

ASSESSMENT OF THE GOVERNMENT FINANCIAL POLICY: THE SITUATION IN LATVIA

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Abstract.

Purpose and aim of the study: *the research aim is to evaluate the factors influencing national financial policy, their socio-economic impact, and assess Latvia's fiscal policies.*

Design/Methodology/Approach: *the study uses the monographic, logical constructivism, content analysis methods, and the comparison method for opinions and concepts. The paper is based on theoretical knowledge, studies of foreign and Latvian authors, as well as Latvian laws and other regulatory documents on the relevant issues.*

Main findings: *The research highlights the main challenges in the making of national financial policies. The research identifies the most important factors that need to be considered when making national financial policies.*

Originality: *The research takes a comprehensive approach to the analysis of national financial policies. The study uses a variety of data sources and methodological approaches.*

Implications: *The findings of the research can be used to inform the development of more effective national financial policies. The study provides a valuable resource for policymakers, researchers, and practitioners.*

Keywords: *national financial policy, fiscal policy, state budget, taxes, government spending.*

Received: 20 October 2023 **Revised:** 7 November 2023 **Accepted:** 16 November 2023

Published: 4 December 2023

Introduction

Today is marked by significant fluctuations in social and economic development in the world, and especially in Europe, which have undoubtedly had an impact on development processes in Latvia, which have called for measures to reorganise and restructure the economy in specific time periods: complex geopolitical conditions, population migration, a economic slowdown in Europe.

All this has been aggravated by the spread of the Covid-19 pandemic, the war started by Russia in Ukraine, which has completely changed the situation in Europe, notably in the field of energy, causing the energy price shock crisis, immigration problems and other political issues.

Thus, the importance of the decisions taken by national policy-makers to address the problems caused by the geopolitical situation is growing, along with the effectiveness of government activity. Traditionally, all this has been based on the performance objectives set in accordance with the defined

national development strategy and the specific priorities established by the government in a specific political and economic situation.

All this brings into focus the notion of the financial resources required for government activity, or more generally, public finances, and their management with the aim of making a positive contribution to economic growth, the quality of public services, and the overall welfare of the country.

Several socio-economic problems are currently prevailing in Latvia: social stratification, emigration, unorganised education and healthcare systems, the grey economy, slowing economic growth, and heavy public administration. All this calls for a sound and effective national financial policy, identifying the most important factors that influence it and to what extent they are objective or subjective in nature. An assessment of potential risks in the context of securing national finances is also important.

Overall, it can be argued that an effective national financial policy requires not only the definition of the objectives of government activities but also an assessment of how the various financial policy instruments affect the socio-economic situation in the state.

The research aim is to evaluate the factors influencing national financial policy, their socio-economic impact, and assess Latvia's fiscal policies.

The main research objectives are the following:

1. Evaluate economic beliefs on national financial policy and assess policy implementation;
2. Identify influencing factors, examine Latvia's fiscal policy, and develop improvement recommendations.

The research novelty is that it highlights the main challenges in the making of national financial policies, identifies the most important factors that affect these, i.e. administrative, political, economic, and international.

The research hypothesis: the effectiveness of national financial policy in a given economic and political situation is influenced by objective and subjective factors.

The study uses the monographic, logical constructivism, content analysis methods, and the comparison method for opinions and concepts.

The paper is based on theoretical knowledge, studies of foreign and Latvian authors, as well as Latvian laws and other regulatory documents on the relevant issues.

Literature Review

Economic theory and practice emphasise that the decisions of governments (politicians) are the main factor influencing a country's development in both social and economic contexts. Implementation of any measures adopted by the government requires monetary resources.

Traditionally, these have been provided through tax payments, generating the financial resources for the state. These are allocated to the implementation of the objectives set by the state, i.e. the priorities set by the government, their directions, the financing of the relevant activities (Greene, 2020).

This brings into focus the notions of public finances and the factors that influence their provision – taxes, government spending – which are assessed in the context of national financial policy. Nowadays, it has become an important subject of both economic and political debate. By implementing national financial policy measures, the government has a clear impact on the socio-economic situation in the country and its potential development prospects in the short and long term (Donaldson, 2006).

It can be clearly agreed that national financial policy has an important role in promoting the stability and sustainable development of a country's economy and that, in determining how public finances are generated and used, an understanding of the impact of these processes on society as a whole (private sector, business sector) is essential (Baumann & Bradbury, 2023).

It can thus be argued that the government, by ensuring appropriate national financial policy measures, must be generally responsible for the efficiency of collection and use of public finances (Giovann et al., 2021).

National financial policy is defined as the strategy and action plan developed and implemented by the government with regard to the drafting and implementation of the state budget and all related economic and social issues. It is part of a broader economic policy and includes decisions and measures taken to manage public finances, influence economic activity and ensure the provision of public services to the population (Gorina et al., 2017).

In economic theory, the debate on national financial policy has resulted in different opinions on which should be given more attention - taxes, government spending, or the state budget as a whole. The author believes that, given the main aspects that determine the state budget, one has to agree with the argument that all of these, including both taxation and government spending, accurately outline the importance of fiscal policy. Traditionally, fiscal policy is nowadays defined as a set of measures whereby social and economic processes in a country are regulated through government spending and taxation (Greene, 2020).

It is important to emphasise that it is implemented by the government through the state budget, which is defined as the state's revenue and expenditure plan, established and approved for a given period of time, and whose main supporting instruments are taxes, budget spending, and government borrowing (Nice, 2002).

It needs to be emphasised that there is a diversity of opinions in economic theory, with several approaches explaining particular economic

problems differently, including the effects of fiscal policy on key indicators of economic activity: gross domestic product growth, employment, the price level, the foreign trade balance, the government budget deficit. However, it is argued that fiscal policy measures have an important role in the national economy because the government uses them to influence the goods and services, financial and labour markets, as well as to address problems related to income redistribution and social justice in society (Mikesel, 2007).

Thus, different approaches to fiscal policy-making exist and are emerging in economic theory and national financial practice when implementing tax and government spending policies. However, it has to be pointed out that no perfect fiscal policy is possible because there are always various factors to consider, which require specific measures to solve the problems. Some of the factors that influence fiscal policy are similar in many countries; however, their degree of impact may vary considerably, and there may also be factors that are specific to a particular country (Tobias et al., 2022).

These have already been assessed and highlighted in previous periods (Kavale & Žubule, 2016). However, it must be emphasised that, especially now, considering both the economic and social situation, which has been affected by the Covid-19 pandemic in 2019-2021, as well as the geopolitical situation, countries are reinforcing aspects of government activity that are closely tied to the specific measures affecting fiscal policy. These are also relevant for Latvia, whose economy can be generally described as small and open. It can therefore be argued that the following factors are crucial in the design and implementation of national financial policies:

- International factors: Participating in various international organisations (WTO, IMF, EU, UN, NATO), it is understood that the member states are bound by certain contractual obligations (including financial) which oblige the member states to comply (membership fees, administrative instruments, financial aid, international requirements for public finances), therefore the following aspects are essential:
 - ✓ this requires all international financial commitments to be reflected in annual national budgets;
 - ✓ in this context, it has to be taken into account that certain requirements from international organisations can have both positive effects (especially when domestic politicians fail to take certain important decisions, such as fiscal discipline) as well as negative effects, especially in situations where such requirements are not consistent with the country's national interests;
 - ✓ the government must respond to changes in the global economy, financial markets, economic trends in partner countries, geopolitical events and the problems arising from population migration. These

factors can emerge rapidly and unexpectedly and threaten a country's economic development, which may require governments to adjust their established fiscal policies, which can also provoke public frustration.

- The political factor – the most frequently highlighted factor with a strong potential impact on government decisions; politicians tend to increase government activity and its role in the economy, bringing about an increase in the government machinery and costs. This is known as fiscal policy distortions; problematic issues – funding for specific activities or programmes that has little economic justification, short-term tax policies, uncertainty in the social sphere.
- The administrative factor, which correlates closely with the notion of government effectiveness in influencing fiscal policy measures. It is important to emphasise that, in highlighting the need for administrative research, economists have already emphasised in previous periods the aspects of assessing government performance – what the government can feasibly and successfully do with the greatest possible efficiency at the lowest possible cost (Fry & Brian, 2008). It can be argued that the administrative factor should be viewed broadly as the institutional support for fiscal policy.
- The socio-economic development of the country (indicators of gross domestic product, employment, inflation, public finances) and the resulting objectives and priorities set by the government, all of which call for the adoption and implementation of fiscal policy measures appropriate to the situation.

It can be concluded that the factors influencing fiscal policy are both subjective and objective in nature and can affect the overall state budget in different ways. Thus, in the context of administration of public finances, it has to be understood that these decisions will always involve government compromises, which result from the underlying factors. This means that a permanent and stable fiscal policy is essentially impossible. In certain situations, the general public wants a stable and predictable fiscal policy; however, it is important for governments to pursue flexible fiscal policies in order to be able to react to changes in one of these groups of factors in a timely manner and, if necessary, to revise decisions taken in the past (Park et al., 2023; Isaiah et al., 2019).

Research results and discussion

In a structural analysis of public finances and their administration and spending, it is important to understand the main components that influence

national financial policy and their potential impact on socio-economic processes in the country. The following can be identified as key:

- Budget policy – the process of drafting the state budget, identifying possible revenues and expenditures to ensure the achievement of set objectives in the context of social and economic welfare (assessing and deciding on the allocation of public funding to various government sectors, programmes, activities);
- Tax policy involves designing the tax system and ensuring its efficient operation and is concerned with generating the monetary resources required for government activity, affecting taxpayers and society as a whole;
- Fiscal policy involves budgetary and tax policy measures and is an essential component of national financial management, as it is the main factor influencing a country's economic development;
- National debt policy determines how much a country is prepared to borrow and how these borrowings will be used; thus, emphasising the level of national debt highlights debt repayment capacity (amounts, time frames, interest payments) as an important aspect. It needs to be emphasised that it is most closely linked to government borrowing.

Thus, it can be concluded that, overall, government financial policy:

- involves measures aimed at promoting economic growth with a positive impact on social and economic welfare;
- affects the potential capacity of the government to achieve its economic objectives, as indicated by gross domestic product, employment, inflation, export and import indicators.

It can therefore be argued that the design and implementation of national financial policy is a complex process, which requires analysis of the economic and social situation and the appropriate policy decisions. In this context, the economic, political, administrative, ideological, and international aspects are important (International Federation of Accountants, 2022).

In Latvia, in the context of the national financial policy assessment, an analytical study of the state budget for 2023 has been performed, identifying the factors that have influenced specific decisions regarding the fiscal performance of the country.

It has to be emphasised that when adopting Latvia's state budget for 2023, the government has associated it with the medium-term budgetary framework. This means that the main potential indicators of the national budget for 2023-2025 have been set out in a single law. Overall, this is considered positive, as it shows long-term fiscal policy measures. However, it cannot be denied that the influence of various factors (political, economic, geopolitical) can change fiscal decision-making.

The key indicators describing Latvia's fiscal policy in 2023 are the following:

- Latvia's consolidated state budget revenue for 2023 is planned at 12.7 billion euro;
- Expenditure is planned at 14.7 billion euro;
- Compared with the budget for 2022, the state budget revenue in 2023 is projected to be higher by 2.025 billion euro and state budget expenditure is projected to be higher by 2.233 billion euro (Par valsts budžetu 2023.gadam, 2023).

It can be concluded regarding the above that national fiscal policy measures are influenced by several factors in a given situation. The items of Latvia's state budget for 2023 are shaped by the geopolitical situation in the region, the government's commitment to support the Latvian population by partially compensating for the increase in energy prices and the planned support to Ukraine in its fight against Russian aggression. The main objective set by the government for 2023 is the implementation of the economic transformation, prioritising national security, education, energy, competitiveness, quality of life, personal and public health by allocating 710 million euro in additional funding:

- 215 million euro from fiscal space (additional money available to finance various measures);
- 141 million euro from financial resources to be reallocated during budget implementation and additional contributions to the state budget from state capital companies;
- 354 million euro allocated from outside the fiscal space for one-off investments to strengthen national security and to support Ukraine (Finanšu ministrija, 2023).

It has been stressed that all this should ensure a balanced achievement of the objectives set out in the government's declaration. Without denying the planned commitment of the government, it has to be emphasised that there may be some risks with negative implications for the national economy as a whole and for the situation in the area of public finances. All this could affect the taking of new decisions on government policy and consequently appropriate fiscal measures. Thus, the notion of fiscal sustainability, i.e. the capacity of the government to provide sufficient monetary resources to finance the prioritised measures, has to be highlighted as the main issue.

When assessing Latvia's state budget items for 2023, it has to be emphasised that they were shaped primarily on the basis of an assessment of the macroeconomic situation. In the context of Latvia, it should be stressed that this is currently taking place in the circumstances of high uncertainty, which is mainly influenced by geopolitical events.

It is emphasised that Latvia's economic development is currently most affected by the situation in its main foreign trade partner states, many of which are among the countries most affected by the Russian war and the price rises. In 2023, GDP is forecast to fall by 0.6%, whereas in 2024 and 2025, GDP growth is forecast at 3.0%. In the author's opinion, all this acts as a factor influencing the instability of public finances, which makes predicting fiscal policy measures more difficult in terms of fiscal space management, and consequently the potential state budget deficit and government debt figures.

In accordance with the projected macroeconomic indicators, and taking into account the government's decisions on additional financing for priority measures, the general government budget balance was updated in the state budget for 2023, setting the deficit at 4.2% of GDP. The maximum debt ceiling allowed is therefore set in the general government budget at 19.2 billion euro, or 45% of GDP. It also provides for the possibility of additional financing measures to raise financial resources in time to repay the planned debt in the event of favourable financial market conditions or in the event of risks with a negative impact on the national economy and the government deficit. In the absence of the above circumstances, the national debt is projected at 18 billion euro, or 42% of GDP.

Having assessed the potential national financial policy measures and the results in Latvia, it can be concluded that the administration of public finances is currently affected by all the issues discussed above, i.e. the economic, political, and international aspects. All this illustrates the correlative effects of the factors (objective and subjective) that influence national fiscal policy which shapes the administration of public finances and consequently the socio-economic situation in the country.

Conclusions

Decisions of the government (politicians) are the main factor that influences a country's social and economic development. However, any decision taken by the government requires monetary resources to implement. Traditionally, these have been provided through tax payments, generating the financial resources for the state.

Based on the fact that national financial policy has an important role in promoting the stability and sustainable development of the national economy, it has become an important subject of both economic and political debate, since in determining how public finances are generated and used, an understanding of the impact of these processes on society as a whole (private sector, business sector) is essential.

Thus, different approaches to fiscal policy-making exist and are emerging in economic theory and national financial practice when implementing tax and government spending policies. However, it has to be pointed out that no perfect fiscal policy is possible because there are always various factors to consider, which require specific measures to solve the problems. The economic, political, administrative, international factors can be highlighted as key.

It can be concluded that the factors influencing fiscal policy are both subjective and objective in nature and can affect the overall state budget in different ways. Thus, in the context of administration of public finances, it has to be understood that these decisions will always involve government compromises, which result from the different factors.

It can therefore be argued that designing and implementing a national financial policy is a complex process, which requires analysis of the economic and social situation and the appropriate policy decisions. In this context, the economic, political, administrative, and international aspects are important.

When assessing Latvia's state budget figures for 2023, it has to be emphasised that these are, firstly, affected by the geopolitical situation in the region, and secondly, by the government's commitment to support the Latvian population by partially compensating for the increase in energy prices and also by the planned support to Ukraine in its fight against Russian aggression.

The Latvian government has set the implementation of the economic transformation as its main objective for 2023 and has prioritised national security, education, energy, competitiveness, quality of life, personal and public health by allocating 710 million euro in additional funding.

In the author's opinion, all this acts as a factor influencing the instability of public finances, which makes the predictability of fiscal policy measures more difficult in terms of fiscal space management, and consequently the potential state budget deficit and government debt figures.

Having assessed the potential national financial policy measures and expected outcomes in Latvia, the author proposes to public policy makers (representatives of the executive and legislative powers) that they should not ignore but should take into account all aspects that influence the administration of public finances (tax, government spending, government borrowing policies) with their potential to have a positive impact on the solutions to problems that arise in a given situation. It needs to be emphasised that all this relates to the correlative effects of the factors (objective and subjective) that influence the national fiscal policy which shapes the administration of public finances and consequently the socio-economic situation in the country.

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