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Recommendation for a

COUNCIL RECOMMENDATION

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

{SWD(2024) 600 final} - {SWD(2024) 614 final}

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 Articles 121(2) and 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:

(1) Regulation (EU) 2021/241 of the European Parliament and of the Council[2], which established the Recovery and Resilience Facility, entered into force on 19 February 2021. The Recovery and Resilience Facility provides financial support to the Member States for the implementation of reforms and investment, entailing a fiscal impulse financed by the EU. In line with the European Semester priorities, it helps achieve the economic and social recovery and implement sustainable reforms and investment, in particular to promote the green and digital transitions and make the 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 EU and support the continued implementation of the European Pillar of Social Rights.

(2) The REPowerEU Regulation[3], adopted on 27 February 2023, aims to phase out the EU's dependency on Russian fossil fuel imports. This would help achieve energy security and diversify the EU's energy supply, while increasing the uptake of

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

2 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.

3 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.

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.

(3) On 16 March 2023, the Commission issued a Communication on the 'Long-term competitiveness of the EU: looking beyond 2030'[4], in order to inform policy decisions and create the framework conditions for increasing growth. The Communication frames competitiveness along nine mutually reinforcing drivers. Among these drivers, access to private capital, research and innovation, education and skills, and the single market emerge as paramount policy priorities for reform and investment to address current productivity challenges as well as to build up the long-term competitiveness of the EU and its Member States. On 14 February 2024, the Commission followed this Communication with the Annual Single Market and Competitiveness Report[5]. The report details the competitive strengths and challenges of Europe's Single Market, tracking yearly developments according to the nine competitiveness drivers identified.

(4) On 21 November 2023, the Commission adopted the 2024 Annual Sustainable Growth Survey[6], marking the start of the 2024 cycle of the European Semester for economic policy coordination. The European Council endorsed the priorities of the survey around the four dimensions of competitive sustainability on 22 March 2024. On 21 November 2023, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the 2024 Alert Mechanism Report, in which it did not identify Latvia as one of the Member States that may be affected or may be at risk of being affected by imbalances, and for which an in-depth review would be needed. On the same date, the Commission adopted an opinion on the 2024 draft budgetary plan of Latvia. The Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area, which the Council adopted on 12 April 2024, as well as the proposal for the 2024 Joint Employment Report analysing the implementation of the Employment Guidelines and the principles of the European Pillar of Social Rights, which the Council adopted on 11 March 2024.

(5) On 30 April 2024, the EU's new economic governance framework came into force. The framework includes the new Regulation of the European Parliament and of the Council (EU)2024/1263 on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97. It also includes the amended Regulation (EC) No 1467/97 on the implementation of the excessive deficit procedure and the amended Directive 2011/85/EU on the budgetary frameworks of Member States[7]. The objectives of the new framework are public debt sustainability and sustainable and inclusive growth gradual fiscal consolidation as well as through reforms and investments. It promotes national ownership and has a greater medium-term focus, combined with more effective and coherent enforcement. Each Member State should submit to the Council and to the Commission a national medium-term fiscal-structural plan. National medium-term fiscal-structural plans contain the fiscal, reform and investment

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4 COM(2023) 168 final.

5 COM(2024) 77 final.

6 COM(2023) 901 final.

7 Council Regulation (EU) 2024/1264 of 29 April 2024 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ L, 2024/1264, 30.4.2024, ELI: http://data.europa.eu/eli/reg/2024/1264/oj) and Council Directive (EU) 2024/1265 of 29 April 2024 amending Directive 2011/85/EU on requirements for budgetary frameworks of the Member States (OJ L, 2024/1265, 30.4.2024, ELI: http://data.europa.eu/eli/dir/2024/1265/oj).

commitments of a Member State, covering a planning horizon of 4 years or 5 years depending on the regular length of the national legislature. The net expenditure[8] path in the national medium-term fiscal-structural plans should comply with the requirements of Regulation (EU) 2024/1263, including the requirements to put or keep general government debt on a plausibly downward path by the end of the adjustment period at the latest, or for it to remain at prudent levels below 60% of GDP, and to bring and/or maintain the government deficit below the 3% of GDP 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 Regulation (EU) 2024/1263, the adjustment period may be extended by 3 years at most. For the purpose of supporting the preparation of those plans, on [21 June] 2024, the Commission is set to provide Member States with guidance on the content of the plans and the subsequent annual progress reports that they will need to submit and, in accordance with Article 5 of Regulation (EU) 2024/1263, will transmit to them technical guidance on the fiscal adjustments (reference trajectories and technical information, where applicable). Member States should submit their medium-term fiscal-structural plans by 20 September 2024, unless the Member State and the Commission agree to extend the deadline by a reasonable period of time. Member States should ensure the involvement of their national parliaments, and the consultation of independent fiscal institutions, of social partners and other national stakeholders, as appropriate.

(6) In 2024, the European Semester for economic policy coordination continues to evolve in line with the implementation of the Recovery and Resilience Facility. The full implementation of the recovery and resilience plans remains essential for delivering 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 issued in recent years. The 2019, 2020, 2022 and 2023 country-specific recommendations remain equally relevant also for recovery and resilience plans revised, updated or amended in accordance with Articles 14, 18 and 21 of Regulation (EU) 2021/241.

(7) 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 Regulation (EU) 2021/241, the Commission assessed the relevance, effectiveness, efficiency and coherence of the recovery and resilience plan, in accordance with the assessment guidelines of Annex V to that Regulation. On 13 July 2021, the Council adopted its Decision on the approval of the assessment of the recovery and resilience plan for Latvia[9], which was amended on 8 December 2023 following Article 18(2) of Regulation (EU) 2021/241 to update the maximum financial contribution for non-repayable financial support, as well as to include the REPowerEU chapter[10]. The release of instalments is conditional on a decision by the Commission,

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8 Net expenditure as defined in Article 2 of Council Regulation (EU) 2024/1263 of 29 April 2024 (OJ L 2024/1263, 30.4.2024, ELI: http://data.europa.eu/eli/reg/2024/1263/oj). Net expenditure means government expenditure net of (i) interest expenditure, (ii) discretionary revenue measures, (iii) expenditure on programmes of the Union fully matched by Union funds revenue, (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.

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

10 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).

taken in accordance with Article 24(5) of Regulation (EU) 2021/241, that Latvia has satisfactorily fulfilled the relevant milestones and targets set out in the Council Implementing Decision. Satisfactory fulfilment presupposes that the achievement of preceding milestones and targets has not been reversed.

(8) On 14 May 2024, Latvia submitted its 2024 National Reform Programme and, on 30 April 2024, its Stability Programme, in line with Article 4(1) of Regulation (EC) No 1466/97.

(9) The Commission published the 2024 country report for Latvia[11] on 19 June 2024. It assessed Latvia's progress in addressing the relevant country-specific recommendations adopted by the Council between 2019 and 2023 and took stock of Latvia's implementation of the recovery and resilience plan. Based on this analysis, the country report identified gaps with respect to those challenges that are not addressed or only partially addressed by the recovery and resilience plan, as well as new and emerging challenges. It also assessed Latvia's progress on implementing the European Pillar of Social Rights and on achieving the EU headline targets on employment, skills and poverty reduction, as well as progress in achieving the UN's Sustainable Development Goals.

(10) Based on data validated by Eurostat[12], Latvia's general government deficit decreased from 4.6% of GDP in 2022 to 2.2% in 2023, while the general government debt rose from 41.8% of GDP at the end of 2022 to 43.6% at the end of 2023.

(11) On 12 July 2022, the Council recommended[13] that Latvia takes action to ensure in 2023 that the growth of nationally financed primary current expenditure is in line with an overall neutral policy stance[14], taking into account continued temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. Latvia was recommended to stand ready to adjust current spending to the evolving situation. Latvia was also recommended to expand public investment for the green and digital transitions, and for energy security taking into account the REPowerEU initiative, including by making use of the Recovery and Resilience Facility and other Union funds. In 2023, according to the Commission estimates, the fiscal stance[15] was expansionary, by 0.5% of GDP, in a context of high inflation. The growth in nationally financed primary current expenditure (net of discretionary revenue measures) in 2023 provided an expansionary contribution to the fiscal stance of 1.1% of GDP. This includes the reduced cost of the targeted emergency support measures to households and firms most vulnerable to energy price hikes by 0.4% of GDP. The expansionary contribution of nationally financed net

11 SWD(2024) 614 final.

12 Eurostat-Euro Indicators, 22.4.2024.

13 Council Recommendation of 12 July 2022 on the National Reform Programme of Latvia and delivering a Council opinion on the 2022 Stability Programme of Latvia OJ C 334, 1.9.2022, p. 112.

14 Based on the Commission spring 2024 forecast, the medium-term potential output growth of Latvia in 2023, which is used to measure the fiscal stance, is estimated at 7.6% in nominal terms, based on the 10-year average real potential growth rate and the 2023 GDP deflator.

15 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 excluding temporary emergency measures related to the COVID-19 crisis) and including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other Union funds.

primary current expenditure in 2023 was therefore not due to the targeted emergency support to households and firms most vulnerable to energy price hikes. The expansionary growth in nationally financed primary current expenditure (net of discretionary revenue measures) was driven by increases in public sector wages and social benefits. In sum, the projected growth of nationally financed primary current expenditure in 2023 was not in line with the Council recommendation. Expenditure financed by Recovery and Resilience Facility grants and other EU funds amounted to 1.5% of GDP in 2023. Nationally financed investment amounted to 3.3% of GDP in 2023, with an annual decline of 0.1 percentage points from 2022. Latvia financed additional investment through the Recovery and Resilience Facility and other EU funds. It financed public investment for the green and digital transitions, and for energy security, such as the purchase of electric vehicles for public transport, improving the energy efficiency of multi-apartment buildings and business properties, modernising the electricity transmission and distribution networks, centralising the governance of digital platforms and systems in the public sector, developing the digital skills and digitisation of processes in businesses, broadband infrastructure development as well as fostering digitalisation in the education sector, which are largely funded by the Recovery and Resilience Facility and other EU funds.

(12) The key projections in the 2024 Stability Programme can be summarised as follows. The macroeconomic scenario underpinning the budgetary projections foresees real GDP to grow by 1.4% in 2024 and 2.9% in 2025, while it projects HICP inflation at 1.6% in 2024 and 2.5% in 2025. The general government deficit under current policies[16] in the 2024 Stability Programme is projected to increase to 2.9% of GDP in 2024 and decline to 2.7% of GDP in 2025, while the general government debt-to-GDP ratio is set to increase to 45.2% by the end of 2024 and 46.3% by the end of 2025. After 2025, the general government deficit is projected to decrease to 2.2% of GDP in 2026, 2.0% in 2027 and 1.7% in 2028. Therefore, the general government balance is planned to remain below the 3% of GDP deficit reference value over the programme horizon. In turn, after 2025, the general government debt-to-GDP ratio is projected to decrease to 46.2% in 2026, increase to 48.8% in 2027 and decrease to 48.2% in 2028.

(13) The Commission Spring 2024 Forecast projects real GDP to grow by 1.7% in 2024 and 2.6% in 2025, and HICP inflation to stand at 1.6% in 2024 and 2.0% in 2025.

(14) The Commission Spring 2024 Forecast projects a government deficit of 2.8% of GDP in 2024, while the general government debt-to-GDP ratio is set to increase to 44.5% by the end of 2024. In 2024, the impact of the complete phasing-out of energy-related measures by the end of 2023 will be more than offset by additional expenditure, on public wage increases for teachers and administration, healthcare and education, as well as supplementary payments to pensioners. Development of technical infrastructure on the country's border will contribute to an increase in public investment expenditure. The introduction of corporate income tax advance payments from the financial sector, an increase in the rates for several excise products and additional dividend payments from state-owned companies are expected to yield a moderate increase in revenue. Based on the Commission's estimates, the fiscal stance is projected to be expansionary by 0.9% of GDP in 2024.

[16] The 2024 Stability Programme states that according to current policies the budget deficit in 2025 is forecast to be 0.5ppt higher than the deficit target in the Programme. The Stability Programme does not include any details on policy measures to be taken in order to ensure compliance with deficit targets.

(15) Expenditure amounting to 1.6% of GDP is expected to be financed by non-repayable support ("grants") from the Recovery and Resilience Facility in 2024, compared to 0.4% of GDP in 2023, according to the Commission Spring 2024 Forecast. Expenditure financed by Recovery and Resilience Facility grants will enable high-quality investment and productivity-enhancing reforms without a direct impact on the general government balance and debt of Latvia.

(16) On 14 July 2023, the Council recommended[17] that Latvia ensure a prudent fiscal policy, in particular by limiting the nominal increase in net nationally financed primary expenditure[18] in 2024 to not more than 3.0%. When executing their 2023 budgets and preparing their Draft Budgetary Plans for 2024, Member States were invited to take into account that the Commission would propose to the Council the opening of deficit-based excessive deficit procedures based on the outturn data for 2023. According to the Commission Spring 2024 Forecast, Latvia's net nationally financed primary expenditure is projected to increase by 4.9% in 2024, which is above the recommended maximum growth rate. This excess spending over the recommended maximum growth rate in net nationally financed primary expenditure corresponds to 0.7% of GDP in 2024. However, net expenditure in 2023 was lower than expected at the time of the recommendation (by 0.9% of GDP). As the recommendation for 2024 was formulated as a growth rate, the assessment of compliance also needs to take into account the base effect from 2023. Had net expenditure in 2023 been the same as expected at the time of the recommendation, the resulting growth rate of net expenditure in 2024 would have been below the recommended growth rate by 0.2% of GDP. Overall, net nationally financed primary expenditure is assessed as at risk of being not fully in line with the recommendation.

(17) Moreover, the Council recommended that Latvia take action to wind down the emergency energy support measures in force, using the related savings to reduce the government deficit, as soon as possible in 2023 and 2024. The Council further specified that, should renewed energy price increases necessitate new or continued support measures, Latvia should ensure that these were targeted at protecting vulnerable households and firms, fiscally affordable, and preserve incentives for energy savings. According to the Commission Spring 2024 Forecast, the net budgetary cost[19] of emergency energy support measures is estimated at 1.0% of GDP in 2023 and 0.0% of GDP in both 2024 and 2025. If the related savings were used to reduce the government deficit, as recommended by the Council, these projections would imply a fiscal adjustment of 1.0% of GDP in 2024, whereas net nationally financed primary expenditure[20] provides a contractionary contribution to the fiscal stance of 0.5% of GDP in that year. The emergency energy support measures are projected to be wound down as soon as possible in 2023 and 2024. This is in line with the Council

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17 Council Recommendation of 14 July 2023 on the 2023 National Reform Programme of Latvia and delivering a Council opinion on the 2023 Stability Programme of Latvia, OJ C 312, 1.9.2023, p. 125.

18 Net primary expenditure is defined as nationally financed expenditure net of (i) discretionary revenue measures, (ii) interest expenditure, (iii) cyclical unemployment expenditure, and (iv) and one-offs and other temporary measures.

19 The figure represents the level of the annual budgetary cost of those measures, including revenue and expenditure and, where applicable, net of the revenue from taxes on windfall profits of energy suppliers.

20 This contribution is measured as the change in general government primary expenditure, net of (i) the incremental budgetary impact of discretionary revenue measures, (ii) one-offs, (iii) cyclical unemployment expenditure and (iv) expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other EU funds, relative to the medium-term (10-year) average potential nominal GDP growth rate, expressed as a ratio to nominal GDP.

recommendation. However, the related savings are not projected to be fully used to reduce the government deficit. This risks being not in line with the Council recommendation.

(18) In addition, the Council also recommended that Latvia preserve nationally financed public investment and ensure the effective absorption of Recovery and Resilience Facility grants and other EU funds, in particular to foster the green and digital transitions. According to the Commission Spring 2024 Forecast, nationally financed public investment is projected to increase to 3.4% of GDP in 2024 from 3.3% of GDP in 2023. This is in line with what was recommended by the Council.

(19) Based on policy measures known at the cut-off date of the forecast and on a no-policy-change assumption, the Commission Spring 2024 Forecast projects a government deficit of 2.9% of GDP in 2025. The general government debt-to-GDP ratio is set to increase to 46.3% by the end of 2025. The increase of the debt-to-GDP ratio in 2025 mainly reflects positive stock-flow adjustment and the government deficit.

(20) Latvia's tax revenue as a share of GDP remains significantly below the EU average, limiting the funding for public services, in particular healthcare and social protection. In 2022, the share of tax revenues decreased to 30.3% of GDP (40.2% of GDP in the EU), the lowest level in the last 3 years. In the taxation fields less detrimental to growth, in particular capital and property, Latvia still scores below the EU average. Revenue from corporate income tax has been gradually recovering after the sharp downward correction following the 2018 reform, while cadastral reform for property taxation to reflect current market values has not yet been adopted. The relatively low revenue from labour taxation, despite relatively high tax rates, suggests that there is potential to increase revenue from labour taxes. This warrants sustained efforts to improve tax compliance and shift economic activity from the shadow economy to the formal economy. Meanwhile, poverty and income inequality remain high in Latvia. Among EU Member States, Latvia has one of the highest percentages of people at risk of poverty and social exclusion, one of the highest risks of poverty for older people, as well as some of the lowest pensions compared to wages. Moreover, income inequality remains significantly above the EU average. Fragmentation of social support at municipal level, the poor quality and limited availability of existing social housing as well as significant socio-economic differences across regions continue to pose challenges for social inclusion and the labour market. Public spending on healthcare in Latvia remains among the lowest in the EU, leading to a high level of unmet healthcare needs and weak health outcomes. In recent years, public spending on healthcare and social support temporarily increased against the backdrop of pandemic emergency support as well as other additional budget allocations on an ad hoc basis. However, the 2024 budget envisages that general government expenditure on healthcare will fall to its 2020 level (4.7% of GDP) and expenditure on social protection will drop below the 2020 level (12.4% of GDP planned in 2024, compared to 13.3% in 2020). Medium-term plans envisage a further reduction of public spending on healthcare, which would hit 4.1% of GDP in 2028, while public spending on social protection is expected to increase gradually to 13.8% of GDP in 2028.

(21) In accordance with Article 19(3), point (b), and Annex V, criterion 2.2 of Regulation (EU) 2021/241, 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, proceeding swiftly with the effective implementation of the plan, including the REPowerEU

chapter, is essential to boost Latvia's long-term competitiveness through the green and digital transition, while ensuring social fairness. To deliver on the commitments of the plan by August 2026, it is essential for Latvia to continue the implementation of reforms and investments. The systematic involvement of local and regional authorities, social partners, civil society and other relevant stakeholders remains essential to ensure broad ownership for the successful implementation of the recovery and resilience plan.

(22) As part of the mid-term review of the cohesion policy funds, in accordance with Article 18 of Regulation (EU) 2021/1060, Latvia is required to review each programme by March 2025, taking into account, among other things, the challenges identified in the 2024 country-specific recommendations, as well as its national energy and climate plan. This review forms the basis for the definitive allocation of the EU funding included in each programme. While Latvia has made progress in implementing cohesion policy and the European Pillar of Social Rights, challenges remain and significant regional disparities persist between the capital city Riga and the rest of Latvia, in particular Latgale in the east. Accelerating the implementation of cohesion policy programmes is crucial. The priorities agreed in programme remain relevant. It is important to support the capacity of businesses to innovate and digitise in order to increase productivity. Supporting energy efficiency measures in buildings and businesses remains a priority. It is equally important to ensure access to timely and equal good quality health services and infrastructure, social services, including social housing, continuing the transition to independent living and community-based care. Activation, reskilling and upskilling of the unemployed and boosting participation in the labour market for under-represented groups remains a priority. Improving the quality and inclusiveness of education together with upskilling and reskilling the adult population should continue. In the context of the mid-term review of cohesion policy programmes, the existing regional disparities and ensuring an adequate level of investment in the field of material deprivation (including food and material assistance) merits specific consideration. Latvia could also use the Strategic Technologies for Europe Platform initiative to support the transformation of industry, with the focus on smart and renewable energy (e.g. offshore wind energy parks) where there is interest from international investors, as well as knowledge-intensive bioeconomy and biotechnology.

(23) 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, labour and skills shortages, and the transition to clean energy and a green economy.

(24) At 14.9% of GDP in 2022, business investment in Latvia is somewhat below Estonia's level of 16.5% of GDP and slightly higher than 13.1% of GDP in Lithuania. However, levels of net private investment have remained one of the lowest in the EU, amounting to 0.5% over the past 5 years compared to the EU average of 3.5%. Results from the 2023 EIB Investment Survey suggest that private investment is affected by high uncertainty, the lack of availability of skilled staff and high energy costs. In 2023, 77% of Latvian firms perceived business regulations to be a long-term obstacle to investment, which is one of the highest percentages in the EU. Moreover, bank lending has been weak, acting as a further barrier to business investment. Small and medium-sized enterprises find it particularly difficult to get credit. This is partly due to their higher credit risk, but also to the high cost of credit, stringent collateral requirements and administrative burden. The banking sector is concentrated, leading

to weak competition among banks, which is one of the factors behind the high interest rates. Continued efforts to increase competition in the banking sector, including through greater transparency on interest rates and other costs associated with loans, would foster lending activity over the medium term. Furthermore, public lending and/or guarantee schemes for strategically important investment areas like the green transition and regional development could increase effective competition in the banking market. In addition, boosting the availability of financing sources other than banking would be helpful for the business investment. The shadow economy has been a long-standing problem for the business environment, hindering investment, skills development and with it long-term competitiveness. According to Latvian business organisations, it distorts competition and incentivises businesses to remain small. Moreover, the prevalence of the shadow economy and weak company balance sheets are key obstacles to higher business lending, according to Latvia's banks.

(25) Labour and skills shortages are increasing in Latvia. In combination with demographic challenges and the declining working age population, this poses a challenge to the country's competitiveness. In 2023, the biggest labour shortages were in science, technology, engineering and mathematics (STEM), sectors that are highly relevant for productivity gains, as well as in the green and digital transition. By 2030, the most significant shortages are expected in engineering, manufacturing and construction, science, mathematics and IT. In addition, Latvia also continues to face shortages in healthcare and social care. 91% of Latvian companies mention the lack of skilled labour as a barrier to investment, which is above the EU average of 81%. The low proportion of graduates in technology, engineering and science, and the resulting lack of researchers in these areas, is one of the main barriers to strengthening the Latvian research and innovation capacity, especially in the private sector. High-quality education and training systems aligned with changing labour market needs and well-targeted upskilling and reskilling measures are key to reducing the labour and skills shortages and improving the competitiveness of the country as well as boosting the digital and green transition. While recent reforms have made vocational education and training more flexible and attractive, continued efforts are needed to modernise and improve the training offer. To unlock untapped labour supply, training measures need to be accessible, including for the low-skilled and across regions.

(26) Latvia enjoys one of the highest shares of energy from renewable sources in the EU. This is mostly attributable to power production from hydro plants and the high use of biomass, mainly in the heating sector. There is scope to further diversify the country's renewable energy mix. In 2022 and 2023, Latvia experienced an increase in installed capacity for solar and wind power, but these capacities remain significantly below the levels installed in both Estonia and Lithuania. To increase its share of renewables in final energy consumption, Latvia would benefit in particular from tapping into wind and solar power, and by scaling up production from these sources. Despite some limited action planned under the national recovery and resilience plan, additional efforts are needed to remove remaining barriers in the granting of permits for the construction or installation of wind and solar power generation facilities. Moreover, Latvia could take further action to promote demand-side flexibility, such as energy storage owned by end consumers and participation in distributed energy resources and in balancing and flexibility services. It could also clearly define the roles for 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

issuing of new permits has been halted since July 2023. This shows that there is scope for further regulatory action.

(27) Latvia's progress towards a circular economy needs accelerating to meet the EU circular economy goals. Indicators of sustainable economic growth are below the EU average, and the country's material footprint is on the rise. Latvia is an average performer in eco-innovation and would benefit from accelerating the implementation of circular business models and boosting investment in eco-innovation to increase resource efficiency and competitiveness. Latvia has made progress with its waste management system, but still landfills more than half of its municipal waste.

(28) In view of the close interlinkages between the economies of euro area Member States and of their collective contribution to the functioning of the Economic and Monetary Union, in 2024 the Council recommended that the euro area Member States take action, including through their recovery and resilience plans, to implement the recommendation on the economic policy of the euro area. For Latvia, recommendations (1), (2), (3) and (4) help implement the first, second, third and fourth euro area recommendations.

HEREBY RECOMMENDS that Latvia take action in 2024 and 2025 to:

1. Submit the medium-term fiscal-structural plan in a timely manner. In line with the requirements of the reformed Stability and Growth Pact, limit the growth in net expenditure[21] in 2025 to a rate consistent with maintaining the general government deficit below the 3% of GDP Treaty reference value and keeping the general government debt at a prudent level over the medium term. Broaden taxation, including of capital and property, and strengthen the adequacy of healthcare and social protection.

2. Continue with the swift and effective implementation of the recovery and resilience plan, including the REPowerEU chapter, ensuring completion of reforms and investments by August 2026. Accelerate the implementation of cohesion policy programmes. In the context of the mid-term review continue focusing on the agreed priorities, taking action to better address persistent regional disparities and inequalities while considering the opportunities provided by the Strategic Technologies for Europe Platform initiative to improve competitiveness.

3. Improve the business environment by reducing the administrative and regulatory burden for companies and improving access to finance for small and medium-sized enterprises, including through public lending and guarantee schemes aimed at facilitating investments of strategic importance and boosting competition in the financial markets. Address labour and skills shortages, in particular in STEM, and in other specialisations needed for the green and digital transition, as well as in the social and healthcare sectors, including through targeted upskilling and reskilling.

4. Accelerate the deployment of wind and solar energy by improving permit-granting procedures and promoting demand-side flexibility. Foster the transition to a circular economy through eco-innovation and sustainable resource management practices.

[21] According to Article 2(2) of Regulation (EU) 2024/1263, 'net expenditure' means government expenditure net of interest expenditure, discretionary revenue measures, expenditure on programmes of the Union fully matched by revenue from Union funds, national expenditure on co-financing of programmes funded by the Union, cyclical elements of unemployment benefit expenditure, and one-offs and other temporary measures.

Done at Brussels,

For the Council
The President