

TV studio

A fierce debate on budget is still going on, but whatever the decision of the Latvian government will be, the final word still remains with the international lenders. They will arrive in March, but before that they expect concrete proposals from the government. We had an exclusive opportunity to meet the official of the European Commission responsible for the loan. Coming up next — what do they think about the situation in Latvia and budget cut options.

Story

The repeated cutting of this year's budget by 50 million lats as required by the lenders has caused the government a lot of headache. It involves both combating the informal economy, increase of the gambling tax and harmonising of the fuel excise duty between the Baltic States, implying fuel price increase and cut of salaries for public sector workers.

The horror-struck government members refuse to cut more in any part of the budget, while the lenders insist on the required 50 million lats stressing that otherwise Latvia's credit ratings will suffer, which might make the loan even more expensive and the objective of 6 % budgetary deficit this year and 3 % the next year harder to achieve.

The Prime Minister underlines that the main issue is the lenders' agreement, as we on our part do not need 50 million lats, because the current budgetary deficit is below the required level already — less than 5,4 %. The International Monetary Fund and the European Commission suggest that we should not deceive ourselves, as the current optimism may be altered both by the global economic situation and unexpected occurrences (like the judgement of Constitutional Court on pensions in 2009).

10:49 Gabriele Giudice (GG): *There must be a further budgetary adjustment by 50 million lats. However, we would like to see the adjustment as part of the budgetary consolidation to be implemented in the coming years. If you start to implement it consistently and gradually already now, less cutting will be needed in the coming years in order to achieve a budgetary deficit of below 3 %. It should be noted that we still can face some surprises in the global and European context, some pressure may arise due to inflation and other problems that can influence the budget. We have provided general recommendations. In our discussions with the government we mainly seek to clarify how the measures and corrections adopted by the government comply with our principles of sustainability, competitiveness and fairness.*

The Prime Minister and the government will try to convince the lenders to count in the revenue from combating the informal economy with the requested 50 million lats. Currently the lenders consider only 9 million lats of the planned 15 million lats to be realistic, and so far it is not likely to change.

13:22 GG: *I am aware that an intensive discussion is going on inside the coalition. We are looking forward to an early result and appreciate their effort, as the discussion is taking place. On the one hand, there are some areas where we encourage them, like combating the informal economy, which is essential in order to increase revenue without raising taxes. On the other hand, we are taking precautions to avoid facing holes in the budget, namely, to avoid that the expectation of higher revenues from combating the grey economy leads to higher spending, when such revenues may eventually not be collected.*

14:35 GG: *It is important to be aware that there will be budgetary revenue from combating the informal economy. However, it would be better not to take it for granted – if the strategy developed by the government will bear fruit this year, being as ambitious and good as it is, it will reduce the budgetary consolidation in 2012.*

The biggest part, at least two thirds of the 290 million lats saved in this year's budget, has been raised through revenue by increasing taxes. The lenders point out that one should think also about reducing the expenditure to achieve balance.

28:49 GG: *There is a need to focus expenditure – the emphasis should be placed upon those who need support most, while reducing expenditure as a whole. Such a concept should be borne in mind. Those who really need it should be helped, and as Latvia ranks first in the European Union as regards inequality, there are many who need help, especially those who have very low incomes. There are special groups that could get more aid from the state than they currently do, and at the same time there are people who could contribute more towards securing that aid. That is, of course, a general principle. Furthermore, in my view, the efficiency of the public administration still needs some improvement. There are areas where a lot of work has been done, however, there are as many where more effort should be invested.*

Politicians who promised not to cut pensions and social benefits before the elections now point out annoyed that cut of the social budget are required by the lenders, who in their turn just share general recommendations.

30:09 GG: *It is difficult to evaluate separate parts of the budget without seeing the system as a whole. There have been cuts in many areas, therefore it is difficult to find more possibilities for cutting. I believe, it depends on how it will be done. As regards the social budget which is the largest budget part, I am not so sure it is social in its nature. If you grant money to everyone, what is the social objective then? The objective is to support those who really need that. Therefore, we propose that the social budget should be evaluated constructively.*

The fight for concrete percentage for the budgetary deficit has two objectives, not just getting the economy right. Budgetary deficit of 3 % is one of the conditions for being able to join the euro area. Recent crises in Europe show once again how difficult it is for less developed European countries to integrate into the euro club.

22:16 GG: *To be ready to join the euro area implies being strong, especially because we have experienced that living in the euro area is not easy – the crises of the past years show that one should be strong and continue to be strong – to adopt relevant measures and to observe fiscal discipline.*

22:59 GG: *Already now you as a state face the same difficulties as the euro area. You cannot use the monetary instruments because of the strong pegging of the lats to the euro. And the potential loss of that pegging causes costs and uncertainty. Furthermore, you are currently sharing the difficulties of the euro area, but you do not get the benefits that it can offer: easy transfers of money, risk aversion, easier attracting investments from Europe and the European market with no more concern about eventual currency exchange rate fluctuations.*