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NOTE

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To: Permanent Representatives Committee/Council

No. prev. doc.: 9779/23 - COM(2023) 614 final

Subject: Recommendation for a COUNCIL RECOMMENDATION on the 2023 National Reform Programme of Latvia and delivering a Council opinion on the Stability Programme of Latvia

Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees and finalized by the Economic and Financial Committee, based on the Commission Proposal COM(2023) 614 final.

Recommendation for a
COUNCIL RECOMMENDATION

**on the 2023 National Reform Programme of Latvia and delivering a Council opinion
on the Stability Programme of Latvia**

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 policies¹, and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances², and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

¹ OJ L 209, 2.8.1997, p. 1.

² OJ L 306, 23.11.2011, p. 25.

- (1) Regulation (EU) 2021/241 of the European Parliament and of the Council³, which established the Recovery and Resilience Facility, entered into force on 19 February 2021. The Recovery and Resilience Facility provides financial support to the Member States for the implementation of reforms and investments, entailing a fiscal impulse financed by the EU. In line with the European Semester priorities, it contributes to economic and inclusive recovery and to the implementation of sustainable and growth-enhancing reforms and investments, in particular to promote the green and digital transition and make the Member States' economies more resilient. It also helps strengthen public finances and boost growth and job creation in the medium and long term, improve territorial cohesion within the EU and support the continued implementation of the European Pillar of Social Rights. The maximum financial contribution per Member State under the Recovery and Resilience Facility was updated on 30 June 2022 in accordance with Article 11(2) of Regulation (EU) 2021/241.

³ Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17).

- (2) On 22 November 2022, the Commission adopted the 2023 Annual Sustainable Growth Survey⁴, marking the start of the 2023 European Semester for economic policy coordination. The European Council endorsed the priorities of the survey around the four dimensions of competitive sustainability on 23 March 2023. On 22 November 2022, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the 2023 Alert Mechanism Report, in which it identified Latvia as one of the Member States that may be affected or may be at risk of being affected by imbalances, and for which an in-depth review would be needed. On 24 February 2023, the Commission also adopted an opinion on Latvia's 2023 draft budgetary plan. The Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which the European Council endorsed on 23 March 2023 and the Council adopted on 16 May 2023, as well as the proposal for the 2023 Joint Employment Report analysing the implementation of the Employment Guidelines and the principles of the European Pillar of Social Rights, which the Council adopted on 13 March 2023.
- (3) While the EU economies are showing remarkable resilience, the geopolitical context continues to have a negative impact. As the EU stands firmly with Ukraine, the EU economic and social policy agenda is focused on reducing the negative impact of energy shocks on both vulnerable households and companies in the short term, and on keeping up efforts to deliver on the green and digital transition, support sustainable and inclusive growth, safeguard macroeconomic stability and increase resilience in the medium term. It also focuses heavily on increasing the EU's competitiveness and productivity.

⁴ COM(2022) 780 final.

- (4) On 1 February 2023, the Commission issued the Communication *A Green Deal Industrial Plan for the Net-Zero Age*⁵ to boost the competitiveness of the EU's net-zero industry and support the fast transition to climate neutrality. The plan complements ongoing efforts under the European Green Deal and REPowerEU. It aims to provide a more supportive environment for scaling up the EU's manufacturing capacity for the net-zero technologies and products required to meet the EU's ambitious climate targets, as well as ensuring access to relevant critical raw materials, including by diversifying sourcing, properly exploiting geological resources in Member States and maximising the recycling of raw materials. The plan is based on four pillars: a predictable and simplified regulatory environment, speeding up access to finance, enhancing skills, and open trade for resilient supply chains. On 16 March 2023, the Commission also issued the Communication *Long-term competitiveness of the EU: looking beyond 2030*⁶, structured along nine mutually reinforcing drivers with the objective to work towards a growth-enhancing regulatory framework. It sets policy priorities aimed at actively ensuring structural improvements, well focused investments and regulatory measures for the long-term competitiveness of the EU and its Member States. The recommendations below help address those priorities.
- (5) In 2023, the European Semester for economic policy coordination continues to evolve in line with the implementation of the Recovery and Resilience Facility. Fully implementing the recovery and resilience plans remains essential for delivering of the policy priorities under the European Semester, as the plans address all or a significant subset of the relevant country-specific recommendations issued in recent years. The 2019, 2020 and 2022 country-specific recommendations remain equally relevant also for recovery and resilience plans revised, updated or amended in accordance with Articles 14, 18 and 21 of Regulation (EU) 2021/241.

⁵ COM(2023) 62 final.

⁶ COM(2023) 168 final.

- (6) The REPowerEU Regulation⁷ adopted on 27 February 2023, aims to rapidly phase out the EU's dependence on Russian fossil fuel imports. This will contribute towards energy security and the diversification of the EU's energy supply, while increasing the uptake of renewables, energy storage capacities and energy efficiency. The Regulation enables Member States to add a new REPowerEU chapter to their national recovery and resilience plans in order to finance key reforms and investments that will help achieve the REPowerEU objectives. They will also help boost the competitiveness of the EU's net-zero industry as outlined in the Green Deal Industrial Plan for the Net-Zero Age and address the energy-related country-specific recommendations issued to the Member States in 2022 and, where applicable, in 2023. The REPowerEU Regulation introduces a new category of non-repayable financial support, made available to Member States to finance new energy-related reforms and investments under their recovery and resilience plans.

⁷ Regulation (EU) 2023/435 of the European Parliament and of the Council of 27 February 2023 amending Regulation (EU) 2021/241 as regards REPowerEU chapters in recovery and resilience plans and amending Regulations (EU) No 1303/2013, (EU) 2021/1060 and (EU) 2021/1755, and Directive 2003/87/EC (OJ L 63, 28.2.2023, p. 1).

(7) On 8 March 2023, the Commission adopted a communication providing fiscal policy guidance for 2024. It aims to support the preparation of Member States' stability and convergence programmes and thereby strengthen policy coordination⁸. The Commission recalled that the general escape clause of the Stability and Growth Pact will be deactivated at the end of 2023. It called for fiscal policies in 2023-2024 that ensure medium-term debt sustainability as well as raise potential growth in a sustainable manner. Member States were invited to set out in their 2023 stability and convergence programmes how their fiscal plans will ensure that the 3% of GDP deficit reference value is adhered to as well as plausible and continuous debt reduction, or for debt to be kept at prudent levels in the medium term. The Commission invited Member States to phase out national fiscal measures introduced to protect households and firms from the energy price shock, starting with the least targeted ones. It indicated that, if support measures needed to be extended because of renewed energy price pressures, Member States should target such measures much better than in the past towards vulnerable households and firms. The Commission proposed that the fiscal recommendations would be quantified and differentiated. Moreover, as proposed in its Communication on orientations for a reform of the EU economic governance framework⁹, the fiscal recommendations would be formulated on the basis of net primary expenditure. It recommended that all Member States should continue to protect nationally financed investment and ensure the effective use of the Recovery and Resilience Facility and other EU funds, in particular in light of the green and digital transition and resilience objectives. The Commission indicated that it will propose to the Council to open deficit-based excessive deficit procedures in spring 2024 on the basis of the outturn data for 2023, in line with existing legal provisions.

⁸ COM(2023) 141 final.

⁹ COM(2022) 583 final.

- (8) On 26 April 2023, the Commission presented legislative proposals to implement a comprehensive reform of the EU's economic governance rules. The central objective of the proposals is to strengthen public debt sustainability and promote sustainable and inclusive growth in all Member States through reforms and investments. In its proposals, the Commission aims at improving national ownership, simplifying the framework and moving towards a greater medium-term focus, combined with effective and more coherent enforcement. According to the Council Conclusions adopted on 14 March 2023, the objective is to conclude the legislative work in 2023.
- (9) On 30 April 2021, Latvia submitted its national recovery and resilience plan to the Commission, in accordance with Article 18(1) of Regulation (EU) 2021/241. Pursuant to Article 19 of Regulation (EU) 2021/241, the Commission assessed the relevance, effectiveness, efficiency and coherence of the recovery and resilience plan, in accordance with the assessment guidelines of Annex V to that Regulation. On 13 July 2021, the Council adopted its Decision on the approval of the assessment of the recovery and resilience plan for Latvia¹⁰. The release of instalments is conditional on a decision by the Commission, taken in accordance with Article 24(5) of Regulation (EU) 2021/241, that Latvia has satisfactorily fulfilled the relevant milestones and targets set out in the Council Implementing Decision. Satisfactory fulfilment presupposes that the achievement of preceding milestones and targets has not been reversed.

¹⁰ Council Implementing Decision of 13 July 2021 on the approval of the assessment of the recovery and resilience plan for Latvia (ST 10157/21; ST 10157/21 ADD 1; ST 10157/21 ADD 1 COR 1).

- (10) On 25 April 2023, Latvia submitted its 2023 National Reform Programme and, on 17 April 2023, its 2023 Stability Programme, in line with Article 4(1) of Regulation (EC) No 1466/97. To take account of their interlinkages, the two programmes have been assessed together. In accordance with Article 27 of Regulation (EU) 2021/241, the 2023 National Reform Programme also reflects Latvia's biannual reporting on the progress made in achieving its recovery and resilience plan.
- (11) The Commission published the 2023 country report for Latvia¹¹ on 24 May 2023. It assessed Latvia's progress in addressing the relevant country-specific recommendations adopted by the Council between 2019 and 2022 and took stock of Latvia's implementation of the recovery and resilience plan. Based on this analysis, the country report identified gaps with respect to those challenges that are not addressed or only partially addressed by the recovery and resilience plan, as well as new and emerging challenges. It also assessed Latvia's progress on implementing the European Pillar of Social Rights and on achieving the EU headline targets on employment, skills and poverty reduction, as well as progress in achieving the UN's Sustainable Development Goals.

¹¹ SWD(2023) 614 final.

(12) The Commission carried out an in-depth review under Article 5 of Regulation (EU) No 1176/2011 for Latvia and published its results on 24 May 2023¹². It concluded that Latvia is not experiencing macroeconomic imbalances. In particular, vulnerabilities relating to external borrowing and housing remain mild; risks to competitiveness are pertinent, but overall seem contained in the near future. The recent widening of the current account deficit was significant, but the deficit is expected to narrow substantially this year and further in 2024. Latvia's net international investment position, which improved markedly in the past decade, is expected to remain broadly stable. Nonetheless, inflation and wage pressures, if persistent, risk impairing Latvia's competitiveness, particularly as core inflation is well above the euro area average. While house price growth has been elevated recently, the house price overvaluation does not appear to be substantial. Moreover, house price growth slowed down in late 2022, mortgage lending has been weak, and household debt is limited and falling in terms of household income. Latvia faces key structural economic challenges related to declining labour supply, which has contributed to fast unit labour cost increases and risks impairing competitiveness over the medium term. The policy setting is overall favourable, although some additional efforts could help to address the risks from the identified vulnerabilities. Policies to safeguard competitiveness, including measures to increase the quality and quantity of labour supply, would be important in that respect. Shortening the construction permitting process would help supporting housing supply and improve the housing market situation.

¹² SWD(2023) 636 final.

- (13) Based on data validated by Eurostat,¹³ Latvia's general government deficit decreased from 7.1% of GDP in 2021 to 4.4% in 2022, while general government debt fell from 43.7% of GDP at the end of 2021 to 40.8% at the end of 2022. On 24 May 2023, the Commission published a report under Article 126(3) TFEU;¹⁴ the report discussed the budgetary situation of Latvia, as its general government deficit in 2022 exceeded the 3% of GDP Treaty reference value. The report concluded that the deficit criterion was not fulfilled. In line with the Communication of 8 March 2023,¹⁵ the Commission did not propose to open new excessive deficit procedures in spring 2023; in turn, the Commission stated that it would propose to the Council to open deficit-based excessive deficit procedures in spring 2024, on the basis of the outturn data for 2023. Latvia should take account of this in the execution of its 2023 budget and in preparing the Draft Budgetary Plan for 2024.
- (14) The general government balance has been impacted by the fiscal policy measures adopted to mitigate the economic and social impact of the increase in energy prices. In 2022, such expenditure-increasing measures included cost compensation for heating (based on the energy source used) and reduction of electricity bills for households; monthly benefits to vulnerable households and families with children as well as earlier indexation of pensions; grants to energy intensive companies and compensation for the increase of electricity costs for companies. The Commission estimates the net budgetary cost of these measures at 1.5% of GDP in 2022. The general government balance has also been impacted by the budgetary cost of temporary protection to displaced persons from Ukraine, which is estimated at 0.2% of GDP in 2022. At the same time, the estimated cost of COVID-19 temporary emergency measures dropped to 1.2% of GDP in 2022, from 5.0% in 2021.

¹³ Eurostat-Euro Indicators, 47/2023, 21.4.2023.

¹⁴ COM(2023) 631 final, 24.05.2023.

¹⁵ COM(2023) 141 final, 8.3.2023.

- (15) On 18 June 2021, the Council recommended that in 2022 Latvia¹⁶ maintain a supportive fiscal stance, including from the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment. The Council also recommended Latvia to keep the growth of nationally financed current expenditure under control.
- (16) According to the Commission estimates, the fiscal stance¹⁷ in 2022 was neutral, at 0.0% of GDP, which was appropriate in a context of high inflation. As recommended by the Council, Latvia continued to support the recovery with investments financed by the Recovery and Resilience Facility. Expenditure financed by Recovery and Resilience Facility grants and other EU funds amounted to 1.1% of GDP in 2022 (1.3% of GDP in 2021). Due to capacity constraints and a rise in construction prices, some investments financed by Recovery and Resilience Facility grants and other EU funds in 2022 were delayed, leading to the small decrease in expenditure. Nationally financed investment provided a contractionary contribution of 1.2 percentage points to the fiscal stance.¹⁸ Latvia therefore did not preserve nationally financed investment, which is not in line with the Council recommendation. At the same time, the growth in nationally financed primary current expenditure (net of new revenue measures) provided a contractionary contribution of 0.3 percentage points to the fiscal stance. Latvia therefore kept under control the growth in nationally financed current expenditure.

¹⁶ Council Recommendation of 18 June 2021 delivering a Council opinion on the 2021 Stability Programme of Latvia, OJ C 304, 29.07.2021, p. 63.

¹⁷ The fiscal stance is measured as the change in primary expenditure (net of discretionary revenue measures), excluding Covid-19 crisis-related temporary emergency measures but including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds, relative to medium-term potential growth. For more details see Box 1 in the Fiscal Statistical Tables.

¹⁸ This contractionary contribution is due in particular to lower spending on investment projects co-financed by EU funds which also affected the national co-financing developments (in particular at the local government level) as well as due to the transfer of military equipment to Ukraine which is recorded as a negative GFCF off-set by a capital transfer.

At the same time, other nationally financed capital expenditure provided an expansionary contribution of 1.7 percentage points of GDP. Increase in the other capital expenditure is largely explained by two factors – creation of natural gas reserves for the security of national energy supply as well as by delivery of military equipment to Ukraine.

- (17) The macroeconomic scenario underpinning the budgetary projections in the Stability Programme is cautious in 2023 and thereafter. The government projects real GDP to stagnate in 2023 and grow by 2.0% in 2024. By comparison, the Commission 2023 spring forecast projects a higher real GDP growth of 1.4% in 2023 and 2.8% in 2024, reflecting the incorporation of new data releases compared to the Stability Programme, namely data revisions of 2022 GDP growth as well as the flash estimate for the first quarter of 2023, both of which put the GDP growth higher than previously expected. However, in nominal terms, GDP growth is closer in both forecasts with 11.7% and 5.5% growth expected for 2023 and 2024, respectively, in the Stability Programme and 10.5% and 5.6% growth forecast for the respective years by the Commission.
- (18) In its 2023 Stability Programme, the government expects that the general government deficit will decrease to 4.0% of GDP in 2023. The deficit adjustment in 2023 mainly reflects expenditure developments. A deficit-decreasing contribution is expected from the phasing out of most pandemic-related support measures and the lump-sum expenditure in 2022 for the creation of a national gas reserve is not foreseen for 2023. These savings are set to be partially offset by expenditure measures included in the 2023 budget package, such as a wage increase for public administration and medical personnel, higher current expenditure for healthcare services, science, research and higher education as well as a substantial public investment package for defence and internal security. Moreover, higher spending is expected for pensions and allowances due to higher indexation coefficients. According to the Programme, the general government debt-to-GDP ratio is expected to decrease from 40.8% at the end of 2022 to 39.6% at the end of 2023. The Commission 2023 spring forecast projects a government deficit of 3.8% of GDP for 2023. This is in line with the deficit projected in the Stability Programme. The Commission 2023 spring forecast projects a slightly higher general government debt-to-GDP ratio, of 39.8% at the end of 2023.

(19) The government balance in 2023 is expected to continue to be impacted by the measures adopted to mitigate the economic and social impact of the increase in energy prices. They mainly consist of measures extended from 2022. The net budgetary cost of the support measures is projected in the Commission 2023 spring forecast at 1.0% of GDP in 2023¹⁹. Most measures in 2023 do not appear targeted to the most vulnerable households or firms, and do not fully preserve the price signal to reduce energy demand and increase energy efficiency. As a result, the amount of targeted support measures, to be taken into account in the assessment of compliance with the recommendation for 2023, is estimated in the Commission 2023 spring forecast at 0.1% of GDP in 2023 (compared to 0.5% of GDP in 2022). The budgetary cost of temporary protection to displaced persons from Ukraine is projected to increase by 0.1 pps. of GDP compared to 2022. Finally, the 2023 government balance is expected to benefit from the phasing out of COVID-19 temporary emergency measures of 1.2% of GDP.

¹⁹ The figure represents the level of annual budgetary cost of those measures, including current revenue and expenditure as well as – where relevant – capital expenditure measures.

- (20) On 12 July 2022, the Council recommended²⁰ that Latvia take action to ensure in 2023 that the growth of nationally financed primary current expenditure is in line with an overall neutral policy stance²¹, taking into account continued temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. Latvia should stand ready to adjust current spending to the evolving situation. Latvia was also recommended to expand public investment for the green and digital transitions, and for energy security taking into account the REPowerEU initiative, including by making use of the Recovery and Resilience Facility and other Union funds.

²⁰ Council Recommendation of 12 July 2022 on the National Reform Programme of Latvia and delivering a Council opinion on the 2022 Stability Programme of Latvia OJ C 334, 01.09.2022, p. 112.

²¹ Based on the Commission spring 2023 forecast, the medium-term (10-year average) potential output growth of Latvia, which is used to measure the fiscal stance, is estimated at 11.5% in nominal terms.

(21) In 2023, the fiscal stance is projected in the Commission 2023 spring forecast to be expansionary (- 0.9% of GDP), in a context of high inflation. This follows a neutral fiscal stance in 2022 (0.0% of GDP). The growth in nationally financed primary current expenditure (net of discretionary revenue measures) in 2023 is projected to provide an expansionary contribution of 0.5% of GDP to the fiscal stance. This includes the reduced cost of the targeted support measures to households and firms most vulnerable to energy price hikes by 0.4% of GDP. This also includes higher costs to offer temporary protection to displaced persons from Ukraine (by 0.1% of GDP). The expansionary contribution of nationally financed net primary current expenditure is therefore not due to the targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. The expansionary growth in nationally financed primary current expenditure (net of discretionary revenue measures) is driven by expenditure measures included in the 2023 budget package, such as wage increase for administration and medical personnel, additional current expenditure financing oncology, science and research and other discretionary current expenditure for national administration as well as higher spending for pensions and allowances. In sum, the projected growth of nationally financed primary current expenditure is not in line with the recommendation of the Council. Expenditure financed by Recovery and Resilience Facility grants and other EU funds is projected to amount to 2.2% of GDP in 2023, while nationally financed investment is projected to provide an expansionary contribution to the fiscal stance of 1.0 percentage points²².

²² Other nationally financed capital expenditure is projected to provide a contractionary contribution of 1.7 percentage points of GDP due the fact that Commission forecast for 2023 does not include creation of natural gas reserves for security of energy supply and military assistance to Ukraine.

Therefore, Latvia plans to finance additional investment through the Recovery and Resilience Facility and other EU funds, and it is projected to preserve nationally financed investment. It plans to finance public investment for the green and digital transitions, and for energy security, such as the purchase of electric vehicles for public transport, improving the energy efficiency of multi-apartment buildings and business properties, modernising the electricity transmission and distribution networks, strengthening the response capacity of rescue services, centralising governance digital platforms and systems in the public sector, developing the digital skills and digitisation of processes in businesses, broadband infrastructure development as well as fostering digitalisation in the education sector, which are largely funded by the Recovery and Resilience Facility and other EU funds.

- (22) According to the Stability Programme the general government deficit is expected to decline to 2.5% of GDP in 2024. The decrease in 2024 mainly reflects the phasing out of support measures to mitigate the impact of high energy prices and absence of COVID-19 pandemic related current expenditure and finalisation in 2023 of investment to support the recovery from the pandemic. The programme expects the general government debt-to-GDP ratio to increase slightly to 39.7% at the end of 2024. Based on policy measures known at the cut-off date of the forecast, the Commission 2023 spring forecast projects a government deficit of 2.7% of GDP in 2024. This is in line with the deficit projected in the programme. The Commission 2023 spring forecast projects a higher general government debt-to-GDP ratio, of 40.5% at the end of 2024, mainly due to the lower nominal GDP.

- (23) The Stability Programme envisages the phasing out of all of the energy support measures in 2024. The Commission also assumes full phasing out of energy support measures in 2024. This hinges upon the assumption of no renewed energy price increases.
- (24) Council Regulation (EC) No 1466/97 calls for an annual improvement in the structural budget balance toward the medium-term objective by 0.5% of GDP as a benchmark.²³ Taking into account fiscal sustainability considerations, and the need to reduce the deficit to below the 3% of GDP reference value, an improvement in the structural balance of at least 0.5% of GDP for 2024 would be appropriate, according to the Commission. To ensure such an improvement, and in accordance with the Commission's methodology, the growth in net nationally financed primary expenditure²⁴ in 2024 should not exceed 3.0%, as reflected in this recommendation. This will also contribute to reducing core inflation, which is well above the euro area average, and which could lead to competitiveness losses if persistent. At the same time, the remaining energy support measures (currently estimated by the Commission at 1.0% of GDP in 2023) should be phased out, contingent on energy market developments and starting from the least targeted ones, and the related savings should be used to reduce the government deficit. Based on Commission estimates, this would lead to a growth in net primary expenditure below the recommended maximum growth rate for 2024. In addition, according to the Commission 2023 spring forecast, the growth in net nationally financed primary current expenditure in 2023 is not in line with the recommendation of the Council. If this is confirmed, lower growth in net primary expenditure in 2024 would be appropriate.

²³ Cf. Article 5 of Council Regulation (EC) No 1466/97, which also requires an adjustment of more than 0.5% of GDP for Member States with a government debt exceeding 60% of GDP, or with more pronounced debt sustainability risks.

²⁴ Net primary expenditure is defined as nationally financed expenditure net of discretionary revenues measures and excluding interest expenditure as well as cyclical unemployment expenditure.

- (25) Assuming unchanged policies, the Commission 2023 spring forecast projects net nationally financed primary expenditure to grow at 1.3% in 2024 which is below the recommended growth rate.
- (26) According to the programme, government investment is expected to increase from 5.5% of GDP in 2023 to 6.1% of GDP in 2024. This reflects both higher nationally financed investment and higher investment financed by the EU, including through the Recovery and Resilience Facility.
- (27) The Stability Programme outlines a medium-term fiscal path until 2026. According to the programme, the general government deficit is expected to decline to 2.2% of GDP in 2025 and to 0.7% by 2026. The general government deficit is therefore planned to decrease below 3% of GDP in 2024 and remain below 3% of GDP over the programme horizon. According to the programme, the general government debt-to-GDP ratio is expected to decrease from 39.7% at the end of 2024 to 38.9% by the end of 2026.

(28) Latvia's tax revenue as a share of GDP is significantly below the EU average. This limits the delivery of public services, in particular in healthcare and social protection. Capital and property are relatively undertaxed compared with the EU average and offer potential for increasing tax revenue. Moreover, Latvia collects relatively low revenues from labour taxation despite relatively high tax rates. This suggests that continued efforts are needed to improve tax compliance and tackle the shadow economy. Poverty and inequality remain high, in particular due to low spending on social protection. The adequacy of the social safety net has improved, but the risk of poverty or social exclusion remains high, in particular for the most vulnerable. The poverty or social exclusion risk in old age is the highest in the EU (45.9% compared to 19.5% in the EU in 2021) and also remains very high for people with disabilities (41.2% against 29.7% in the EU in 2021). Access to and the quality of individual needs-based social services remains a challenge due to the shortage and high workload of social workers as well as disparities across municipalities. The long-term care system is fragmented, with limited progress in the transition from institutional care to home care and community-based services. The adequacy and availability of social housing is limited due to insufficient long-term funding. Public spending on healthcare as a share of GDP is low compared to the EU average, and the medium-term budgetary plans expect it to decrease, notably from 5.6% of GDP in 2022 to 3.6% in 2026 according to the 2023 Stability Programme. This is also significantly below the needed public financing for healthcare of 6% of GDP by 2027 as indicated in the Public Health Policy Guidelines 2021–2027. While the decrease is mainly due to temporary COVID-19 support being gradually phased out, plans for the sustainable financing of healthcare are also lacking. In addition, Latvia faces health workforce shortages, especially of nurses. As a result, timely and equal access to healthcare is limited.

- (29) In accordance with Article 19(3), point (b) and Annex V, criterion 2.2 of Regulation (EU) 2021/241, the recovery and resilience plan includes an extensive set of mutually reinforcing reforms and investments to be implemented by 2026. The implementation of Latvia's recovery and resilience plan is well underway. Latvia has submitted 1 payment request, corresponding to 9 milestones and resulting in an overall disbursement of EUR 201 million. As a result of objective circumstances related to increases in the prices of energy and construction materials, and supply chain constraints due to Russia's aggression against Ukraine, Latvia intends to submit modifications to the plan, as well as a REPowerEU chapter to accelerate the decarbonisation of the economy and reduce dependence on fossil fuels. The swift inclusion of the new REPowerEU chapter in the recovery and resilience plan will allow additional reforms and investments to be financed in support of Latvia's strategic objectives in the field of energy and the green transition. The systematic and effective involvement of local and regional authorities, social partners and other relevant stakeholders remains important for the successful implementation of the recovery and resilience plan, as well as other economic and employment policies going beyond the plan, to ensure broad ownership of the overall policy agenda.
- (30) The Commission approved all of Latvia's cohesion policy programming documents in 2022. Proceeding with the swift implementation of the cohesion policy programmes in complementarity and synergy with the recovery and resilience plan, including the REPowerEU chapter, is key to achieving the green and digital transition, increasing economic and social resilience as well as achieving balanced territorial development in Latvia.
- (31) Beyond the economic and social challenges addressed by the recovery and resilience plan and cohesion policy programmes, Latvia faces challenges related to access to finance, energy and the green transition.

(32) Private sector credit flow amounted to 1% of GDP in 2021, which was considerably below the growth rate of the economy. This leads to a further reduction of private sector debt, which is among the lowest in the EU. This weak credit growth to some extent reflects weak demand, but is also influenced by a number of challenges on the supply side. Small and medium-sized enterprises have found it particularly difficult to get credit. This is partly due to their higher credit risk, but also due to the high cost of credit and red tape. Furthermore, poor liquidity of the assets available for collateral makes it particularly hard to get credit outside of the Riga region. This creates a significant barrier both for mortgage lending and lending to businesses. Policy efforts have mainly focused on supporting lending by combining it with public grants. However, this comes with a significant cost to the government budget and is therefore not a sustainable way of boosting lending. Easing the credit supply constraints requires general improvements in transparency and trust in the business environment, including a reduction in the size of the shadow economy. Furthermore, improving the insolvency process to achieve a high rate of business restructuring and possibly higher loan recovery rates would reduce banks' perceived risks and boost lending. Targeted loan and guarantee schemes could help lower the liquidity risks faced by banks when accepting collateral in relatively illiquid markets. Public lending schemes for strategically important investment areas like the green transition and regional development could increase effective competition in the banking market or fill a market gap where bank financing is either too expensive or not available. Moreover, public guarantee and lending schemes offer a much more cost-efficient way of supporting private borrowing than grant schemes. Besides the barriers to bank financing, the Latvian market for alternative sources of finance is underdeveloped and has the potential to improve firms' access to finance.

(33) Latvia has ensured its independence from Russian gas following parliament's decision in July 2022 to stop buying Russian natural gas from 1 January 2023. Domestic gas suppliers have been able to find alternative sources of natural gas thanks to imports of liquified natural gas (LNG) from the Lithuanian Klaipeda LNG terminal and the new Finnish LNG terminal in Inkoo. The current situation has shown the need to speed up the slow roll-out of installations for electricity generation from renewable energy sources. Latvia has one of the highest shares of renewable energy in the EU, although this share stagnated from 2020 to 2021. Latvia would benefit from accelerating its efforts in the uptake of wind and solar power, which is the most viable and long-term solution to increase the share of renewables. Latvia's recovery and resilience plan already includes measures to remove regulatory barriers to the deployment of onshore wind energy. However, further efforts could be made to speed up the deployment of renewable energy for electricity generation, heating and cooling. This would involve modernising the electricity grid, promoting decentralised renewable electricity generation, flexibility of the power system (demand response and storage), further improving permit granting procedures and establishing a legal framework and incentives to promote energy communities. Completing Latvia's synchronisation with the EU electricity grid would add transmission capacity so that an increasing share of offshore and onshore renewables could be integrated into the grid. The Latvian electricity network, like that of other Baltic Member States, remains exposed as it is synchronised with the BRELL (Belarus, Russia, Estonia, Lithuania and Latvia) power grid. The regional synchronisation of the electricity grid with the rest of the EU is making progress, but still needs to be completed. To that end, cooperation with Estonia and Lithuania is necessary. Latvia's consumption of natural gas has dropped by 30% in the period between August 2022 and March 2023, compared with the average gas consumption over the same period in the preceding 5 years, beyond the 15% reduction target. Latvia could keep pursuing efforts to temporarily reduce gas demand until 31 March 2024²⁵.

²⁵ Council Regulation (EU) 2022/1369 and Council Regulation (EU) 2023/706.

- (34) Latvia should accelerate its efforts to scale up energy efficiency measures to decarbonise its building stock as well as transport and industry and put in place new financing and support measures to achieve the renovation targets of its long-term renovation strategy.
- (35) Labour and skills shortages in sectors and occupations key for the green transition, including manufacturing, deployment and maintenance of net-zero technologies, are creating bottlenecks in the transition to a net-zero economy. High-quality education and training systems that respond to changing labour market needs and targeted upskilling and reskilling measures are key to reducing skills shortages and promoting labour inclusion and reallocation. To unlock untapped labour supply, these measures need to be accessible, in particular for individuals and in sectors and regions most affected by the green transition. In 2022, labour shortages were reported in 25 out of 436 occupations that required specific skills or knowledge for the green transition, including electricians and mechanical engineers. The labour shortages were reported as a factor that constrained production in industry and construction.
- (36) In light of the Commission's assessment, the Council has examined the 2022 Stability Programme and its opinion²⁶ is reflected in recommendation (1) below.

²⁶ Under Articles 5(2) and 9(2) of Council Regulation (EC) No 1466/97.

(37) In view of the close interlinkages between the economies of euro area Member States and their collective contribution to the functioning of the Economic and Monetary Union, the Council recommended that euro area Member States take action, including through their recovery and resilience plans, to (i) preserve debt sustainability and refrain from broad-based support to aggregate demand in 2023, better target fiscal measures taken to mitigate the impact of high energy prices and reflect on appropriate ways to wind down support as energy price pressures diminish; (ii) sustain high public investment and promote private investment to support the green and digital transition; (iii) support wage developments that mitigate the loss in purchasing power while limiting second-round effects on inflation, further improve active labour market policies and address skills shortages; (iv) improve the business environment and ensure that energy support to companies is cost-effective, temporary, targeted to viable firms and that it maintains incentives for the green transition; and (v) preserve macro-financial stability and monitor risks while continuing to work on completing the Banking Union. For Latvia, recommendations (1), (2), (3), and (4) contribute to the implementation of the first, second, third and fourth euro area recommendations.

HEREBY RECOMMENDS that Latvia take action in 2023 and 2024 to:

1. Wind down the emergency energy support measures in force, using the related savings to reduce the government deficit, as soon as possible in 2023 and 2024. Should renewed energy price increases necessitate new or continued support measures, ensure that these are targeted at protecting vulnerable households and firms, fiscally affordable, and preserve incentives for energy savings.

Ensure prudent fiscal policy, in particular by limiting the nominal increase in nationally financed net primary expenditure in 2024 to not more than 3.0%²⁷.

Preserve nationally financed public investment and ensure the effective absorption of RRF grants and other EU funds, in particular to foster the green and digital transitions.

For the period beyond 2024, continue to pursue a medium-term fiscal strategy of gradual and sustainable consolidation, combined with investments and reforms conducive to higher sustainable growth, to achieve a prudent medium-term fiscal position.

Broaden taxation, including of property and capital, and strengthen the adequacy of healthcare and social protection.

2. Continue the steady implementation of its recovery and resilience plan and swiftly finalise the REPowerEU chapter with a view to rapidly starting its implementation. Proceed with the speedy implementation of cohesion policy programmes, in close complementarity and synergy with the recovery and resilience plan.

²⁷ Which is estimated to correspond to an annual improvement in the structural budget balance of at least 0.5% of GDP for 2024, as described in recital 24.

3. Improve access to finance for small and medium-sized enterprises through public lending and guarantee schemes aimed at facilitating investments of strategic importance, in particular in the areas of the green transition and regional development.
4. Reduce overall reliance on fossil fuels by accelerating the deployment of renewables, in particular onshore and offshore wind as well as solar energy, and strengthening energy efficiency measures, e.g. through new financing and support measures to meet the targets of the long-term renovation strategy. Ensure sufficient capacity of interconnections to increase security of supply and continue synchronisation with the EU electricity grid. Step up policy efforts aimed at the provision and acquisition of skills and competences needed for the green transition.

Done at Brussels,

For the Council

The President
