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COMMISSION OPINION

of 21.11.2018

on the Draft Budgetary Plan of Latvia

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GENERAL CONSIDERATIONS

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

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

CONSIDERATIONS CONCERNING LATVIA

3. On the basis of the Draft Budgetary Plan for 2019 submitted on 15 October 2018 by Latvia, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013. The Draft Budgetary Plan was submitted by the outgoing government on the basis of unchanged policies.

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

5. According to the Commission 2018 autumn forecast, the Latvian economy is expected to grow by 4.1% in 2018 and 3.2% in 2019, reflecting the expected investment slowdown to single-digit growth rates. The Draft Budgetary Plan assumes similar GDP developments, which appear to be plausible. The macroeconomic forecast has been endorsed by Latvia's independent fiscal authority. In order to ensure compliance with the requirement of Regulation (EU) No 473/2013, the draft Budget Act to be transmitted to the national parliament should be based on an independently endorsed macroeconomic forecast.

6. The Draft Budgetary Plan estimates a headline deficit of 0.8% of GDP in 2018 and 0.7% of GDP in 2019. The budgetary no-policy-change estimates for 2019 currently assume lower government revenue and expenditure growth in anticipation of further policy measures to be adopted by the new government. The Commission 2018 autumn forecast of the government deficit for 2018 is 0.8% of GDP and 1.0% of GDP in 2019, under the no-policy-change assumption. The Commission forecast assumes smoother revenue and expenditure growth over 2018-2019 and applies trend growth assumption where the policy is not yet specified.

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

7. The tax wedge on low-wage earners remains relatively high even after the reform measures implemented from 2018. The no-policy-change Draft Budgetary Plan presents no new measures in response to the Council Recommendation of 13 July 2018 to reduce taxation for low-income earners by shifting it to other sources, particularly capital and property, and by improving tax compliance.

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

At the same time, Latvia has a requirement that the nominal growth rate of net primary government expenditure should not exceed 6.0% in 2018 and 4.6% in 2019, corresponding to a maximum deterioration of the structural balance by 0.3% in 2018 and an adjustment of 0.3% of GDP in 2019. Based on the Commission 2018 autumn forecast, the expenditure benchmark would currently point to a risk of a significant deviation from those requirements in 2018 and 2019. If the structural balance is no longer projected to be close to the medium-term budgetary objective taking into account the allowance related to the implementation of structural reforms in future assessments for 2018 or 2019, the overall assessment of compliance will need to take into account a possible deviation from that requirement.

9. Overall, while acknowledging the no-policy-change nature of the current projections, the Commission is of the opinion that the Draft Budgetary Plan of Latvia is broadly compliant with the provisions of the Stability and Growth Pact. However, this assessment is dependent on the current projection that Latvia will be close to its medium-term budgetary objective, taking into account the allowance linked to the implementation of structural reforms. If such a projection is not confirmed in future assessments, the overall assessment of compliance will need to take into account the extent of the deviation from the requirement set by the Council. The Commission invites the authorities to stand ready to take the necessary measures within the national budgetary process to ensure that the 2019 budget will be compliant with the SGP.

The Commission is also of the opinion that Latvia has made limited progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 13 July 2018 in the context of the European Semester and thus invites the authorities to accelerate progress. A comprehensive description of progress made with the implementation of the country-specific recommendations will be made in the 2019 Country Reports and assessed in the context of the country-specific recommendations to be proposed by the Commission in May 2019.

As soon as a new government takes office and as a rule at least one month before the draft budget law is planned to be adopted by the national parliament, the authorities are invited to submit to the Commission and the Eurogroup an updated Draft Budgetary Plan.

Done at Brussels, 21.11.2018

For the Commission
Pierre MOSCOVICI
Member of the Commission

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For the Secretary-General,

Jordi AYET PUIGARNAU
Director of the Registry
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