COUNCIL OF THE EUROPEAN UNION

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from:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
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Subject:	Recommendation for a COUNCIL RECOMMENDATION on Latvia's 2012 national reform programme and delivering a Council opinion on Latvia's convergence programme for 2012-2015

Delegations will find attached Commission document COM(2012) 320final.

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Recommendation for a

COUNCIL RECOMMENDATION

on Latvia's 2012 national reform programme

and delivering a Council opinion on Latvia's convergence programme for 2012-2015

{SWD(2012) 320 final}

Recommendation for a

COUNCIL RECOMMENDATION

on Latvia's 2012 national reform programme

and delivering a Council opinion on Latvia's convergence programme for 2012-2015

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission[2],

Having regard to the resolutions of the European Parliament[3],

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

After consulting the Economic and Financial Committee,

Whereas:

(1) On 26 March 2010, the European Council agreed to the European Commission's proposal to launch a new strategy for jobs and growth, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 13 July 2010, the Council adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, adopted a decision on guidelines for the employment policies of the Member States[4], which together form the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

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1 OJ L 209, 02.08.1997, p. 1
2 COM(2012)320 final
3 P7_TA(2012)0048 and P7_TA(2012)0047
4 Council Decision 2012/238/EU of 26 April 2012

(3) On 12 July 2011, the Council adopted a recommendation on Latvia's national reform programme for 2011 and delivered its opinion on Latvia's updated convergence programme for 2011-2014.

(4) On 23 November 2011, the Commission adopted the second Annual Growth Survey, marking the start of the second European Semester of ex-ante and integrated policy coordination, which is anchored in the Europe 2020 strategy. On 14 February 2012, the Commission, on the basis of Regulation (EU) No 1176/2011, adopted the Alert Mechanism Report[5], in which it did not identify Latvia as one of the Member States for which an in-depth review would be carried out.

(5) Latvia has met most of the conditions related to the financial assistance programme in 2011. The Commission completed the fifth and final review under Latvia's balance-of-payments programme on 21 December 2011 with an overall positive assessment on the government's progress in budgetary, financial and structural reforms. The programme expired in January 2012. Following the expiration of the programme, Latvia is subject to post-programme surveillance. This surveillance forms an integral part of the existing procedures and surveillance mechanisms and it aims at close monitoring of risks that could jeopardise macro-economic stability and hence affect the repayment capacity. The post-programme surveillance will continue until the repayment of a large fraction (about 70%) of loans.

(6) On 2 March 2012, the European Council endorsed the priorities for ensuring financial stability, fiscal consolidation and action to foster growth. It underscored the need to pursue differentiated, growth-friendly fiscal consolidation, to restore normal lending conditions to the economy, to promote growth and competitiveness, to tackle unemployment and the social consequences of the crisis, and to modernise public administration.

(7) On 2 March 2012, the European Council also invited the Member States participating in the Euro Plus Pact to present their commitments in time for inclusion in their stability or convergence programmes and their national reform programmes.

(8) On 30 April 2012, Latvia submitted its 2012 convergence programme covering the period 2012-2015 and its 2012 national reform programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

5 COM(2012) 68 final.

(9) Based on the assessment of the 2012 convergence programme pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections is cautious in 2012, taking into account the latest available information, and plausible in 2013. While macroeconomic projections for 2012 in the programme scenario are very close to those in the Commission's spring 2012 forecast (with GDP growth projections respectively at 2.0% and 2.2%), recent economic data indicates that the outturn may be higher. The objective of the budgetary strategy outlined in the programme is to correct an excessive deficit by 2012 and to approach the medium-term budgetary objective (MTO) by the end of the programme period. The 2012 convergence programme has changed the medium-term objective from -1.0% to -0.5% of GDP; the new MTO adequately reflects the requirements of the Stability and Growth Pact. The planned headline deficit in 2012 complies with the deadline for correction of the excessive deficit established in Council Recommendation of 7 July 2009. For 2013, the programme targets a headline deficit of 1.4% of GDP, although the planned expenditure reduction is not yet fully supported by measures. Based on the (recalculated) structural budget balance[6], Latvia will approach its MTO by the end of the programme period in 2015. While the recalculated information suggests that progress towards the MTO is less than 0.5% of GDP in structural terms in outer years of the programme, planned expenditure restraint would ensure that the growth rate of government expenditure, taking into account discretionary revenue measures, would be in line with the expenditure benchmark of the Stability and Growth Pact. At the same time, possible tax changes from the second half of 2012, which are not yet reflected in the programme scenario but acknowledged in the letter accompanying the submission of the 2012 convergence programme represent a risk to the attainment of targets in 2013 and beyond. The general government debt ratio is below 60% of GDP, increasing from 42.6% of GDP in 2011 to 46.7% of GDP in 2014, as the authorities pre-fund large repayments related to the international financial assistance programme that are due in 2014-2015, and falling to 38.9% in 2015 as these repayments are made.

(10) Latvia should pursue the strategy of shifting taxation from labour to taxation of consumption, property, and the use of natural and other resources, while improving the structural balance. The relatively high tax burden on low-wage earners and the high level of undeclared work indicate the need for appropriate labour-market policies, a review of the tax and benefit system and increased efforts to tackle the shadow economy. Environmental taxes remain relatively underdeveloped and are heavily dominated by motor-fuel taxation, while taxation on other energy sources, pollution and the use of natural resources is below the EU average. Further broadening the tax base to other sources of environmental taxation, in particular pollution, as well as more broad-based taxation of energy sources, would help in achieving environmental goals while providing room for a tax shift away from the taxation of labour.

[6] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission services on the basis of the information provided in the programme, using the commonly agreed methodology.

(11) In the process of the on-going reform of fiscal governance, Latvia is invited to ensure adoption of the Fiscal Discipline Law by the Parliament and to develop a medium term budgetary framework law to support the long-term sustainability of public finances. The adoption of the Fiscal Discipline Law will be in line with the commitments by the Latvian government under the balance-of-payments programme; the draft law adopted by the government also seeks to implement the evolving EU acquis in the area of fiscal governance into Latvian legislation. When adopted and implemented, the new law would considerably strengthen the fiscal framework in Latvia, which currently lacks an effective mechanism to limit expenditure growth in good economic times.

(12) So as to ensure the continuity of the pension reform, Latvia should restore contributions to the mandatory funded private pension scheme at 6% of gross wages in 2013, from the current reduced level of 2% of gross wages.

(13) Latvia needs to strengthen and reform the social assistance system and tackle one of the highest unemployment rates in the EU. The challenge of youth unemployment became especially evident during the crisis, revealing also high skills mismatches. Special active labour market policies targeted at young people have been designed and implemented including vocational training, volunteer work and wage subsidies for young people. However, given the scale of the problem, these limited activities have a relatively small impact.

(14) In 2011, 40% of the Latvian population is facing the risk of poverty which has implications for the employability of the workforce and future growth prospects. Latvia adopted an Emergency Social Safety Net Strategy. Government policies to reduce poverty are concentrated on the reduction of income inequality, reduced tax burden for working families and increased access to the labour market. Nevertheless, Latvia spends relatively little on social protection and social transfers have only a low impact on poverty reduction, as a large share of social transfers is redistributed back to middle and high income earners. Spending on means tested benefits is low, while the role of social safety net is partly fulfilled by temporary low-paid public jobs. The design of social assistance benefits also contains poverty and unemployment traps and there are abuses of the system. Large inequality exists in access to social assistance across local governments and poor transparency complicates evidence-based decision making. The challenges of long term unemployment and of youth unemployment became especially evident during the crisis. Most of the young unemployed do not possess professional qualifications. The number of young people not in employment, education or training (NEET's) is relatively high. Measures should be taken in line with the outcome of the Latvian - Commission joint action team on youth unemployment

(15) Latvia should further improve energy efficiency and promote competition in major energy networks, while improving connectivity with EU energy networks. The tax system does not provide sufficient incentives for reducing energy costs and shifting consumption and investment towards energy efficient products (transport vehicles, insulation of buildings, heating systems). Energy markets in Latvia remain dominated by monopolies. For historical reasons, the gas and electricity markets are largely separated from other EU member states.

(16) Inefficiencies in the civil justice system have a negative impact on business and the economic environment, as the risk and cost of doing business increases. There is a large backlog of proceedings in the first and second instance courts in civil and commercial cases, especially as regards contractual obligations and insolvencies. The professional performance of judges should be evaluated. Further improvements in the insolvency law regime are warranted.

(17) Despite the relatively high educational attainment, a significant share of the workforce does not possess professional qualifications and has limited access to higher education. Universities perform poorly in worldwide rankings and are characterized by low international competitiveness and weak governance. Low cooperation among universities, research institutions, and businesses affects the very low innovation performance. A systematic and effective research and innovation strategy is lacking. Latvia also has the lowest business R&D expenditure in the EU.

(18) Latvia has made a number of commitments under the Euro Plus Pact. These commitments, and the implementation of the commitments presented in 2011, relate to fostering employment, improving competitiveness, enhancing sustainability of public finances and reinforcing financial stability. The Commission has assessed the implementation of the Euro Plus Pact commitments. The results of this assessment have been taken into account in the recommendations.

(19) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Latvia's economic policy. It has assessed the convergence programme and national reform programme. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Latvia but also their compliance with EU rules and guidance, given the need to reinforce the overall economic governance of the European Union by providing EU-level input into future national decisions. Its recommendations under the European Semester are reflected in recommendations (1) to (7) below.

(20) In the light of this assessment, the Council has examined Latvia's convergence programme, and its opinion[7] is reflected in particular in recommendation (1) below,

HEREBY RECOMMENDS that Latvia should take action within the period 2012-2013 to:

1. Ensure planned progress towards the timely correction of the excessive deficit. To this end, implement the budget for the year 2012 as envisaged and achieve the fiscal effort specified in the Council recommendation under the Excessive Deficit Procedure. Thereafter, implement a budgetary strategy, supported by sufficiently specified structural measures, for the year 2013 and beyond, to make sufficient progress towards the medium-term budgetary objective (MTO), and to respect the expenditure benchmark. Use better than expected cyclical revenue to reduce government debt.

[7] Under Article 9(2) of Council Regulation (EC) No 1466/97.

2. Implement measures to shift taxation away from labour to consumption, property, and use of natural and other resources while improving the structural balance; ensure adoption of the Fiscal Discipline Law and develop a medium term budgetary framework law to support the long-term sustainability of public finances; restore contributions to the mandatory funded private pension scheme at 6% of gross wages from 2013.

3. Take measures to reduce long-term and youth unemployment by fighting early school leaving, promoting more efficient apprenticeships and VET, enhancing the quality, coverage and effectiveness of active labour market policy and its training component and through an effective wage subsidy scheme

4. Tackle high rates of poverty and social exclusion by reforming the social assistance system to make it more efficient, while better protecting the poor. Ensure better targeting and increase incentives to work.

5. Further encourage energy efficiency by providing incentives for reducing energy costs and shifting consumption towards energy-efficient products, including vehicles, buildings and heating systems. Promote competition in major energy networks (electricity, natural gas, heating) and improve connectivity with EU energy networks.

6. Take measures to improve management and efficiency of the judiciary, in particular to reduce the backlog and length of procedures. Take steps to improve the insolvency regime and the mediation laws.

7. Continue reforms in higher education, inter alia, by implementing a new financing model that rewards quality, strengthens links with market needs and research institutions, and avoids fragmentation of budget resources. Design and implement an effective research and innovation policy encouraging companies to innovate, including via tax incentives, upgrading infrastructure and rationalising research institutions.

Done at Brussels,

For the Council
The President