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COMMISSION OPINION

of 21.11.2023

on the 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[1] lays down provisions for enhanced monitoring of budgetary policies in the euro area, in order to ensure 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, by 15 October, setting out the budgetary targets for the forthcoming year, and outlining the main aspects underlying the budgetary outlook for general government and its subsectors.

3. On 8 March 2023, the Commission adopted a Communication[2] providing fiscal policy guidance for 2024, which confirmed that the general escape clause of the Stability and Growth Pact will be deactivated at the end of 2023.

4. On 26 April 2023, the Commission presented three legislative proposals[3] to implement a comprehensive reform of the EU fiscal framework. The central objective of the proposals is to strengthen public debt sustainability and to promote sustainable and inclusive growth through reforms and investments. In its proposals, the Commission aims at improving national ownership, simplifying the framework and moving towards a greater medium-term focus, combined with effective and more coherent enforcement. According to the Council Conclusions adopted on 14 March 2023[4], and on 27 October 2023[5], the objective is to conclude the legislative work in 2023. As a new legal framework, based on the outcome of the ongoing economic governance review, is not yet in place, the current legal framework continues to apply. The fiscal component of the Spring 2023 country-specific recommendations

[1] Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, (OJ L 140, 27.5.2013, pp. 11).

[2] Communication from the Commission to the Council, 'Fiscal policy guidance for 2024', 8.3.2023, COM(2023) 141 final.

[3] Commission Proposal for a Regulation of the European Parliament and of the Council on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97, 26.4.2023, COM(2023) 240 final; Commission Proposal for a Council Regulation amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, 26.4.2023, COM(2023) 241 final; Commission Proposal for a Council Directive amending Directive 2011/85/EU on requirements for budgetary frameworks of the Member States, 26.4.2023, COM(2023) 242 final.

[4] Council Conclusions on 'Orientations for a reform of the EU economic governance framework' of the ECOFIN Council meeting, 14.3.2023, 6995/1/23 – REV 1.

[5] European Council meeting (26 and 27 October 2023) – Conclusions, EUCO 14/23.

included elements of the legislative proposals of 26 April 2023 that were consistent with the existing legislation.

5. As announced in its fiscal policy guidance for 2024[6], the Commission will propose to the Council to open deficit-based excessive deficit procedures in spring 2024, on the basis of the outturn data for 2023, in line with the existing legal provisions. Member States were invited to take this into account when executing their 2023 budgets and preparing their Draft Budgetary Plans for 2024.

6. The Recovery and Resilience Facility[7] provides financial support for the implementation of reforms and investments, notably to promote the green and digital transitions. The Facility also aims at increasing the resilience of the Union's energy system by reducing dependence on fossil fuels and diversifying energy supply at Union level ('REPowerEU objectives')[8]. The Facility will strengthen the resilience and potential growth of Member States' economies, which contributes to job creation and sustainable public finances. Part of this support takes the form of non-repayable financial support ("grants"), entailing a fiscal impulse financed by the Union. Together with cohesion policy funds and the Just Transition Mechanism, the Facility is supporting a fair and inclusive recovery in the EU, in line with the European Pillar of Social Rights.

7. Economic policy should continue to tackle the risks linked to high inflation and address long-term challenges. Despite declining, inflation in the euro area remains a concern. It is essential that inflation continues to fall and that inflation expectations remain well anchored, with consistent monetary and fiscal policies, while remaining agile in the face of high uncertainty. In particular, emergency energy support measures taken to respond to the energy price shock should be wound down, using the related savings to reduce the government deficits, as soon as possible in 2023 and 2024. Should renewed energy price increases necessitate new or continued support measures, these should be targeted at protecting vulnerable households and firms, as well as be fiscally affordable and preserve incentives for energy savings. Furthermore, Member States should continue to preserve nationally financed public investment and ensure the effective absorption of grants under the Recovery and Resilience Facility and of other EU funds, in particular to foster the green and digital transitions.

CONSIDERATIONS CONCERNING LATVIA

8. On 1 November 2023, Latvia submitted its Draft Budgetary Plan for 2024[9]. On that basis and taking into account the Council Recommendation to Latvia of 14 July

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6 Communication from the Commission to the Council, 'Fiscal policy guidance for 2024', 8.3.2023, COM(2023) 141 final.

7 Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility, (OJ L 57, 18.2.2021, p. 17).

8 Regulation (EU) 2023/435 of the European Parliament and of the Council of 27 February 2023 amending Regulation (EU) 2021/241 as regards REPowerEU chapters in recovery and resilience plans and amending Regulations (EU) No 1303/2013, (EU) 2021/1060 and (EU) 2021/1755, and Directive 2003/87/EC (OJ L 63, 28.2.2023, p. 1).

9 The submission was delayed compared to the 15 October submission deadline because a new government has been approved on 15 September.

2023[10], the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013. The Commission sent a letter to Latvia on 3 November 2023 with its preliminary observations on the Draft Budgetary Plan and asking for further information. Latvia replied to the Commission's letter on 10 November 2023[11]. This information has been taken into account in the Commission's assessment of budgetary developments and risks.

10. According to the Draft Budgetary Plan, Latvia's real GDP is projected to grow by 2.5% in 2024 (1.0% in 2023), while HICP inflation is forecast at 2.2% in 2024 (10.0% in 2023). In turn, according to the Commission 2023 autumn forecast, Latvia's real GDP is projected to grow by 2.4% in 2024 (-0.2% in 2023), while inflation is forecast at 3.2% in 2024 (9.6% in 2023). The main differences between the two sets of projections in 2023 reflect the negative performance of the Latvian economy during the two first quarters of 2023 which is taken into account in the Commission's forecast and not in the Draft Budgetary Plan's figure. The difference in the inflation forecast for 2024 is due to different assumptions regarding the pace with which the inflation will decrease at the component level.

Overall, the macroeconomic scenario underpinning the budgetary projections in the Draft Budgetary Plan appears to be in line with the Commission's 2023 autumn forecast for 2024 (while it is more favourable for 2023).

Latvia complies with the requirement of Article 4(4) of Regulation (EU) No 473/2013, since the Draft Budgetary Plan is based on independently endorsed macroeconomic forecasts.

11. According to the Draft Budgetary Plan, Latvia's general government deficit is projected to increase to 2.8% of GDP in 2024 (from 2.7% in 2023). The general government debt-to-GDP ratio is set to increase to 41.0% at the end of 2024 (from 39.9% at the end of 2023). In turn, according to the Commission 2023 autumn forecast, Latvia's general government deficit is projected to decrease to 3.1% of GDP in 2024 (from 3.2% in 2023), while the general government debt-to-GDP ratio is set to increase to 42.3% at the end of 2024 (from 41.7% at the end of 2023). For 2023, the main differences between both sets of projections reflect lower nominal tax revenue and higher investment in the Commission's forecast. In addition, the Commission's forecast foresees lower nominal GDP. For 2024, the main differences between both sets of projections stem from lower nominal tax revenue and lower nominal GDP in the Commission's forecast.

12. Based on the Commission's estimates, the fiscal stance[12] is projected to be expansionary at 0.5% of GDP in 2024, following an expansionary fiscal stance of 0.7% in 2023.

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[10] Council Recommendation on the 2023 National Reform Programme of Latvia and delivering a Council opinion on the 2023 Stability Programme of Latvia, OJ C 312, 1.9.2023, p. 10.

[11] The Commission's letter and the reply by Latvia have been published: https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/annual-draft-budgetary-plans-dbps-euro-area-countries/draft-budgetary-plans-2024_en.

[12] The fiscal stance is measured as the change in general government primary expenditure, net of the incremental budgetary impact of discretionary revenue measures, excluding one-off and cyclical unemployment expenditure, but including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds, relative to medium-term (10-year) average potential GDP growth rate, expressed as a ratio to nominal GDP.

13. The Draft Budgetary Plan assumes that expenditure amounting to 1.3% of GDP will be financed by non-repayable support ("grants") from the Recovery and Resilience Facility in 2024, compared to 0.6% of GDP in 2023. This is in line with the assumptions underlying the Commission 2023 autumn forecast. Expenditure financed by Recovery and Resilience Facility grants will enable high-quality investment and productivity-enhancing reforms without a direct impact on the general government balance and debt of Latvia.

14. According to the Commission 2023 autumn forecast, taking into account the information contained in the Draft Budgetary Plan, the measures to mitigate the economic and social impact of the increase in energy prices introduced in 2022 and 2023 are expected to be wound down by the end of 2023. At the same time, the 2024 budget includes a conditional provision foreseeing that a targeted support would be provided to low-income households in case substantial upward fluctuations of energy prices would be observed in 2024.[13]

In addition, the Draft Budgetary Plan includes new discretionary revenue and expenditure measures for 2024 that are not directly related to energy price developments. The main revenue measures as presented in the Draft Budgetary Plan are the introduction of corporate income tax advance payments from the financial sector, an increase in the rates for a number of excise products, legislated additional dividend payments from state-owned enterprises and second-round tax revenue due to public wage increases[14]. On the expenditure side, the main measures are public wage increases (teachers, sectoral ministries and institutions), additional financing for healthcare and education, supplementary payments to pensioners, and targeted support for the sharp increase in mortgage interest rates, as well as the development of border infrastructure. The aggregate deficit-increasing impact of the measures is estimated by the Commission at 0.8% of GDP in 2024 (consisting of measures increasing revenue by 0.8% of GDP and measures increasing expenditure by 1.5% of GDP) and the measures are expected to have a permanent impact on public finances.

15. On 14 July 2023, the Council recommended that Latvia ensure a prudent fiscal policy, in particular by limiting the nominal increase in nationally financed net primary expenditure[15] in 2024 to not more than 3.0%.

According to the Commission 2023 autumn forecast, Latvia's net nationally financed primary expenditure is projected to increase by 4.8% in 2024, which is above the recommended maximum growth rate. This excess spending over the recommended maximum growth rate in net nationally financed primary expenditure corresponds to 0.6% of GDP in 2024. However, current estimates of net expenditure in 2023 are lower than expected at the time of the recommendation (by 0.6% of GDP). Therefore, as the recommendation for 2024 was formulated as a growth rate, the assessment of compliance also needs to take into account the base effect from 2023. If net expenditure in 2023 had been the same as expected at the time of the recommendation, the resulting growth rate of net expenditure in 2024 would be the

[13] In the Commission 20023 autumn forecast this provision is considered as a downside risk which would lead to a further increase in current expenditure.

[14] The Commission does not classify the later as a discretionary fiscal measure. The second-round revenue impact is not a discretionary fiscal measure but does enter the Commission 2023 autumn forecast via macroeconomic effects.

[15] Net primary expenditure is defined as nationally financed expenditure net of discretionary revenues measures and excluding interest expenditure as well as cyclical unemployment expenditure.

same as the recommended one. Therefore, the net nationally financed primary expenditure is assessed as not being fully in line with the recommendation.

16. Moreover, the Council recommended that Latvia takes action to wind down the emergency energy support measures in force, using the related savings to reduce the government deficit, as soon as possible in 2023 and 2024. The Council further specified that, should renewed energy price increases necessitate new or continued support measures, Latvia should ensure that these were targeted at protecting vulnerable households and firms, fiscally affordable, and preserve incentives for energy savings.

According to the Commission 2023 autumn forecast, the net budgetary cost[16] of energy support measures is projected at 0.9% of GDP in 2023 and 0.0% of GDP in both 2024 and 2025. If the related savings were used to reduce the government deficit, as recommended by the Council, these projections would imply a fiscal adjustment of 0.9% of GDP in 2024, which compares with a contractionary contribution of net nationally financed primary expenditure[17] to the fiscal stance of 0.7% of GDP in that year. To sum up, the energy support measures are projected to be wound down by the end of 2023, which is in line with what was recommended by the Council. However, the related savings are not fully used to reduce the government deficit, which risks being not in line with the Council recommendation.

17. In addition, the Council recommended that Latvia preserves nationally financed public investment and ensure the effective absorption of Recovery and Resilience Facility grants and other EU funds, in particular to foster the green and digital transitions.

According to the Commission 2023 autumn forecast, nationally financed public investment is projected to increase to 4.1% of GDP in 2024 (from 3.8% of GDP in 2023) and, therefore, it is expected to be preserved. This is in line with what was recommended by the Council. In turn, public expenditure financed from revenues from EU funds, including Recovery and Resilience Facility grants, is expected to increase to 3.4% of GDP in 2024 (from 2.2% of GDP in 2023).

18. Furthermore, on 14 July 2023, the Council also recommended that, for the period beyond 2024, Latvia continues to pursue a medium-term fiscal strategy of gradual and sustainable consolidation, combined with investments and reforms conducive to higher sustainable growth, to achieve a prudent medium-term fiscal position.

The Draft Budgetary Plan includes references to the government's investment strategy beyond 2024 – the increase in national defence financing to 2.75% of GDP in 2026 and 3.0% of GDP in 2027, development of technical infrastructure of the state external border and postponed purchase of passenger trains. In the medium term the government also plans to continue financing priority directions introduced in 2024, including education sector (increase of salaries for teachers and additional funding for higher education) and healthcare (overall increase of financing to improve the accessibility and quality of healthcare services).

[16] The figure represents the level of the annual budgetary cost of those measures, including revenue and expenditure and, where applicable, net of the revenue from taxes on windfall profits of energy suppliers.

[17] This contribution is measured as the change in general government primary expenditure, net of the incremental budgetary impact of discretionary revenue measures, excluding one-off and cyclical unemployment expenditure, as well as expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds, relative to the medium-term (10-year) average potential nominal GDP growth rate, expressed as a ratio to nominal GDP.

19. Finally, on 14 July 2023, the Council also recommended Latvia to broaden taxation, including of property and capital, and strengthen the adequacy of healthcare and social protection. The Draft Budgetary Plan does not include measures to address taxation policy issues. At the same time, it does include a substantial increase of funding for healthcare, intended to solve long-standing issues, namely, (i) to improve early diagnosis and the ability to effectively treat patients suffering from diseases with high mortality rates, (ii) introduce a sustainable health financing model with effective e-government data solutions and (iii) ensure public financing of the health sector in the amount of at least 12% of the State budget expenditure basic functions. The Draft Budgetary Plan also envisages several measures that could enhance social protection by (i) increasing the supplements to old-age and invalidity pensions and extending the range of recipients and (ii) increasing the remuneration of assistants of persons with disabilities.

20. According to the Commission's forecast, the growth of net nationally financed primary expenditure is projected to not respect the recommended maximum growth rate in 2024. However, if net expenditure in 2023 had been the same as expected at the time of the recommendation, the resulting growth rate of net expenditure in 2024 would be at the recommended growth rate.

Moreover, according to the Commission 2023 autumn forecast, and taking into consideration the information included in Latvia's Draft Budgetary Plan, the emergency energy support measures are expected to be wound down by the end of 2023. However, the related savings are projected to be only partially used to reduce the general government deficit.

Latvia is expected to preserve nationally financed public investment. Latvia should also continue to ensure the effective absorption of Recovery and Resilience Facility grants and other EU funds.

Overall, the Commission is of the opinion that the updated Draft Budgetary Plan of Latvia is not fully in line with the Council Recommendation of 14 July 2023. Therefore, the Commission invites Latvia to stand ready to take the necessary measures within the national budgetary process to ensure that fiscal policy in 2024 will be in line with the Council Recommendation of 14 July 2023.

At the same time, the Commission projects Latvia's headline budget deficit at 3.2% of GDP in 2024, above the Treaty reference value of 3% of GDP, and the government debt ratio at 42.3% in 2024, below the Treaty reference value of 60% of GDP.

The Commission is also of the opinion that Latvia has made limited progress with regard to the structural elements of the fiscal recommendations made by the Council on 14 July 2023, and thus invites the Latvian authorities to accelerate progress.

A comprehensive description of progress made with the implementation of the Council's country-specific recommendations will be included in the 2024 Country Report and assessed in the context of the Council's country-specific recommendations to be recommended by the Commission in spring 2024.

Table: Key macroeconomic and fiscal figures

	2022	2023		2024	
	Outturn	**DBP**	**COM**	**DBP**	**COM**
Real GDP (% change)	3,4	1,0	-0,2	2,5	2,4
HICP inflation (%; annual average)	17,2	10,0	9,6	2,2	3,2
General government balance (% of GDP)	-4,6	-2,7	-3,2	-2,8	-3,1
Primary balance (% of GDP)	-4,2	-2,0	-2,5	-1,9	-2,1
General government gross debt (% of GDP; at end-year)	41,0	39,9	41,7	41,0	42,3
	COM	**COM**		**COM**	
Fiscal stance (*) (% of GDP)	-0,1	-0,7		-0,5	
Fiscal adjustment (**) (% of GDP)	-0,4	0,4		0,7	
Change in total net budgetary cost of energy support measures (***) (% of GDP)	1,4	-0,5		-1,0	
Growth in net nationally financed primary expenditure (% change) (A)				4,8	
Recommended maximum growth rate of net nationally financed primary expenditure (****) (% change) (B)				3,0	
Difference from recommended growth in net nationally financed primary expenditure (pps.) (B-A)				-1.8	
[If net expenditure grows above CSR] **Impact on fiscal adjustment of deviation in net nationally financed primary expenditure compared with the Council recommendation (*****)** (% of GDP)				0,6	

Notes:

(*) Change in general government primary expenditure, net of the incremental budgetary impact of discretionary revenue measures (and COVID-19 pandemic-related temporary emergency measures), excluding one-off and cyclical unemployment expenditure, but including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds, relative to the medium-term (10-year) average potential nominal GDP growth rate. A negative (positive) sign indicates an excess (a shortfall) of net primary expenditure growth over medium-term potential GDP growth, corresponding to an expansionary (a contractionary) fiscal stance.

(**) Change in general government primary expenditure, net of the incremental budgetary impact of discretionary revenue measures (and COVID-19 pandemic-related temporary emergency measures), excluding one-off and cyclical unemployment expenditure, as well as expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds, relative to the medium-term (10-year) average potential nominal GDP growth rate. A negative (positive) sign indicates an excess (a shortfall) of net nationally financed primary expenditure growth over medium-term potential GDP growth, corresponding to an expansionary (a contractionary) fiscal adjustment.

(***) Energy support measures less revenue from new taxes and levies on windfall profits by energy producers.

(****) According to the Council Recommendation 'on the 2023 National Reform Programme of Latvia and delivering a Council opinion on the 2023 Stability Programme of Latvia', (OJ C 312, 1.9.2023, p. 10).

(*****) Excess in growth of net nationally financed primary expenditure over the recommended maximum growth rate, expressed as a percentage of GDP.

'DBP' 2024 Draft Budgetary Plan, 'COM' Commission 2023 autumn forecast.

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For the Commission
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