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**COMMISSION OPINION**

**of 28.11.2014**

**on the Draft Budgetary Plan of LATVIA**

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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 for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) 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 presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING LATVIA

3. On the basis of the Draft Budgetary Plan for 2015 submitted on 15 October by Latvia, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. The Draft Budgetary Plan was submitted by the outgoing government on the basis of unchanged policies. Following the general elections on 4 October, the new government took office on 5 November.

5. Latvia is subject to the preventive arm of the Stability and Growth Pact. On 8 July 2014 the Council recommended that Latvia should preserve a sound fiscal position in 2014 and strengthen the budgetary strategy as of 2015, ensuring compliance with its medium-term budgetary objective (MTO), while allowing for the impact of the systemic pension reform.

6. The macroeconomic scenario underlying the Draft Budgetary Plan foresees a slowdown in economic growth from 4.2% in 2013 to 2.9% in 2014 and 2.8% in 2015. This represents a significant revision from the latest Stability Programme where economic growth was forecast at 4% in 2014 and 2015. Inflation and employment are also revised downwards. The macroeconomic scenario underlying the Draft Budgetary Plan is broadly in line with the Commission 2014 autumn forecast.

7. Regulation (EU) No 473/2013 requires the draft budget to be based on independently endorsed or produced macroeconomic forecasts. However, the macroeconomic forecasts underlying the Draft Budgetary Plan have not been endorsed by an independent body. The Fiscal Discipline Council, Latvia's fiscal monitoring institution, will provide its opinion on the 2015 budget proposal when sent to the national parliament, including an independent evaluation of the macroeconomic projections and cyclical position of the economy, according to the provisions of the Fiscal Discipline Law.

8. The Draft Budgetary Plan estimates a headline deficit of 1.5% of GDP in 2014, as compared to the deficit target of 1% of GDP in the Stability Programme. The worsening of the fiscal position is largely due to weaker tax revenue (0.1% of GDP)

and a one-off measure related to the support of one bank (0.4% of GDP). Based on unchanged policies, the Draft Budgetary Plan envisages a fiscal deficit of 1% of GDP in 2015, as compared to the target of 0.8% of GDP in the Stability Programme. The worsening of the fiscal position is related to lower tax revenue and higher social spending, both reflecting the softening of the economic activity.

9. Latvia is eligible to the systemic pension reform clause from 2013, which allows a deviation from the MTO (a structural deficit of 1% of GDP) of 0.5%, 0.5%, and 0.8% of GDP in 2013, 2014 and 2015, respectively. According to the information provided in the Draft Budgetary Plan, the recalculated structural balance is within the limits of the allowed deviation from the MTO in 2014 and 2015. This is confirmed by the Commission 2014 autumn forecast. Furthermore, based on the Commission forecast, the growth rate of government expenditure, net of discretionary revenue measures, corrected for the pension reform clause will not exceed the reference medium-term rate of potential GDP growth of 1.4%. However, the projected significant deviation of the expenditure benchmark over 2013 and 2014 is related to dynamic expenditure growth in 2013, largely due to capital injections in state owned enterprises, which were of a temporary nature. Based on an overall assessment, the adjustment towards the MTO seems compliant with the requirement of the preventive arm of the Pact in 2014.

   In 2015, some deviation from the expenditure benchmark is projected on no-policy-change basis. An overall assessment, based on the Commission forecast, points to some deviation from the requirements of the preventive arm of the SGP in 2015.

10. The Draft Budgetary Plan estimates gross public debt at around 40% of GDP in 2014 and declining to some 35% of GDP in 2015. The reduction in the gross debt ratio mostly reflects a large repayment of the EU financial support due in early 2015 from the accumulated cash reserves.

11. The Draft Budgetary Plan does not include any plans that affect the tax wedge on labour. However, the authorities have announced the Tax Policy Strategy for 2015-17, including plans to reduce tax burden on labour and improving tax compliance.

12. Latvia submitted on 15 October a Draft Budgetary Plan based on a no-policy change basis. Overall, the Commission is of the opinion that the Draft Budgetary Plan of Latvia, which is currently under the preventive arm, is broadly compliant with the provisions of the Stability and Growth Pact. The Commission invites the authorities to take the necessary measures in the 2015 budget in order to be compliant with the SGP.

    The Commission is also of the opinion that Latvia has made limited progress with regard to the structural part of the fiscal recommendations issued by the Council in the context of the 2014 European Semester and thus invites the authorities to accelerate implementation.

    Following the submission of an updated Draft Budgetary Plan on 22 November 2014 by the new government, the Commission aims to adopt an opinion on the updated Draft Budgetary Plan before the draft budget law is planned to be adopted by the national parliament.

Done at Brussels, 28.11.2014

*For the Commission*
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*Member of the Commission*