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Recommendation for a

COUNCIL RECOMMENDATION

on the economic, social, employment, structural and budgetary policies of Latvia

{SWD(2025) 214 final}

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Recommendation for a

COUNCIL RECOMMENDATION

on the economic, social, employment, structural and budgetary policies 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 Regulation (EU) 2024/1263 of the European Parliament and of the Council of 29 April 2024 on the effective coordination of economic policies and on multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97[1], and in particular Article 3(3) 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:

General considerations

(1) Regulation (EU) 2024/1263, which entered into force on 30 April 2024, specifies the objectives of the economic governance framework, which aims at promoting sound and sustainable public finances and sustainable and inclusive growth and resilience through reforms and investments, and preventing excessive government deficits. The Regulation stipulates that the Council and the Commission conduct multilateral surveillance in the context of the European Semester in accordance with the objectives and requirements set out in the TFEU. The European Semester includes, in particular, the formulation, and the surveillance of the implementation of country-specific recommendations. The Regulation also promotes national ownership of fiscal policy and emphasises its medium-term focus, combined with more effective and coherent enforcement. Each Member State must submit to the Council and the Commission a national medium-term fiscal-structural plan, containing its fiscal, reform and investment commitments, over 4 or 5 years, depending on the length of the national legislative term. The net expenditure[2] path in these plans has to comply with the

[1] OJ L, 2024/1263, 30.4.2024, ELI: http://data.europa.eu/eli/reg/2024/1263/oj.

[2] Net expenditure as defined in Article 2, point (2), of Regulation (EU) 2024/1263: 'net expenditure' means government expenditure net of (i) interest expenditure; (ii) discretionary revenue measures; (iii) expenditure on programmes of the Union fully matched by revenue from Union funds; (iv) national expenditure on co-financing of programmes funded by the Union; (v) cyclical elements of unemployment benefit expenditure; and (vi) one-offs and other temporary measures.

Regulation's requirements, including the requirements to put or keep general government debt on a plausibly downward path by the end of the adjustment period, or for it to remain at prudent levels below 60% of gross domestic product (GDP), and to bring and/or maintain the general government deficit below the 3%-of-GDP Treaty reference value over the medium term. Where a Member State commits to a relevant set of reforms and investments in accordance with the criteria set out in the Regulation, the adjustment period may be extended by up to three years.

(2) Regulation (EU) 2021/241 of the European Parliament and of the Council[3], which established the Recovery and Resilience Facility (the 'RRF'), entered into force on 19 February 2021. The RRF provides financial support to Member States for implementing reforms and investments, delivering a fiscal impulse financed by the Union. In line with the priorities of the European Semester for economic policy coordination, the RRF fosters economic and social recovery while driving sustainable reforms and investments, in particular promoting the green and digital transitions and making 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.

(3) Regulation (EU) 2023/435 of the European Parliament and of the Council[4] (the 'REPowerEU Regulation'), which was adopted on 27 February 2023, aims to phase out the Union's dependence on Russian fossil-fuel imports. This helps achieve energy security and diversify the Union's energy supply, while increasing the uptake of renewables, energy storage capacities and energy efficiency. Latvia added a new REPowerEU chapter to its national recovery and resilience plan in order to finance key reforms and investments that will help achieve the REPowerEU objectives.

(4) 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 that Regulation, 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. On 13 July 2021, the Council adopted its Implementing Decision approving the assessment of the recovery and resilience plan for Latvia[5], which was amended under Article 18(2) on 8 December 2023 to update the maximum financial contribution for non-repayable financial support, as well as to include the REPowerEU chapter[6]. The release of instalments is conditional on the adoption of a decision by the Commission, in accordance with Article 24(5), stating that Latvia has satisfactorily achieved the relevant milestones and targets set out in the Council Implementing Decision. Satisfactory achievement requires that the

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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, ELI: http://data.europa.eu/eli/reg/2021/241/oj).

4 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, ELI: http://data.europa. eu/eli/reg/2023/435/oj).

5 Council Implementing Decision of 13 July 2021 on the approval of the assessment of the recovery and resilience plan for Latvia (10157/2021).

6 Council Implementing Decision of 8 December 2023 amending the Implementing Decision of 13 July 2021 on the approval of the assessment of the recovery and resilience plan for Latvia (15569/2023).

achievement of preceding milestones and targets for the same reform or investment has not been reversed.

(5) On 21 January 2025 the Council, upon the recommendation of the Commission, adopted a recommendation endorsing the national medium-term fiscal-structural plan of Latvia[7]. The plan was submitted in accordance with Articles 11 and 36(1), point (a) of Regulation (EU) 2024/1263, covers the period from 2025 until 2028 and presents a fiscal adjustment spread over four years.

(6) On 26 November 2024, the Commission adopted an opinion on the 2025 draft budgetary plan of Latvia. On the same date, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the 2025 Alert Mechanism Report, in which it did not identify Latvia as one of the Member States for which an in-depth review would be needed. The Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area and a proposal for the 2025 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[8] on 13 May 2025 and the Joint Employment Report on 10 March 2025.

(7) On 29 January 2025, the Commission published the Competitiveness Compass, a strategic framework that aims to boost the EU's global competitiveness over the next five years. It identifies the three transformative imperatives of sustainable economic growth: (i) innovation; (ii) decarbonisation and competitiveness; and (iii) security. To close the innovation gap, the EU aims to foster industrial innovation, support the growth of start-ups through initiatives like the EU Start-up and Scale-up Strategy, and promote the adoption of advanced technologies like artificial intelligence and quantum computing. In pursuit of a greener economy, the Commission has outlined a comprehensive Affordable Energy Action Plan and a Clean Industrial Deal, ensuring that the shift to clean energy remains cost-effective, competitiveness-friendly, particularly for energy-intensive sectors, and is a driver for growth. To reduce excessive dependencies and increase security, the Union is committed to strengthening global trade partnerships, diversifying supply chains and securing access to critical raw materials and clean energy sources. These priorities are underpinned by horizontal enablers, namely regulatory simplification, deepening of the single market, financing competitiveness and a Savings and Investments Union, promotion of skills and quality jobs, and better coordination of EU policies. The Competitiveness Compass is aligned with the European Semester, ensuring that Member States' economic policies are consistent with the Commission's strategic objectives, creating a unified approach to economic governance that fosters sustainable growth, innovation and resilience across the Union.

(8) In 2025, the European Semester for economic policy coordination continues to develop alongside the implementation of the RRF. The full implementation of the recovery and resilience plans remains essential for delivering on the policy priorities under the European Semester, as the plans help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations

[7] Council Recommendation of 21 January 2025 endorsing the medium-term fiscal-structural plan of Latvia, OJ C/2025/652, 10.2.2025.

[8] Council Recommendation of 13 May 2025 on the economic policy of the euro area (OJ C, C/2025/2782, 22.5.2025, ELI: http://data.europa.eu/eli/C/2025/2782/oj).

issued in recent years. These country-specific recommendations remain equally relevant for the assessment of amended recovery and resilience plans in accordance with Article 21 of Regulation (EU) 2021/241.

(9) The 2025 country-specific recommendations cover the key economic policy challenges that are not sufficiently addressed by measures included in the recovery and resilience plans, taking into account the relevant challenges identified in the 2019-2024 country-specific recommendations.

(10) On 4 June 2025, the Commission published the 2025 country report for Latvia. It assessed Latvia’s progress in addressing the relevant country-specific recommendations and took stock of Latvia’s implementation of the recovery and resilience plan. Based on this analysis, the country report identified the most pressing challenges Latvia is facing. 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.

Assessment of the Annual Progress Report

(11) On 21 January 2025 the Council recommended the following maximum growth rates of net expenditure for Latvia: 5.9% in 2025, 3.6% in 2026, 3.4% in 2027, and 3.3% in 2028, which corresponds to the maximum cumulative growth rates calculated by reference to 2023 of 15.5% in 2025, 19.7% in 2026, 23.8% in 2027, and 27.9% in 2028. On 29 April 2025 Latvia submitted its Annual Progress Report[9], on adherence to the recommended maximum growth rates of net expenditure and the implementation of reforms and investments responding to the main challenges identified in the European Semester country-specific recommendations. The Annual Progress Report also reflects Latvia’s biannual reporting on the progress made in achieving its recovery and resilience plan in accordance with Article 27 of Regulation (EU) 2021/241.

(12) Russia’s war of aggression against Ukraine and its repercussions constitute an existential challenge for the European Union. The Commission recommended to activate the national escape clause of the Stability and Growth Pact in a coordinated manner to support the EU efforts to achieve a rapid and significant increase in defence spending and this proposal was welcomed by the European Council of 6 March 2025. Following the request of Latvia on 28 April 2025, on [date] the Council, upon the recommendation of the Commission, adopted a recommendation allowing Latvia to deviate from, and exceed, the recommended maximum growth rates of net expenditure[10].

(13) Based on data validated by Eurostat[11], Latvia’s general government deficit decreased from 2.4% of GDP in 2023 to 1.8% in 2024, while the general government debt rose from 44.6% of GDP at the end of 2023 to 46.8% at the end of 2024. According to the Commission’s calculations, these developments correspond to a net expenditure growth rate of 4.5% in 2024. In the 2025 Annual Progress Report, Latvia estimates the net expenditure growth in 2024 at 3.9%. The Commission estimates that the net

[9] The 2025 Annual Progress Reports are available on: https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/preventive-arm/annual-progress-reports_en.

[10] Council recommendation allowing Latvia to deviate from, and exceed, the recommended net expenditure path (Activation of the national escape clause), [Please complete: OJ C/2025/xxx, x.x.2025].

[11] Eurostat-Euro Indicators, 22.4.2025.

expenditure growth was higher than in the Annual Progress Report. The difference between the Commission's calculations and the estimates of national authorities is due to different assessment of discretionary revenue measures in 2024[12]. Based on the Commission's estimates, the fiscal stance[13], which includes both nationally and EU financed expenditure, was neutral in 2024. On 4 June 2025, the Commission adopted a report under Article 126(3) of the TFEU[14]. That report assessed the budgetary situation of Latvia, as its planned general government deficit in 2025 exceeds the reference value of 3% of GDP. The report concluded that, taking into account all the relevant factors as appropriate, the deficit criterion is assessed as being fulfilled. In light of this assessment, and after considering the opinion of the Economic and Financial Committee as established under article 126(4) TFEU, the Commission does not at this stage intend to propose in June to open an excessive deficit procedure.

(14) According to the Annual Progress Report, the macroeconomic scenario underpinning the budgetary projections by Latvia expects real GDP growth at 1.2% in 2025 and 2.1% in 2026, while HICP inflation is projected at 2.5% in 2025 and 2.2% in 2026. The Commission Spring 2025 Forecast projects real GDP to grow by 0.5% in 2025 and 2.0% in 2026, and HICP inflation to stand at 3.0% in 2025 and 1.7% in 2026.

(15) In the Annual Progress Report, the general government deficit is expected to increase to 3.1% of GDP in 2025, while the general government debt-to-GDP ratio is set to increase to 49.0% by the end of 2025. These developments correspond to net expenditure growth of 5.7% in 2025. The Commission Spring 2025 Forecast projects a general government deficit of 3.1% of GDP in 2025. The projected increase of the deficit in 2025 is driven by revenue and expenditure factors. Revenues are expected to be negatively affected by a reduction in income tax revenue, due to the reform of the personal income tax system, and a decline in property income, primarily due to the normalisation of profitability of state-owned companies in the energy and forestry sectors, as a result of lower energy prices. On the expenditure side, growth of compensation of employees, interest payments and social transfers are the main factors behind the increase in the deficit. According to the Commission's calculations, these developments correspond to net expenditure growth of 5.7% in 2025. Based on the Commission's estimates, the fiscal stance, which includes both nationally and EU financed expenditure, is projected to be expansionary, by 1.1% of GDP, in 2025. The general government debt-to-GDP ratio is set to increase to 48.6% by the end of 2025. The increase of the debt-to-GDP ratio in 2025 mainly reflects stock-flow adjustments and the projected primary deficit.

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12 The Commission does not classify certain revenue measures as discretionary fiscal measures, e.g. additional dividend payments from state joint-stock companies and secondary tax revenue impacts. The second-round revenue impact is not a discretionary fiscal measure but does enter the Commission forecast via macroeconomic effects. Additional dividend payments from state joint-stock companies also enter the Commission's forecast but are not treated as discretionary fiscal measures as they do not involve the changes in "normal" dividend policy, e.g., adjustments to dividend pay-out ratio.

13 The fiscal stance is defined as a measure of the annual change in the underlying budgetary position of the general government. It aims to assess the economic impulse stemming from fiscal policies, both those that are nationally financed and those that are financed by the EU budget. The fiscal stance is measured as the difference between (i) the medium-term potential growth and (ii) the change in primary expenditure net of discretionary revenue measures and including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other Union funds.

14 Report from the Commission, prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union, 4.6.2025, COM(2025) 615 final.

(16) General government expenditure amounting to 1.8% of GDP is expected to be financed by non-repayable support (“grants”) from the Recovery and Resilience Facility in 2025, compared to 0.9% of GDP in 2024, according to the Commission Spring 2025 Forecast. Expenditure financed by Recovery and Resilience Facility non-repayable support enables high-quality investment and productivity-enhancing reforms without a direct impact on the general government balance and debt of Latvia.

(17) General government defence expenditure in Latvia amounted to 2.5% of GDP in 2021, 2.4% of GDP in 2022 and 3.1% of GDP in 2023[15]. According to the Commission Spring 2025 Forecast, expenditure on defence is projected at 3.0% of GDP in 2024 and 3.3% of GDP in 2025. This corresponds to an increase of 0.8 percentage points of GDP compared to 2021. The period when the national escape clause is activated (2025-2028) allows Latvia to reprioritise government expenditure or increase government revenue so that lastingly higher defence expenditure would not endanger fiscal sustainability in the medium term.

(18) According to the Commission Spring 2025 Forecast, net expenditure in Latvia is projected to grow by 5.7% in 2025 and 10.4% cumulatively in 2024 and 2025. Based on the Commission 2025 spring forecast, the net expenditure growth of Latvia in 2025 is projected to be below the recommended maximum growth rate, both annually and when considering 2024 and 2025 together.

(19) In the Annual Progress Report, the general government deficit is projected to decrease to 3.0% of GDP in 2026, while the general government debt-to-GDP ratio is projected to increase to 49.5% by the end of 2026. After 2026, in the Annual Progress Report, the general government deficit is projected to increase to 3.2% of GDP in 2027 and decrease to 2.3% of GDP in 2029. In turn, after 2026, the general government debt-to-GDP ratio is projected to increase to 52.8% in 2027, and gradually decrease to 51.3% in 2029. Based on policy measures known at the cut-off date of the forecast, the Commission Spring 2025 Forecast projects the government deficit to remain at 3.1% of GDP in 2026. These developments correspond to net expenditure growth of 4.4% in 2026. Based on the Commission’s estimates, the fiscal stance, which includes both nationally and EU financed expenditure, is projected to be expansionary, by 0.3% of GDP, in 2026. The general government debt-to-GDP ratio is projected by the Commission to increase to 49.3% by the end of 2026. The increase of the debt-to-GDP ratio in 2026 mainly reflects the projected primary deficit.

Key policy challenges

(20) Latvia’s tax revenue remains below the EU average, at 32.9% of GDP in 2023, compared to the EU average of 39.0%. Labour and consumption taxes are Latvia’s main revenue sources, whereas taxes on capital – including corporate income tax, tax on income from capital and taxes on property – represent a relatively low share of total tax revenue and of GDP compared to other Member States. While this relative overall tax revenue gap might not be an issue per se, the issue of new structural funding sources becomes relevant against the background of rising medium-term pressures on public finances, including: (i) the government’s commitments to considerably strengthen internal and external security; (ii) substantial financing needs to improve public services, in particular healthcare and social care; and (iii) the implementation of large-scale infrastructure projects co-funded by the EU (e.g. Rail Baltica).

[15] Eurostat, government expenditure by classification of functions of government (COFOG).

(21) While the tax reform that entered into force in January 2025 addressed some aspects related to capital taxation, the estimated fiscal impact on capital tax revenue is rather minor, amounting to less than 0.1% of GDP in 2025 and in 2026. Meanwhile, despite its commitment to transition to new land and property values for immovable property taxation from 2026, the government targets limited gains in terms of fiscal space and mainly plans to stabilise real estate tax revenue close to the historical average.

(22) According to surveys of company owners and managers, the shadow economy decreased in size in 2023, to 22.9% of GDP. This is 3.6 percentage points lower than in 2022, marking the first decrease since 2019. While there are different ways of measuring the size of the shadow economy and it is difficult to establish direct causality, the government's persistent focus on implementing policy measures to formalise economic activity seems to have reduced companies' tolerance for the shadow economy and their willingness to participate in it. At the same time, observed positive developments in reducing the informal economy warrant continued efforts to implement the current action plans.

(23) While annual spending reviews have aimed to make public spending more effective, the current practice provides for a return of most savings (approximately 0.3% of GDP annually) to the sectoral ministries involved in the review process. Instead, redirecting the resulting funding to a limited number of priority areas – such as defence, healthcare and social protection – should be considered.

(24) 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. These are expected to help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations. Within this tight timeframe, finalising the effective implementation of the recovery and resilience plan including the REPowerEU chapter, is essential to boost Latvia's long-term competitiveness through the green and digital transitions, while ensuring social fairness. To deliver on the commitments of the recovery and resilience plan by August 2026, it is essential for Latvia to accelerate the implementation of reforms and investments by addressing relevant challenges. Latvia could benefit from strengthening its administrative capacity and improving execution strategies to help mitigate delays and administrative hurdles. EU-funded construction projects are at risk of delayed delivery due to the construction sector's strained capacity, caused by competing demands, regulatory burden and external factors. The systematic involvement of local and regional authorities, social partners, civil society and other relevant stakeholders remains essential in order to ensure broad ownership for the successful implementation of the recovery and resilience plan.

(25) The implementation of cohesion policy programmes, which encompass support from the European Regional Development Fund (ERDF), the Just Transition Fund (JTF), the European Social Fund Plus (ESF+) and the Cohesion Fund (CF), has accelerated in Latvia. It is important to continue efforts to ensure the swift implementation of these programmes, while maximising their impact on the ground. Latvia is already taking action under its cohesion policy programmes to boost competitiveness and growth. At the same time, Latvia continues to face challenges, including those relating to economic and social resilience, including addressing poverty and social exclusion, social housing, the labour market integration of disadvantaged groups, as well as educational supply, energy transition and regional competitiveness, especially in the eastern border regions. In accordance with Article 18 of Regulation (EU) 2021/1060,

Latvia is required – as part of the mid-term review of the cohesion policy funds – to review each programme taking into account, among other things, the challenges identified in the 2024 country-specific recommendations. The Commission proposals adopted on 1 April 2025[16] extend the deadline for submitting an assessment – for each programme – of the outcome of the mid-term review beyond 31 March 2025. It also provides flexibilities to help speed up programme implementation and incentives for Member States to allocate cohesion policy resources to five strategic priority areas of the Union, namely competitiveness in strategic technologies, defence, housing, water resilience and energy transition.

(26) The Strategic Technologies for Europe Platform (STEP) provides the opportunity to invest in a key EU strategic priority by strengthening the EU's competitiveness. STEP is channelled through 11 existing EU funds. Member States can also contribute to the InvestEU programme supporting investments in priority areas. Latvia could use these initiatives to support the development or manufacturing of critical technologies, including clean and resource-efficient technologies.

(27) Beyond the economic and social challenges addressed by the recovery and resilience plan and other EU funds, Latvia faces several additional challenges related to the business environment, access to finance, research and innovation, renewable energy, energy efficiency, sustainable transport, resource management, labour and skills shortages, social protection, healthcare and housing.

(28) As set in the Competitiveness Compass, all the EU, national, and local institutions must make a major effort to produce simpler rules and to accelerate the speed of administrative procedures. The Commission has set ambitious goals for reducing administrative burden: by at least 25% and by at least 35% for SMEs; and has created new tools to achieve these goals, including systematic stress test of the stock of EU legislation and enhanced stakeholders' dialogue. To match this ambition, Latvia also needs to take action. 47% of businesses consider the complexity of administrative procedures to be a problem for their company when doing business in Latvia[17]. Latvia's regulatory framework presents a barrier to investment, for example due to an overly complex licensing system. These issues are particularly burdensome in sectors such as real estate development, highlighting the need for reforms to improve the business environment. Simplification and streamlining of administrative procedures is crucial to stimulating economic growth and boosting competitiveness, aligning with broader EU-supported initiatives. It could also improve public trust in evidence-based governmental decisions, contribute to reducing the shadow economy, and, as a result, drive sustainable economic progress.

(29) Latvian businesses use the traditional sources of external financing, such as bank loans and capital market, less often than businesses in most other EU countries. Market lending rates are high and collateral requirements stringent, most notably in the corporate sector, including among small and medium-sized enterprises. This undermines the capacity of businesses to scale up and puts at risk possibilities for investments in areas of strategic importance, such as the green transition, commercialisation of innovations, and projects for regional development. Latvia's

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16 Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulations (EU) 2021/1058 and (EU) 2021/1056 as regards specific measures to address strategic challenges in the context of the mid-term review - COM(2025) 123 final.

17 'Businesses' attitudes towards corruption in the EU' Flash Report, Eurobarometer Report (April 2024).

eastern border region merits particular attention, with increased investment to strengthen its societal and economic resilience. Stimulating competition in the banking sector and promoting public lending and guarantee schemes to facilitate investments in areas of strategic importance could improve the access to finance.

(30) Latvian private investment in research and innovation, as a percentage of GDP, is among the lowest in the EU. Businesses in Latvia employ fewer researchers than their counterparts in similar countries. The valorisation of research activities and the cooperation between private business and academia is limited. The Latvian government has already implemented a few important steps to reform the academic system. For example, the requirement of knowledge of the Latvian language was relaxed for several academic positions, which gives Latvian universities more possibilities for attracting talented foreigners. Latvia is in the process of reforming its research and innovation system to improve talent creation and retention, such as by increasing the salary of doctoral students. A successful implementation of these reforms, as well as increasing academic research funding, could increase the supply of well-trained researchers to businesses. In addition, Latvia should stimulate cooperation between businesses and academia and could consider direct R&D incentives for businesses, such as tax reductions for R&D investment or innovation procurement.

(31) In 2024, 74% of Latvia's electricity was generated from renewable sources, with hydropower accounting for 51% of the total. However, the shares of solar and wind production, at 8% and 4%, respectively, were still significantly lower than in Lithuania and Estonia, and below the EU average. There is scope to further diversify the country's renewable energy mix by tapping into wind and solar power, and by scaling up production from these sources. In particular, despite some limited action planned under the national recovery and resilience plan, additional efforts are needed to expedite and streamline permitting procedures for new solar and wind energy projects. Latvia should also take further action to promote demand-side flexibility, such as stimulating energy storage owned by end consumers and participation in distributed energy resources and in balancing and flexibility services. Additionally, it should clearly define the roles of certain energy market participants, such as aggregators of small-scale demand. Separately, applications for grid connection permits for renewable energy generation facilities considerably exceed the electricity network's available capacity, which is why the issuance of new permits has been halted since July 2023. Despite some positive legislative developments in 2025, there is scope for further regulatory action to improve grid queue management.

(32) The buildings and transport sectors are key from both an energy and climate perspective. While significant energy efficiency schemes are currently running or being planned, they remain overly reliant on public, mostly EU, funding. Latvia could benefit from stepping up the renovation of its rather old building stock by: (i) attracting additional private funding; (ii) favouring financial instruments and de-risking options over grant-based energy efficiency schemes; and (iii) supporting the development of the energy services sector as a key market-enabler for energy efficiency investments. In the transport sector, which still relies heavily on oil products, the potential for further electrification and overall decarbonisation is also significant. Despite some positive measures, either in place or in the pipeline, Latvia could do more to promote the uptake of electric vehicles and the production and uptake of renewable and low-carbon fuels for both public and private transport. In parallel, additional investment to expand the recharging network would also be beneficial. Also, outside the buildings and transport sectors, given the high and

increasing share of renewables in the national electricity mix, promoting further electrification could be an effective strategy to reduce overall carbon intensity and increase energy security.

(33) Latvia needs to accelerate its progress towards a circular economy in order to meet the EU's circular economy goals. The country's indicators for sustainable economic growth lag behind the EU average, and its material footprint continues to increase. Although Latvia has improved its waste management system, it still landfills almost half of its municipal waste and is at risk of not meeting the 2025 target for municipal waste recycling.

(34) Labour and skills shortages continue to weigh on economic growth and slow down the transition to an innovative, digital and green economy. The ageing of the population is leading to a decline in the labour force and there are high vacancy rates in key sectors such as construction, manufacturing, insulation, forestry and healthcare. Long-term forecasts show that in the coming decades, these shortages will grow even stronger. Improved working conditions could help attract and retain skilled workers, including in sectors such as healthcare and social care. The low proportion of graduates in science, technology, engineering and mathematics (STEM), and the lack of researchers in these areas, is one of the main barriers to strengthening Latvia's research and innovation capacity, especially in the private sector. Latvia is in the process of developing a sustainable adult learning framework; however, adult participation in learning and the involvement of unemployed people and people at risk of unemployment in policy measures to help people find or stay in work is lower than the EU average. The relatively low and decreasing level of digital competency also poses a significant risk to productivity. To unlock the untapped labour supply, upskilling and reskilling measures could be more targeted, including for low-skilled people and across regions. Collaboration with employers could be intensified by increasing the uptake of work-based learning programmes and employer-led and financed employee training to further improve workers' skills.

(35) Latvia still faces persistently high levels of inequality and significant risks of poverty and social exclusion, particularly impacting older people. Expenditure on social protection in relation to GDP is low and decreased from 14.0% in 2022 to 13.5% in 2023, while the impact of social transfers other than pensions in terms of mitigating income inequality is still one of the lowest in the EU. In addition, ensuring adequate income support for older people remains a key challenge. Consequently, the social protection system fails to lift a considerable proportion of the population out of poverty or social exclusion. In addition, significant socio-economic disparities across regions affect the provision of social services by municipalities despite the introduction of the minimum services basket. Lastly, public spending on long-term and home care remains inadequate given the demographic trends.

(36) Low public spending on healthcare and unhealthy lifestyle choices are the main reasons for the population's poor health outcomes. Access to publicly funded healthcare in Latvia is constrained by the limited scope of the state benefits package, resulting in high out-of-pocket payments for healthcare. The financial burden of this affects low-income households disproportionately. Consequently, Latvia has one of the highest rates of self-reported unmet needs for medical care. In addition, Latvia faces health workforce shortages, especially of nurses, which further undermines the delivery of health services. The government has proposed a draft law to reform the financing for healthcare; however, the proposal falls short of committing to a higher share of GDP for the sector.

(37) There is a shortage of quality affordable housing, mainly due to low investments in housing. The shortage of housing undermines labour mobility and social inclusion. In addition, the existing housing stock is of poor quality, in particular in terms of energy efficiency, which puts financial pressure on households due to raising energy costs.

(38) 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, in 2025, the Council recommended that the euro-area Member States take action, including through their recovery and resilience plans, to implement the 2025 Recommendation on the economic policy of the euro area. For Latvia, recommendations (2), (3), (4) and (5) help implement the first euro-area recommendation on competitiveness, while the recommendations (4) and (5) help implement the second euro-area recommendation on resilience, and the (1) recommendation helps implement the third euro-area recommendation on macro-economic and financial stability set out in the 2025 Recommendation.

HEREBY RECOMMENDS that Latvia take action in 2025 and 2026 to:

1. Reinforce overall defence spending and readiness in line with the European Council conclusions of 6 March 2025. Adhere to the maximum growth rates of net expenditure recommended by the Council on 21 January 2025, while making use of the allowance under the national escape clause for higher defence expenditure. Make public finances fit to cope with rising structural spending needs including for defence, healthcare and social protection, such as by broadening taxation to sources less detrimental to growth, moving informal or undeclared activities into the formal economy, and redirecting expenditure to priority areas based on public spending reviews.

2. In view of the applicable deadlines for the timely completion of reforms and investments under Regulation (EU) 2021/241, accelerate the implementation of the recovery and resilience plan, including the REPowerEU chapter. Accelerate the implementation of cohesion policy programmes (ERDF, JTF, ESF+, CF), building, where appropriate, on the opportunities offered by the mid-term review. Make optimal use of EU instruments, including the scope provided by the InvestEU and the Strategic Technologies for Europe Platform, to improve competitiveness.

3. Simplify regulation, improve regulatory tools and reduce administrative burden on companies. Improve access to finance for small and medium-sized enterprises, including by stimulating competition in the financial markets and promoting public lending and guarantee schemes to facilitate investments of strategic importance, in particular in the areas of the green transition, scaling-up and commercialisation of innovations, and regional development. Facilitate private investment in research and innovation, including by pursuing further reforms in the higher education system to strengthen cooperation between businesses and academia.

4. Reduce reliance on fossil fuels and increase energy security by accelerating the deployment of renewable energy, particularly wind and solar. Improve permit-granting procedures and electricity grid queue management, and promote energy storage, demand response and market-based flexibility solutions. Reduce primary and final energy consumption, and carbon intensity by strengthening energy efficiency measures, especially in the buildings sector, and by promoting further electrification. Accelerate the decarbonisation of transport, especially road transport, by promoting the uptake of electric vehicles, the production and distribution of renewable transport fuels and the expansion of recharging infrastructure. Increase

resource efficiency and the transition to a circular economy through eco-innovation and sustainable resource management practices.

5. Address labour and skills shortages, in particular in science, technology, engineering and mathematics (STEM) and in other specialisations needed for the green transition, for research and for digitalisation, as well as in the social and healthcare sectors, including through targeted upskilling and reskilling and improved working conditions. Strengthen social protection to reduce inequality, including by improving the adequacy of old-age pensions and the access to quality social services, notably home care, while maintaining fiscal sustainability. Strengthen the adequacy and accessibility of the health system to improve health outcomes, including by providing additional human and financial resources, broadening the statutory benefits package and reducing out-of-pocket payments. Increase the availability and quality of social and affordable energy-efficient housing, including through renovations.

Done at Brussels,

For the Council
The President