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Subject:	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 discussed by the Council and European Council, based on the Commission Recommendation COM(2023) 614 final.

COUNCIL RECOMMENDATION

of …

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 Article 121(2) and Article 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 Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances[2], 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,

[1] OJ L 209, 2.8.1997, p. 1.
[2] OJ L 306, 23.11.2011, p. 25.

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) Regulation (EU) 2021/241 of the European Parliament and of the Council[3], which established the Recovery and Resilience Facility ('the Facility'), entered into force on 19 February 2021. The Facility provides financial support to the Member States for the implementation of reforms and investments, entailing a fiscal impulse financed by the Union. In line with the priorities of the European Semester, the Facility contributes to economic and inclusive recovery and to the implementation of sustainable and growth-enhancing reforms and investments, in particular reforms and investments to promote the green and digital transitions and to 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 Union and support the continued implementation of the European Pillar of Social Rights. The maximum financial contribution per Member State under the 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 Survey, marking the start of the 2023 European Semester for economic policy coordination. On 23 March 2023, the European Council endorsed the priorities of the 2023 Annual Sustainable Growth Survey, which are centred around the four dimensions of competitive sustainability. 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 and a proposal for the 2023 Joint Employment Report, which analyses the implementation of the Employment Guidelines and the principles of the European Pillar of Social Rights. The Council adopted the Recommendation on the economic policy of the euro area[4] ('2023 Recommendation on the euro area') on 16 May 2023 and the Joint Employment Report on 13 March 2023.

(3) While the Union's economies are showing remarkable resilience, the geopolitical context continues to have a negative impact. As the Union stands firmly with Ukraine, the Union's economic and social policy agenda is focused on reducing the negative impact of energy shocks on both vulnerable households and firms 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 Union's competitiveness and productivity.

[4] Council Recommendation of 16 May 2023 on the economic policy of the euro area (OJ C 180, 23.5.2023, p. 1).

(4) On 1 February 2023, the Commission issued a communication entitled 'A Green Deal Industrial Plan for the Net-Zero Age' ('the Green Deal Industrial Plan'). The aim of the Green Deal Industrial Plan is to boost the competitiveness of the Union's net-zero industry and support the fast transition to climate neutrality. It complements ongoing efforts under the European Green Deal and REPowerEU. It also aims to provide a more supportive environment for scaling up the Union's manufacturing capacity for the net-zero technologies and products required to meet the Union's ambitious climate targets, and to ensure 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 Green Deal Industrial Plan is based on four pillars: a predictable and simplified regulatory environment, faster access to finance, the enhancement of skills, and open trade for resilient supply chains. On 16 March 2023, the Commission also issued a further communication entitled 'Long-term competitiveness of the EU: looking beyond 2030', structured along nine mutually reinforcing drivers with the objective of working towards a growth-enhancing regulatory framework. It sets policy priorities aimed at actively ensuring structural improvements, well-focused investment and regulatory measures for the long-term competitiveness of the Union 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 Facility. The full implementation of 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 for the recovery and resilience plans revised, updated or amended in accordance with Articles 14, 18 and 21 of Regulation (EU) 2021/241.

(6) Regulation (EU) 2023/435 of the European Parliament and of the Council[5] (the 'REPowerEU Regulation'), which was adopted on 27 February 2023, aims to rapidly phase out the Union's dependence on Russian fossil fuel imports. This will contribute to energy security and the diversification of the Union's energy supply, while increasing the uptake of renewables, energy storage capacities and energy efficiency. The REPowerEU 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. Those reforms and investments will also help boost the competitiveness of the Union's net-zero industry as outlined in the Green Deal Industrial Plan 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 in order to finance new energy-related reforms and investments under their recovery and resilience plans.

[5] 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 ('the communication of 8 March 2023'). It aims to support the preparation of Member States' stability and convergence programmes and thereby strengthen policy coordination. 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 and raise potential growth in a sustainable manner and invited Member States to set out in their 2023 stability and convergence programmes how their fiscal plans will ensure that the Treaty reference value of 3 % of gross domestic product (GDP) is adhered to and ensure plausible and continuous debt reduction, or for debt to be kept at prudent levels, in the medium term. The Commission also 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 better target such measures at vulnerable households and firms. The Commission stated that the fiscal recommendations would be quantified and differentiated. Moreover, as proposed in its communication of 9 November 2022 on orientations for a reform of the EU economic governance framework, the fiscal recommendations would be formulated on the basis of net primary expenditure. It recommended that all Member States continue to protect nationally financed investment and ensure the effective use of the Facility and other Union funds, in particular in light of the green and digital transitions 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) On 26 April 2023, the Commission presented legislative proposals to implement a comprehensive reform of the Union'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 to improve national ownership, simplify the framework and move towards a greater medium-term focus, in combination with effective and more coherent enforcement. According to the Council conclusions of 14 March 2023 on orientations for a reform of the EU economic governance framework, 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 set out in Annex V to that Regulation. On 13 July 2021, the Council adopted its Implementing Decision on the approval of the assessment of the recovery and resilience plan for Latvia[6]. The release of instalments is conditional on the adoption of a decision by the Commission, in accordance with Article 24(5) of Regulation (EU) 2021/241, stating 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.

[6] ST 10157/2021 INIT; ST 10157/2021 ADD 1; ST 10157/2021 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) On 24 May 2023, the Commission published the 2023 country report for Latvia. 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. On the basis of thatanalysis, the country report identified gaps with regard 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 in implementing the European Pillar of Social Rights and in achieving the Union headline targets on employment, skills and poverty reduction, as well as progress in achieving the United Nations Sustainable Development Goals.

(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 2023. The Commission concluded that Latvia is not experiencing macroeconomic imbalances. In particular, vulnerabilities relating to external borrowing and housing remain mild, whereas those relating to competitiveness are pertinent, but are expected to remain contained overall in the near future. The recent widening of the current account deficit was significant, but the deficit is expected to narrow substantially in 2023 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 support housing supply and improve the housing market situation.

(13) According to data validated by Eurostat, 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 issued a report under Article 126(3) of the Treaty. That 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, the Commission did not propose to open new excessive deficit procedures in spring 2023. The Commission subsequently 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 its draft budgetary plan for 2024.

(14) The general government balance has been impacted by the fiscal policy measures taken to mitigate the economic and social impact of the increase in energy prices. In 2022, such fiscal policy 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 those measures at 1,5 % of GDP in 2022. The general government balance has also been impacted by the budgetary cost of offering 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 temporary emergency measures related to the COVID-19 crisis dropped to 1,2 % of GDP in 2022, from 5,0 % in 2021.

(15) On 18 June 2021, the Council recommended that in 2022 Latvia[7] maintain a supportive fiscal stance, including from the impulse provided by the 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 stance[8] 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 Facility. Expenditure financed by grants under the Facility and other Union 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 Facility grants and other Union 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[9]. 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.

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7 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).

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

9 This contractionary contribution is caused in particular by lower spending on investment projects co-financed by Union funds, which has also affected national co-financing developments (in particular at the local government level), as well as by the transfer of military equipment to Ukraine, which is recorded as a negative gross fixed capital formation offset by a capital transfer.
At the same time, other nationally financed capital expenditure provided an expansionary contribution of 1,7 percentage points of GDP. The increase in other capital expenditure is largely explained by two factors: the creation of natural gas reserves for the security of national energy supply and the transfer of military equipment to Ukraine.

(17) The macroeconomic scenario underpinning the budgetary projections in the 2023 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's 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 not included in the 2023 Stability Programme, namely data revisions of GDP growth in 2022 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, the projected GDP growth is similar in both forecasts with 11,7 % and 5,5 % growth expected for 2023 and 2024, respectively, in the 2023 Stability Programme and 10,5 % and 5,6 % growth forecast for the respective years in the Commission's 2023 spring forecast.

(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 2023 Stability 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's 2023 spring forecast projects a government deficit of 3,8 % of GDP for 2023. This is in line with the deficit projected in the 2023 Stability Programme. The Commission's 2023 spring forecast projects a slightly higher general government debt-to-GDP ratio, of 39,8 % at the end of 2023.

(19) The general government balance in 2023 is expected to continue to be impacted by the measures taken 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's 2023 spring forecast at 1,0 % of GDP in 2023[10]. Most measures in 2023 do not appear to be targeted at 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 Council Recommendation of 12 July 2022[11], is estimated in the Commission's 2023 spring forecast at 0,1 % of GDP in 2023 (compared to 0,5 % of GDP in 2022). The budgetary cost of offering temporary protection to displaced persons from Ukraine is projected to increase by 0,1 percentage points of GDP compared to 2022. Finally, the general government balance in 2023 is expected to benefit from the phasing-out of temporary emergency measures related to the COVID-19 crisis, which have been estimated at 1,2 % of GDP.

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10 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.

11 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, 1.9.2022, p. 112).

(20) In its Recommendation of 12 July 2022, the Council recommended 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 stance[12], 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 Facility and other Union funds.

[12] Based on the Commission spring 2023 forecast, potential output growth of Latvia, which is used to measure the fiscal stance, in the medium-term (10-year average), is estimated at 11,5 % in nominal terms.

(21) In 2023, the fiscal stance is projected in the Commission's 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 cost of offering 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 a wage increase for administration and medical personnel, additional current expenditure to finance 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 Council Recommendation of 12 July 2022. Expenditure financed by grants under the Facility and other Union 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 points[13].

[13] 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 Facility and other Union 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 purchasing 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, developing the broadband infrastructure as well as fostering digitalisation in the education sector. That public investment is largely funded by the Facility and other Union funds.

(22) According to the 2023 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, the absence of current expenditure related to the COVID-19 pandemic and the fact that the investment to support the recovery from the pandemic will come to an end in 2023. According to the 2023 Stability Programme, the general government debt-to-GDP ratio is expected to increase slightly to 39,7 % at the end of 2024. On the basis of the policy measures known at the cut-off date of the forecast, the Commission's 2023 spring forecast projects a government deficit of 2,7 % of GDP in 2024. This is in line with the deficit projected in the 2023 Stability Programme. The Commission's 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 2023 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 is based on the assumption of no renewed energy price increases.

(24) Regulation (EC) No 1466/97 calls for an annual improvement in the structural budget balance toward the medium-term budgetary objective, with 0,5 % of GDP as a benchmark[14]. Taking into account fiscal sustainability considerations and the need to reduce the deficit to below the 3 %-of-GDP Treaty 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 expenditure[15] 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 it remains 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, if energy-market developments so permit and starting with the least targeted measures, and the related savings should be used to reduce the government deficit. According to 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's 2023 spring forecast, the growth in net nationally financed primary current expenditure in 2023 is not in line with the Council Recommendation of 12 July 2022. If this is confirmed, lower growth in net primary expenditure in 2024 would be appropriate.

[14] Article 5 of Regulation (EC) No 1466/97 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.

[15] Net primary expenditure is defined as nationally financed expenditure net of discretionary revenue measures and excluding interest expenditure and cyclical unemployment expenditure.

(25) Assuming unchanged policies, the Commission's 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 2023 Stability Programme, government investment is expected to increase from 5,5 % of GDP in 2023 to 6,1 % of GDP in 2024. The higher investment reflects higher nationally financed investment and higher investment financed by the Union, including through the Facility.

(27) The 2023 Stability Programme outlines a medium-term fiscal path until 2026. According to the 2023 Stability Programme, the general government deficit is expected to decline to 2,2 % of GDP in 2025 and to 0,7 % by 2026. Therefore, the general government deficit is planned to decrease below 3 % of GDP in 2024 and remain below 3 % of GDP over the Programme horizon. According to the 2023 Stability 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 Union average. This limits the delivery of public services, in particular in healthcare and social protection. Capital and property are relatively undertaxed compared with the Union 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 been improved, but the risk of poverty or social exclusion remains high, in particular for the most vulnerable. The risk of poverty or social exclusion in old age is the highest in the Union (45,9 % in Latvia compared to 19,5 % in the Union in 2021) and also remains very high for people with disabilities (41,2 % in Latvia compared to 29,7 % in the Union 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 Union average and the medium-term budgetary plans expect it to decrease from 5,6 % of GDP in 2022 to 3,6 % in 2026 according to the 2023 Stability Programme. This is also significantly below the level of public financing needed for healthcare by 2027, namely 6 % of GDP, as indicated in the Latvian Public Health Policy Guidelines 2021–2027. While the decrease is mainly due to the gradual phasing-out of temporary COVID-19 support measures, plans for the sustainable financing of healthcare are also lacking. In addition, Latvia faces workforce shortages in the health sector, especially of nurses. As a result, timely and equal access to healthcare is limited.

(29) In accordance with Article 19(3), point (b), of Regulation (EU) 2021/241 and criterion 2.2 of Annex V to that Regulation, 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 one 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 to supply chain constraints due to Russia's war of aggression against Ukraine, Latvia intends to submit amendments to the plan, as well as to add a new 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 that plan, in order to ensure broad ownership of the overall policy agenda.

(30) The Commission approved all 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 and 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, to energy and to 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 Union. 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 to 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 the perceived risks for banks 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 LNG terminal in Klaipėda, Lithuania and the new LNG terminal in Inkoo, Finland. 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 Union, 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 renewable energy. 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 Union 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 Union 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 dropped by 30 % in the period between August 2022 and March 2023, compared to the average gas consumption over the same period in the preceding five years, beyond the 15 % reduction target. Latvia could keep pursuing efforts to temporarily reduce gas demand until 31 March 2024 in accordance with Council Regulation (EU) 2022/1369[16].

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[16] Council Regulation (EU) 2022/1369 of 5 August 2022 on coordinated demand-reduction measures for gas (OJ L 206, 8.8.2022, p. 1).

(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, those 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 require 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 the light of the Commission's assessment, the Council has examined the 2023 Stability Programme and its opinion[17] is reflected in recommendation (1).

[17] Under Article 5(2) of 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 the 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 a high level of public investment and promote private investments 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 and 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 recommendations set out in the 2023 Recommendation on the euro area,

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 such support measures are targeted at protecting vulnerable households and firms are 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 %[18].

   Preserve nationally financed public investment and ensure the effective absorption of grants under the Facility and of other Union 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, in order 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 the implementation thereof. Proceed with the speedy implementation of cohesion policy programmes, in close complementarity and synergy with the recovery and resilience plan.

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[18] 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 renewable energy, in particular onshore and offshore wind energy and solar energy, and strengthening energy efficiency measures, for example 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 Union 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