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COMMISSION OPINION

of 6.3.2019

on the updated Draft Budgetary Plan of Latvia

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(Only the Latvian text is authentic)

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan by 15 October presenting the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING LATVIA

3. On 15 October 2018, the outgoing Latvian government submitted a no-policy-change Draft Budgetary Plan in compliance with Regulation (EU) No 473/2013, on which the Commission issued an opinion on 21 November 2018[1].

4. After the general election on 6 October 2018, the new government took office on 23 January 2019 and submitted the updated Draft Budgetary Plan of Latvia for 2019 on 19 February 2019. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

5. Latvia is subject to the preventive arm of the SGP. On 13 July 2018, the Council recommended Latvia to achieve the medium-term budgetary objective of a structural deficit of 1% of GDP in 2019, taking into account the allowances linked to the implementation of the structural reforms for which a temporary deviation is granted.[2]

6. According to the Commission ad hoc forecast,[3] Latvia’s economy is expected to have grown by 4.7% in 2018 and is forecast to grow by 3.1% in 2019. Growth in 2019 is forecast to be driven by private consumption and investment, albeit to a lesser extent than in 2017 and 2018. The updated Draft Budgetary Plan expects GDP growth to reach 4.8% in 2018 and 3.0% in 2019. The macroeconomic scenario underlying the updated Draft Budgetary Plan is assessed to be plausible. Latvia complies with the requirement of Regulation (EU) No 473/2013 since the macroeconomic forecast underlying the updated Draft Budgetary Plan has been endorsed by Latvia's independent fiscal authority.

[1] https://ec.europa.eu/info/sites/info/files/economy-finance/c_2018_8022_lv_en.pdf

[2] Council Recommendation of 13 July 2018 on the 2018 National Reform Programme of Latvia and delivering a Council opinion on the 2018 Stability Programme of Latvia, OJ C 320, 10.9.2018, p. 60.

[3] The Commission published its winter 2019 forecast (interim) on 7 February 2019. It only includes projections for GDP growth and inflation. In order to assess the updated Draft Budgetary Plan, the Commission complemented its winter 2019 forecast for Latvia by a fully-fledged “ad-hoc” forecast, including in particular projections for the general government balance and the structural balance.

7. The updated Draft Budgetary Plan estimates a headline deficit of 0.7% of GDP in 2018 and 0.5% of GDP in 2019. The structural balance[4] is estimated to amount to a deficit of 1.9% in 2018 and 1.6% in 2019. The Commission ad hoc forecast foresees the government deficit for 2018 at 0.7% of GDP and 0.6% of GDP in 2019, which broadly corresponds to the updated Draft Budgetary Plan. The structural deficits are forecast at 1.7% in 2018 and 1.6% in 2019, according to the Commission ad hoc forecast. According to the Commission ad hoc forecast, the general government gross debt is projected to decrease to 35.7% of GDP in 2019, well below the 60% of GDP reference value of the Treaty.

8. In 2019, Latvia's fiscal stance is expected to remain expansionary but somewhat less so than in 2018. Expenditure growth is projected to be below the growth of nominal GDP, according to both the updated Draft Budgetary Plan and the Commission ad hoc forecast. With respect to the Recommendations of 13 July 2018 addressed by the Council to Latvia, the updated Draft Budgetary Plan presents no new measures for reducing the tax burden on labour or shifting taxation to property. However, the updated Draft Budgetary Plan includes a number of measures to improve tax compliance, notably, measures targeting unlicensed gambling and undeclared wages in the construction sector. In addition to tax compliance measures, an expected increase in dividends from the State forest management company is also planned to increase revenue in 2019. On the expenditure side, wage increases for medical personnel and other public sector employees comprise the majority of the expenditure-increasing measures. The revenue and expenditure measures included in the updated Draft Budgetary Plan are of about equal size and amount to 0.6% of GDP. However, even when they are taken into account, both revenue and expenditure are planned to decline as a share of GDP between 2018 and 2019 by some 1 percentage point due to nominal GDP growth exceeding nominal revenue and expenditure growth.

9. In 2018 and 2019, for Latvia to comply with the requirements of the preventive arm, it should achieve its medium-term budgetary objective, taking into account the allowances linked to the implementation of the systemic pension reform and of the structural reforms. According to the information provided in the updated Draft Budgetary Plan, the projected distance of the (recalculated) structural balance to the medium-term budgetary objective in 2018 and 2019 is only marginally above what is allowed when considering the temporary deviation from the medium-term budgetary objective related to the implementation of structural reforms. Based on the Commission ad hoc forecast, the structural balance is expected to be at the medium-term budgetary objective in 2018, taking into account the allowances linked to the implementation of the systemic pension reform and of the structural reforms, and only marginally below it in 2019, taking into account the allowances linked to the implementation of the structural reforms. Thus, the current assessment indicates compliance in 2018 and a risk of some deviation in 2019.

At the same time, for Latvia to comply with the requirement of the preventive arm, the nominal growth rate of net primary government expenditure should not exceed 6.0% in 2018 and 4.8% in 2019, corresponding to a maximum deterioration of the structural balance by 0.3% in 2018 and an adjustment of 0.2% of GDP in 2019. According to the information provided in the updated Draft Budgetary Plan, the

[4] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

expenditure benchmark points to a risk of some deviation in 2018 and to a risk of significant deviation over 2017 and 2018 taken together, but would comply with the requirement in 2019. Based on the Commission ad hoc forecast, the expenditure benchmark would currently point to a risk of a significant deviation from those requirements in 2018 and over 2018 and 2019 taken together. If the structural balance is no longer projected to be in line or close to the medium-term budgetary objective taking into account the allowance related to the implementation of the systemic pension reform and structural reforms in future assessments for 2018 or 2019, the overall assessment of compliance will need to take into account a possible deviation from that requirement.

10. Overall, the Commission is of the opinion that the updated Draft Budgetary Plan of Latvia is broadly compliant with the provisions of the Stability and Growth Pact. However, that assessment is dependent on the current projection that Latvia will be close to its medium-term budgetary objective in 2019, taking into account the allowance linked to the implementation of structural reforms. If that projection is not confirmed in future assessments, the overall assessment of compliance will need to take into account the extent of the deviation from the requirement set by the Council. The Commission invites the authorities to stand ready to take the necessary measures within the national budgetary process to ensure that the 2019 budget will be compliant with the SGP.

The Commission is also of the opinion that Latvia has made limited progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 13 July 2018 in the context of the European Semester and thus invites the authorities to accelerate progress. There is a comprehensive description of progress made with the implementation of the country-specific recommendations in the 2019 Country Report published on 27 February 2019 and the Commission will assess that progress in the context of the country-specific recommendations it proposes in June 2019.

Done at Brussels, 6.3.2019

For the Commission
Pierre MOSCOVICI
Member of the Commission