# COUNCIL RECOMMENDATION

## of 14 July 2015

## on the 2015 National Reform Programme of Latvia and delivering a Council opinion on the 2015 Stability Programme of Latvia

(2015/C 272/17)

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 policies ([1]), 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) On 26 March 2010, the European Council agreed to the Commission's proposal to launch a new strategy for growth and jobs, Europe 2020, based on enhanced coordination of economic policies. The strategy focuses on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 14 July 2015, the Council, on the basis of the Commission's proposals, adopted a Recommendation on the broad guidelines for the economic policies of the Member States and the Union and, on 21 October 2010, it adopted a decision on guidelines for the employment policies of the Member States ([2]). Together these form the 'integrated guidelines' which Member States were invited to take into account in their national economic and employment policies.

(3) On 8 July 2014, the Council adopted a Recommendation ([3]) on Latvia's National Reform Programme for 2014 and delivered its opinion on Latvia's updated Stability Programme for 2014.

(4) On 28 November 2014, the Commission adopted the Annual Growth Survey, marking the start of the 2015 European Semester for economic policy coordination. On the same day, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council ([4]), the Commission adopted the Alert Mechanism Report, in which Latvia was not identified as one of the Member States for which an in-depth review would be carried out.

(5) On 18 December 2014, the European Council endorsed the priorities for fostering investment, intensifying structural reforms and pursuing responsible growth-friendly fiscal consolidation.

([1]) OJ L 209, 2.8.1997, p. 1.
([2]) Maintained by Council Decision 2014/322/EU of 6 May 2014 on guidelines for the employment policies of the Member States for 2014 (OJ L 165, 4.6.2014, p. 49).
([3]) Council Recommendation of 8 July 2014 on the National Reform Programme 2014 of Latvia and delivering a Council opinion on the Stability Programme of Latvia, 2014 (OJ C 247, 29.7.2014, p. 63).
([4]) 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).

(6) On 26 February 2015, the Commission published its 2015 country report for Latvia. This assessed Latvia's progress in addressing the country-specific recommendations adopted on 8 July 2014.

(7) On 15 April 2015, Latvia submitted its 2015 National Reform Programme and its 2015 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(8) Latvia is currently in the preventive arm of the Stability and Growth Pact and benefits from the implementation of the systemic pension reform clause as confirmed by Eurostat. In its 2015 Stability Programme, Latvia has requested a temporary deviation from the required adjustment path towards the medium-term objective, because it continues to implement a major structural reform in the health sector. The budgetary costs of the health sector reform amount to 0,2 % of GDP in 2016. The reform is estimated to increase employment by 0,6 % and the GDP level by 2,2 % by 2023. The positive impact on growth and the long-term sustainability of public finances is assessed as plausible. However, based on the Commission's 2015 spring forecast, the projected structural deficit of 2,2 % of GDP in 2016 exceeds the appropriate safety margin with respect to the 3 %-of-GDP Treaty reference value which should be respected in order to be eligible for the structural reform clause. Therefore, and while recognising that the ongoing health sector reform is warranted, the Council is of the opinion that Latvia does not fulfil the requirements to benefit from the requested temporary deviation in 2016

(9) In its 2015 Stability Programme, the Government plans a broadly stable headline deficit at 1,4 % of GDP in 2016 and 1,3 % in 2017, rising to 1,7 % in 2018. To achieve these targets, the Government intends to reach a structural deficit of 1,8 % of GDP in 2016, and of 1,4 % of GDP as from 2017. The adjustment path in the Stability Programme incorporates a deviation based on the structural reform clause for which Latvia does not appear to be eligible and classifies planned additional defence spending over 2016-2019 as one-off operations. According to the Stability Programme, the government debt-to-GDP ratio is expected to decline from 37 % of GDP in 2015 to 34 % of GDP by 2018, with some annual fluctuations in between due to the accumulation of liquid assets for debt management purposes. The macroeconomic scenario underpinning these budgetary projections is plausible. Measures for 2015 have largely been implemented as budgeted. However, measures to support the planned deficit targets from 2016 onwards have not been sufficiently specified. Based on the Commission's 2015 spring forecast, Latvia complies with the requirement in 2015, taking into account the application of the systemic pension reform clause. For 2016, there is a risk of a significant deviation. The structural balance is required to improve by 0,3 % of GDP taking into account the allowance for the systemic pension reform. Based on the Commission forecast, it deteriorates by 0,3 % of GDP, which is also linked to the fact that the defence spending cannot be classified as one-off measures. Based on its assessment of the Stability Programme and taking into account the Commission's 2015 spring forecast, the Council is of the opinion that there is a risk that Latvia will not comply with the provisions of the Stability and Growth Pact.

(10) A national independent accreditation agency is being set up and a new quality-targeting financing model is being developed for Latvia's higher education. Despite some progress in reforming the research and innovation system, in line with the Smart Specialisation Framework, inadequate public funding in a fragmented research and innovation system is leading to poor scientific outcomes. Latvia invested only around 0,6 % of GDP in R & D in 2013 — the third lowest level in the Union. Public R & D intensity reached only 0,4 3 % of GDP in 2013. Lack of innovation and private investment in higher-value-added and knowledge-intensive sectors hampers competitiveness.

(11) Notwithstanding the progress made to tackle unemployment, further action is needed to prevent youth unemployment and its negative long-term consequences, given the shrinking labour force. Latvia has made some progress to reform vocational education and training and its apprenticeship component; however, its lack of attractiveness remains a challenge, due to the limited engagement of SMEs.

(12) Even if a significant amount of analytical and planning work has been carried out, the social assistance reforms have not advanced and are not backed by sufficient budgetary plans. Low coverage and adequacy of unemployment and social assistance benefits prevents effective action on reducing poverty, social exclusion and the high degree of inequality. Under these conditions, social expenditure has little impact on poverty reduction. In 2014, around 32,7 % of Latvia's population were at risk of poverty or social exclusion and income inequality remains among the highest in the Union. The financing and coverage of active labour market policies remains low in comparison with other Member States. The high tax wedge for low- income earners remains a disincentive

for formal employment and reduces demand for low-skilled workers; whereas environmental and effective property taxation have significant, unexploited potential. Low public healthcare financing and high out-of-pocket payments, inadequate focus on performance incentives and efficiency and lack of care coordination result in reduced access for a large proportion of the population to the healthcare system. It is necessary to continue actions to improve accessibility, cost-effectiveness and quality of the healthcare system and to link hospital financing to performance-based mechanisms.

(13) Latvia has made significant progress in reforming the judicial system. However, the rate of resolving civil and commercial cases remains low creating an additional burden for business. The role of the Judicial Council and court chairpersons in implementing judicial reforms should be strengthened. The fight against tax evasion and appropriate tax collection is insufficient and the level of tax avoidance is still high. While an insolvency law has been adopted, challenges remain with respect to proper insolvency policy and an effective insolvency administrators' supervision system. The business climate and the quality of public services would benefit from stronger measures against conflict of interest and corruption, especially in vulnerable sectors such as public procurement, construction and healthcare. There has been no progress on the Competition Council's proposals for amendments to the Competition Law to give it greater institutional and financial independence to take effective action against public bodies.The Public Service Law has not been adopted by the Parliament. It will be important that the local government be included.

(14) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Latvia's economic policy and published it in the 2015 country report. It has also assessed the Stability Programme and the National Reform Programme and the follow-up given to the recommendations addressed to Latvia in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Latvia but also their compliance with EU rules and guidance, given the need to strengthen the overall economic governance of the Union by providing EU-level input into future national decisions. The recommendations under the European Semester are reflected in recommendations (1) to (4) below.

(15) In the light of this assessment, the Council has examined the Stability Programme, and its opinion ([1]) is reflected in particular in recommendation (1) below.

(16) In the context of the European Semester, the Commission has also carried out an analysis of the economic policy of the euro area as a whole. On the basis of this analysis, the Council has issued specific recommendations addressed to the Member States whose currency is the euro ([2]). As a country whose currency is the euro, Latvia should also ensure the full and timely implementation of those recommendations,

HEREBY RECOMMENDS that Latvia take action in 2015 and 2016 to:

1. Ensure that the deviation from the medium-term budgetary objective in 2015 and 2016 is limited to the allowance linked to the systemic pension reform.

2. Improve vocational education and training, speed up the curricula reform and increase the offer for work-based learning. Ensure that the new financing model of the higher education system rewards quality. Better target research financing and incentivise private investment in innovation on the basis of the Smart Specialisation Framework.

3. Take concrete steps to reform social assistance, ensuring adequacy of benefits, and take measures to increase employability. Reduce the high tax wedge for low-income earners by shifting the tax burden to other sources less detrimental to growth. Take action to improve the accessibility, cost-effectiveness and quality of the healthcare system and link hospital financing to performance mechanisms.

([1]) Under Article 5(2) of Regulation (EC) No 1466/97.
([2]) OJ C 272, 18.8.2015, p. 98.

4. Improve efficiency of the judicial system, by increasing accountability of all parties (including insolvency administrators), by providing adequate means to fight tax evasion and by strengthening the role of the Judicial Council. Improve the public service legislation to strengthen the conflict of interest regime and link remuneration to responsibilities.

Done at Brussels, 14 July 2015.

*For the Council*

*The President*

P. GRAMEGNA