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EUROPEAN
COMMISSION

Brussels, 18.11.2020
C(2020) 8513 final

COMMISSION OPINION

of 18.11.2020

on the Draft Budgetary Plan of Latvia

{SWD(2020) 863 final}

(Only the Latvian text is authentic)

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GENERAL CONSIDERATIONS

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

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

3. On 20 March 2020, the Commission adopted a Communication[1] on the activation of the general escape clause[2] of the Stability and Growth Pact. In its Communication, the Commission set out its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the conditions to activate the general escape clause were met. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission.[3] As indicated in the Annual Sustainable Growth Strategy 2021[4] and as communicated in the letter of 19 September 2020 from the Commission to the EU Ministers of Finance[5], Member States should continue to provide targeted and temporary fiscal support in 2021 in a context where the general escape clause is activated, while safeguarding fiscal sustainability in the medium term.

4. On 27 May 2020, the Commission put forward its proposal for the creation of a new recovery instrument Next Generation EU[6], alongside the proposal for the reinforced long-term budget of the EU for 2021-2027.[7] This proposal includes the establishment

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[1] Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, Brussels, 20.3.2020, COM(2020) 123 final.

[2] The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn.

[3] https://www.consilium.europa.eu/en/press/press-releases/2020/03/23/statement-of-eu-ministers-of-finance-on-the-stability-and-growth-pact-in-light-of-the-covid-19-crisis/

[4] Communication from the Commission on Annual Sustainable Growth Strategy 2021, Brussels, 17.9.2020, COM(2020) 575 final.

[5] https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/annual-draft-budgetary-plans-dbps-euro-area-countries/draft-budgetary-plans-2021_en

[6] Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions - Europe's moment: Repair and Prepare for the Next Generation, Brussels, 27.5.2020, COM(2020) 456 final.

[7] Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions - The EU budget powering the recovery plan for Europe, Brussels, 27.5.2020, COM(2020) 442 final.

of a Recovery and Resilience Facility offering large-scale financial support for both public investments and reforms. By contributing to the economic recovery and by providing financial support to strengthen the economy's long-term growth, the Recovery and Resilience Facility will help public finances to return to more favourable positions in the near term and will contribute to strengthening their sustainability in the medium and long term.

CONSIDERATIONS CONCERNING LATVIA

5. On 14 October 2020, Latvia submitted the Draft Budgetary Plan for 2021. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

6. On 20 July 2020, the Council recommended Latvia[8] to take all necessary measures, in line with the general escape clause, to effectively address the pandemic, sustain the economy and support the ensuing recovery. It also recommended Latvia to pursue, when economic conditions allow, fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.

   On 20 May 2020, the Commission issued a report under Article 126(3) TFEU, as Latvia's general government deficit in 2020 was planned to exceed the 3% of GDP Treaty reference value. The report concluded that, after the assessment of all relevant factors, the deficit criterion was not fulfilled. In light of the exceptional uncertainty created by the outbreak of COVID-19 and its extraordinary macroeconomic and fiscal impact, including for designing a credible path for fiscal policy, which will have to remain supportive in 2021, the Commission considered that a decision on whether to place Member States under the Excessive Deficit Procedure should not be taken.

7. According to the Commission 2020 autumn forecast, the Latvian economy is expected to contract by 5.6% in 2020 and grow by 4.9% in 2021. The Draft Budgetary Plan projects a steeper drop in GDP of 7% in 2020, while economic growth in 2021 is projected at 5.1%, broadly similar to the Commission forecast. This forecast was prepared before data for Q2-2020 become available, which reported a less severe decline in GDP than expected. The investment performance accounts for the largest difference between the Draft Budgetary Plan and the Commission forecast. According to the Draft Budgetary Plan, employment is projected to decline by 4.4% in 2020 and to only rise slowly by 0.6% in 2021. Correspondingly, the unemployment rate is set to increase to 10.5% in 2020 and decline somewhat to 9.8% in 2021.

   Latvia complies with the requirement of Regulation EU No 473/2013 since the draft budget is based on independently-endorsed macroeconomic forecasts. In its endorsement of the forecasts, the Fiscal Discipline Council expressed concerns over structural changes of the economy in the aftermath of the crisis that would complicate the assessment of the cyclical position and the definition of an appropriate fiscal stance.

8. The Draft Budgetary Plan targets a government deficit of 7.6% of GDP in 2020, narrowing to a deficit of 3.9% of GDP in 2021. The large deficit in 2020 mostly

[8] Council Recommendation of 20 July 2020 on the National Reform Programme of Latvia and delivering a Council opinion on the 2020 Stability Programme of Latvia, OJ C 282, 26.8.2020, p. 89.

reflects a decline in government revenue, which is linked to the drop in economic activity, and an increase in expenditure due to temporary support measures adopted in response to the COVID-19 crisis. The improvement of the deficit in 2021 is underpinned by a discontinuation of most of the temporary support measures adopted in 2020 and the projected recovery in economic activity. At the same time, new budgetary measures for 2021 increase both revenue and expenditure by some 0.7% of GDP and offset each other. The Draft Budgetary Plan does not assume revenue from and expenditure financed under the Recovery and Resilience Facility. The Commission autumn 2020 forecast is slightly more positive on the fiscal outlook for 2020 and 2021, with government deficits of 7.4% of GDP and 3.5% of GDP, respectively, on the back of the better macroeconomic projections.

Since the submission of the Recovery and Resilience Plans and their subsequent approval are expected to take place in 2021, the Commission forecast assumes in its budgetary projections for 2021 the 10% pre-financing of Recovery and Resilience Facility grants and treats it as a financial transaction with no impact on the budget balance but with a public debt-reducing impact. In the case of Latvia, the 10% pre-financing of Recovery and Resilience Facility grants is equivalent to EUR 202 million in 2021.[9] On the expenditure side, in line with its no-policy change assumption, the Commission forecast includes no expenditure related to the Recovery and Resilience Facility, as the corresponding measures were not sufficiently specified at the cut-off date of the forecast.[10] The evolution of the deficit in 2021 could turn out more favourable due to the higher growth resulting from the implementation of measures financed by the Recovery and Resilience Facility.

The Draft Budgetary Plan indicates that the government debt-to-GDP ratio will decline from 47.3% at the end of 2020 to 46% in 2021, similar to the Commission's projection of 45.9%.

9. The Draft Budgetary Plan presents support measures for businesses and households totalling 4.3% of GDP in 2020. The measures include an option to defer tax payment up to 3 years, a temporary support for idle employees, higher health spending on medical purchases and investments, and support for sectors affected by the crisis. The majority of measures are expected to end in 2020, while some investment projects should continue in 2021. The Commission forecast estimates of the measures are in line with those presented in the Draft Budgetary Plan. Loan and guarantee support amounts to around 1% of GDP. State guarantees of 0.1% of GDP have been used up until October 2020. Overall, the measures taken by Latvia in 2020 were in line with the guidelines of the Commission Communication of 13 March 2020 on a coordinated economic response to the COVID-19 outbreak.

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9 Indicative number based on the Council Presidency compromise proposal for the RRF Regulation (11538/20) of 7 October 2020, on which the Council Presidency obtained a mandate for conducting the negotiations with the European Parliament.

10 The treatment of the Recovery and Resilience Facility (RRF) in the Commission's 2020 autumn forecast is explained in detail in Box I.4.3 of the European Commission's Economic Forecast Autumn 2020 (https://ec.europa.eu/info/sites/info/files/economy-finance/ip136_en.pdf). In line with the customary no policy-change assumption, the forecast only incorporates those measures that are credibly announced and sufficiently detailed in the Draft Budgetary Plans, irrespective of whether they are planned to be part of the Recovery and Resilience Plans. No financing from the RRF has been included on the revenue side of the budgetary projections. Only the pre-financing of RRF grants is included in the forecast for 2021. The assumptions on expenditure measures linked to the RRF in the Commission forecast are without prejudge to the assessment of the Recovery and Resilience Plans.

10. The Draft Budgetary Plan presents several permanent measures that increase both revenue and expenditure by some 0.7% of GDP in 2021 and offset each other. The social security contribution rate is reduced by 1 percentage point and the application threshold for income tax allowance is increased with a view to reduce the tax wedge on employees. At the same time, low-wage and part-time employees and self-employed face higher taxation. In particular, the minimum social security contribution is required to be paid irrespective of the level of actual income, which leads to a higher tax wedge for the affected workers. Expenditure is set to increase on wages for health workers and teachers, and higher minimum social benefits.

11. The Commission is of the opinion that the Draft Budgetary Plan of Latvia is overall in line with the recommendation adopted by the Council on 20 July 2020. Most of the measures set out in the Draft Budgetary Plan of Latvia are supporting economic activity against the background of considerable uncertainty. Latvia is invited to regularly review the use, effectiveness and adequacy of the support measures and stand ready to adapt them as necessary to changing circumstances.

    It is anticipated that Latvia will submit its Recovery and Resilience Plan in 2021. The Regulation establishing a Recovery and Resilience Facility will set out how the Commission is to assess that the reforms and investments included in the Recovery and Resilience Plan are coherent with the policy priorities of the Union and the challenges identified in the context of the European Semester. This assessment by the Commission will inform the approval of the Plan by the Council and the information to the European Parliament

Done at Brussels, 18.11.2020

For the Commission
Paolo GENTILONI
Member of the Commission