



Council of the
European Union

Brussels, 8 June 2020
(OR. en)

8433/20

ECOFIN 433
UEM 198
SOC 360
EMPL 279
COMPET 234
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JAI 432
FSTR 90
REGIO 121
GENDER 70
ANTIDISCRIM 63

NOTE

From: General Secretariat of the Council
To: Permanent Representatives Committee

No. Cion doc.: ST 8187/20 - COM(2020) 514 final

Subject: Recommendation for a COUNCIL RECOMMENDATION on the 2020 National Reform Programme of Latvia and delivering a Council opinion on the 2020 Convergence Programme of Latvia

Delegations will find attached the above mentioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission Proposal COM(2020) 514 final.

COUNCIL RECOMMENDATION

of ...

on the 2020 National Reform Programme of Latvia and delivering a Council opinion on the 2020 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 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.

- (1) On 17 December 2019, the Commission adopted the Annual Sustainable Growth Strategy, marking the start of the 2020 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. On 17 December 2019, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council², the Commission also adopted the Alert Mechanism Report, in which it did not identify Latvia as one of the Member States for which an in-depth review would be carried out. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area.
- (2) The 2020 country report for Latvia was published on 26 February 2020. It assessed Latvia's progress in addressing the country-specific recommendations adopted by the Council on 9 July 2019³ ('the 2019 country-specific recommendations'), the follow-up given to the country-specific recommendations adopted in previous years and Latvia's progress towards its national Europe 2020 targets.
- (3) On 11 March 2020, the World Health Organization officially declared the COVID-19 outbreak a global pandemic. It is a severe public health emergency for citizens, societies and economies. It is putting national health systems under severe strain, disrupting global supply chains, causing volatility in financial markets, triggering consumer demand shocks and having negative effects across various sectors. It is threatening people's jobs and incomes as well as companies' business. It has delivered a major economic shock that is already having serious repercussions in the Union. On 13 March 2020, the Commission adopted a communication calling for a coordinated economic response to the crisis, involving all actors at national and Union level.

² 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 (OJ L 306, 23.11.2011, p. 25).

³ OJ C 301, 5.9.2019, p. 86.

- (4) Several Member States have declared a state of emergency or introduced emergency measures. Any emergency measures should be strictly proportionate, necessary, limited in time, and in line with European and international standards. They should be subject to democratic oversight and independent judicial review.
- (5) On 20 March 2020, the Commission adopted a communication on the activation of the general escape clause of the Stability and Growth Pact. The general escape clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) No 1466/97 and Articles 3(5) and 5(2) of Council Regulation (EC) No 1467/97⁴, facilitates the coordination of budgetary policies in times of severe economic downturn. In its communication of 20 March 2020, the Commission considered that, given the expected severe economic downturn resulting from the COVID-19 pandemic, the conditions for the activation of the general escape clause had been met and asked the Council to endorse this conclusion. On 23 March 2020, the ministers of finance of the Member States agreed with the assessment of the Commission. They agreed that the severe economic downturn requires a resolute, ambitious and coordinated response. The activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. For the corrective arm, the Council may also decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

⁴ Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ L 209, 2.8.1997, p. 6).

- (6) Continued action is required to limit and control the spread of the COVID-19 pandemic, strengthen the resilience of the national health systems, mitigate the socio-economic consequences of the pandemic through supportive measures for business and households, and ensure adequate health and safety conditions at the workplace with a view to resuming economic activity. The Union should fully use the various tools at its disposal to support Member States' efforts in those areas. In parallel, Member States and the Union should work together to prepare the measures necessary to bring about a return to the normal functioning of our societies and economies and to sustainable growth, integrating inter alia the green transition and the digital transformation, and drawing lessons from the crisis.
- (7) The COVID-19 crisis has highlighted the flexibility that the internal market offers to adapt to extraordinary situations. However, in order to ensure a swift and smooth transition to the recovery phase and the free movement of goods, services and workers, exceptional measures that prevent the internal market from functioning normally should be removed as soon as they are no longer indispensable. The current crisis has shown the need for crisis preparedness plans in the health sector. Improved purchasing strategies, diversified supply chains and strategic reserves of essential supplies are among the key elements for developing broader crisis preparedness plans.

- (8) The Union legislator has already amended the relevant legislative frameworks by means of Regulations (EU) 2020/460⁵ and (EU) 2020/558⁶ of the European Parliament and of the Council to allow Member States to mobilise all unused resources from the European Structural and Investment Funds so they can address the exceptional effects of the COVID-19 pandemic. Those amendments will provide additional flexibility, as well as simplified and streamlined procedures. To alleviate cash-flow pressures, Member States can also benefit from a 100 % co-financing rate from the Union budget in the 2020-2021 accounting year. Latvia is encouraged to make full use of those possibilities to help the individuals and sectors most affected.
- (9) The socioeconomic consequences of the COVID-19 pandemic are likely to be unevenly distributed across sectors and regions due to different specialisation patterns. This entails a risk of widening disparities within Latvia. Combined with the risk of a temporary unravelling of the convergence process between Member States, the current situation calls for targeted policy responses.
- (10) On 30 April 2020, Latvia submitted its 2020 National Reform Programme and its 2020 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.
- (11) Latvia is currently in the preventive arm of the Stability and Growth Pact.

⁵ Regulation (EU) 2020/460 of the European Parliament and of the Council of 30 March 2020 amending Regulations (EU) No 1301/2013, (EU) No 1303/2013 and (EU) No 508/2014 as regards specific measures to mobilise investments in the healthcare systems of Member States and in other sectors of their economies in response to the COVID-19 outbreak (Coronavirus Response Investment Initiative) (OJ L 99, 31.3.2020, p. 5).

⁶ Regulation (EU) 2020/558 of the European Parliament and of the Council of 23 April 2020 amending Regulations (EU) No 1301/2013 and (EU) No 1303/2013 as regards specific measures to provide exceptional flexibility for the use of the European Structural and Investments Funds in response to the COVID-19 outbreak (OJ L 130, 24.4.2020, p. 1).

- (12) In its 2020 Stability Programme, the government plans the headline balance to deteriorate from a deficit of 0,2 % of gross domestic product (GDP) in 2019 to 9,4 % of GDP in 2020. The deficit is projected to decline to 5,0 % of GDP in 2021 and to 2,7 % of GDP by 2023, under unchanged policies. After decreasing to 36,9 % of GDP in 2019, the general government debt-to-GDP ratio is expected to peak at around 53 % in 2022, based on the 2020 Stability Programme. The macroeconomic and fiscal outlook is affected by high uncertainty because of the COVID-19 pandemic.
- (13) In response to the COVID-19 pandemic, and as part of a coordinated Union approach, Latvia has adopted timely budgetary measures to increase the capacity of its health system, contain the pandemic, and provide relief to those individuals and sectors that have been particularly affected. According to the 2020 Stability Programme, those budgetary measures amounted to 3,0 % of GDP. The measures include tax deferral options for up to three years, expanded coverage of State-paid sick leave, support for specific sectors and additional health spending. In addition, Latvia has adopted liquidity support to businesses through guarantees and loans amounting to 3,2 % of GDP. Overall, the measures taken by Latvia are in line with the guidelines set out in the Commission communication of 13 March 2020. The full implementation of the emergency measures and of supportive fiscal measures, followed by a refocusing of fiscal policies towards achieving prudent medium-term fiscal positions when economic conditions allow, will contribute to preserving fiscal sustainability in the medium term.
- (14) Based on the Commission 2020 spring forecast under unchanged policies, Latvia's general government balance is forecast at -7,3 % of GDP in 2020 and -4,5 % of GDP in 2021. This reflects a broadly similar effect of the stimulus measures as in the 2020 Stability Programme, but the drop in employment is projected to be lower and automatic stabilisers on the expenditure side are also assumed to be lower. The general government debt ratio is projected to remain below 60 % of GDP in 2020 and 2021.

- (15) On 20 May 2020, the Commission issued a report prepared in accordance with Article 126(3) of the Treaty because of Latvia's projected breach of the 3%-of-GDP deficit threshold in 2020. Overall, the Commission's analysis suggests that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/97 has not been fulfilled.
- (16) Latvia declared a state of emergency on 13 March 2020 and extended it until 9 June 2020. The government limited the movement of persons across Latvia's borders by air, rail and sea, closed schools and universities while ensuring distance learning, prohibited all public events, enforced social distancing measures, restricted sales on weekends and promoted digital public services. Considering the improved epidemiological situation, the authorities loosened national restrictions as of 12 May 2020 and agreed to reopen borders with Lithuania and Estonia as of 15 May 2020. According to the Commission 2020 spring forecast, unemployment is expected to rise to 8,6 % in 2020 and slightly recover to 8,3 % in 2021. The economy is projected to decline by 7 % in 2020 with investments and export taking the largest hit amid declining foreign demand and growing uncertainty. Employment is expected to decrease by 2,5 %, taking into account the fact that the negative impact on employment will be considerably cushioned by the government-subsidised employee furlough scheme and salary subsidies in export-oriented sectors. In response to the COVID-19 crisis, Latvia has developed a comprehensive fiscal and economic policy response. The authorities have targeted the response in three directions: (1) support to workers; (2) support to businesses; and (3) support to the hardest-hit economic sectors. Labour policy measures, aimed at maintaining employment and strengthening the social safety net include inter alia salary subsidies of up to 75 % of a person's gross wage, coverage of sick leave if a worker is diagnosed with COVID-19 or is in quarantine, and extension of unemployment benefits. Support to businesses, facing temporary difficulties has aimed to extend liquidity to viable firms and to quickly boost supply of vital goods and services.

(17) The COVID-19 pandemic has required unprecedented measures to contain the spread and impact of the disease. It has amplified the structural weaknesses in Latvia's health system, which are directly related to the limited financial and human resources available to it and to reforms that are only slowly progressing. Access to quality and affordable healthcare and the effectiveness of the health system are affected by low public financing. This leads to high self-reported unmet needs for healthcare, significant out-of-pocket payments, especially for vulnerable groups, as well as inequality of access. Unhealthy lifestyles are another important reason for the poor health outcomes. In addition, health workforce shortages constitute a complex challenge and hamper the delivery of health services. To boost efficiency and quality in healthcare, it is crucial to accelerate the ongoing reforms which remain in an early stage including effective prevention measures, stronger primary care, a rationalised hospital sector and targeted quality management. The extent of the impact of these reforms and the opportunities to improve health outcomes also depend significantly on the amount of public financing for health. In order to be able to manage similar crises in the future, it is important to ensure investments into effective and well-resourced public health measures to prevent, contain and mitigate the spread of infectious diseases and to manage their impact on the health system's performance. Investments could aim at providing the necessary equipment, robust e-health services, facilities and human resources for healthcare and at ensuring the capacity to deliver all expected regular health services alongside care for COVID-19 patients.

(18) Latvia has taken measures to extend income support for workers and to avoid dismissals during the state of emergency. However, the support is limited in coverage and adequacy, mainly because it is dependent on social contribution payments and restrictive eligibility criteria. The scheme also does not allow for partial idle time. A more gradual transition from income support to work income would allow for a greater labour market flexibility during the downtime period and the economic recovery. Continuous efforts are needed to improve the adequacy, duration and coverage of the social safety net for all. However, these efforts are constrained by the low tax revenue as a share of GDP. Despite some slight improvement, the adequacy of the guaranteed minimum income, of minimum pensions and of income support for persons with disabilities remains low. Latvia has introduced the unemployment assistance benefit for the most vulnerable, yet the unemployed are at a high risk of poverty, particularly when the duration of unemployment increases. Coverage gaps in access to social protection, including unemployment insurance, for self-employed and non-standard workers exist and could be tackled. While its share is decreasing, undeclared work and envelope wages remain widespread, weakening affected workers' social protection and increasing occupational risks. Vulnerable groups are likely to face the most difficulties in finding a job again. The integration of employment, education, health and social services and the provision of social services remains low. The share of people facing severe housing deprivation and that of people facing overcrowding are among the highest in the Union, while social housing is scarce.

- (19) Providing support to small and medium-sized enterprises to help them quickly develop flexible work and teleworking capacities may significantly help mitigate the impact of the crisis. Low registration with public employment services and the low level of involvement of the unemployed in active labour market measures are of particular concern. The delivery and composition of active labour market measures have to be reinforced and adapted to reduce the duration of the unemployment spells and facilitate transitions back to work. Equipping people with the right skills is even more important to improve the resilience of the labour force in times of an economic downturn. Effective and easily accessible adult learning, reskilling and upskilling measures, together with the provision of social services and mobility support, could provide more people with the skills necessary for the labour market. Digital skills also need to be improved as only 43% of Latvians have basic or above basic digital skills. The COVID-19 pandemic has also highlighted the need to enhance quality digital education and training and to ensure equal access to all learners. Strengthening the capacity of social partners is also important to ensure their meaningful and timely involvement in the COVID-19 crisis response and recovery.
- (20) A sizable liquidity support scheme was quickly set up and deployed through the national development institution, Altum. It has helped restructure loan repayment schedules for businesses and provided liquidity support through new loans. At the same time, most restructurings of bank loans take place without involvement of State guarantees. However, the eligibility conditions for State guarantees are relatively strict. As a result, there is a risk that smaller companies with weaker financial position or overdue tax payments will not receive support. Restaurants and hotels, which are among the hardest hit industries in this crisis, experience difficulties accessing liquidity because of their weak collateral and financial position. At the same time, it is important to sustain the resilience of the banking sector.

(21) To foster the economic recovery, it will be important to front-load mature public investment projects and promote private investment, including through relevant reforms. Policies to support the country's digital transformation and green transition should take into account the significant regional disparities. Most urban areas in Latvia have excellent digital infrastructure, but fixed broadband coverage in rural areas, especially last-mile connections, is low. Continued and strengthened efforts to deploy very high-speed broadband will help further improve the digital infrastructure. In order to tackle the challenges posed by the transition to a climate neutral economy, investments are needed to diversify the economy and make it more modern and competitive, including by strengthening investment in research and innovation and human capital and to alleviate the socio-economic costs of the transition. Latvia's environmental sustainability rests on making progress towards improved energy efficiency, implementing its National Energy and Climate Plan, including in particular in transport and buildings, and mainstreaming environmental sustainability considerations in other economic sectors, in particular in agriculture and forestry. Improving intermodal transport infrastructure within and around Riga would both facilitate labour mobility and help curb growing energy consumption from passenger cars. Furthermore, the Rail Baltica project and the energy interconnection projects are Latvia's key investment priorities aimed at improving its safety and integration into the internal market. Making further investments in renewable energy, in particular wind power, and promoting the transition to a circular economy with significantly higher recycling rates can also improve both environmental and economic outcomes and help achieve climate change mitigation targets. The programming of the Just Transition Fund, which is the subject of a Commission proposal, for 2021-2027 could help Latvia address some of the challenges posed by the transition to a climate-neutral economy, in particular in the territories covered by Annex D to the 2020 country report. This would allow Latvia to make the best use of that Fund.

- (22) Latvia has significantly reduced the flow of risky money through its banks and overhauled its anti-money-laundering system. In particular, Latvia banned the servicing of non-resident shell companies and amended a number of laws. The capacity and capability of key supervisory, financial intelligence and law enforcement institutions has been strengthened. While supervision of financial institutions has been tightened considerably, it could be better targeted and become more efficient with improved risk assessment. Moreover, while the capacity and cooperation between law enforcement bodies has been improved, their capacity to investigate and prosecute money laundering cases could be further strengthened.
- (23) While the country-specific recommendations set out in this Recommendation ('the 2020 country-specific recommendations') focus on tackling the socio-economic impacts of the COVID-19 pandemic and facilitating the economic recovery, the 2019 country-specific recommendations also covered reforms that are essential to address medium- to long-term structural challenges. The 2019 country-specific recommendations remain pertinent and will continue to be monitored throughout next year's European Semester. That includes the 2019 country-specific recommendations regarding investment-related economic policies. All of the 2019 country-specific recommendations should be taken into account for the strategic programming of post-2020 cohesion policy funding, including for mitigating measures and exit strategies with regard to the current crisis.
- (24) The European Semester provides the framework for continuous economic and employment policy coordination in the Union, which can contribute to a sustainable economy. In their 2020 National Reform Programmes, Member States have taken stock of progress made in the implementation of the United Nations Sustainable Development Goals (SDGs). By ensuring the full implementation of the 2020 country-specific recommendations, Latvia will contribute to the progress towards the SDGs and to the common effort of ensuring competitive sustainability in the Union.

- (25) Close coordination between economies in the economic and monetary union is key in achieving a swift recovery from the economic impact of the COVID-19 pandemic. As a Member State whose currency is the euro, Latvia should ensure that its policies remain consistent with the 2020 euro-area recommendations and coordinated with those of the other Member States whose currency is the euro, while taking into account political guidance from the Eurogroup.
- (26) In the context of the 2020 European Semester, the Commission has carried out a comprehensive analysis of Latvia's economic policy and published it in the 2020 country report. It has also assessed the 2020 Stability Programme, the 2020 National Reform Programme and the follow-up given to the country-specific recommendations addressed to Latvia in previous years. The Commission has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Latvia, but also their compliance with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.
- (27) In the light of this assessment, the Council has examined the 2020 Stability Programme and its opinion⁷ is reflected in particular in recommendation (1) below,

⁷ Under Article 5(2) of Regulation (EC) No 1466/97.

HEREBY RECOMMENDS that Latvia take action in 2020 and 2021 to:

1. Take all necessary measures, in line with the general escape clause of the Stability and Growth Pact, to effectively address the COVID-19 pandemic, sustain the economy and support the ensuing recovery. When economic conditions allow, pursue fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment. Strengthen the resilience and accessibility of the health system including by providing additional human and financial resources.
2. Provide adequate income support to the groups most affected by the crisis and strengthen the social safety net. Mitigate the employment impact of the crisis, including through flexible working arrangements, active labour market measures and skills.
3. Ensure access to liquidity support by firms and in particular small and medium-sized enterprises. Front-load mature public investment projects and promote private investment to foster the economic recovery. Focus investment on the green and digital transition, in particular on research and innovation, clean and efficient production and use of energy, sustainable transport and digital infrastructures.
4. Continue progress on the anti-money-laundering framework.

Done at Brussels,

For the Council

The President