby, the Ministry of Finance and the Cabinet of Ministers are those who actually apply the FDL rules.

The theory of law¹ provides that an interpreter of a legal norm is an application of legal norms.

There are no legal norms in Latvia that regulate one-off revenue and expenditure measures. The term "one-off measure" is not used in FDL legal norms. The Article 5, third section, third point of the FDL introduces the term "structural balance" by stating that "A term "structural balance of the general government budget" within this Law is used in the same meaning as the term "structural balance" in the Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies".

The term "medium-term budgetary objective" is used in the mentioned regulation: "the country-specific medium-term budgetary objectives shall be set within a defined range between -1% of GDP and a balance or surplus in cyclically-adjusted terms, excluding one-off and temporary measures."

The regulation also states that the structural balance measures the progress towards the medium-term budgetary objective. It follows from the regulation that the structural balance is a cyclically-adjusted nominal balance, from which one-off and temporary measures have been deducted.

It should be noted that there are no common standards in the world for what to recognize as one-off and temporary measures. Even EU Member States have not issued legislation on this issue. There is only the methodology adopted unilaterally by the European Commission that is set out in the document "Vade Mecum on the Stability & Growth Pact". This document refers to the European Commission and describes how the EC is conducting an assessment of the fiscal policies of EU Member States in line with the Stability and Growth Pact. Consequently, there are no legal provisions that require Member States to use the EC methodology for national fiscal frameworks.

The FDL regulation applies to the national fiscal framework. Fiscal policy must be in line with the national fiscal framework and must provide compliance with the Stability and Growth Pact.

Consequently, the Ministry of Finance, as the institution applying the FDL law, has the right to translate the relevant norms, including the measures to be considered as one-off measures.

Of course, the translation of norms cannot be arbitrary and the principles of translation of legal norms must be respected.

¹ Edgars Melķis, *Tiesību normu iztulkošana* (Rīga: Latvijas Universitāte, 2000), p. 10.

Article 17 of the Administrative Procedure Law defines the principles of interpretation of legal norms:

(1) In interpreting (construing) the norms of law institutions and courts shall apply the following basic methods of interpretation:

- 1) grammatical (linguistic) interpretation method, that is, ascertaining the meaning of the norm of law linguistically;
- 2) historical interpretation method, that is, ascertaining the meaning of the norm of law, considering the circumstances on the basis of which it has been created;
- 3) systemic interpretation method, that is, ascertaining the meaning of the norm of law in relation to other norms of law; and
- 4) teleological (meaning and purpose) interpretation method, that is, ascertaining the meaning of the norm of law on the basis of the useful and equitable purpose as is to be attained pursuant to the relevant norm of law.

Although the application of the FDL legal norms is not part of the administrative process, the interpretation of the above-mentioned norms also applies to cases outside the administrative procedure.

It follows from a grammatical interpretation that a one-off measure can be considered as a measure that has a one-off nature, respectively, a measure whose positive or negative fiscal impact does not recur from year to year - "temporary"/"not lasting or needed for a long time".

Regarding the teleological interpretation of the legal norm, the introduction of the concept of a one-off measure in fiscal policy is aimed at "netting" the nominal balance from "non-essential" factors, namely, creating a size that gives an idea of the "basics" of fiscal policy. This indicator measures the average balance in the long-term, and it depends only on revenue and expenditure flows that have fundamental nature and that is determined by the structure of public financial revenues and expenditures in the long-term, which is governed by national rules. Therefore, it is logical that this balance should be netted from the cyclical effects of the economy and from one-off revenues and one-off expenditures. From this point of view, there are no differences in terms of one-off expenditures and one-off revenues.

However, the European Commission, in its approach, deliberately retreats from the equal treatment of one-off revenues and one-off expenditures; revenue is more likely to be recognized as one-off, but expenditure very rarely. The EC approach is also evolving over time, for example in the case of Latvia, EC did not treat the presidency costs as one-off expenditure but in the case of Malta, they did. Also, the EC has accepted that bank rescue costs are one-off measures. However, as already noted, an EU Member State is not obliged to use the EC approach within the national fiscal framework, including a different assessment of the one-off nature of revenues and expenditures.

The Ministry of Finance classifies the fall in tax revenue as a one-off. The meaning and essence of the tax reform is to stimulate potential growth and thus to generate higher revenue for the state budget. However, in the short-term, the tax reform triggers a fall in revenue (against revenue forecasts if the reform would not be implemented). Therefore, the temporary nature of the fall in revenue is fulfilled.

This is not only justified by the grammatical interpretation of the norm, but also by the effective fiscal policy aspect and the meaning of the FDL fiscal rules. The sense of a fiscal rule to withhold a structural deficit of 1% of GDP is to prevent excessive debt growth, and this fiscal rule aim is not to prevent the country from carrying out the necessary reforms. If we assume that the negative fiscal impact of the tax is not a one-off measure, it would only be possible to do so by consolidating other expenditures by 0.5% of GDP, saying "only temporary". First of all, such a consolidation "only temporarily" would call for a justified public dissatisfaction, and secondly, if the only way to implement the tax reform would be such consolidation, then the implementation of the reform is unlikely to happen because of the insufficient political support. In a result, the Ministry of Finance chose the translation of the one-off measure that corresponded to both grammatical and teleological translation.