EUROPEAN
COMMISSION

Brussels, 26.11.2024
C(2024) 9060 final

COMMISSION OPINION

of 26.11.2024

on the Draft Budgetary Plan of Latvia

{SWD(2024) 950 final}

(Only the Latvian text is authentic)

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 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 EU economic governance framework.

2. Article 6 of Regulation (EU) No 473/2013 requires euro area 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 30 April 2024, the new economic governance framework entered into force. The main objectives of the new framework are to promote sound and sustainable public finances, sustainable and inclusive growth and resilience through reforms and investments. The framework helps to make the EU more competitive and better prepared for future challenges by supporting progress towards a green, digital, inclusive, and resilient economy.

4. In order to simplify the Union fiscal framework and increase transparency, a single operational indicator, anchored in debt sustainability, serves as a basis for setting the fiscal path and for carrying out annual fiscal surveillance for each Member State. That single operational indicator is the nominal growth rate of net expenditure[1].

5. The Recovery and Resilience Facility[2] 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'). The Facility is expected to 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.

[1] According to Article 2(2) of Regulation (EU) 2024/1263, 'net expenditure' means government expenditure net of interest expenditure, discretionary revenue measures, expenditure on programmes of the Union fully matched by revenue from Union funds, national expenditure on co-financing of programmes funded by the Union, cyclical elements of unemployment benefit expenditure, and one-offs and other temporary measures.

[2] 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. 17–75.

CONSIDERATIONS CONCERNING LATVIA

6. On 15 October 2024, Latvia submitted its Draft Budgetary Plan for 2025 to the Commission and to the Eurogroup. On that basis, the Commission adopts this following opinion in accordance with Article 7 of Regulation (EU) No 473/2013, and taking into account the Council Recommendation on economic, budgetary, employment and structural policies of Latvia of 21 October 2024[3]. This opinion is adopted by the Commission together with the Commission Recommendation for a Council Recommendation setting the net expenditure path of Latvia for the years 2025 to 2028[4], which the Commission expects the Council to adopt in a timely manner.

7. On 21 October 2024, upon the Commission recommendation for Council Recommendation on the economic, social, employment, structural and budgetary policies of Latvia of 19 June 2024[5], the Council recommended Latvia, in line with the requirements of the reformed Stability and Growth Pact, to limit the growth in net expenditure in 2025 to a rate consistent with, inter alia, maintaining the general government deficit below the 3% of GDP Treaty reference value and keeping the general government debt at a prudent level over the medium term.

8. On 15 October 2024, Latvia submitted to the Commission its medium-term fiscal-structural plan in line with Regulation (EU) 2024/1263[6]. The plan commits to net expenditure growth not exceeding 5.9% in 2025, 3.6% in 2026, 3.4% in 2027 and 3.3% in 2028. The Commission has assessed the medium-term fiscal-structural plan of Latvia and recommended to the Council to adopt a recommendation setting the net expenditure growth ceilings contained therein. The Draft Budgetary Plan for 2025 is the first step in the implementation of the medium-term fiscal-structural plan.

9. According to the Draft Budgetary Plan, Latvia’s real GDP is projected to grow by 2.9% in 2025 (1.4% in 2024), while inflation is forecast at 2.2% in 2025 (1.2% in 2024). According to the European Commission Autumn 2024 Forecast, Latvia’s real GDP is projected to grow by 1.0% in 2025 (0.0% in 2024), while inflation is forecast at 2.2% in 2025 (1.2% in 2024). The main differences between both sets of projections reflect their different cut-off dates. The Commission forecast takes into account more recent data for the first three quarters of 2024, which were weaker than expected in the Draft Budgetary Plan. This translates into a different carry-over and a slower recovery in 2025 in the Commission forecast. Overall, the macroeconomic scenario underpinning the budgetary projections in the Draft Budgetary Plan is more favourable than the Commission’s forecast for 2025 (and 2024). 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.

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[3] Not yet published.

[4] Commission Recommendation for a Council Recommendation endorsing the national medium-term fiscal-structural plan of Latvia, 26.11.2024, COM(2024)720 final.

[5] Commission Recommendation for a Council Recommendation on the economic, social, employment, structural and budgetary policies of Latvia, 19.06.2024, COM(2024)614 final.

[6] Regulation (EU) 2024/1263 of the European Parliament and of the Council of 29 April 2024 on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97, OJ L, 30.4.2024, ELI: http://data.europa.eu/eli/reg/2024/1263/oj.

10. Based on the Commission's estimates, the fiscal stance[7] is projected to be expansionary at 1.2% of GDP in 2025, following a neutral fiscal stance of 0.0% in 2024. This measure of fiscal stance appropriately considers the impact on aggregate demand of expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds.

11. According to the Draft Budgetary Plan, Latvia's general government deficit is projected to increase to 2.9% of GDP in 2025 (2.6% in 2024), while the general government debt-to-GDP ratio is set to increase to 47.0% at the end of 2025 (45.8% at the end of 2024). According to the Draft Budgetary Plan, net expenditure is projected to grow by 9.1% in 2024 and 4.4% in 2025. The growth rate of net expenditure in 2025 according to the Draft Budgetary Plan is below the growth rate in the medium-term fiscal-structural plan submitted by Latvia on 15 October 2024. In turn, according to the European Commission Autumn 2024 Forecast, Latvia's general government deficit is projected to increase to 3.2% of GDP in 2025 (2.8% in 2024), while the general government debt-to-GDP ratio is set to increase to 50.3% at the end of 2025 (48.1% at the end of 2024). The increase in the deficit is driven by the budget revenue side, including a negative fiscal impact from the labour tax reform, in particular on taxes on income, as well as a projected reduction of revenues from property income which were elevated in 2023 and 2024 due to high profitability of state-owned companies in the energy and forestry sectors. The revenue from corporate income tax advance payments from the financial sector is projected to decrease in line with expected lower profit margins following the decrease in interest rates. According to the European Commission Autumn 2024 Forecast, net expenditure is projected to grow by 3.8% in 2024 and 4.1% in 2025. The main differences between both sets of projections for the government deficit reflect different assessments of tax revenue both in 2024 and 2025. According to the more recent data taken into account in the Commission forecast, tax revenue collection in 2024 has been below the budgeted levels. For this reason, the Commission's assumptions for 2024 are more conservative than those in the Draft Budgetary Plan, which in turn creates a negative carry-over effect in 2025. In addition, in 2025 the Commission forecast expects weaker economic growth compared to the macroeconomic scenario in the Draft Budgetary Plan, which would act as a drag on tax revenue. The main differences in the projections for net expenditure growth, in particular for 2024, stem from the base effect in 2023 where the Draft Budgetary Plan utilises the data from the 2024 Spring general government deficit and debt notification while the Commission forecast uses more recent 2024 Autumn notification data. The main expenditure related revisions between notification rounds include substantial upward revision of gross fixed capital formation due to sectoral reclassification of units[8] and updated annual data of reclassified enterprises. The risks to achieving the budget balance objective for 2025 set out in the Draft Budgetary Plan are tilted to the downside, and mainly relate to potentially lower tax revenue collection.

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[7] 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.

[8] Latvijas dzelzscelš group.

12. The Draft Budgetary Plan assumes that expenditure amounting to 1.6% of GDP will be financed by non-repayable support ("grants") from the Recovery and Resilience Facility in 2025, compared to 1.2% of GDP in 2024. Expenditure financed by Recovery and Resilience Facility grants enables high-quality investment and productivity-enhancing reforms without a direct impact on the general government balance and debt of Latvia.

13. The Draft Budgetary Plan includes policy measures with fiscal impact in 2025. On the revenue side, these include revisions of labour taxation as of 2025, in particular an upward revision of personal income tax rates and an increase and horizontal application of non-taxable income. As these revenue measures result in a negative overall fiscal impact, the government has proposed: a bank windfall profit tax as of 2025; shifting 1 percentage point of pension contributions levied on earned income from the funded to the state pension; as well as other compensatory measures, including an upward revision of excise rates for different product groups and an increase of tax rates for private and company cars. On the expenditure side, the measures include expenditure-increasing discretionary measures which are mainly dedicated to strengthening internal and external security, including capacity of internal security services (including increase of renumeration), cybersecurity, purchase of ammunition and individual equipment as well as military support to Ukraine and support for Ukrainian civilians in Latvia. Expenditure-decreasing measures include limiting the renumeration growth in the public sector, reduction of expenditure for goods and services across sectoral ministries, revision of the municipal expenditure for salaries and investment, as well as revision of expenditure for companies included in the general government. According to the Commission estimates, the overall additional impact of the revenue measures decreases the general government deficit by 0.4%[9] of GDP in 2025.

14. According to the European Commission Autumn 2024 Forecast, Latvia's net expenditure is projected to increase by 4.1% in 2025, which corresponds to cumulative growth of 8.0% in 2024 and 2025 taken together. The Commission is of the view that these net expenditure growth rates are in line with the Council recommendation of 21 October 2024 to limit the growth in net expenditure in 2025 to a rate consistent with maintaining the general government deficit below the 3% of GDP Treaty reference value and keeping the general government debt at a prudent level over the medium term. Moreover, those net expenditure growth rates would be appropriate initial steps towards the implementation of the medium-term fiscal structural plan.

15. According to the European Commission Autumn 2024 Forecast, nationally financed public investment is projected to increase to 4.1% of GDP in 2025 (from 3.9% of GDP in 2024). In turn, public expenditure on EU funded programmes, including Recovery and Resilience Facility grants, is expected to increase to 3.7% of GDP in 2025 (from 2.3% of GDP in 2024).

16. Finally, the Council also recommended Latvia to broaden taxation, including of capital and property, and strengthen the adequacy of healthcare and social protection. Regarding broadening of taxation, as a part of the labour tax reform, the Draft

[9] The Commission does not classify certain measures as discretionary fiscal measures e.g. the second-round revenue impact is not considered a discretionary fiscal measure but does enter the Commission forecast via macroeconomic effects.

Budgetary Plan as of 2025 introduces an additional personal income tax rate of 3% for income above EUR 200 000 per year, including income from capital. Regarding strengthening the adequacy of healthcare and social protection, as of 2025, the Draft Budgetary Plan foresees additional financing for the increase of minimum income (raising the lower minimum income threshold from 20% to 22% of the median income and increasing the size of benefits and indemnities related thereto) and additional financing for the state paid pharmaceuticals for oncology patients.

17. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Latvia is in line with the Council Recommendation of 21 October 2024. According to the European Commission Autumn 2024 Forecast, Latvia's net expenditure growth in 2025 is consistent with what was recommended by the Council on 21 October 2024.

The progress made with the implementation of the Council's country-specific recommendations will be assessed by the Commission in spring 2025, in the context of the European Semester Spring Package.

Table 1. Key macroeconomic and fiscal figures

#	Variables		2023	2024		2025	
			Outturn	DBP	COM	DBP	COM
1	Real GDP	% change	1.7	1.4	0.0	2.9	1.0
2	HICP inflation	% change	9.1	1.2	1.2	2.2	2.2
3	General government balance	% GDP	-2.4	-2.6	-2.8	-2.9	-3.2
4	Primary balance	% GDP	-1.7	-1.5	-1.7	-1.7	-1.9
5	General government gross debt	% GDP	45.0	45.8	48.1	47.0	50.3
6	Fiscal stance (**)	% GDP	-1.1		0.0		-1.2
7	Net expenditure growth (annual)	% change		9.1	3.8	4.4	4.1
8	Net expenditure growth (cumulative)	% change				13.8	8.0
			Commission Recommendation for a Council Recommendation setting the net expenditure path of Latvia				
9	Maximum growth rates of net expenditure (*)	% change			Annual	**5.9**	
10		% change			Cumulative	**15.5**	

Notes :
* According to the Commission Recommendation for a Council Recommendation setting the net expenditure path of Latvia for the years 2025 to 2028.
** The fiscal stance is measured as the change in general government primary expenditure, net of the incremental budgetary impact of both discretionary revenue measures and COVID-19 pandemic-related temporary emergency measures, excluding cyclical unemployment expenditure, but including the change in 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 GDP growth rate in nominal terms. A negative (positive) sign indicates an excess (shortfall) of primary expenditure growth over medium-term potential GDP growth, which corresponds to an expansionary (contractionary) fiscal stance. For more details, see Box 1 of the Fiscal Statistical Tables.

Source : European Commission Autumn 2024 Forecast and Draft Budgetary Plan for 2025

Done at Brussels, 26.11.2024

For the Commission
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