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COMMISSION OPINION

of 20.11.2019

on the Draft Budgetary Plan of Latvia

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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 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 presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING LATVIA

3. On 11 October 2019, Latvia submitted the Draft Budgetary Plan for 2020. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.
4. Latvia is subject to the preventive arm of the Stability and Growth Pact. On 9 July 2019, the Council recommended Latvia to ensure that the nominal growth rate of net primary government expenditure does not exceed 3.5% in 2020, corresponding to an annual structural adjustment of 0.5% of GDP towards the medium-term budgetary objective of -1.0% of GDP [1].
5. According to the Commission 2019 autumn forecast, Latvia's economic growth is expected to slow from 4.6% in 2018 to around 2.5% in 2019 and 2020. This is due to a slowing investment cycle and weakening exports. The Draft Budgetary Plan assumes real GDP growth rates of 3.2% and 2.8% in 2019 and 2020. The macroeconomic assumptions underpinning the Draft Budgetary Plan are markedly favourable for 2019 and favourable for 2020. Notably. the Commision 2019 autumn forecast assumes lower investment and export growth in 2019 and 2020 than the Draft Budgetary Plan. Latvia complies with the requirement of Regulation (EU) No 473/2013 since the draft budget is based on an independently-endorsed macroeconomic forecast. In its endorsement of the forecasts the Fiscal Discipline Council nevertheless flagged several risks to the forecast, mainly due to weakening external demand. In the more recent Fiscal Discipline Surveillance Report the Fiscal Discipline Council furthermore noted that a number of short-term economic indicators had worsened since the adoption of the opinion on the macroeconomic forecast.

[1] Council Recommendation of 9 July 2019 on the 2019 National Reform Programme of Latvia and delivering a Council opinion on the 2019 Stability Programme of Latvia, OJ C 301, 5.9.2019, p.86.

6. The Draft Budgetary Plan plans a reduction of the headline deficit from 0.5% of GDP in 2019 to 0.3% of GDP in 2020. The recalculated structural deficit[2] is estimated to decrease from 1.8% of GDP in 2019 to 1.1% of GDP in 2020. The Commission 2019 autumn forecast estimates the headline government deficit to be 0.6% of GDP in 2019 and 2020. As compared to the Draft Budgetary Plan, the Commission forecast for 2020 is based on a weaker starting position in 2019 and assumes slower tax revenue growth, in line with the somewhat lower economic growth outlook.

7. According to both the Draft Budgetary Plan and the Commission 2019 autumn forecast, the fiscal stance in 2020 is expected to be contractionary based on the change in the (recalculated) structural balance. Government revenue as a percentage of GDP is planned to decrease by 1 percentage point between 2018 and 2020, reflecting the effect of tax-cutting measures being implemented from 2018. The government expenditure ratio to GDP is set to contract by 1.5 percentage points over the period 2018-2020. Only a few new revenue measures have been announced, in view of the government's commitment of no major tax policy changes in 2020. A steeper increase in the income-differentiated basic allowance, which was already planned for 2020, is estimated to reduce the tax wedge on low wages in line with the benchmark against other Member States. This partly responds to the Council Recommendation of 9 July 2019 to reduce taxation for low-income earners by shifting it to other sources, particularly capital and property, and by improving tax compliance. As for expenditure measures, the Draft Budgetary Plan increases spending on wages for medical personnel and teachers, and extends subsidies for farmers in 2020. These measures are mostly financed by reallocating resources from existing budgetary envelopes.

8. In 2019, for Latvia to comply with the requirements of the preventive arm, it should achieve its medium-term budgetary objective, taking into account the allowance linked to the implementation of structural reforms for which a temporary deviation is granted. According to the information provided in the Draft Budgetary Plan, Latvia would be at risk of a significant deviation from this requirement, since both the expenditure benchmark and the structural balance indicators point to a risk of significant deviation over 2018 and 2019 taken together, with gaps of 0.7 and 0.3% of GDP respectively. Based on the Commission 2019 autumn forecast, the structural balance is expected to be only marginally below the medium-term budgetary objective in 2019, taking into account the allowances linked to the implementation of structural reforms. Thus, the current assessment indicates 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 government expenditure, net of discretionary revenue measures and one-offs, should not exceed 4.8% in 2019, corresponding to an annual structural adjustment of 0.2% of GDP. Based on the Commission 2019 autumn forecast, the expenditure benchmark would currently point to a risk of a significant deviation from that requirement in 2018-2019 taken together. If the structural balance is no longer projected to be close to the medium-term budgetary objective, taking into account the allowance linked to structural reforms, the future assessment

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

of compliance with the requirements of the preventive arm would consider a possible deviation from that requirement.

In 2020, for Latvia to comply with the requirements of the preventive arm, the nominal growth rate of government expenditure, net of discretionary revenue measures and one-offs, should not exceed 3.5% in 2020, corresponding to an annual structural adjustment of 0.5% of GDP. According to the information provided in the Draft Budgetary Plan and based the Commission 2019 autumn forecast, Latvia is expected to be only marginally below the medium-term budgetary objective in 2020. Thus, the current assessment indicates a risk of some deviation in 2020.

At the same time the expenditure benchmark would point to a risk of a significant deviation according to the information provided in the Draft Budgetary Plan and based the Commission 2019 autumn forecast. If the structural balance is no longer projected to be close to the medium-term budgetary objective, the future assessments of compliance with the requirements of the preventive arm would consider a possible deviation from that requirement.

9. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Latvia is broadly compliant with the provisions of the Stability and Growth Pact. However, this assessment is dependent on the current projection that Latvia will be close to its medium-term budgetary objective. If that projection is not confirmed in future assessments of compliance with the requirements of the preventive arm, the overall assessment of compliance will consider 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 2020 budget will be compliant with the Stability and Growth Pact rules.

The Commission is also of the opinion that Latvia has made some progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 9 July 2019 in the context of the European Semester and invites the authorities to make further progress. A comprehensive description of progress made with the implementation of the country-specific recommendations will be made in the 2020 Country Report and assessed in the context of the country-specific recommendations to be proposed by the Commission in spring 2020.

Done at Brussels, 20.11.2019

For the Commission
Pierre MOSCOVICI
Member of the Commission