

DRAFT BUDGETARY PLAN OF THE REPUBLIC OF LATVIA 2022

RIGA
2021

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Abbreviations

CIT	Corporate Income Tax
CoM	Cabinet of Ministers
ESA	European System of Accounts
EU	European Union
FDL	Fiscal Discipline Law
Framework Law	Medium-Term Budget Framework Law
GDP	Gross Domestic Product
MoF	Ministry of Finance
OECD	Organization of Economic Cooperation and Development
PIT	Personal Income Tax
SGP	Stability and Growth Pact
SSC	Social Security Contributions
VAT	Value Added Tax
RRF	Recovery and Resilience Facility

Summary

The Republic of Latvia hereby submits the Draft Budgetary Plan for 2022.

The Draft Budgetary Plan for 2022 has been prepared based on the macroeconomic development scenario developed in June, which foresees GDP growth of 5.1% in 2022. The fiscal development scenario for 2022 includes a no-policy change scenario as well as a policy scenario incorporating discretionary revenue and expenditure measures adopted by the CoM. The budget for 2022 has been prepared forecasting the headline general government deficit of 4.8% of GDP in 2022.

The Draft Budgetary Plan for 2022 has been approved by the CoM on 13th October 2021.

Macroeconomic development scenario

Medium-term macroeconomic scenario 2021-2024 is based on 1Q 2021 GDP data, as well as short-term macroeconomic information available up to June 2021 and government-approved support measures to mitigate the economic and social effects of the Covid-19 crisis. Regarding the scenario, MoF consulted with experts from the International Monetary Fund and the EC. Forecasts of macroeconomic indicators have been agreed with the Bank of Latvia and the Ministry of Economics, and approved by the Fiscal Discipline Council on June 14, 2021.

According to the scenario, Latvia's GDP will grow by 3.7% in 2021 and by 5.0% in 2022, which is by 0.7 percentage points and 0.5 percentage points more, respectively, than the February's 2021 forecast of Latvia's Stability Program for 2021-2024. In following years of 2023 and 2024, the GDP will grow by 3.5% and 3.4%, respectively, which is 0.3 and 0.7 percentage points more than in February's forecast. Higher growth is due to a better economic response to the challenges coming from the pandemic.

The macroeconomic scenario is based on an assumption that the Covid-19 outbreak both in Latvia and around the world, particularly in Latvia's main foreign trade partners, will be successfully limited in 2021 and 2022, stimulating domestic and external demand. A similar assumption regarding Covid-19 dynamics was among all international institutions for their respective economic forecasts at that time.

According to the scenario, a sufficient level of vaccination will be achieved by the autumn 2021 to avoid the third wave of Covid-19, and no new restrictions will be needed to reduce the spread of the disease. In addition, the state support measures planned for this year and the growing amount of EU financial resources, incl. from the Recovery and Stability Fund, will strengthen the economy. However, these measures will not be able to restore the output to the levels of 2019 in the sectors hardest hit by the crisis, i.e., transport, accommodation and catering, arts, entertainment and leisure, and professional services.

The main driver of Latvia's economic growth this year will be private consumption, which has rapidly recovered in the 2Q 2021 after the lifting of restrictions and along with improving of consumer sentiment. Therefore, it will increase by 6.3% in 2021. Given the low base, private consumption growth will reach 10.4% in 2022, still the level being only a 5% higher than in 2019. The amount of investments (gross fixed capital formation) will increase by 4.1% in 2021 and by 8,5% in 2022, thanks to the availability of EU funds and the Recovery and Sustainability Mechanism, as well as the implementation of the Rail Baltica project.

Average annual inflation is projected at 2.0% in 2021 and 2.4% in 2022. Compared to the February's forecast, it is higher by 0.6 percentage points in 2021 and by 0.4 percentage points in 2022. The faster rise in consumer prices comes from the rise in world commodity prices, including oil and food commodity prices, as well as the acceleration of economic growth in Latvia and higher service prices. Inflation will come back to 2% over the next two years.

Along with higher economic growth, the unemployment rate in Latvia will fall to 7.9% in 2021, which is by 0.4 percentage points less than in February' forecast, as the government support program reduces the employment decline in the sectors affected by Covid-19. In 2022, the economic growth and the working age population decline will further reduce the unemployment rate to 7.0%. The number of employees will increase slightly in 2022 and stabilize at 900 thousands by 2024.

The average monthly gross wage growth is forecasted at 8.0% in 2021, the average wage will reach EUR 1,234. Wage will grow by 6.0% in 2022 and will be close to the productivity growth in the medium term, which is around 3.2% in real terms.

Table 0i. Basic assumptions

	2020	2021	2022
Short-term interest rate (annual average)	-0.4	-0.5	-0.5
Long-term interest rate (annual average)	-0.5	-0.3	-0.1
USD/EUR exchange rate (annual average)	1.14	1.20	1.20
Nominal effective exchange rate	3.9	2.3	0.1
World excluding EU, GDP growth	-2.9	9.0	5.7
EU GDP growth	-6.1	4.2	4.4
Growth of relevant foreign markets	-3.2	3.4	4.1
World import volumes, excluding EU	-9.3	9.0	5.7
Oil prices (Brent, USD/barrel)	43.4	63.9	61.6

Table 1a: Growth and related factors

	ESA code	2020	2020	2021	2022
		Levels	Rate of change, %		
1. Real GDP	B1*g	26.6	-3.6	3.7	5.0
of which					
Attributable to the estimated impact of aggregated budgetary measures on economic growth					
2. Potential GDP		27.7	2.0	2.1	2.7
Contributions					
Potential GDP contributions: labour			0.0	0.0	0.0
Potential GDP contributions: capital			0.9	1.0	1.2
Potential GDP contributions: total factor productivity			1.1	1.1	1.5
3. Nominal GDP	B1*g	29.3	-3.6	6.9	8.5
Components of real GDP					
4. Private consumption expenditure	P.3	14.7	-10.0	6.3	10.4
5. Government consumption expenditure	P.3	5.1	2.6	3.5	1.6
6. Gross fixed capital formation	P.51	6.3	0.2	4.1	8.5
7. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	1.7	–	–	–
8. Exports of goods and services	P.6	17.0	-2.7	6.5	5.8
9. Imports of goods and services	P.7	18,2	-3,3	8,6	9,5
Contribution to real GDP growth					
10. Final domestic demand			-5,4	5,1	8,2
11. Changes in inventories and net acquisition of valuables	P.52 + P.53		1,3	0,3	-0,3
12. External balance of goods and services	B.11		0,5	-1,8	-3,0

Table 1b. Price developments

	ESA code	2019	2019	2020	2021
		Levels	Rate of change		
1. GDP deflator			0.1	3.1	3.3
2. Private consumption deflator			0.8	2.0	2.4
3. HICP			0.8	2.0	2.4
4. Public consumption deflator			-0.8	0.8	0.8
5. Investment deflator			1.4	4.0	5.0
6. Export price deflator (goods and services)			-0.8	3.0	3.0
7. Import price deflator (goods and services)			-3.5	1.5	3.0

Table 1c. Labour market developments

	ESA code	2019	2019	2020	2021
		Levels	Rate of change		
1. Employment, persons ('000)		893.0	-1.9	-1.1	1.8
2. Employment, hours worked, per employee		1604.9	-1.2	0.0	0.0
3. Unemployment rate (%)			8.1	7.9	7.0
4. Labour productivity, per person			-1.8	4.9	3.1
5. Labour productivity, per hours worked			-1.8	4.9	3.1
6. Compensation of employees, bln euro	D.1	15.3	1.5	6.2	6.9
7. Compensation per employee (Gross wage)		1143	6.2	8.0	6.0

Table 1d. Sectoral balances

	ESA code	2019	2020	2021
		% of GDP		
1. Net lending/borrowing vis-a-vis the rest of the world	B.9	4.7	3.9	2.9
of which				
- Balance on goods and services		1.2	0.9	-1.2
- Balance of primary incomes and transfers		1.7	1.4	1.7
- Capital account		1.8	1.7	2.4
2. Net lending/borrowing of the private sector	B.9	9.2	13.3	7.6
3. Net lending/borrowing of general government	EDP B.9	-4.5	-9.3	-4.8
4. Statistical discrepancy		0.0	0.0	0.0

Fiscal strategy and the structural balance objective

This draft budgetary plan is being prepared at a time when the Latvian economy and public finances have been affected by the Covid-19 pandemic, which has led to significant changes in the fiscal policy implemented so far, which is based on the balanced budget in the economic cycle.

In 2020, the general escape clause of the SGP was activated at the EU level, which allowed EU Member States to increase the general government budget deficit in 2020 as necessary to reduce the economic damage caused by the Covid-19 pandemic. Consequently, the EU fiscal policy framework in 2020 allowed to deviate from the previously set deficit targets. Section 12 of the FDL provides for a similar possibility to deviate from the 0.5% structural deficit during a severe economic downturn. The activation of the general escape clause of the SGP was the basis for activating the derogation provided for in Section 12 of the FDL. Developing the draft law "On the State Budget for 2022", the "Law on the Suppression of Consequences of the Spread of COVID-19 Infection" provided broader options to deviate from the numerical fiscal conditions set in the FDL.

Regarding the support provided by the CoM in the context of the Covid-19 crisis, it should be noted that support mechanisms were developed and financed outside the indicators set for the state budget of the respective year, promptly responding to the necessary interventions. This is done by reallocating resources to support mechanisms from the state budget programme "Funds for Unforeseen Events", which in turn can be increased by increasing the appropriation above the level specified in the state budget law. Consequently, state support mechanisms are developed and implemented throughout the period from the preparation of the previous state budget law.

The overall objective of Latvia's fiscal policy in 2022 and the forthcoming years remains as previously set - to continue "a sustainable increase of Latvian citizens' quality of life". The general objective of Latvia's fiscal policy is implemented (operationalized) with the following specific objectives of fiscal policy, or medium-term budget policy priority development directions:

- 1) reduction of income inequality by increasing the differentiated non-taxable minimum income and implementing the family state benefit reform;
- 2) maintaining and strengthening the capacity of human capital in the public sector by increasing funding for the wages of medical personnel, officials with special service ranks, teachers, employees of the cultural sector and social care and social rehabilitation institutions;
- 3) improving healthcare services in the field of oncology by increasing funding for reimbursable medication and ensuring the purchase of necessary equipment;
- 4) strengthening the innovative potential of the state by increasing funding for science as well as fundamental and applied research;
- 5) promoting the sustainability of the post-pandemic economic environment by supporting the recovery and development of enterprises, strengthening the capital base of enterprises and attracting investment;
- 6) increase of the portfolio of public investment projects and financing for municipal investment projects in the field of reconstruction and renewal of state regional roads, improvement of infrastructure of agricultural, forestry and

fisheries sectors, purchase of fire and rescue vehicles and investments in development of state military and defence industry.

The main development directions of Latvia's medium-term budget policy indicate the challenges that have to be solved and can be solved by implementing a consistent policy over several years. Medium-term budgetary policy developments do not include issues that can be considered resolved.

Similarly, medium-term budgetary priorities do not always directly correlate with the amount of funding allocated to a sector from the fiscal space, for example, if additional funding is allocated to the implementation of existing policies on a larger scale but is not related to policy change.

During the preparation of the State Budget for 2022, the CoM adopted decisions on discretionary revenue and expenditure measures to ensure the financing of the priorities set by the government. Additional resources for priority financing were provided through the implementation of the revision of the State Budget base expenditures.

The fiscal data provided in Table no. 3 have been prepared under a no-policy change scenario, which includes the discretionary revenue and expenditure measures of 2022 included in the Framework Law for 2021, 2022 and 2023, as well as Covid-19 support measures with fiscal impact in 2022 that were adopted after the preparation of the Framework Law for 2021, 2022 and 2023 (economic support measures approved by 10th August this year), but does not include those Covid-19 support measures that were adopted during the preparation of this budget.

Tables no. 5 show the discretionary revenue and expenditure measures adopted by the CoM in the current budget preparation cycle. These include both decisions on government priorities and individual decisions on support in the context of Covid-19. At the same time, Tables no. 5 include a separate section on the adjustments in the fiscal scenario that have been necessary in order to ensure the discretionary decisions adopted by the CoM. Thus, a clear reflection of the changes between the fixed and changing policy scenario in 2022 is provided.

For the sake of clarity, Table A of this budgetary plan also provides an update on Covid-19 support measures and their fiscal impact in 2020 and 2021 and the projected impact for 2022.

In view of what is written above, the budget for 2022 has been prepared:

- 1) continuing to provide funding for the priorities defined in the previous Framework Law and the State Budget Law for 2021;
- 2) allocating financing to the medium-term budgetary priorities of the new budget cycle;
- 3) forecasting that the general government nominal deficit in 2022 will be 4.8% of GDP;
- 4) by reviewing the basic expenditures of the state budget and developing additional discretionary revenue and expenditure measures in order to ensure financing for the priorities defined by the CoM;
- 5) continuing to implement tax policy that promotes further reduction of income inequality.

Taking into account the SGP general exemption clause is still intact in 2022, in this budget cycle for 2022 the structural balance target is still determined based on the nominal balance, taking into account fiscal forecasts with no no-policy change scenario and decisions made by the CoM with fiscal impact in the current budget cycle.

In this budget cycle, the fiscal space available for government policy is calibrated against both the projected general government debt level and the principles set out in the EU Recommendation on nationally financed primary current expenditure, public investment and Covid-19 support.

Accordingly, the target of Latvia's structural balance in 2022 is -4.7% of GDP. According to the Draft Budget Law for 2022, the structural deficit is planned at -4.6% of GDP. The

difference of 0.1% of GDP is a fiscal security reserve that is designed to take into account fiscal risks. It should be noted that together with the Draft Budget Law for 2022, the Draft Framework Law for 2022, 2023, and 2024 has been prepared, which envisages the reduction of the general government budget structural deficit from 4.7% of GDP in 2022 to 2.1% of GDP in 2023, and 1.4% of GDP in 2024. According to the Draft Budget Law for 2022, the general government budget deficit will be 4.8% of GDP.

As a result of the Covid-19 pandemic, the general government deficit has widened significantly over the last two years, well above pre-pandemic levels. If, according to *Eurostat* data, in 2019 the general government budget deficit was EUR 171,7 million, in 2020 the deficit was EUR 1,3 billion or 4.5% of GDP, due to declining tax revenues and a significant increase in economic support expenditure. According to the MoF's estimate, the general government deficit in 2021 could reach EUR 2,9 billion or 9.3% of GDP, which is twice as high as planned in the budget law. The higher deficit is due to a large package of Covid-19 support measures, the impact of which is estimated at EUR 2.2 billion or 6.9% of GDP this year.

Until October 3rd approved economic support for Covid-19 in 2021 was estimated to EUR 3,25 billion or 10.4% of GDP, according to the Ministry of Finance. Of which, EUR 1.75 billion was actually disbursed by 30th September, 2021. The largest support in the first nine months of this year was spent on grants for current assets (EUR 501 million), to the health sector (EUR 309 million), to allowance for families with children, EUR 500 per child (EUR 188 million), downtime benefits (EUR 136 million) and benefits to pensioners and people with disabilities (EUR 110 million).

In three quarters of 2021, the dynamics of tax revenues showed positive trends. While in the first quarter of this year tax revenues lagged behind the revenues of the respective period of 2020, then in the second and third quarter, with improvement of the epidemiological situation and easing of restrictions, tax revenues significantly exceeded the level of the corresponding period of 2020. The total amount of tax revenues in three quarters of this year even exceeded the level of the pre-pandemic - the corresponding period of 2019. If tax revenues grow faster than projected in the last months of the year, as economic growth accelerates, then no additional funding for support measures is needed, the deficit could be lower this year than currently estimated.

The general government deficit for 2022 is projected to amount EUR 1.6 billion or 4.8% of GDP. Covid-19 support measures will continue in the next year, with continued implementation of high preparedness investment projects at the national and municipal levels, as well as funding for the purchase of vaccines. The impact of the support on the general government budget deficit next year is estimated at EUR 263 million or 0.8% of GDP.

Table 2.a: General government budgetary targets broken down by subsector

	ESA code	2021	2022
		% of GDP	
Net lending (+) / net borrowing (-) (B.9) by sub-sector			
1. General government	S.13	-9.3	-4.8
2. Central government	S.1311	-8.9	-4.3
3. State government	S.1312		
4. Local government	S.1313	-0.3	-0.5
5. Social security funds	S.1314	-0.1	0.1
6. Interest expenditure	D.41	0.7	0.6
7. Primary balance		-8.7	-4.1
8. One-off and other temporary measures		0.0	0.0
9. Real GDP growth (%) (=1. in Table 1a)		3.7	5.0
10. Potential GDP growth (%) (=2 in Table 1.a)		2.1	2.7
contributions:			
- labour		0.0	0.0
- capital		1.0	1.2
- total factor productivity		1.1	1.5
11. Output gap (% of potential GDP)		-2.6	-0.5
12. Cyclical budgetary component (% of GDP)		-1.0	-0.2
13. Cyclically-adjusted balance (1 - 12) (% of GDP)		-8.4	-4.6
14. Cyclically-adjusted primary balance (13 + 6) (% of GDP)		-7.7	-3.9
15. Structural balance (13 - 8) (% of GDP)		-8.4	-4.6

Table 2.b: General government debt developments

	ESA code	2021	2022
		% of GDP	
1. Gross debt		48.8	51.7
2. Change in gross debt ratio		5.3	2.9
Contributions to change in gross debt			
3. Primary balance		-8.7	-4.1
4. Interest expenditure	EDP D.41	0.7	0.6
5. Stock-flow adjustment		-4.0	-1.8
Implicit interest rate on debt		1.7%	1.4%
Other relevant variables			
6. Liquid financial assets			
7. Net financial debt (7=1-6)			
8. Debt amortization (existing bonds) since the end of the previous year		6.3	1.8
9. Percentage of debt denominated in foreign currency		0.0	0.0
10. Average maturity		8.43 years	
1. Gross debt			
2. Change in gross debt ratio		31364.0	34021.8

Table 2.c: Contingent liabilities

% of GDP	2021	2022
Public guarantees	2.1	2.1

Table 3: General government expenditure and revenue projections at unchanged policies broken down by main components

	ESA code	2021	2022
		% of GDP	
1. Total revenue at unchanged policies	TR	38.5	38.9
of which			
1.1. Taxes on production and imports	D.2	14.4	14.0
1.2. Current taxes on income, wealth, etc.	D.5	6.9	7.0
1.3. Capital taxes	D.91	0.0	0.0
1.4. Social contributions	D.61	10.1	9.9
1.5. Property income	D.4	0.7	0.5
1.6. Other		6.4	7.4
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		31.6	31.2
2. Total expenditure at unchanged policies	TE	47.7	41.8
of which			
2.1. Compensation of employees	D.1	11.6	10.8
2.2. Intermediate consumption	P.2	6.6	6.1
2.3. Social payments	D.62; D.632	14.5	13.3
of which Unemployment benefits		0.5	0.5
2.4. Interest expenditure	D.41	0.7	0.8
2.5. Subsidies	D.3	1.2	1.0
2.6. Gross fixed capital formation	P.51	5.5	5.9
2.7. Capital transfers	D.9	0.2	0.1
2.8. Other		7.4	3.9

Table 4.a: General government expenditure and revenue targets, broken down by main components

	ESA code	2021	2022
		% of GDP	
1. Total revenue target	TR	38.5	38.8
Of which			
1.1. Taxes on production and imports	D.2	14.4	14.1
1.2. Current taxes on income, wealth, etc.	D.5	6.9	6.7
1.3. Capital taxes	D.91	0.0	0.0
1.4. Social contributions	D.61	10.1	10.0
1.5. Property income	D.4	0.7	0.6
1.6. Other		6.4	7.4
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		31.6	31.0
2. Total expenditure target	TE	47.8	43.6
Of which			
2.1. Compensation of employees	D.1	11.6	11.1
2.2. Intermediate consumption	P.2	6.6	6.3
2.3. Social payments	D.62 D.632	14.4	13.3
of which Unemployment benefits		0.5	0.5
2.4. Interest expenditure (= Table 2.a.9.)	D.41	0.7	0.6
2.5. Subsidies	D.3	1.2	0.9
2.6. Gross fixed capital formation	P.51	5.5	6.5
2.7. Capital transfers	D.9	0.4	0.1
2.8. Other		7.3	4.7

Table 4.b: Expenditure to be excluded for expenditure criteria

	ESA code	2020	2020	2021	2022
		million, euro	% of GDP		
1. Expenditure on EU programmes fully matched by EU funds revenue		488.7	1.7	1.9	3.2
1.a Of which investment expenditure fully matched by EU funds revenue		291.2	1.0	1.3	1.6
2. Cyclical unemployment benefit expenditure		15.6	0.1	0.0	0.0
3. Effect of discretionary revenue measures		-65.5	-0.2	0.5	0.3
4. Revenues increased mandated by law					

Table 4.c General government expenditure by function**Table 4.c.i) General government expenditure on education, healthcare and employment**

	2021		2022	
	% of GDP	% of general government expenditure	% of GDP	% of general government expenditure
Education	5.8	12.1	5.5	12.7
Health	6.2	12.9	5.5	12.7
Employment	0.1	0.2	0.1	0.3

Table 4.c.ii) Classification of the functions of the Government

	COFOG Code	2021	2022
		% of GDP	
1. General public services	1	6.5	5.2
2. Defence	2	2.4	2.3
3. Public order and safety	3	2.4	2.3
4. Economic affairs	4	7.0	6.6
5. Environmental protection	5	0.5	0.3
6. Housing and community amenities	6	1.1	1.0
7. Health	7	6.2	5.5
8. Recreation, culture and religion	8	1.7	1.4
9. Education	9	5.8	5.5
10. Social protection	10	14.4	13.5
11. Total Expenditure (= item 2 in Table 2.c.i)	TE	47.8	43.6

Implementation of medium-term budget policy priority development directions

Reducing income inequality

Reducing income inequality is one of the most important tasks of the state and has been a priority in several budget preparation cycles. It has become even more relevant in the period 2022-2024, as the Covid-19 crisis has further exacerbated income inequality. Covid-19 restrictions have affected those sectors (e.g. catering, hospitality and trade) with a high proportion of relatively low-paid workers more. On the other hand, sectors (e.g. information technology companies) with a high proportion of employees with relatively high salaries have experienced growth.

An important indicator for assessing the average quality of life is the amount of GDP per capita, which according to *Eurostat* data Latvia has the sixth lowest in the EU (GDP per capita in terms of PPP (Purchasing Power Parity) in 2020). In contrast, according to the Gini coefficient, which characterises income inequality, Latvia has one of the highest in the EU according to 2019 *Eurostat* data, ahead of only Lithuania and Bulgaria.

In 2022, significant increases in the differentiated non-taxable minimum income from EUR 300 (330) to EUR 500 are planned, envisaging EUR 93.8 million in 2022 and EUR 152.8 million in the following years for this reform.

Changes in the non-taxable minimum and the non-taxable minimum for pensioners in 2022

Parameters	2021	2022	
		As of 01.01	As of 01.07
Differentiated Non-Taxable Minimum, euro per month	300	350	500
<i>income up to which the non-taxable minimum is applied in full, euro per month</i>	500	500	
<i>income above which the non-taxable does not apply, euro per month</i>	1 800	1 800	
Non-taxable minimum for pensioners, euro per month	330	350	500

Income inequality is also reduced by the reform of family state benefit implemented in 2021, which enters into force on 1 January 2022. One of its goals is to reduce the risk of income inequality for families with children by ensuring that the child's entry into the family does not significantly reduce the income level per family member. The government declaration envisages a review of the family state benefit system, so that the amount of the benefit would depend not on which child enters into the family in a row, but on the number of children actually being brought up, significantly increasing the support intensity, starting with two children in the family.

The reform provides for the following benefits:

- for 1 child EUR 25 per month;
- for 2 children EUR 100 per month (EUR 50 for each child);
- for 3 children EUR 225 per month (EUR 75 for each child);

- for 4 and more children under 20 years of age 100 euro per month for each child.

EUR 91.0 million is projected for this reform in 2022 and EUR 90.9 million in the following years. This funding is included in a no-policy change scenario.

Increasing the state's human capital in the health care sector and investments

In the context of unfavourable demographic trends, the contribution of the labour component to total potential GDP growth will be close to zero. In such circumstances, the contribution of the labour component can be increased by reducing the length of time that the working-age population is absent due to illness. Strengthening public health by providing better and more accessible health care measures has a direct impact on the growth of potential gross domestic product and is therefore one of the indicators of the country's human capital. It should also be noted that better and more accessible health care has a direct positive impact on the general goal of fiscal policy – the quality of life of the population. Consequently, public financial investment in health care both directly improves the quality of life of the population and creates preconditions for economic growth, which in turn ensures the sustainability of improved quality of life.

Increasing the salaries of those working in the health sector has been a priority in previous budgets and Framework Laws and remains a priority in this budget plan as well. The Covid-19 pandemic has created additional physical and mental strain on medical personnel, as well as demand for the people of the relevant profession abroad. In order to reduce the risk of the outflow of medical personnel and to ensure wages corresponding to working conditions for one workload, the increase of wages of medical personnel in the country is being continued.

One of the decisions of the Cabinet of Ministers in the medium term includes the allocation of EUR 40.6 million for 2022 and further to ensure the increase of salaries of medical personnel – EUR 35 million for medical practitioners and EUR 5.6 million for residents.

This draft budget law and the draft framework law continue to invest in technical equipment and provide increased funding for state-paid medicines and funding for increasing access to health services, including funding for rare diseases, increasing the coverage of the population for which the state will pay for influenza vaccination, improving palliative care services, in particular improving the quality and availability of services for oncology.

The Cabinet of Ministers has decided to allocate EUR 30.0 million for 2022 and further to improve health care services in the field of oncology (reimbursable medicines, purchase of equipment and facilities for the Children's Clinical University Hospital, Riga East Clinical University Hospital, Pauls Stradiņš Clinical University Hospital).

Increasing the state's human capital in the internal affairs sector

In 2021, the internal affairs system faced an emergency situation on the country's border with Belarus. The emergency situation highlighted the shortcomings in the remuneration system of officials with special service ranks, as well as raised the issue of strengthening the human resources capacity of the internal affairs system, including closing the gap with the national defence department, where funding is tied to GDP. Consequently, in addition to the health and education sector, the internal affairs sector is included in the priority of increasing the capacity of human resources in this draft budget law and the draft framework law.

The trends of recent years, as well as the current situation on the state border with Belarus, show that crimes against the state border security are well organised. The mobility and strengthening of border control by the State Border Guard personnel is important, which could

be promoted by setting a special additional payment. It is also important to improve the remuneration system so that the level of remuneration for the same work in different institutions of the internal affairs system is not differentiated.

From 1 January 2017, the Law on Remuneration of Officials and Employees of State and Local Government Authorities stipulates that the maximum monthly salary of officials of special institutions of the system of the Ministry of the Interior with special service ranks who are obliged to investigate particularly complex crimes is determined according to the district prosecutor's monthly salary; in practice, however, investigators' monthly salaries still lag far behind. Thus, in order to improve the efficiency of economic and financial investigations, it is necessary to ensure equal wages for investigators of the institutions of Ministry of the Interior and investigators employed in other institutions, including by approximating the monthly salaries of highly qualified specialists to the monthly salary of the district prosecutor, which will facilitate the attraction and retention of specialists in the Interior Affairs Service.

Taking the aforementioned issues into account, one of the decisions of the Cabinet of Ministers in the medium term includes the allocation of EUR 20.7 million for 2022 and further capacity building of officials with special service ranks (border allowance, investigators' wages, equalisation of monthly wages).

Increasing the state's human capital in the education sector

Taking the constraints on the amount of the labour into account, increasing the productivity of common factors in Latvian conditions is the main factor in the growth of potential gross domestic product. The knowledge, skills and ability of the Latvian population to be innovative and the creation of conditions for the possibility of implementing innovative ideas in life are the preconditions necessary for the growth of potential gross domestic product. Education and science play a key role here.

According to *Eurostat* COFOG general government expenditure classification data, education funding in Latvia (5.8% of GDP according to 2019 data) is the fifth highest in the EU, exceeding both the EU average (4.7% of GDP) and Lithuania (4.6% of GDP), while lagging behind Estonia (6.0% of GDP). This indicates that funding for education in Latvia is at an adequate level, but issues related to the optimisation of the school network and increasing the number of students per teacher need to be addressed. It should be noted that a significant increase in the number of students per teacher, as well as significant progress in the reorganisation of the school network is not possible in a short period of time without endangering the quality of education. Thus, one of the solutions is to invest additional funds in the education system in order to increase the wages of teachers, which has also been one of the decisions of the Cabinet of Ministers in the previous Framework Law and is a priority in this draft Framework Law as well. This year, the increase in salaries for teachers is also related to the additional work and emotional burden caused by remote learning, which will continue to be created by the implementation of Covid-19 safety protocols in educational institutions.

Respectively, one of the decisions of the Cabinet of Ministers in the medium term includes the allocation of EUR 15.2 million for 2022 and EUR 45.6 million in the next years for the implementation of the schedule for the increase in teachers' salaries.

Strengthening the state's innovative potential by increasing science base funding and funding for basic and applied research

Taking the constraints on the amount of the labour into account, increasing the productivity of common factors in Latvian conditions is the main factor in the growth of

potential gross domestic product. The knowledge, skills and ability of the Latvian population to be innovative and the creation of conditions for the possibility of implementing innovative ideas in life are the preconditions necessary for the growth of potential gross domestic product.

In Latvia, investment in research and development in 2019 was the fourth lowest in the EU. Latvia's total expenditure on research and development in 2019 was 0.64% of GDP.

Total R&D funding over the last ten years (2011-2019) averaged EUR 74 per capita, which is only 13% of the EU average (EUR 582 per capita). According to this indicator, Latvia lags behind most EU member states, as well as the Baltic neighbours Lithuania and Estonia.

Private sector funding is small, at around $\frac{1}{4}$ a share of total R&D investment (0.2% of GDP), well below the EU average (1.4% of GDP), where entrepreneurs provide more than half of the total R&D investment funding. In the long-term vision, the level of business investment in R&D has not increased.

Increasing the country's innovative potential in 2022-2024 is important not only as a key factor in increasing the potential gross domestic product, but also in the context of new competitiveness challenges – the transformation of the economy to carbon neutrality and the development of EU defence capabilities.

The transformation of the economy towards climate neutrality will be the biggest economic transformation of this century, where those countries that develop the necessary technologies will gain significant advantages in international competitiveness and the export of new technologies can serve as an important driver of economic development.

The development of the EU's defence capabilities allows Member States to develop the technologies needed for defence capabilities. The defence industry is primarily the potential of the largest EU Member States, but other EU Member States can also develop niche technologies for the sector.

Taking these factors into account, in the period of 2022-2024 a separate priority development direction of the budget is the development of the state's innovative potential, increasing funding for science, as well as making public investments in military and defence industry projects. The budget has allocated EUR 10.5 million for 2022 to further increase funding for the science base as well as to fund basic and applied research.

Promoting the sustainability of the post-pandemic economic environment by supporting the recovery and development of enterprises, strengthening the capital base of enterprises and attracting investment

In the post-pandemic period, it is essential to ensure the sustainability of viable companies. During this period, sustainability risks increase as State support to reduce losses from the Covid-19 restrictions is reduced in line with the annulment of restrictions. However, there is no reason to believe that with the annulment of restrictions, the behaviour of economic actors and consumers will fully return to pre-crisis levels. In some cases, this happens with a time lag, but in other cases, the change in behaviour is irreversible. Reducing the losses caused by restrictions through state support instruments provided liquidity to companies, however, as indemnification of losses was not 100% in most cases, companies' financial performance deteriorated during the pandemic. There is a risk that, with the annulment of support instruments and a change in behaviour on the demand side, companies' financial performance will continue to deteriorate, leading to long-term negative structural changes on the supply side. Consequently, one of the priorities of the post-pandemic budget is to support viable companies by concentrating and shifting the emphasis from liquidity support instruments to capital support

instruments.

Respectively, in this draft budget law and the draft framework law, EUR 41.0 million will be allocated in 2022 for loans for corporate investment projects with a capital allowance. The loan will be available for large-scale projects – investments for the introduction of new production facilities, equipment and technological processes. The purpose of the loan is to invest in tangible and intangible assets to start, expand and streamline production. If the project provides for a number of conditions, including sufficient salaries for employees, new jobs, investment in research and development at least to a certain extent, up to 30% of the loan amount can be converted into company capital.

Increasing the amount of public investment

Although the amount of Latvia's public investment (gross fixed capital growth) in the group of EU countries is relatively high, so far there have been obstacles to investing in certain nationally significant projects. Such investments are hampered if they do not meet the priorities of EU funds or the Renewal and Sustainability Fund. An alternative is to finance these projects from the state budget. In this case, the allocation of funding has been hampered, as the fiscal space available so far has been set for all budgetary priorities together. In such circumstances, investment projects are at greater risk of being rejected than those budget priorities that directly affect a large part of the population.

In 2022, the SGP general escape clause remains in force. According to the EU fiscal recommendations of June 2021, the growth of nationally financed primary expenditure shall be controlled in 2022. As regards the amount of gross fixed capital formation, the recommendation calls for investment to be maintained. The context of the recommendation is linked to the risk that the abolition of state support mechanisms introduced during the pandemic could slow down the economic recovery. This can be prevented by an increase in public investment, which would maintain the level of demand necessary for economic growth. These considerations, as well as the non-application of fiscal rules in 2022, allow the state to implement the necessary investment projects, financing them from the resources attracted in the financial markets.

This draft budget law uses this opportunity by allocating EUR 264.7 million in 2022 for the implementation of investment projects – municipal investment projects, reconstruction and renewal of regional roads, improvement of infrastructure in agriculture, forestry and fisheries (including investments in drainage systems and investments to achieve Green Course goals), the purchase of fire-fighting and rescue service vehicles and investment to the national military and defence industry.

Table 5: Description of discretionary measures included in the draft budget**Table 5.a i) Discretionary revenue measures taken by General Government**

List of measures	Type of tax	ESA code	Accounting principle	Adoption status	Budgetary impact		
					2022	2023	2024
					% of GDP		
Increase of differentiated non-taxable minimum and non-taxable minimum for pensioners. As of 01.01.2022. differentiated non-taxable minimum from EUR 300 to EUR 350 per month and non-taxable minimum for pensioners from EUR 300 to EUR 350 per month. As of 01.07.2022. From EUR 350 to EUR 500 per month both.	PIT	D.5	Accrual	Not yet adopted but credibly planned	-0.31	-0.19	
	VAT	D.2			0.04	0.02	0.00
Increase of the maximum SSC object from EUR 62,800 to EUR 78,100	PIT	D.5	Accrual	Not yet adopted but credibly planned	-0.02		
	SSC	D.61			0.03		
	SSC for the Health payment	D.61			0.00		
Reduction of VAT rate from 12% to 5% for books, press and other mass media issued in the form of printed or electronic publication	VAT	D.2	Accrual	Not yet adopted but credibly planned	-0.01		
Increase in income from the share of profit to be paid in dividends by JSC <i>Latvijas valsts meži</i> for 2021	Non-tax revenue	D.421	Cash flow	Not yet adopted but credibly planned	0.08	-0.07	0.00
	CIT	D.5			0.02	-0.02	0.00
Spillover effects of wage increase for doctors, teachers, employees of the internal affairs system	PIT	D.5	Cash flow	Not yet adopted but credibly planned	0.05	0.01	0.00
	SSC	D.61			0.08	0.02	0.00
	SSC for the Health payment	D.61			0.00	0.00	0.00
	VAT	D.2			0.01	0.00	0.00
					0.00	0.00	0.00
					0.01	0.00	0.00
				In total:	-0.04	-0.22	0.00

Other changes in the budget preparation process (% of GDP)	2022
Other changes in budget taxes and own revenues	-0.02

Table 5.a.ii) Discretionary expenditure measures taken by General Government

List of measures	ESA code	Accounting principle	Adoption status	2022	2023	2024
				% of GDP		
Ministry of Defence						
Latvian military and defence industries, which form local production, incl. attracting science and research, development projects	P.51	Cash flow	Approved	0.03	-0.03	0.00
Ministry of Economy						
Innovation Fund (sectoral research programs)	P.2	Cash flow	Approved	0.01	0.00	0.00
Ministry of Finance						
Reduced funding for public debt management	D.41	Cash flow	Approved	-0.12	0.11	0.00
Financing for the refund of VAT to the state budget for construction works performed in projects implemented by EU Funds	D.21	Cash flow	Approved	0.02	-0.01	0.00
Funding for the Ministry of Interior infrastructure development	P.51	Cash flow	Approved	0.01	-0.01	0.00
Ministry of Interior						
For the implementation of high readiness projects related to Covid-19 crisis management and economic recovery - for the construction of the SFRS depot	P.51	Cash flow	Approved	0.03	-0.03	0.00
Capacity building of officials with special service ranks (marginal allowance, wages of investigators, equalization of monthly wages)	D.1	Cash flow	Approved	0.06	0.00	0.00
Purchase of special fire and rescue vehicles	P.51	Cash flow	Approved	0.04	-0.04	0.00
Strengthening the priority areas of the State Security Service		Cash flow	Approved	0.01	0.00	0.00
Ministry of Education and Science						
Implementation of high-quality vocational training projects related to the Covid-19 crisis management and economic recovery	P.51	Cash flow	Approved	0.02	-0.02	0.00
Implementation of the schedule of increase of teachers' salaries	D.1	Cash flow	Approved	0.04	0.08	-0.01
Provision of social scholarships for students from large families	D.6	Cash flow	Approved	0.01	0.01	0.01
Increase of basic funding for science and financing of fundamental and applied research		Cash flow	Approved	0.03	0.00	0.00
Ministry of Agriculture						
State aid for the entry of breeding animals in the herd-book, as well as for the determination of their genetic quality and the evaluation of productivity data	D.3	Cash flow	Approved	0.07	-0.07	0.00

Materials for scientific research used in agriculture and materials for improvement of the technical base of agricultural scientific institutions		Cash flow	Approved	0.01	-0.01	0.00
Income support for small agricultural producers	D.3	Cash flow	Approved	0.01	-0.01	0.00
Wage growth in the agricultural sector	D.1	Cash flow	Approved	0.01	0.00	0.00
Improvement of the sectoral infrastructure of the Ministry of Agriculture and renewal of the technical provision for the performance of state functions of the department, including investments in drainage systems and investments for achieving the objectives of the Green Course	P.51	Cash flow	Approved	0.15	-0.15	0.00
Ministry of Transport						
Reconstruction and renovation of state regional roads	P.51	Cash flow	Approved	0.17	-0.17	0.00
Financing of public railway infrastructure	P.41	Cash flow	Approved	0.02	-0.01	0.00
Grant to cover losses to public transport service providers	D.9	Cash flow	Approved	0.03	-0.02	0.00
Ministry of Welfare						
Reduction in expenditure on unemployment benefits due to the projected monthly decline in the average number of beneficiaries	D.6	Cash flow	Approved	-0.03	0.00	0.00
Raising the wages of caregivers in long-term social care and social rehabilitation institutions	D.1	Cash flow	Approved	0.03	-0.01	-0.01
Arranging the infrastructure of state social care centres	P.51	Cash flow	Approved	0.02	-0.02	0.00
Increasing the number of state-paid incapacity days	D.6	Cash flow	Approved	0.02	0.00	0.00
Ministry of Justice						
Construction of a new prison in Liepaja	P.51	Cash flow	Approved	-0.11	0.11	0.10
Ministry of Environmental Protection and Regional Development						
Financing of high readiness municipal investment projects to overcome the Covid-19 crisis	P.51	Cash flow	Approved	0.07	-0.07	0.00
Municipal investment program	P.51	Cash flow	Approved	0.09	-0.09	0.00
Ministry of Culture						
Increase of funding for the implementation of high readiness infrastructure projects	P.51	Cash flow	Approved	0.03	-0.03	0.00
Wage growth in the cultural sector	D.1	Cash flow	Approved	0.02	0.00	0.00
150 years of the tradition of general Latvian song and dance festival		Cash flow	Approved	0.01	-0.01	0.00
Sustainability of the initiatives launched in the centenary of the Latvian state - a Latvian school bag	D.6	Cash flow	Approved	0.01	0.00	0.00

Ministry of Health						
Ensuring an increase in the salaries of medical personnel	D.1	Cash flow	Approved	0.10	-0.01	0.00
Provision of wages to residents whose residency studies are not paid from the state budget	D.1	Cash flow	Approved	0.02	0.00	0.00
Improvement of health care services in the field of oncology, including equipment	D.7	Cash flow	Approved	0.09	-0.01	0.00
Measures to reduce the long-term negative effects on public mental health caused by the Covid-19 pandemic	D.7	Cash flow	Approved	0.01	0.00	0.00
Co-payment compensation for persons with group 2 disability (norms of the Health Care Financing Law as of 01.01.2022)	D.6	Cash flow	Approved	0.02	0.00	0.00
Provision of palliative care	D.7	Cash flow	Approved	0.01	0.00	0.00
Increasing health services (including rare diseases, etc.)	D.7	Cash flow	Approved	0.02	0.00	0.00
Capital investments and investments in institutions subordinated to the Ministry of Health	P.51	Cash flow	Approved	0.01	-0.01	0.00
Implementation of the conceptual report "On the future development of the nursing profession"	D.7	Cash flow	Approved	0.01	0.00	0.00
Dotation to municipalities						
MFI special grant adjustment	D.72	Cash flow	Approved	-0.09	-0.14	-0.21
Funding to be redistributed in the process of execution of the annual state budget						
Adjusted funding in the budget department" 74 funding to be redistributed in the annual state budget execution process"		Cash flow	Approved	0.21	-0.23	0.21
Adjusted funding for the purchase of Covid-19	P.2	Cash flow	Approved	0.08	-0.08	0.00
Redistribution of funding for the implementation of high readiness projects	P.51	Cash flow	Approved	-0.25	0.25	0.00
Increased funding for reforms ensuring the wages for approved and appointed officials	D.1	Cash flow	Approved	0.00	0.02	0.00
For the provision of demographic measures	D.72	Cash flow	Approved	0.01	-0.01	0.00
Other measures combined				0.34	-0.10	0.01
In total				1.39	-0.80	0.08
Public investment policy decisions budgeted under the funding heading, but according to the ESA methodology should be accounted for as budget expenditure						

List of measures	ESA code	Accounting principle	Adoption status	2022	2023	2024
				% of GDP		
Ministry of Education and Science						
Implementation of projects of high-quality vocational education institutions related to coping with the consequences of the Covid-19 crisis and economic recovery	P.51	Cash flow	Approved	0.01	-0.01	0.00
Implementation of a high-readiness project related to overcoming the consequences of the Covid-19 crisis and economic recovery - establishment of a team sports games hall at 99C Krišjāņa Barona Street in Riga	P.51	Cash flow	Approved	0.04	-0.04	0.00
Ministry of Justice						
Covid-19 crisis management and economic recovery readiness projects - Establishment of a single forensic body	P.51	Cash flow	Approved	0.01	-0.01	0.00
Ministry of Health						
Improvement of the infrastructure of the high readiness project Children's Clinical University Hospital by increasing the energy efficiency of the old buildings	P.51	Cash flow	Approved	0.01	-0.01	0.00
Renovation of the historical buildings and increase of energy efficiency and renovation of the high-readiness project Pauls Stradiņš Clinical University Hospital	P.51	Cash flow	Approved	0.00	0.00	0.00
Construction of a new building of the National Rehabilitation Centre <i>Vaivari</i> of the high readiness project "VSIA" to distribute the flow of patients to provide better quality outpatient rehabilitation services in more epidemiologically safe premises	P.51	Cash flow	Approved	0.00	0.00	0.00
Priority measure "Land and real estate acquisition investments RAKUS, RPNC and PSKUS"	P.51	Cash flow	Approved	0.01	-0.01	0.00
Capital investments and investments in institutions subordinated to the Ministry of Health	P.51	Cash flow	Approved	0.00	0.00	0.00
Improving oncology health services. including equipment	P.51	Cash flow	Approved	0.06	-0.06	0.00
In total				0.15	-0.15	0.00
Other changes						

List of measures	ESA code	Accounting principle	Adoption status	2022	2023	2024
				% of GDP		
Changes in the balance sheet of classified merchants – <i>Rīgas satiksme</i> bus procurement	P.51	Cash flow		0.06	-0.06	0.00
Increasing the borrowing limit for local governments (projected impact on the budget balance)	P.51	Cash flow		0.18	-0.18	0.00
In total				0.24	-0.24	0.00

Table 5.b.i) Discretionary revenue measures taken by Central Government

List of measures	Type of tax	ESA code	Accounting principle	Adoption status	Budgetary impact		
					2022	2023	2024
					% of GDP		
Increase of differentiated non-taxable minimum and non-taxable minimum for pensioners. As of 01.01.2022. differentiated non-taxable minimum from EUR 300 to EUR 350 per month and non-taxable minimum for pensioners from EUR 300 to EUR 350 per month. As of 01.07.2022. From EUR 350 to EUR 500 per month both.	PIT	D.5	Accrual	Not yet adopted but credibly planned	-0.08	-0.05	
	VAT	D.2			0.04	0.02	0.00
Increase of the maximum SSC object from EUR 62,800 to EUR 78,100	PIT	D.5	Accrual	Not yet adopted but credibly planned	0.00		
	SSC	D.61			0.03		
	SSC for the Health payment	D.61			0.00		
Reduction of VAT rate from 12% to 5% for books, press and other mass media issued in the form of printed or electronic publication	VAT	D.2	Accrual	Not yet adopted but credibly planned	-0.01		
Increase in income from the share of profit to be paid in dividends by JSC <i>Latvijas valsts meži</i> for 2021	Non-tax revenue	D.421	Cash flow	Not yet adopted but credibly planned	0.08	-0.07	0.00
	CIT	D.5			0.02	-0.02	0.00
Spillover effects of wage increase for doctors, teachers, employees of the internal affairs system	PIT	D.5	Cash flow	Not yet adopted but credibly planned	0.01	0.00	0.00
	SSC	D.61			0.08	0.02	0.00
	SSC for the Health payment	D.61			0.00	0.00	0.00
	VAT	D.2			0.01	0.00	0.00
					0.00	0.00	0.00
					-0.01	0.00	0.00
				In total:	0.17	-0.09	0.00

Table 5.b.ii): Discretionary expenditure measures taken by Central Government

List of measures	ESA code	Accounting principle	Adoption status	2022	2023	2024
				% of GDP		
Ministry of Defence						
Latvian military and defence industries, which form local production, incl. attracting science and research, development projects	P.51	Cash flow	Approved	0.03	-0.03	0.00
Ministry of Economy						
Innovation Fund (sectoral research programs)	P.2	Cash flow	Approved	0.01	0.00	0.00
Ministry of Finance						
Reduced funding for public debt management	D.41	Cash flow	Approved	-0.12	0.11	0.00
Financing for the refund of VAT to the state budget for construction works performed in projects implemented by EU Funds	D.21	Cash flow	Approved	0.02	-0.01	0.00
Funding for the Ministry of Interior infrastructure development	P.51	Cash flow	Approved	0.01	-0.01	0.00
Ministry of Interior						
For the implementation of high readiness projects related to Covid-19 crisis management and economic recovery - for the construction of the SFRS depot	P.51	Cash flow	Approved	0.03	-0.03	0.00
Capacity building of officials with special service ranks (marginal allowance, wages of investigators, equalization of monthly wage)	D.1	Cash flow	Approved	0.06	0.00	0.00
Purchase of special fire and rescue vehicles	P.51	Cash flow	Approved	0.04	-0.04	0.00
Strengthening the priority areas of the State Security Service		Cash flow	Approved	0.01	0.00	0.00
Ministry of Education and Science						
Implementation of high-quality vocational training projects related to the Covid-19 crisis management and economic recovery	P.51	Cash flow	Approved	0.02	-0.02	0.00
Implementation of the schedule of increase of teachers' salaries	D.1	Cash flow	Approved	0.04	0.08	-0.01
Provision of social scholarships for students from large families	D.6	Cash flow	Approved	0.01	0.01	0.01
Increase of basic funding for science and financing of fundamental and applied research		Cash flow	Approved	0.03	0.00	0.00
Ministry of Agriculture						
State aid for the entry of breeding animals in the herd-book, as well as for the determination of their genetic quality and the evaluation of productivity data	D.3	Cash flow	Approved	0.07	-0.07	0.00

Materials for scientific research used in agriculture and materials for improvement of the technical base of agricultural scientific institutions		Cash flow	Approved	0.01	-0.01	0.00
Income support for small agricultural producers	D.3	Cash flow	Approved	0.01	-0.01	0.00
Wage growth in the agricultural sector	D.1	Cash flow	Approved	0.01	0.00	0.00
Improvement of the sectoral infrastructure of the Ministry of Agriculture and renewal of the technical provision for the performance of state functions of the department, including investments in drainage systems and investments for achieving the objectives of the Green Course	P.51	Cash flow	Approved	0.15	-0.15	0.00
Ministry of Transport						
Reconstruction and renovation of state regional roads	P.51	Cash flow	Approved	0.17	-0.17	0.00
Financing of public railway infrastructure	P.41	Cash flow	Approved	0.02	-0.01	0.00
Grant to cover losses to public transport service providers	D.9	Cash flow	Approved	0.03	-0.02	0.00
Ministry of Welfare						
Reduction in expenditure on unemployment benefits due to the projected monthly decline in the average number of beneficiaries	D.6	Cash flow	Approved	-0.03	0.00	0.00
Raising the wages of caregivers in long-term social care and social rehabilitation institutions	D.1	Cash flow	Approved	0.03	-0.01	-0.01
Arranging the infrastructure of state social care centres	P.51	Cash flow	Approved	0.02	-0.02	0.00
Increasing the number of state-paid incapacity days	D.6	Cash flow	Approved	0.02	0.00	0.00
Ministry of Justice						
Construction of a new prison in Liepaja	P.51	Cash flow	Approved	-0.11	0.11	0.10
Ministry of Environmental Protection and Regional Development						
Financing of high readiness municipal investment projects to overcome the Covid-19 crisis	P.51	Cash flow	Approved	0.07	-0.07	0.00
Municipal investment program	P.51	Cash flow	Approved	0.09	-0.09	0.00
Ministry of Culture						
Increase of funding for the implementation of high readiness infrastructure projects	P.51	Cash flow	Approved	0.03	-0.03	0.00
Wage growth in the cultural sector	D.1	Cash flow	Approved	0.02	0.00	0.00
150 years of the tradition of general Latvian song and dance festival		Cash flow	Approved	0.01	-0.01	0.00
Sustainability of the initiatives launched in the centenary of the Latvian state - a Latvian school bag	D.6	Cash flow	Approved	0.01	0.00	0.00

Ministry of Health						
Ensuring an increase in the salaries of medical personnel	D.1	Cash flow	Approved	0.10	-0.01	0.00
Provision of wages to residents whose residency studies are not paid from the state budget	D.1	Cash flow	Approved	0.02	0.00	0.00
Improvement of health care services in the field of oncology, including equipment	D.7	Cash flow	Approved	0.09	-0.01	0.00
Measures to reduce the long-term negative effects on public mental health caused by the COVID-19 pandemic	D.7	Cash flow	Approved	0.01	0.00	0.00
Co-payment compensation for persons with group 2 disability (norms of the Health Care Financing Law as of 01.01.2022)	D.6	Cash flow	Approved	0.02	0.00	0.00
Provision of palliative care	D.7	Cash flow	Approved	0.01	0.00	0.00
Increasing health services (including rare diseases, etc.)	D.7	Cash flow	Approved	0.02	0.00	0.00
Capital investments and investments in institutions subordinated to the Ministry of Health	P.51	Cash flow	Approved	0.01	-0.01	0.00
Implementation of the conceptual report "On the future development of the nursing profession"	D.7	Cash flow	Approved	0.01	0.00	0.00
Dotation to municipalities						
MFI special grant adjustment	D.72	Cash flow	Approved	-0.09	-0.14	-0.21
Funding to be redistributed in the process of execution of the annual state budget						
Adjusted funding in the budget department "74 funding to be redistributed in the annual state budget execution process"		Cash flow	Approved	0.21	-0.23	0.21
Adjusted funding for the purchase of Covid-19	P.2	Cash flow	Approved	0.08	-0.08	0.00
Redistribution of funding for the implementation of high readiness projects	P.51	Cash flow	Approved	-0.25	0.25	0.00
Increased funding for reforms ensuring the wages of approved and appointed officials	D.1	Cash flow	Approved	0.00	0.02	0.00
For the provision of demographic measures	D.72	Cash flow	Approved	0.01	-0.01	0.00
Other measures combined				0.34	-0.10	0.01
In total				1.39	-0.80	0.08
Public investment policy decisions budgeted under the funding heading, but according to the ESA methodology should be accounted for as budget expenditure						

List of measures	ESA code	Accounting principle	Adoption status	2022	2023	2024
				% of GDP		
Ministry of Education and Science						
Implementation of projects of high-quality vocational education institutions related to coping with the consequences of the Covid-19 crisis and economic recovery	P.51	Cash flow	Approved	0.01	-0.01	0.00
Implementation of a high-readiness project related to overcoming the consequences of the Covid-19 crisis and economic recovery - establishment of a team sports games hall at 99C Krišjāņa Barona Street in Riga	P.51	Cash flow	Approved	0.04	-0.04	0.00
Ministry of Justice						
Covid-19 crisis management and economic recovery readiness projects - Establishment of a single forensic body	P.51	Cash flow	Approved	0.01	-0.01	0.00
Ministry of Health						
Improvement of the infrastructure of the high readiness project Children's Clinical University Hospital by increasing the energy efficiency of the old buildings	P.51	Cash flow	Approved	0.01	-0.01	0.00
Renovation of the historical buildings and increase of energy efficiency and renovation of the high-readiness project Pauls Stradiņš Clinical University Hospital	P.51	Cash flow	Approved	0.00	0.00	0.00
Construction of a new building of the National Rehabilitation Centre <i>Vaivari</i> of the high readiness project to distribute the flow of patients to provide better quality outpatient rehabilitation services in more epidemiologically safe premises	P.51	Cash flow	Approved	0.00	0.00	0.00
Priority measure "Land and real estate acquisition investments RAKUS, RPNC and PSKUS "	P.51	Cash flow	Approved	0.01	-0.01	0.00
Capital investments and investments in institutions subordinated to the Ministry of Health	P.51	Cash flow	Approved	0.00	0.00	0.00
Improving oncology health services. including equipment	P.51	Cash flow	Approved	0.06	-0.06	0.00
In total				0.15	-0.15	0.00
Other changes						

Table 5.c.i): Discretionary revenue measures taken by Local Government

List of measures	Type of tax	ESA code	Accounting principle	Adoption status	Budgetary impact		
					2022	2023	2024
					% of GDP		
Increase of differentiated non-taxable minimum and non-taxable minimum for pensioners. As of 01.01.2022. differentiated non-taxable minimum from EUR 300 to EUR 350 per month and non-taxable minimum for pensioners from EUR 300 to EUR 350 per month. As of 01.07.2022. From EUR 350 to EUR 500 per month both.	PIT	D.5	Accrual	Not yet adopted but credibly planned	-0.23	-0.14	
Inclusion of the employer's health service in the benefits provided for in collective agreements with a limit of EUR 480 per year	PIT	D.5	Accrual	Not yet adopted but credibly planned	0.00		
Increase of the maximum SSC object from EUR 62,800 to EUR 78,100 euro	PIT	D.5	Accrual	Not yet adopted but credibly planned	-0.01		
Spillover effects of wage increase for doctors, teachers, employees of the internal affairs system	PIT	D.5	Cash flow	Not yet adopted but credibly planned	0.04	0.01	0.00
					0.00	0.01	0.00
					0.00	0.00	0.00
				In total:	-0.21	-0.13	0.00

Table 5.c.ii): Discretionary expenditure measures taken by Local Government

List of measures	ESA code	Accounting principle	Adoption status	2022	2023	2024
				% of GDP		
Increase in capital expenditure (government decision - financing the implementation of high-readiness municipal investment projects to overcome the Covid-19 crisis)	P.51	Cash flow	Approved	0.07	-0.07	0.00
Increase in capital expenditure (government decision - municipal investment programme)	P.51	Cash flow	Approved	0.09	-0.09	0.00
Reduction in maintenance costs (government decision - downward adjustment of MFI special grants)	D.72	Cash flow	Approved	-0.09	-0.14	-0.21
Increase in capital expenditure (government decision - increase of the loan limit for local governments)	P.51	Cash flow	Approved	0.18	-0.18	0.00
Wage increase (government decision - increase of targeted grants (teachers, doctors, employees of social centres))	D.1	Cash flow	Approved	0.08	0.04	-0.01
In total:				0.32	-0.43	-0.22

Table 6.a CSR recommendations

CSR no.	Measures	Description
1	<p>In 2022, maintain a supportive fiscal stance, including the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment. Keep the growth of nationally financed current expenditure under control.</p>	<p>In 2022, the SGP exemption clause remains in force. According to the EU fiscal recommendations of June 2021, the growth of nationally financed primary expenditure must be controlled in 2022. In terms of gross fixed capital formation, the recommendation calls for investment to be maintained.</p> <p>The fiscal policy scenario of the budget plan ensures that the increase in nationally financed primary current expenditures in 2022 is in line with the EU fiscal recommendation that this increase should not exceed the ten-year average increase in potential gross domestic product.</p> <p>The context of the recommendation regarding the retention of investment runs the risk that the abolition of state aid mechanisms introduced during the pandemic could slow down the economic recovery. This can be prevented by an increase in public investment, which would maintain the level of demand necessary for economic growth. These considerations, as well as the non-application of fiscal rules in 2022, allow the state to implement the necessary investment projects, financing them from the resources attracted in the financial markets. Accordingly, in this draft budget law, this possibility is used in 2022 by allocating 264.7 million euro for the implementation of investment projects - municipal investment projects, reconstruction and renewal of regional roads, improvement of infrastructure of agricultural, forestry and fisheries sectors (including investments in drainage systems and investments to achieve Green Course objectives), purchase of fire and rescue vehicles and investments of state military and defence industry.</p> <p>This budget plan envisages the implementation of projects in 2022 within the framework of the Recovery and Sustainability Plan, envisaging current expenditures in the amount of 0.3% of GDP, and capital expenditures in the amount of 0.5% of GDP.</p>
2	<p>When economic conditions allow, pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring fiscal sustainability in the medium term. At the same time, enhance investment to boost growth potential.</p>	<p>The fiscal policy scenario of the budgetary plan ensures that the increase in nationally financed primary current expenditure in 2022, 2023 and 2024 between years n-1 and n in any of these years is in line with the EU fiscal recommendation that this increase should not exceed the ten-year average potential domestic gross product growth.</p>

3	<p>Pay particular attention to the composition of public finances, both on the revenue and expenditure sides of the budget, and to the quality of budgetary measures, to ensure a sustainable and inclusive recovery. Prioritise sustainable and growth-enhancing investment, notably supporting the green and digital transition. Give priority to fiscal structural reforms that will help provide financing for public policy priorities and contribute to the long-term sustainability of public finances, including by strengthening the coverage, adequacy, and sustainability of health and social protection systems for all.</p>	<p>In accordance with international standards, the regulatory framework in the field of state budget policy is systematically developed, resulting in improving the budget revenue and expenditure classification, assessing the needs of users, reducing the risk of misinterpretation of legal regulation, thus leading to administrative burden reduction. At the same time, an improved budget flexibility mechanism has been introduced in budget management processes to expand the ministries' ability to use the previous year's unused appropriations in the next financial year, enabling ministries to achieve higher results with assigned budget resources, continue implementation of ongoing projects and activities, thus leading to more rational use of budget resources and process continuity.</p> <p>In order to inform the population in an interactive and visible way about in which areas and to what extent taxpayers' money is invested and what are the expected results, an interactive budget infographics and structured ministerial budgets are available on the website of the MoF. As well as information on the performance of ministries and their performance indicators is published on the open data portal. Thus, the public is provided with an opportunity to get familiar with information about the state budget in a convenient way - thus public confidence in the state governance is increased, which is based on openness, public awareness of public administration processes and implementation of public administration tasks.</p> <p>In order to promote more efficient management of government finances, strengthen responsibility for the results to be achieved and promote the use of good international practice in budget management processes - change management projects are being implemented. In order to create, develop and implement reforms in budget planning and analysis of execution processes, the MoF in cooperation with the EC and OECD has launched a technical assistance project “Improving the functioning of public financial management in Latvia - budget preparation and implementation”, thus aiming to promote more efficient management of state budget funds and improving budgetary processes to bring them more in line with international sound financial management practices. The first results of the project implementation are expected in 2023.</p>
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Table A. Covid-19 crisis economic support measures and their fiscal impact

Measure	ESA code	Budgetary impact (% of GDP - change from previous year)		
		2020	2021	2022
Support to the field of taxation		-0.4	0.3	0.2
Extension or division of the term for payment of taxes into terms of up to 3 years	D2; D5; D61	-0.1	0.0	0.1
Possibility not to pay PIT advance payments	D5	-0.1	0.1	0.1
Faster VAT overpayment refund	D2	-0.2	0.2	0.0
Aid in the field of benefits		-0.4	-1.2	1.5
Downtime support for company employees, patent payers, self-employed	D7	-0.2	-0.2	0.4
Wage subsidies for part-time workers	D7	-0.2	0.1	0.1
Payment of sickness benefit from the state budget	D632; D62	0.0	-0.1	0.1
Allowance for families with children	D632; D62	0.0	-0.6	0.6
Benefit for pensioners and persons with disabilities	D632; D62	0.0	-0.4	0.3
Other		-0.1	0.0	0.0
Aid in the field of loans and guarantees		-0.3	-0.1	0.2
Increase of local governments borrowing limit	P51	-0.2	-0.2	0.2
Working capital loans	D7	0.0	0.0	0.0
Credit guarantees	D7	-0.1	0.0	0.0
Other		0.0	0.0	0.0
Sectoral support		-2.1	-2.8	3.7
Support to the air transport industry	D7; D9	-0.9	0.4	0.4
Healthcare-related support	P2; P51; D1; D7	-0.4	-1.1	0.9
To alleviate financial difficulties in the agricultural, forestry, fisheries and food production sectors	D3	-0.1	0.0	0.1
For construction of state roads and repairs of bridges	P51	-0.2	-0.3	0.5
Support for passenger and freight carriers	D3; D7; D9	-0.3	0.2	0.0
Grant for current assets	D7	0.0	-1.6	1.5

High readiness projects related to overcoming the Covid-19 crisis and economic recovery	P51	0.0	-0.1	-0.2
Support for the cultural sector	P2; D7; P51	-0.1	0.0	0.1
Support for education, science and sport	D1; D7; P2	-0.1	-0.1	0.1
To compensate the decline in shopping center revenue	D7	0.0	-0.1	0.1
Other		0.0	-0.2	0.2
Support related to EU funds		0.0	0.0	0.0
In total:		-3.3	-3.9	5.6

Tabula B. Covid-19 related guarantees

Measure		Date of adoption	Maximum amount of contingent liabilities (% of GDP) ¹	Estimated take-up (% of GDP) ²
Covid-19	Credit guarantees	24.03.2020	1.0	0.3
	Portfolio guarantees	24.03.2020	0.3	0.0
	Guarantees for economic operators	17.12.2020	0.1	0.0
	In total:		1.4	0.3

¹ GDP of 2021

² 2021 data till 30th of September

Table C. RRF impact

<i>Revenue from RRF grants (% of GDP)</i>			
	2020	2021	2022
RRF GRANTS as included in the revenue projections	0.00	0.01	0.75
Cash disbursements of RRF GRANTS from EU	0.00	0.76	0.59
<i>Expenditure financed by RRF grants (% of GDP)</i>			
	2020	2021	2022
TOTAL CURRENT EXPENDITURE	0.00	0.00	0.26
Gross fixed capital formation P.51g	0.00	0.01	0.49
Capital transfers D.9			
TOTAL CAPITAL EXPENDITURE	0.00	0.01	0.49

Table 7: Divergence from Stability Programme 2021–2024

	ESA Code	2020	2021	2022
		% of GDP		
Target general government net lending/ net borrowing	B.9			
Stability Programme		-5.4	-9.3	-2.7
Draft Budgetary Plan		-4.5	-9.3	-4.8
Difference		0.8	0.0	-2.1
General government net lending projection at unchanged policies	B.9			
Stability Programme		-5.4	-9.3	-2.7
Draft Budgetary Plan		-4.5	-9.3	-2.9
Difference ³		0.8	0.1	-0.3

³ This difference can refer to both deviations stemming from changes in the macroeconomic scenario and those stemming from the effect of policy measures taken between the submission of the Stability Programme and the submission of the DBP. Differences are expected due to the fact that the no-policy change scenario is defined differently for the purpose of this Code of Conduct with respect to the Stability Programme.

Annex: Methodological aspects

Macroeconomic forecasts are developed by applying the medium-term macro-economic model, which ensures proper macroeconomic relationships within the forecasts and employs short-term and medium-term results of econometric models as well as expert assessment.

In the preparation of tax revenue projections, widely known forecasting methods and assumptions are applied, however the most used is a specially developed tool, i.e. the model LATIM-F. The most frequently used tax revenue forecasting techniques are as follows:

- using detailed tax revenue estimations;
- forecasting of tax revenue share in GDP, %;
- forecasting the actual taxable base/base modelled relationships;
- using expert assessment;
- using other techniques.

In order to project tax revenue, as stated above, the MoF applies the tax revenue forecast model LATIM-F, the main components of which are a data base of macroeconomic indicators, actual tax revenue and legislative changes (including tax rates, etc.). Moreover, in the process of analysis the information from the State Treasury, the State Revenue Service, the Central Statistics Bureau and other sources is used.