Latvia's Stability Programme for 2021-2024

Ministry of Finance of the Republic of Latvia

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CONTENT

1. Overall Economic Policy Guidelines and Objectives

The Stability Programme of Latvia for 2021 - 2024 has been prepared following the conditions and guidelines of the Stability and Growth Pact implementation and prepared in accordance with the requirements of European Union Council Regulation (EC) No1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies.

Like the previous Stability Programme, this Programme is also being prepared under the circumstances, when Covid-19 pandemic is still reality in Latvia, as well as throughout the European Union and other countries of the world. As compared to the situation last year at the moment of preparation of the previous Stability Programme, the uncertainty with respect to further prospects of economic development in Latvia has slightly reduced, Covid-19 cumulative morbidity rate in the country continues decreasing and vaccination of population against Covid-19 is being implemented. Nevertheless, at the same time, there are circumstances forcing to preserve the adopted measures restricting economic activity and social distancing of the population - morbidity growth rates in the European Union as a whole, growth of spread of Covid-19 subtypes in public, as well as the risk that the current vaccination rate as a result of insufficient quantity of vaccines may lag behind the scenario provided for in the national vaccination plan.

Considering the referred to risks, the macroeconomic and fiscal forecasts of the Stability Programme still entail high uncertainty and are rooted in the assumption of successful implementation of the vaccination plan approved by the government, providing that 70% of Latvian population would be vaccinated by the end of summer 2021, therewith the repeated Covid-19 morbidity wave is not expected in fall this year, thus the economic recovery is expected starting from the third quarter of this year. Rigid restrictions in the retail sector are kept by the end of February, being gradually lifted in March-April, in turn, starting from May the sector operates with practically no restrictions. Restrictions are being reduced at a similar pace also in other service sectors. The scenario provides for considerable European Union investments for 2021 - 2027 programming period, in light of the expected planned funding of the European Union structural funds, *Rail Baltica* and European Recovery and Resilience Facility.

Under the impact of Covid-19, Latvian gross domestic product last year reduced by 3.6% at constant prices. It was the first reduction of the gross domestic product since 2010, however the economic downturn last year turned out to be considerably smaller than forecasted at the beginning of Covid-19 crisis. It was due to both successful overcoming of the first Covid-19 outburst in spring 2020 and economic support measures and favourable economic structure, as the manufacturing industries practically did not face the fall in output volumes. This year, the growth of gross domestic product is being forecasted in the amount of 0.3%, in turn, in 2022, the expected growth of gross domestic product amounts to 4.5%, being, correspondingly, by 2 percentage points and 1 percentage point more than in the previous Stability Programme.

According to the assessment of the Ministry of Finance the general government budget deficit in 2020 reached 5.4% of gross domestic product, *inter alia*, the calculations of the Ministry of Finance show that the direct fiscal impact of Covid-19 support measures on the general government budget deficit comprised 3.7% of gross domestic product. At the same time, the current assessment of 2020 budget deficit is considerably better than the forecast of the previous Stability Programme, which comprised 9.4% of gross domestic product. Updated fiscal forecasts, based on the renewed macroeconomic development scenario and containing the support measures for national economy for mitigating Covid-19 impact approved by the government by March 23 this year, provide for the deficit of 9.3% of gross domestic product this year, whereas, in 2022, considerable reduction of deficit is forecasted to 2.7% of gross domestic product.

Following the economic development trends and considerable increase of the general government budget deficit, the general government debt in 2020 reached 43.5% of gross domestic product, which is by 6 percentage points more than in 2019, however, at the same time, by more than 8 percentage points lower than the forecast of the previous Stability Programme. Considering that this year the government is also planning to provide temporary targeted support to national economy and population for mitigating the consequences of Covid-19 crisis, in 2021, the increase of the debt level is forecasted up to 48.9% of gross domestic product, whereas the current forecasts for 2022 provide for debt increase of up to 50.3% of gross domestic product.

2. ECONOMIC SITUATION

2.1. External Economic Environment

Global economy in the crisis caused by Covid-19 pandemic faced the fall of 3.5% last year, which was, nevertheless, smaller than initially expected and this year the restoration of economic growth is expected, which, based on the forecasts of the International Monetary Fund, might reach 5.5%. Unlike all the previous crises, which were caused by macroeconomic imbalances and the overcoming whereof required several years, the crisis of 2020 constituted the reduction of output volumes caused by virus disease, by overcoming which the economic growth has all the possibility to rapidly recover.

Already for the entire second half of last year the economic development forecasts have been gradually improved and also in January this year the global growth forecast of the International Monetary Fund for 2021 was increased by 0.3 percentage points as compared to the forecast of October last year. This improvement entails significantly steeper economic growth in the United States of America, as well as slightly steeper growth in the developing countries, while the economic growth forecast of the Eurozone for 2021 has been lowered.

Economy of the United States of America, following 3.4% fall last year, this year could grow by 5.1%, which is by two percentage points more than forecasted by the International Monetary Fund in October last year. In turn, the economic growth forecast of developing countries for 2021 is increased by 0.3 percentage points to 6.3%.

The forecasts for the European Union and Eurozone, being the main export market of Latvia, for this year, are being reduced over the period of last months, determined by both higher Covid-19 spread and lower rates of vaccination of population, meaning slower lifting of restrictions and lower rates of recovery of economic growth. The International Monetary Fund, in its forecasts of January, reduced the growth forecast for Eurozone for 2021 by one percentage point to 4.2%, while the European Union in its February forecasts provides a reduction of 0.4 percentage points to 3.8%. The Organisation for Economic Cooperation and Development (OECD), in its forecasts published in March this year, provides for the growth of 3.9% for Eurozone. Over the period of last weeks, the reduction of forecasts have been notified also by some European countries, *inter alia*, the economic advisory board of the largest Eurozone country - Germany - has reduced the growth forecasts for 2021 from 3.7% to 3.1%.

Based on the latest economic forecasts of the European Commission, the weighted average growth forecast for 2021 for the ten largest foreign trade partner countries of Latvia comprises 2.8%, which is by 0.6 percentage points less than in accordance with the forecasts of the European Commission of November last year. The growth forecast for 2021 for both largest Latvia’s foreign trade countries

Lithuania and Estonia has been reduced by 0.8 percentage points to, correspondingly, 2.2% and 2.9%. Here, though, it should be noted that the economic growth drop in the main trade partner countries of Latvia last year was considerably smaller than forecasted and also considerably smaller than in Eurozone overall, which also, to a large extent, determines a slower growth rate this year.

Last year, the economy of the ten largest Latvia's foreign trade partner countries dropped by 3.3%, while the Eurozone drop comprised 6.6.%. Likewise, also in the largest partner countries - Lithuania, Estonia, Poland, Denmark, and Sweden - the economic drop was among the smallest in Europe.

Given an extremely high uncertainty as to the time required for containing Covid-19, vaccination rates and new disease outbreaks and mutations, the economic growth forecasts of both the world and the main export partner countries of Latvia have undergone quite sharp corrections for the entire period of last year and changes in the forecasts is the aspect to be taken into account also further on. Forecasts of the macroeconomic indices of Latvia have been developed at the beginning February, considering information available at that time and the forecasts regarding global economic development and situation in the main foreign trade partner countries of Latvia.

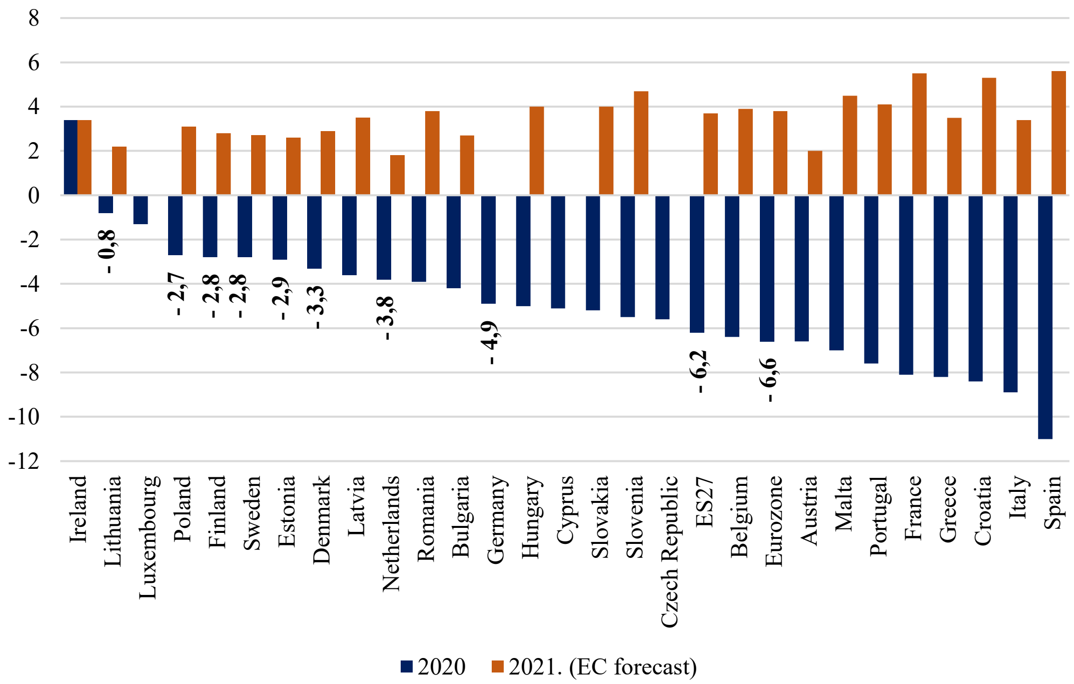

Figure 2.1. Growth of gross domestic product in the European Union Member States, %

Along with economy recovering from Covid-19 crisis, in 2021, steeper rise in consumer prices is expected and the inflation level in the developed countries, based on the forecasts of the International Monetary Fund, can increase from 0.7%

last year up to 1.3% this year. Inflation in Eurozone, based on the forecasts of the European Commission, will correspondingly grow from 0.3% to 1.4%. Economic stimulation measures, with the central banks lowering interest rates, acquiring securities, as well as with the governments providing financial aid to population, along with the economic growth, might also bring about steeper rise in prices. Price changes can also be affected by high instability in financial markets, where, following a sharp fall at the beginning of Covid-19 crisis, the stock prices have been steeply growing already for a year, while steeper rise in oil prices and prices of other raw products started to emerge in autumn last year. In 2021, *Brent* crude oil price has increased by more than 25%, approaching 70 United States of America dollars per barrel and already exceeding the level before Covid-19 crisis.

2.1. Current Economic Development

Due to spread of Covid-19 disease, Latvia's gross domestic product last year reduced by 3.6% at constant prices. It is the first reduction of the gross domestic product since 2010, however the economic downturn last year turned out to be considerably smaller than forecasted at the beginning of Covid-19 crisis. It was determined by both quite successful overcoming of the first outburst of the disease in spring 2020 and economic support measures as well as favourable economic structure, where the producing industries practically did not face the fall in output volumes. In 2020, the scope of support approved by the government for mitigating Covid-19 consequences comprised 1.3 billion *euro* (4.5% of gross domestic product), constituting considerable support for both businesses and the employees.

Security measures introduced for containing the spread of Covid-19 virus most significantly affected the service sectors - transport and storage services, accommodation and catering services, as well as arts, entertainment and leisure. Last year, these sectors have demonstrated the steepest falls in value added and determined by the overall economic contraction, while the producing sectors have managed to demonstrate a slight growth in 2020. On the expenditure side, last year Covid-19 crisis has been most directly reflected in the fall of domestic demand, affected both by Covid-19 control measures restricting economic activity in the sectors related to private consumption and precaution and uncertainty of population as to their financial situation. Therewith, private consumption has demonstrated a very steep fall last year - by 10%. While exports last year, as compared to 2019, decreased by 2.7%, determined by steep fall in export of services, while the growing volumes of reexport of agricultural and food products, as well as machinery and electrical appliances have managed to maintain the rise in export of goods last year. In 2020, import of goods and services decreased even steeper - by 3.3%, thus the impact of changes in foreign trade on the overall economic performance has been positive last year. At the same time, public consumption last year increased by 2.6% and a slight increase, as compared to 2019, was maintained also in investments, when gross fixed capital formation increased by 0.2%.

Sectoral development

In 2020, the **transportation and storage sector** was one of the sectors most severely affected by Covid-19 crisis, the operation whereof was additionally adversely affected also by reduction of Russian cargo transit through Latvian ports. The added value of the sector, at constant prices, last year reduced by 14.9% and this drop in transport had the largest adverse effect on the overall economic downturn. Due to restrictions of pandemic, number of passengers in Riga International Airport comprised only one fourth of the level of 2019, reducing from 7.8 million to 2.0 million or by 74.2%; number of ferry passengers in Latvian ports reduced by 56.5%, while the number of passengers in road transport dropped by 36.4%. Cargo turnover in transport by road reduced by 8.4% under the influence of Covid-19.

Last year a very steep fall was observed in the volumes of cargoes handled in ports and cargo transport by rail, determined by the reorientation of Russian coal and oil product cargoes over to their Baltic Sea ports, as well as by the drop in coal demand in Europe. Cargo turnover in Latvian ports in 2020 reduced by 28.1%, *inter alia*, with the cargoes of oil products reducing by 20.3% and coal cargoes - by 79.6%. The volume of cargoes carried by rail dropped by 42.3% last year.

In the first months of this year, with Covid-19 spread continuing, the situation in the passenger transportation has remained similar to last year, when the number of passenger in the airport has been by more than 90% smaller than the year before and the volume of passenger transportation by road has dropped, as well. In turn, in the transit cargo transportation, the situation has slightly stabilised, with the cargo volume in ports in the first two months of the year reducing by 11.7%, but showing a slight increase in railway. In the further months of the year, stabilisation and increases are expected also in passenger transportation, with gradual easing of Covid-19 restrictions and more active movement of population resuming. During the entire 2021, the transport sector could achieve a slight increase, with the value added volumes of the sector, nevertheless, still being considerably lower than in 2019.

Covid-19 crisis has also severely affected the **trade sector** - at the beginning of the pandemic, the trade activity became weaker due to precaution of population, however since November of the last year the sector is adversely affected mainly by the restrictions introduced by the government for containing the spread of the disease. Therewith, in 2020, in total, the value added of trade sector has dropped by 2.2%, mainly determined by the drop of sales volumes in wholesale trade, as well as sharp fall in trade of cars and motorcycles. Meanwhile, the retail trade, notwithstanding sharp falls of sales volumes in April and at the end of last year, in 2020, in total, demonstrated an increase by 1.5%. Retail trade growth last year was largely determined by increase in motor fuel trade (+6.5%), facilitated by low fuel prices, and in retail trade in food stores (+3.6%), as the operation of these stores remained practically unaffected by Covid-19 related restrictions. In turn, retail trade of non-food products, except for fuel, last year, as compared to 2019, showed a drop by 1.9%. This was determined by closing shopping centres on weekends and public holidays, being in effect in spring last year and repeatedly introduced in November last year, whereas, since the middle of December, restrictions in the sector have been made even stricter, as a result of which only essential goods were allowed to be sold on site.

Despite a slight mitigation of restrictions in February of 2021, the sector has been operating under rigid restrictions for the entire first quarter of this year. Thus, in the first two months of this year, the retail trade demonstrated a drop by 9.0%, with the steepest reduction recorded in the retail of non-food product stores. This has triggered build-up of savings by population and in February this year, as compared to February 2020, household deposits grew by 14.9%, reaching 8.57 billion euro, determined by rising amount of financial resources on the bank accounts at the end of the day. They have increased by 27.9% over the year, while maturity household deposits and deposits redeemable at notice have dropped, correspondingly, by 28.5% and 32.3%. This indicates on an increase of funds at disposal, which will be allocated to consumption at the moment, when, along with improvement of epidemiological situation in the country, the restrictions would be lifted significantly - not only in the trade sector, but also in service provision.

Other sectors directly affected by Covid-19include **arts, entertainment and culture,** where the value added has dropped by 26.6% last year. Even steeper drop last year was demonstrated by tourism-related **accommodation and catering sector**, with the value added having dropped by 38.1% over the year. This sector was significantly affected by restrictions related to the spread of Covid-19 disease, *inter alia*, closing of external borders in spring, prescribed self-isolation rules, when arriving in Latvia from abroad, suspension of operation of cafes and restaurants both in Spring last year and at the end of last year, as well as population being precautious as to their health, by choosing not to travel. Thus, in 2020, 1.46 million foreign and local guests have been serviced in the tourist accommodations in Latvia, which was by 48.7% less than in 2019 and was the lowest indicator over the period of the last ten years. Guests spent 2.89 million nights in tourist accommodations, which was by 47.6% less than in the previous year.

Last year, contraction of the value added had been registered also in other service sectors oriented towards domestic market - **professional, scientific and technical services**, as well as **in the operation of administrative and maintenance services**. In 2020, these sectors decreased by 3.3%.

Meanwhile, better results last year were demonstrated by producing sectors, which were not affected by restrictions related to Covid-19 directly. The value added generated in industrial production in 2020, as compared to the year before, has decreased by 1.0%. Besides, **manufacturing**, comprising more than 80% of the industrial production value added, has demonstrated the reduction of 0.9%. Thereby, Latvia demonstrated the second smallest manufacturing contraction among all the European Union Member States. Among manufacturing sub-sectors, in 2020 good results were demonstrated by wood processing industry, which was stimulated by the growing external demand and high prices in separate product segments and markets. Thus, wood processing volumes last year were by 4.1% higher than in 2019. Notwithstanding the difficulties caused by Covid-19 crisis, last year growth was also demonstrated by manufacturing of electrical equipment (+5.7%). In printing and reproduction of recorded media, as well as in chemical industry steeper growth has been registered already from the beginning of pandemic. The output growth of correspondingly 6.8% and 3.0% has been recorded in these sub-sectors last year. In turn, the strongest fall, and the largest negative contribution to total manufacturing performance in 2020 has been demonstrated by the sub-sector of repair and installation of machinery and equipment (-29.5%). Last year, the output drop was registered in other mechanical engineering sub-sectors – manufacturing of motor vehicles and trailers (-17.3%), as well as manufacturing of machinery and equipment (-2.8%), determined by instability and precaution caused by pandemic, resulting in reduction of global demand for equipment and investment products, logistics interferences, drop in supplies of component parts for car industry, due to a short-term closure of factories in Europe. Last year, the output volumes declined also in other significant manufacturing sub-sectors, including, manufacturing of fabricated metal products,, construction materials and food products, correspondingly, by 3.8%, 1.9% and 0.7%. In turn, this year for manufacturing has started with growth, with the total output volumes of the sector increasing by 2.2% in January, as compared to January 2020. Similarly, to last year, it was mainly determined by high production volumes in wood processing industry, which, thanks to a strong external demand, have increased by 6.3% in January.

In turn, **other industry**, constituting mining and quarrying, electricity and gas supply, water and heat supply, etc., last year demonstrated value added drop by 1.7% This result is to be largely attributed to low volumes of electricity and gas supply, where the output drop has been registered practically for the entire year of 2020. This coincides with lower volumes of generated electricity, determined by the drop in combined heat and power plant output. This year, in turn, has started with the output growth for the electricity and gas supply sector, which is to be explained by a low base in January last year. Besides, in January this year, high volumes of generated electricity have been achieved in combined heat and power plants, determined by low air temperature in January. Thus, the total electricity and gas supply volumes in January this year have been by 7.5% higher than the year before.

Value added growth of 2.6% last year has been demonstrated by **construction**, since this sector has practically not been affected by Covid-19 crisis and restrictions related thereto. Besides, in the following periods the construction growth will be promoted by the funds allocated to overcoming Covid-19 crisis and economic stimulation, as well as the EU funds' investments and commencement of *Rail Baltica* construction. In 2020, the growth in construction was determined by the rising volumes of specialised construction works, which, as compared to 2019, grew by 8.0%. Volumes of construction of buildings last year remained at the level of the previous year, growing by only 0.9%. Meanwhile, a slight drop was recorded in the construction of civil engineering - by 1.5%. The expected construction area as indicated in the construction permits issued last year, in its turn, decreased by 16.9%, determined by the fall in the planned construction area of industrial buildings and warehouses due to a high base of the previous year, as well as by modest construction plans of commercial buildings. This is an indication of possible reduction in the volumes of construction of non-residential buildings in the following periods, while the development of the sector would be facilitated by implementation of infrastructure projects.

Among the sectors of national economy of Latvia, lats year growth was demonstrated also by agriculture, where the value added has increased by 1.8% over the year. Agricultural growth was determined by the increase recorded in the second half of 2020, thanks to the last year's grain harvest that has been the highest in the history of Latvia. Based on provisional data, last year 3.5 million tons of grain crop have been harvested, which is by 10.6% more than the year before. Besides, in 2020, also the highest productivity of grain crop has been achieved, promoted by weather conditions favourable for hibernation of winter crops and later also for harvesting. High grain harvest has also facilitated the growth of export of goods, with the value of the exported grain products demonstrating very steep growth rates starting from September 2020.

Investments

Despite decline in economic activity in 2020, the volume of investments in Latvia slightly increased. Gross fixed capital formation last year comprised 6, 280 million euro, which, at constant prices, was by 0.2% more than in 2019. Therewith, it is to be concluded that adverse effect of Covid-19 crisis on investment activity had been considerably smaller than on private consumption or foreign trade. In the second quarter of 2020 the investment drop by 4.8% was recorded, as compared to the relevant quarter of the previous year. It was at the beginning of pandemic and during the time, when business sentiment was significantly deteriorating, given the circumstances of high uncertainty. Along with the situation stabilising and the economic activity moderately increasing, in the third quarter investments decreased only by 0.9%, and as soon as in the fourth quarter the rise in investments resumed and the volume of gross capital formation was by 2.6% more than in the fourth quarter of 2019. As a rule, investment activity is more volatile than the average changes of gross domestic product. Besides, investments represent the most business cycle-dependent component of gross domestic product. As Covid-19 crisis is not related to business cycle per se, then the conduct of households and entrepreneurs with respect to provisions and investments can differ from their conduct in the previous financial and economic crises. This is how the investment growth at the end of last year can be explained.

Investments into construction of offices, housing, warehouses and other buildings, as well as into renovation of the already existing buildings and structures still remain the main type of investments. In 2020, investments into buildings and structures made up 51.9% of total investments and, as compared to 2019, grew by 1.5% at constant prices. Thanks to favourable weather conditions at the end of the year and the implemented construction projects in both private and public sector, the volume of construction production, as compared to 2019, increased by 2.7%. Covid-19 pandemic affected all sectors of national economy, nevertheless the fall of sentiment in construction sector was not as large as in other sectors, especially, in service sectors. The volume of construction orders in April and May 2020 dropped down to the average level of 2016, when the volume of construction production in total decreased by 16.6%. Nevertheless, already in June last year the level of confidence in the construction sector started to improve, stabilising around the year-end.

Investments into machinery and equipment, which, in 2020, made up 39.5% of total investments, as compared to the previous year, decreased by 2.2%. Covid-19 crisis had an adverse effect on investor activity, being already weak, with respect to performing new investments into plant and machinery. Notwithstanding that before the pandemic investment volume in these assets was increasing, reaching, in 2019, the highest level over the decade, it was not sufficient enough to significantly promote and ensure productivity growth and introduction of innovations. Volume of investments into machinery and equipment, in 2019 - 2020, on average comprised 2.5 billion euro, corresponding only to the level of 2005. It is indicative of the entrepreneurs being cautious about making investments and expanding their entrepreneurial activity. In turn, the consequences of Covid-19 only make this situation worse. In addition, it should be noted that the latest data from surveys of merchants operating in the processing industry regarding the factors influencing investments show that 56% of investments planned in 2021 will be directed towards replacing old plant and optimising production processes, and only 30% - to expansion of production.

Due to pandemic, turnover has decreased, and profit indices deteriorated significantly in such sectors as accommodation, catering, entertainment and culture, as well as transport. These sectors will, most likely, refrain from new loans and performance of investments in the medium term. Change in work organisation habits and introduction of mass remote work practice, in turn, could reduce demand for office premise, which would adversely affect investment activity, as well. Therewith, in this economic crisis a significant role is played by economic support and growth promotion measures implemented by the government. As compared to the previous economic crisis, at present Latvia's financial standing is better and the available financial resources are considerably broader. State aid to enterprises, by disbursing the idle time allowance, and providing grants for ensuring current asset flow, helps to mitigate the adverse effect of Covid-19 crisis on the operation of enterprises. In turn, in the medium term Latvia will have access to the EU structural funds investments, funds of the Recovery and Resilience Facility, as well as investments for implementation of *Rail Baltic* project. Therewith, the government is to play an important role in promoting investment activity.

Foreign trade

In 2020, **foreign trade turnover of Latvia's goods and services** at constant prices reduced by 3.0%, representing the worst performance since 2010. Covid-19 crisis more affected import of goods and services, as it reduced by 3.3% as compared to 2019. In turn, export at constant pries reduced by 2.7%, affected by steep drop of export of services. Lats year, Latvia's export of goods and services has reduced for the first time in the last 11 years, however the export drop had been one of the smallest among the European Union countries and significantly lower than on average in the European Union (-8.8%), thus attesting to its competitiveness and resilience during the period of pandemic. A lower export drop than on average in the European Union is related to several factors. First of all, in 2020, epidemiological situation in Latvia was, in general, better than in majority of the European Union Member States, enabling the manufacturing businesses to continue working. Secondly, the share of services related to tourism sector in the export of services is smaller in Latvia, especially, as compared to the countries of Southern Europe. Thirdly, the record high cereals harvest in Latvia that promoted the export of grain crop. Considering that the fall of real gross domestic product of Latvia was steeper than reduction of export, the share of export in gross domestic product increased to 63.9%, achieving historically highest level. At current prices, the total value of export of goods and services in 2020 reduced by 3.5%.

2020 was very challenging for Latvian exporters, because the economic activity decline throughout the world, closing of borders and interferences in supply chains of raw materials and intermediate consumer goods, uncertainty with respect to the United Kingdom withdrawal from the European Union, being one of the largest export markets of Latvia, adversely affected the development of export of Latvia's goods. Nevertheless, despite the pandemic and other negative factors, in 2020, the value of export of Latvia's goods was larger than in 2019, increasing by 1.8% and, thus, reaching 13.2 billion *euro* at current prices. Adverse effect of Covid-19 crisis was especially visible at the beginning of pandemic, when, in April and May last year, the drop of export of Latvia's goods, over the year, reached 15%, constituting the steepest export reduction since October 2009. In summer last year, the external demand stabilised, but it was possible to achieve a positive export growth exactly in the last months of the year. Thus, in September last year, the value of export of goods, over the year, increased by 13.7%, in October - by 8.4%, in November - by 9.1% and in December - by 12.5%, facilitated by a record high grain crop harvest, wood and wood products export, as well as rise in reexport of electrical plant. Under current pandemic circumstances, when a foreign trade thorough the world has dropped significantly, such performance of export of Latvian goods both in the entire 2020 and at the end of last year can be assessed as positive.

The largest input to export growth last year was ensured by electrical appliances and electrical pant, as well as mechanical devices, with the export thereof growing by 16.0%. Here, though, it should be noted that this product export group was favourably influenced by the rise in the volume of reexport, because steep growth rates were recorded in the export of telephone sets, monitors and projectors, automatic data processing equipment. This is demonstrated also by import data, because a steep import increase was recorded for all of the above-mentioned goods. The steepest export growth in 2020 as a whole was also recorded in this product group, thus ensuring 2.6 percentage points in the combined growth of export of goods.

In 2020, a significant input to rise of export was in general ensured by agricultural and food products. The export of this product group increased by 6.0%, as compared to 2019. Here the most significant impact was that of the export of cereals products and oil plant seeds (rapeseed), which, as compared to the year before, has increased, correspondingly, by 19.3% and 52.8%. The growth of export of cereals and oil plant seeds was facilitated by a record high harvest of these crops. The value of cereals export was also promoted by the growth in global stock exchanges, due to limited grain crop supply and growing demand in the world as a whole.

In 2020, also the export of chemical industry products and plastic products grew, correspondingly, by 2.3% and 7.9%.

At the same time, considerable export drop in 2020 was recorded in such product export groups as transport vehicles, mineral products and wood. Export of transport vehicles reduced by 17.0%, as compared to 2019. Export drop in this product group was directly related to the consequences of pandemic and reduction of demand. Thus, the export drop was recorded for practically all types of transport vehicles. Nevertheless, the largest reduction was recorded in the export of cars and their parts - in total by 18.6%. Reduction was recorded in export of cars and their parts to Estonia, Lithuania, Sweden and Russia. Export of mineral products reduced by 17.0%, determined by drop of export of electricity and oil products. Electricity export was adversely affected by both reduction in the price of electricity and drop of electricity consumption in the Baltic States. In turn, the drop in export of refined oil products was affected by the fall of oil prices on the world stock exchanges, as well as lower turnover of oil products in Latvian ports.

Even though, at the end of 2020, the export of wood and wood products steeply grew, especially to the United Kingdom, nevertheless, last year, in total, the value of export of this product group has decreased by 2.8%. The drop was determined by the drop of export of rough timber, long-sawn boards, as well as chipboards to Sweden, Poland, China, Germany in the first half of 2020. Steep rise of export of wood and wood products to the United Kingdom at the end of the year could not compensate for the reduction of export of this product group to other markets. Export of wood and wood products to the United Kingdom in 2020, in total, increased by 7.6%. The fact that in December 2020 the agreement has been achieved between the United Kingdom and the EU on trade conditions and non-application of customs tariffs, starting from 2021, is to be assessed positively.

While the adverse effect of Covid-19 pandemic on the export of goods had been comparatively short-term, the impact on the export of services is still observed. In total, the value of export of goods and services in 2020 reduced by 21.2%. The strongest impact is observed in the export of transport services, where the value of export dropped by 34.2%, as compared to 2019, thus explaining almost two thirds of the total drop of export of services. Export of transport services started to reduce already at the end of 2019, being adversely affected by a severe drop in sea and rail transport services with respect to reduction of coal and oil product cargoes from Russia. In 2020, export of sea and rail transport services continued to decrease and, in total, was by 30.0% and 46.1% smaller than in 2019. In turn, starting from March last year, the adverse effect on the development of export of transport services was strengthened by a considerable drop of export of air transport services with respect to the pandemic and declared state of emergency both in Latvia and in other countries of the world.

On a global scale, tourism sector is the most severely affected sector due to pandemic. As the number of incoming tourists reduced significantly, also the demand for air transport services dropped. The value of export of Latvia's air transport services in 2020 was merely 127 million euro, as compared to 537 million euro in 2019, comprising the fall of 76.4%. Therewith, the export of air transport services has reduced to the level of 2005.

Export of road transport services suffered the least due to pandemic, reducing by 7.3% in 2020. Smaller drop of export of road transport, as compared to other types of transport services, is attributable to the fact that cargo transportation had not been made subject to such rigid restrictions as passenger transportation.

Closing of borders, introducing quarantine and restrictions for assembling of people significantly affected the number of incoming foreign tourists in Latvia. Last year, the number of foreign tourists in Latvia has decreased by 63%. Thus, also the expenses of foreign tourists dropped significantly - by 55.5% in total, as compared to 2019.

Similar to export, the **import of goods and services** also reduced in 2020. Along with the slowdown of economic activity in Latvia, the demand for imported goods reduces, as well, especially with respect to intermediate consumer goods applied in the production process. In turn, the drop of external demand adversely affected the volumes of reexport of transport vehicles, thus reducing the import of capital goods. Total import of goods and services at constant prices, in 2020, was by 3.3% smaller than the year before. Considering that the import drop was steeper than that of the export, thus net export input into real gross domestic growth in 2020 was positive, namely, 0.5 percentage points.

The value of the goods' imports in 2020, at constant prices, reduced by 5.1%. It is noteworthy that the largest import drops are recorded for the same product groups as in export, namely, traffic vehicles an mineral products. The largest adverse effect in the import of goods was that of the reduction of import of traffic vehicle by 33.9% or 695 million euro, while the total value of the import of goods reduced by 814 million *euro*; reduction of import of traffic vehicles was determined by the reduction of import of cars and aircrafts, correspondingly, by 22.0% and 58.3%. Significant import drop was recorded also for mineral product, in total by 31.3% or 456 million *euro*. Reduction of import in this product group was determined by decrease in import of electricity and oil products from the Baltic States and Russia.

Drop of import of goods as mitigated by the growth of import of agricultural and food products by 5.4%, as compared to 2019. The growth of import of this product group was promoted by increase of import of fruits, oils, coffee, tea and grain crop. In turn, the growth of import pf electrical appliances and electrical equipment, as well as mechanical devices by 6.4% was mainly determined by the growth of import of telephone sets, monitors and projectors.

Significant adverse effect of pandemic is visible also in the **import of services**, because the value of import of services, in 2020, reduced by 18.2%. Import of transport services and the spending of Latvian population abroad were the aspects with the fastest reaction to the crisis caused by Covid-19 pandemic. The value of these services reduced, correspondingly, by 24.2% and 58.3%. In turn, the import of other transport services increased by 2.9%.

Current account

Consequences caused by Covid-19 pandemic also affected the current account of Latvia's balance of payments. In 2020, the surplus was recorded in the current account in the amount of 866 million euro, in contrast to the deficit of 197 million euro in 2019. Changes were recorded in all sub-accounts of the current account, nevertheless, the defining role in the growth of surplus was played by the changes in the goods accounts. Along with the export of goods increasing and, at the same time, import of goods decreasing, the goods account deficit reduced from 2, 677 million euro in 2019 to 1, 474 million euro in 2020.

In turn, the services account balance last year deteriorated. Considering that the export of services has reduced steeper than import, the account surplus dropped by 609 million euro to 1, 813 million euro. Nevertheless, in total, the foreign trade balance in 2020 was positive and the services account surplus was by 339 million euro larger than the goods account deficit. Components of the current account of Latvia's balance of payments are reflected in Figure 2.2.

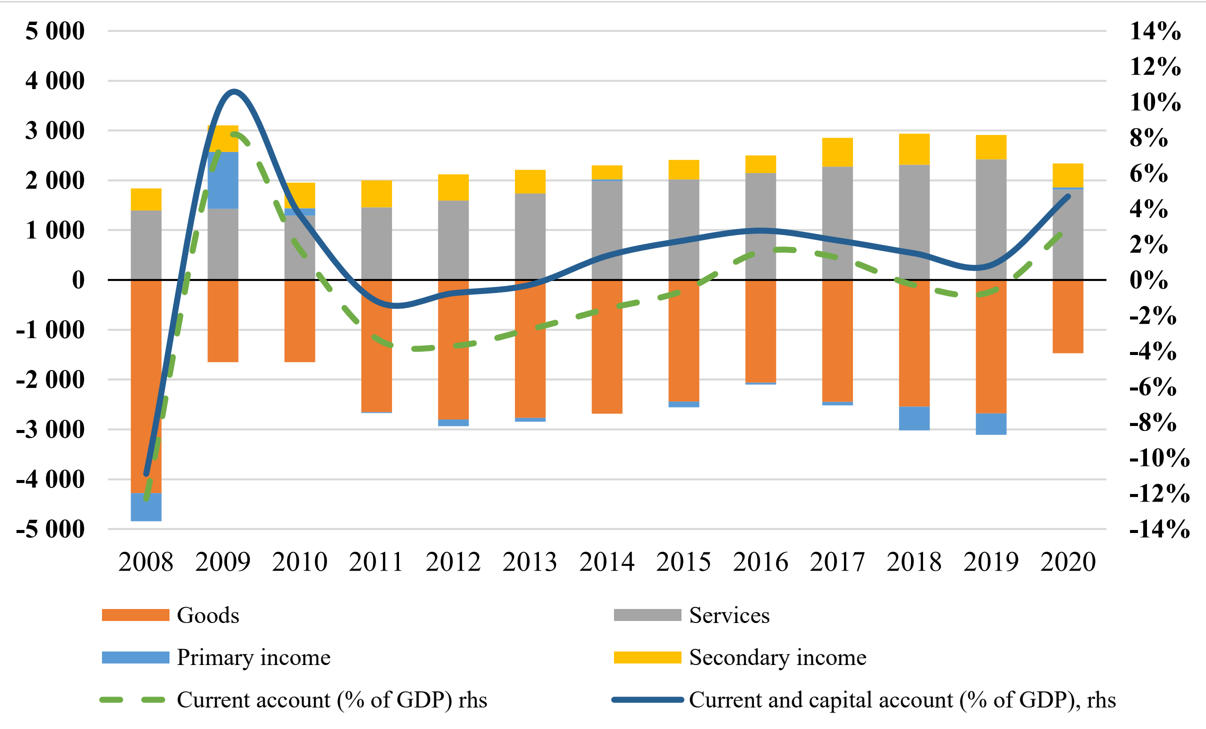

***Figure 2.2. Components of the current account of Latvia's balance of payments (million, euro) and current and capital accounts in percentage of gross domestic product*[1]**

In 2020, the surplus was recorded in the primary income account in the amount of 43 million euro, in contrast to the deficit of 430 million euro in 2019. This improvement of the account balance was largely determined by a lower amount of disbursed dividends to foreign investors, with the amount thereof having dropped by 518 million euro. In turn, changes in the secondary income

[1] Data source: Bank of Latvia

account were insignificant, because the surplus has reduced only by 6 million euro to 483 million euro.

Inflation

In 2020, consumer prices in Latvia grew by 0.2% as compared to the previous year. Pandemic considerably changed the dynamics of consumer prices both in Europe and Latvia. While in January and February last year the annual inflation in Latvia still exceeded 2%, then already in May and June 2020, for the first time since the middle of 2016, the deflation was recorded. Inflation had returned in July and consumer prices grew by 0.5% over the year, largely affected by the rise on food prices. In turn, already in August the deflation was recorded again, accelerating during the following months by the end of 2020. Steep drop in consumer prices over a short period of time was determined by both external and internal factors. However, in both cases, the price drop was related to the consequences caused by Covid-19 pandemic. Due to pandemic, the economic activity and demand for energy resources have reduced on a global scale, therefore the oil price, in April 2020, reduced significantly, achieving the lowest level over the period of the last 16 years. This resulted in steep fall in gas, fuel and heat energy prices in Latvia. In turn, desecration of the state of emergency both in Latvia and in other countries of the world and the introduced measures for combating Covid-19 spread, reduced the demand for the services related to tourism sector, such as, for example, air transportation and accommodation services. As a result, also the prices of these services dropped. In total, in 2020, the prices of goods reduced, on average, by 0.5%, while the services were, on average, by 1.9% more expensive than the year before.

Table 2.1 reflects the consumer prices changes in 2020 by the most important product and service groups. In turn, Figure 2.3 reflects the contribution to annual inflation by the source of origin, in monthly breakdown, during the period from January 2019 until February 2021.

Commodity group	2020
Inflation, total	**0,2**
Catering services	3,3
Health care	3,0
Food and non-alcoholic beverages	2,4
Recreation and culture	2,0
Transport services	0,9
Rentals for housing	-2,2
Electricity	-2,9
Heat energy	-3,6
Accommodation services	-8,2
Fuel for transport	-10,6
Gas	-15,5
Miscellaneous goods and services	-0,1

Table 2.1. Changes of consumer prices index by groups in 2020, %

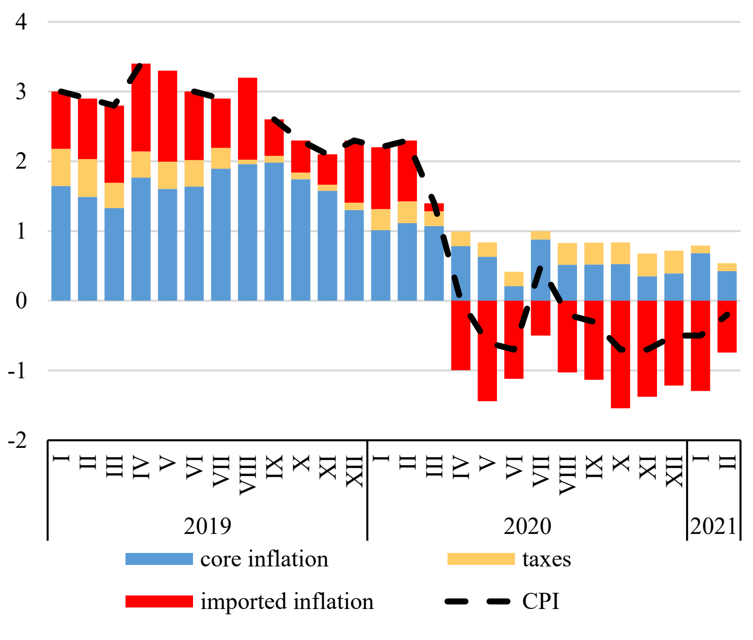

Figure 2.3. Contribution to annual inflation by the source of origin, percentage points and consumer price index, %[2]

Both in December 2020 and in 2020 as a whole, the largest input to consumer price changes was ensured by the fuel price drop, attributable to a sharp drop of oil prices on the world stock exchanges in spring last year. If, in January 2020, the average price of 95-brand petrol in fuel filling stations in Latvia was 1.331 euro per litre, constituting by 12.6% more than in January of the previous year, then in May the average price of petrol of this brand reduced to 1.001 euro per litre, which was already by 24.1% less than in May 2019. Thus, the reduction in prices of petrol recorded in May last year had been the steepest since 1998. Similar changes were also observed in diesel fuel price during this period. In total, in 2020, fuel was by 10.6% less expensive than in 2019 and the input thereof into consumer price changes comprised -0.6 percentage points. In 2020, the average price of Brent brand crude oil was 41.96 United States of America dollars per barrel, which was by 34.7% less than the year before. Whereas at the lowest point or in April last year the prices reduced to 18.38 United States of America dollars per barrel, dropping to the lowest level single the middle of 1999.

Considerable reduction in crude oil prices affected not only fuel prices, but also the prices of other energy resources in Latvia. Thus, the gas and heat energy prices were by, correspondingly, 15.5% and 3.6% lower than in 2019. Gas and heat energy tariffs are subject to administrative regulation, however a different tariff methodology is applied, therefore the changes in gas and heat energy prices in 2020, in total, differ substantially. Gas tariffs were reviewed two times per year,

[2] Data source: Central Statistical Bureau, calculations of the Ministry of Finance

affected by the dynamics of oil product prices on the world stock exchanges. In turn, heat energy tariffs are more flexible and are being reviewed more often, depending on the dynamics of natural gas and biomass prices. Thus, the largest heat energy supplier in Latvia - Joint Stock Company *Rīgas siltums*, reduced the tariff four times in 2020, and at the end of the year increased the heat energy one time. Even though the heat energy prices reduced by 3.6% on average, during the year, nevertheless, in the last months of the year, the drop comprised about 11%. Considering the methodology for calculating gas and heat energy tariff, also in the first half of 2021, gas and heat energy price, over the year, will be smaller than for the relevant period of 2020.

Price drop was observed also for electricity, which was by 2.9% less expensive than in 2019. Price drop was determined by the drop on electricity consumption due to a lower economic activity during the state of emergency. It is important to note that a cheaper gas, heat energy and electricity, forming a large share exactly in consumption of the less well-off population, under the current circumstances of pandemic are to be assessed positively, because they reduce monthly costs of population.

Closing of borders and significant drop of number of foreign tourists adversely affected the dynamics of those services, which are expressly oriented towards foreign tourists. Thus, the prices of accommodation services in 2020 reduced by 8.2%. Measures restricting the pandemic have also affected the residential tenancy market, where the tone is mainly set by the activity in Riga. Smaller demand for rented apartments in Old Riga and the centre of Riga, being predominantly leased out to foreign guests, reduced the housing rent by 2.2%. It should be noted that the number of incoming foreign tourists in Latvia, in 2020, over the period from March to December, was by 71% smaller than during the relevant period in the previous year. Introduced restrictions for reducing the spread of Covid-19 virus affected not only the number of incoming tourists from abroad, but also restricted the possibility of Latvian population to go abroad. Therewith, the prices of passenger air transportation also significantly reduced - in 2020, on average, by 4.3%, but in the last quarter of the year the drop comprised 14.1%.

Drop in prices of the above mentioned goods and services in 2020, in total, was slightly compensated by the growth in prices of food and non-alcoholic beverages. Last year, food products and non-alcoholic beverages became by 2.4% more expensive. Food prices are largely depending upon the global trends and, last year, in the world, in total, the increase of food prices was observed, largely influenced by the outbreak of African swine fever in China, as well as poor harvest of separate food crops. Concurrently, due to Covid-19, consumption of separate food products in restaurants and hotels reduced, therewith separate products, for example, seafood had a price drop.

At the beginning of 2021, the dynamics of consumer prices continued to be determined by the consequences of Covid-19 crisis. In January and February, consumer prices reduced by, correspondingly, 0.5% and 0.2%. Thus, deflation had been recorded in Latvia for the seven month in a row and the factors affecting consumer prices had practically not changed since the beginning of the pandemic. Deflation is related to the drop in prices of energy resources and price reduction in the services that suffered the most from the pandemic, namely, air transportation and accommodation services. Unlike the factors affecting consumer prices last year, price change corrections, at the beginning of 2021, have been introduced by insignificant drop of prices of food and non-alcoholic beverages.

The latest consumer confidence indicators aggregated by the European Commission demonstrate that inflation expectations in Latvia, as compared to the previous months, in February 2021 slightly decreased and lagged behind both the average level of the year before and the level before Covid-19 crisis. This is indicative of the fact that steep consumer price changes are not expected in the coming months. Deflation in Latvia will remain also in March this year, but, starting from the second quarter, a moderate growth of consumer prices is expected. This is due to the fact that in April last year the pandemic introduced significant corrections in the consumer price dynamics, therewith the impact thereof will be preserved also in the first quarter of this year. In turn, along with disappearance of the base effects and considering that food and oil prices on the world stock exchanges are increasing, reaching the highest level since the beginning of the pandemic, also the consumer price level will increase in Latvia, though mainly only in the second half of this year. According to the forecasts of the Ministry of Finance, the consumer prices this year will grow by 1.4%.

Labour market

Already since March last year the situation in the labour market has been determined by Covid-19 pandemic and the restrictions set for containing the spread of the disease. Number of population employed in national economy in 2020 reduced by 17 thousand or 1.9% and comprised 893 thousand, while the unemployment rate, after a constant drop over a decade, increased by 1.8 percentage points, reaching 8.1%. Such unemployment growth was more moderate than forecasted at the beginning of Covid-19 crisis, and was far behind the record high levels, recorded during 2009 - 2010 economic crisis. Unemployment growth in Latvia was also slower than in the neighbouring countries Lithuania and Estonia, determined by both the employment and idle-time allowance mechanisms and the fact that the support specifically in the form of unemployment benefits had not been voluminous, thus motivating people to stay in the labour market.

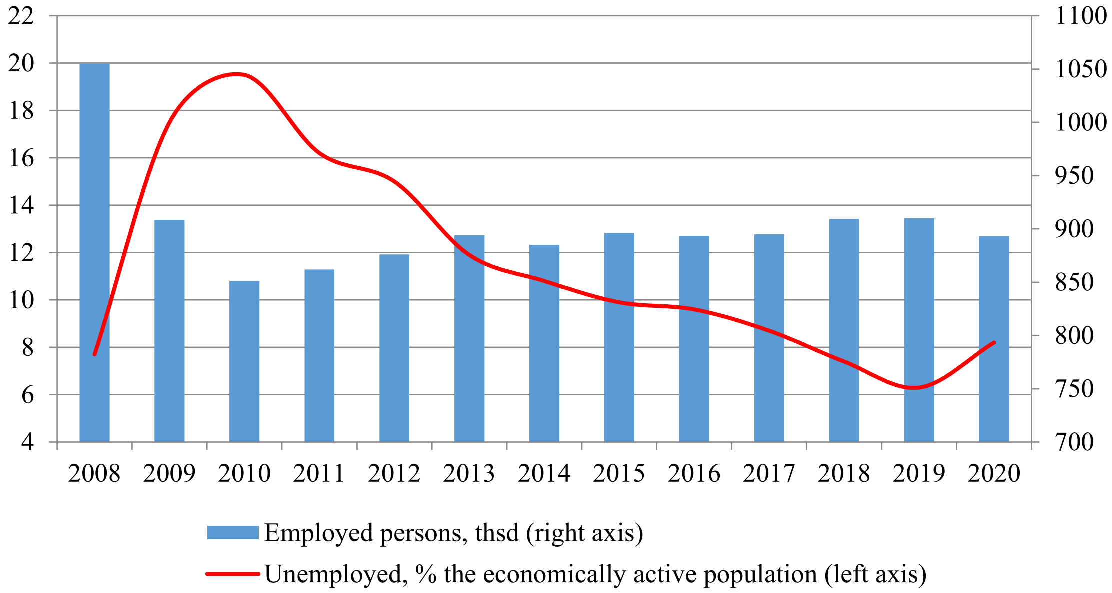

Figure 2.4.Employment and unemployment in 2008 - 2020

Granting of idle-time allowances to the employees of the enterprises, the operation volumes whereof had significantly dropped during the crisis, helped to restrict the total unemployment level in the country during the period of time from March till June 2020. The registered unemployment rate peaked in June 2020 at 8.6% andwithout the idle-time allowances, it could have come near to 12.5% level, at which it was in 2011 - 2012, shortly after overcoming the global financial crisis. During the period till June, idle-time allowances, on average, per months were received by 31.7 thousand people. The largest number of recipients of the idle-time allowances was in April - 42.4 thousand, but by June, along with the crisis mitigating, the number of recipients of allowances dropped to 25.6 thousand.

Concurrently with the overall relatively positive situation, the situation in the labour market is highly diverse, in terms of sectors, professions and regions. Covid-19 crisis severely affected separate sectors and groups of the employed, which had already been less paid previously, considerably increasing the inequality among the working age population.

Data on the occupied workplaces show that, in 2020, the largest drop of the number of the employed has been in the sectors directly affected by Covid-19, *inter alia*, the number of occupied workplaces in accommodation and catering sector declined by 21.4%, in other service sectors - by 8.1%, in transport sector - by 7.1% and in the sector of arts, entertainment and recreation - by 6.5%. At the same time, the number of workplaces in health sector grew by 3.0%, in the sector of information and communication services - by 2.9%, in mining and quarring - by 2.1% and in the education sector - by 1.2%.

Similar heterogeneous situation in the labour market is demonstrated by the registered unemployment data, where the largest growth in the number of the registered unemployed last year was in Riga region, while in municipalities the increase of the number of the unemployed and the unemployment rate was comparatively insignificant. Likewise, the unemployment growth mainly affected younger population and people with a lower level of education, considering the highest share of these groups of the employed in the service sectors directly affected by the crisis, inter alia, accommodation, food service activities and other service sectors. The number of the registered unemployed in Latvia, in total, in 2020, increased by 11.8 thousand, *inter alia*, the number of the unemployed in Riga region grew by 7.7 thousand or 36.3%. In turn, in Latgale region, where the labour market had been much more unfavourable already before the crisis, the number of the unemployed under the impact of Covid-19 crisis increased by only 1.3 thousand or 7.9%, and in other regions the growth of the number of the unemployed over the year did not exceed one thousand.

In the first months of 2021, the situation in the labour market continued to be affected by Covid-19 pandemic - the repeated outbreak of the disease beginning in autumn last year, and suspension or restriction of operation of several sectors. Registered unemployment rate, which had decreased to 7.4% at the end of October last year, at the end of February 2021 increased again to 8.2% and was by 1.9 percentage points higher than the year before. Nevertheless, at present the unemployment growth is much slower that during the first wave of Covid-19 in the period from March till June last year, and also more seasonal, most significantly affecting the regions of Latvia. Like in the first wave of the crisis in 2020, also at the beginning of 2021, the unemployment growth was significantly contained by the idle-time allowances, as well as the additionally introduced employment subsidies. Up to the middle of March 2021, 52.4 thousand employees had received the idle-time allowances, while the employment benefit had been disbursed to 24.5 thousand employees. Without this aid, the registered unemployment in February could have increased up to the level of 11.5-12.5%.

Despite Covid-19 crisis, the average monthly gross wage in 2020, as compared to the year before, increased by 6.2% to 1, 143 euro. It was only a slightly slower growth than the year before, when the wage had grown by 7.2%. In 2020, wage growth was slightly steeper in the private sector, where the average monthly gross wage increased by 6.7%, while in the public sector it grew by 4.9%. Nevertheless, higher average wage level is still preserved in the public sector, where the average wage in 2020 was 1, 156 euro, while in the private sector it comprised 1, 138 euro.

The changes in the average wage last year significantly affected not only changes in the wages of the employees, but also by the structural changes in the labour market, *inter alia*, the enterprises commencing and terminating to operate over the year and the changes on the number of employees and workloads over the year. The number of paid employees, recalculated in he terms of full-time workload, in 2020, declined by 3.9%, affected by dismissal of employees, reduction of workloads and drop in the number of full-time employees. In turn, the wage fund grew by 2.0% last year.

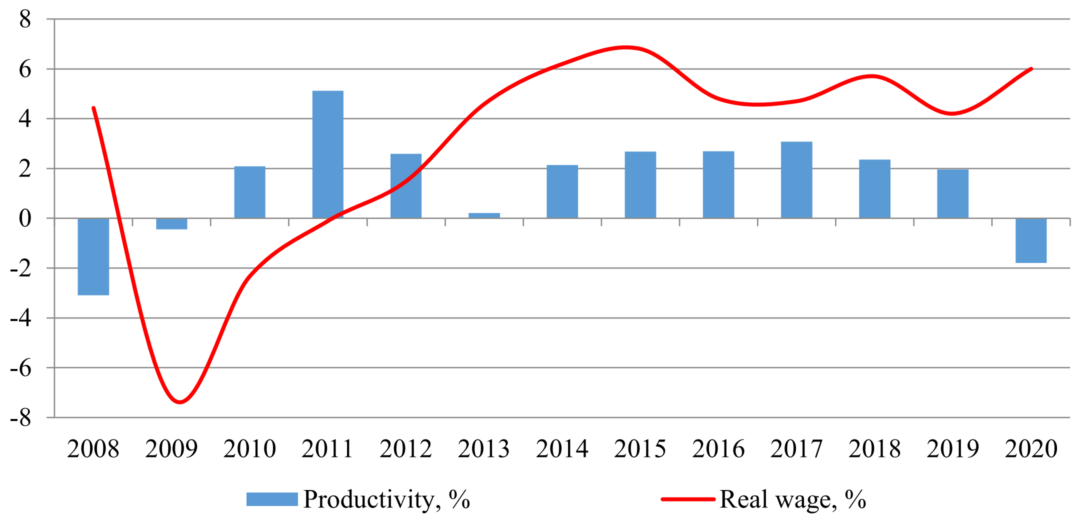

Figure 2.5.Changes in productivity and real wage, % against the previous period

In sectoral terms, wage changes were similar to those affecting the number of the employed. In the accommodation and catering and transport sectors directly affected by Covid-19 crisis and restrictions, the monthly average gross wage decreased, correspondingly, by 5.3% and by 0.3%, while other sectors managed to more or less preserve the average wage growth. The largest services wage growth last year was in the sector of professional services - by 11.1%, in mining and quarring - by 9.7%, and in health and social work activities - by 9.7%. The highest monthly gross wage was recorded in the sector of financial services - 2161 euro, and in the sector of information and communication services - 1866 euro. In turn, lower wage was in the accommodation and food service activities - 726 euro, and the difference in wage levels in higher and lower paid sectors last year only increased.

The real wage growth, which already since 2013 had been steeper than the productivity growth, in 2020, reached 6.0%, while productivity per employed dropped by 1.8%. Such opposite dynamics is not sustainable and already in 2021 a slower wage growth is expected, in parallel to a steeper productivity growth, as the number of the employed continue reducing.

2.3. Macroeconomic Development Scenario

Baseline scenario

The medium-term macroeconomic development baseline scenario for 2021-2024 has been drafted in February 2021. The forecasts have been developed, by consulting the experts of the Bank of Latvia and the Ministry of Economics, as well as the European Commission and the International Monetary Fund. Forecasts of the macroeconomic indicators were approved by the Fiscal Discipline Council, by publishing its opinion on 17 February 2021. The latest forecasts of the European Commission and the International Monetary Fund at the time - 2021 winter forecasts were used as a basis for the external environment assumptions and development of situation in the main foreign trade partner countries of Latvia.

Table 2.2. Growth and Related Factors

	ESA code	2020	2020	2021	2022	2023	2024
		million euro	Growth %				
1. GDP at current prices	B1*y	29, 334	-3.6	4.4	6.4	5.2	5.0
2. GDP at 2015 prices	B1*y	26, 555	-3.6	3.0	4.5	3.2	2.8
GDP by expenditure at 2015 prices							
3. Private consumption	P3	14, 740	-10.0	4.0	10.1	4.0	2.6
4. Public consumption	P3	5, 056	2.6	2.4	2.4	2.4	2.4
5. Gross fixed capital formation	P51	6, 280	0.2	4.1	7.6	2.5	2.5
6. Changes in inventories and acquisition of valuables	P52+ P53	1, 661	-	-	-	-	-
7. Exports	P6	16, 967	-2.7	4.3	4.7	4.0	4.0
8. Import	P7	18, 149	-3.3	4.9	5.4	4.0	3.3
Contribution to GDP growth							
9. Final domestic demand	P3+P 51		-5.4	3.7	8.0	3.4	2.6
10. Changes in inventories and acquisition of valuables	P52+ P53		1.3	-0.1	-2.7	-0.1	-0.1
11. Exports-imports balance	B11		0.5	-0.6	-0.7	-0.2	0.3

Baseline scenario has been developed under the circumstances of high uncertainty, when economy is affected by Covid-19 restrictive measures and uncertainty as to the development of the pandemic. Therefore, the substantiation of these forecasts has laid emphasis on active and successful government action plan, arising out of the vaccination plan of the Ministry of Health.

Vaccination plan provides that, by the end of summer of 2021, 70% of Latvian population would be vaccinated, therewith a repeated Covid-19 morbidity wave is not expected in autumn this year, thus economic recovery is expected starting from the third quarter of this year. Rigid restrictions in the retail sector are kept by the end of February, being gradually lifted in March-April, in turn, starting from May the sector operates with practically no restrictions. Restrictions are being reduced at a similar pace also in other service sectors. The scenario provides for considerable European Union investment for 2021 - 2027 programming period, in light of the expected planned funding of the European Union structural funds, *Rail Baltica* and the Recovery and Resilience Facility.

Even though the economic drop in 2020 in the amount of 3.6% was by 3.4 percentage points smaller than forecasted, due to restrictions set for containing the Repeated Covid-19 outbreak and spread of the disease, the growth of gross domestic product in 2021 will be lower than forecasted in June last year. In the baseline scenario, it is assumed that Covid-19 spread would still continue to adversely affect the economic development even by the middle of 2021, but afterwards, once the majority of restrictions are lifted, the growth would start restoring steeply. As compared to the previous forecasts developed in June 2020, the growth of gross domestic product for 2021 has been reduced by 2.1 percentage point, projecting the growth of 3.0%, while for 2022 the growth of gross domestic product is forecasted by 1.4 percentage points higher than in June last year, expecting the growth of 4.5%. Over the period of the following two years the growth is forecasted close to the potential economic growth rate.

In 2021, economic growth will be ensured by the renewal of private consumption growth in the amount of 4%, as well as investment growth and export rise, correspondingly, by 4.1% and 4.3%, while the public consumption growth would remain at the level of last year and would comprise 2.4%. Increase in public consumption will be ensured by the scope of support planned by the government for mitigating the consequences of Covid-19 , which, in 2021, is planned in the amount of 2.9 billion euro (9.6% of gross domestic product).

As the beginning of 2021, private consumption could still face a slight drop, however, already in the second half of the year, along with lifting restrictions, household might spend the savings accumulated during the crisis, as a result increase in private consumption would reach 10.1% in 2022. In turn, investment growth in 2022 will reach 7.6%, mainly due to significantly larger investments of the European Union funds, related to both commencement of *Rail Baltica* project construction and sharp inflow funds of the Recovery and Resilience Facility. Overall, in the medium term, the growth of gross domestic product will return to the potential growth rate, namely, 2.8%.

In 2021, average annual inflation is projected at the level of 1.4%, increasing from 0.2% last year. In 2020, low inflation was mainly maintained by low prices of energy resources in the world, while this year the impact thereof would have an opposite effect. Steeper growth of consumer prices this year will also be determined by the recovery of global economic growth, inter alia, promoting the growth of food prices in global markets, while the internal factors - wage growth and resumption of consumption - will continue determining the growth of service prices in Latvia. In 2022 and years to come, inflation will reach 2.0% and it will remain at such level for the entire period up to 2024.

Monthly average wage growth in 2021 is forecasted at the level of 4.0%, accelerating in 2022 to 5.0%, and stabilising at such level close to productivity growth for the entire period up to 2024. Unemployment rate, following quite moderate growth in 2020, will slightly also grow this year - to 8.3%, with the economic crisis reflecting in the labour market with a slight deviation. In turn, in

2022, along with growing number of the employed population, unemployment will shrink again to 7.1% of economically activity population.

A significant role in overcoming the consequences of the pandemic will be played by introduction of the European Recovery and Resilience Facility, which will not only accelerate economic growth, but will also strengthen the potential gross domestic product growth. From a short-term perspective, the impact will manifest itself as formation of investments, but, over a longer period of time, - as largest accumulated capital, lower unemployment drop, as well as higher total production factor productivity. In the medium-term, employment in Latvia will decline, despite the European Union investments, determined by Latvia's demographic structure and migration. Nevertheless, the funds of the European Recovery and Resilience Facility and the implemented projects will help decelerating employment decline via newly created jobs and, probably, reduction of immigration. Thus, the cumulative impact of the Facility on the growth of gross domestic product by 2029 are being assessed in the amount of 1.3 - 1.5 percentage points, but the cumulative impact on employment - in the amount of 0.63 - 0.77 percentage points.

Cyclical development of economy

Since 2015, Latvian economy has been growing, on average, by 3.1% annually, ensured by the growing external demand and investment flows, especially in 2017 and 2018, due to the new cycle of the European Union funds. In turn, already in 2019, cyclical slowdown of economy emerged, because the investment growth rates declined from 11.6%, on average, in 2017 - 2018, to 2% in 2019. As a result, in 2019, the growth of gross domestic product slowed down to 2%. Besides, in 2020, the slowdown of economic cycle was reinforced by Covid-19 pandemic, hindering the development in all economic sectors and, in some sectors related to tourism, leaving long-term consequences on the potential gross domestic product level. As a result, the output gap, which has been positive since 2015, already in 2020 became negative and will gradually disappear over the period of three years.

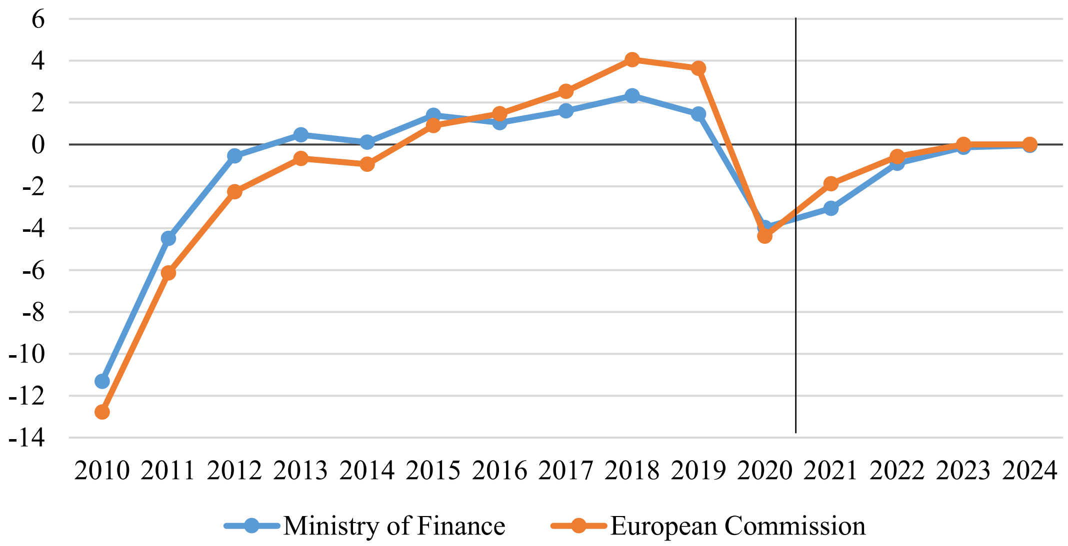

Figure 2.6. Output gap, %

Similar medium-term output gap estimate is also stipulated in the European Commission forecasts of autumn of 2020. Over the period of the last decade, the assessment of the Ministry of Finance has become less volatile, because such cyclical indicators as, for instance, low inflation, current and capital account balance surplus, as well as net debt reduction to gross domestic product and reduction of the volume of issued loans, show that during this period of time no large positive output gap can possibly form in economy. This is also confirmed by the estimates of the alternative output gap "plausibility tool" developed by the European Commission. However, in total, starting from 2020, the forecasts of the Ministry of Finance and the European Commission as to the amount of the output gap are similar.

Historical difference formed out of different assumptions about the real wage impact on the labour market, where the assessment thereof is significantly affected by shadow economy, therewith the wage statistics does not fully reflect the situation in the labour market. On the contrary, in the forecasts, it is assumed that the real wage growth in the medium-term will exceed the labour force productivity growth, which could be indicative of the positive output gap. Therefore, the output gap assessments of the Ministry of Finance and the European Commission are aligning.

The potential GDP growth during the forecasting period will be basically determined by the total productivity growth, the contribution whereof from the low level in 2020 in the post-pandemic period will grow to 2.2 percentage points, which is only slightly higher than in 2018 - 2019 and characterises the economic recovery stage. The rest of the growth of gross domestic product will be ensured by the capital input, constituting approximately one percentage point, while the labour force input will become negative due to demographic situation. According to the estimates of the Ministry of Finance the medium-term potential gross domestic product grow would comprise 2.4 - 2.8%.

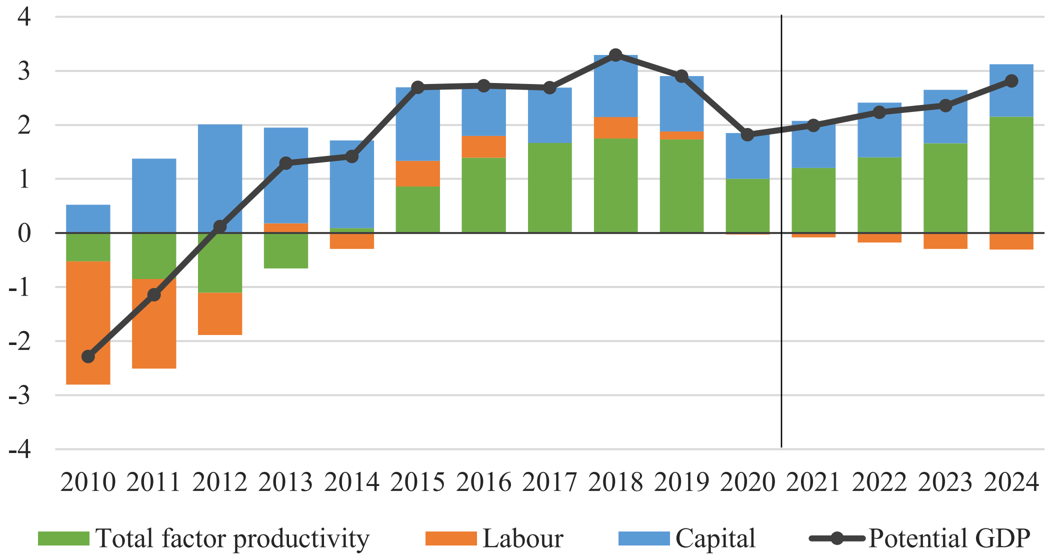

Figure 2.7. Potential gross domestic product growth and contribution of components, %

3. General Government Budget Balance and Debt

3.1. Fiscal Policy Strategy and Medium-Term Objectives

Covid-19 pandemic has imposed significant changes in the previously implemented fiscal policy, which is based on the compliance with the structural deficit objective - 0.5% of gross domestic product.

In 2020, the general escape clause of the Stability and Growth Pact has been activated in the European Union, allowing the European Union Member States to increase the general government budget deficit in 2020 to such an extent as is necessary for mitigating the economic harm caused by Covid-19 pandemic. In its Annual Sustainable Growth Strategy 2021, the European Commission announced that the general escape clause will remain active also in 2021, emphasising that the Member States have to provide targeted and temporary fiscal support to their economies also in 2021, at the same time ensuring fiscal sustainability in the medium-term. In turn, in the Communication of 3 March 2021, providing general orientations for the Member States regarding implementation of fiscal policy in the next period, the European Commission specifies that according to the current forecasts it is necessary to continue applying the general escape clause also in 2022 and to cancel it starting from 2023. The European Commission will adopt the final decision on the basis of Spring forecast 2021, in the first half of this year.

Thus, the European Union fiscal policy framework for 2020 - 2021 allows, as well as - with high probability - in 2022 will allow deviating from budget deficit objectives. Section 12 of the *Fiscal Discipline Law* provides for analogous possibility to deviate from 0.5% structural deficit, during a severe economic downturn. Activation of the general escape clause of the European Union formed the basis for activating the deviation rule laid down in Section 12 of the *Fiscal Discipline Law.*

Even though Section 12 of the *Fiscal Discipline Law* states that in case of a severe economic downturn, the deviation from the budget deficit target shall be permissible only up to the amount which does not exceed the decrease in revenues caused by the crisis, Section 33 of the *Law on the Suppression of Consequences of the Spread of Covid-19 Infection* states that the referred restriction shall be cancelled, thus providing for a legal possibility to deviate from the deficit objective, in order to stimulate economy to an extent necessary for overcoming the crisis. At the same time, the current wording of the Law stipulates that deviations shall be applicable only in 2020 and 2021. Thus, on the basis of current legal framework, starting from 2022, the application of the deviation rule of the *Fiscal Discipline Law* would have to be terminated and the regulation of the *Fiscal Discipline Law* would have to be applied according to the standard rules.

Nevertheless, when deciding upon further fiscal policy direction, several conditions must be considered. In Latvia, planning of public finances for the next budget year and for the medium-term takes place in autumn, when the Annual State Budget Law and the Medium-Term Budget Framework Law is adopted. Also the fiscal policy rules defined in the *Fiscal Discipline Law* are applicable to the budget preparation cycle in Autumn. Therewith, at the moment of preparation of the Stability Programme it is not necessary to adopt lawfully binding decision about the fiscal policy rules with respect to the following years.

Activation of the general escape clause of the European Union formed the basis for launching the deviation mechanism laid down in Section 12 of the *Fiscal Discipline Law.* Proposal from the European Commission of 3 March this year provides for keeping the operation of the clause also in 2022 and, unless significant and currently unpredicted positive risks emerge, the decision of the European Commission to be based upon the Spring forecast 2021 of the European Commission, will, most probably, approve the initial proposal for keeping the general escape clause active in 2022. Therewith, from the aspect of the policy of harmonising legal norms of the European Union and Latvia implemented up to now, there would be grounds to preserve the operation of the deviation rule specified by the *Fiscal Discipline Law* also in 2022.

Based on the initial assessment of the European Commission, explicated in the referred communication, decision on continuation or deactivation of the general escape clause would have to be adopted, on the basis of quantitative criteria. The European Commission concludes that the assessment of such economic indicators as output gap, quarterly/annual economic growth rate or labour market indicators, under the present circumstances of still high uncertainty, do not ensure sufficient grounds for them to serve as criterion for renewal of fiscal rules. The European Commission concludes that the most appropriate quantitative criterion is the level of economic activity in the European Union or Eurozone, as compared to the pre-crisis level (at the end of 2019). The European Commission's Winter forecast 2021 show that the European Union would reach the pre-crisis growth level in the middle of 2022 and, therefore, the general escape clause is still necessary in 2022.

The updated macroeconomic forecasts of the Ministry of Finance show that Latvia will achieve the economic output volume of 2019 already at the end of this year and, in 2022, it will even be higher. Therewith, using this indicator in Latvia's case, according to which the European Commission concludes that the general escape clause is to be kept, it would have to be concluded that it would have to be terminated in Latvia in 2022. However, as already emphasised in Chapter 2, the baseline scenario of the economic development of the country is exposed to high risk of uncertainty.

In the baseline scenario, it is assumed that vaccination against Covid-19 is being implemented according to the vaccination plan approved by the Cabinet on 27 January this year, stipulating to vaccinate at least 70% of all adult population of Latvia by the end of Summer this year, ensuring 100 thousand vaccination episodes per week.

Therewith, in addition to economic growth forecasts, it is essential to also consider the current Covid-19 epidemiological situation in the country. At the moment of elaboration of this Stability Programme, significant measures restricting economic activity and measures prescribing social distancing of population adopted by the Cabinet are still in effect in Latvia. Even though in accordance with data aggregated by the European Centre for Disease Prevention and Control[3] 14-day notification rate of new cases per 100 thousand people in Latvia continues to decline, it still remains at the level of a very high risk. At the same time, the growth of spread of Covid-19 subtypes is observed in the country, demonstrated by Covid-19 testing sample analysis. Also, at the time of elaboration of his Stability Programme, negative trends are observed in the European Union and the European Economic Area in total, where the 14-day notification rate of new cases per 100 thousand people is growing consistently over the period of last four weeks. Concurrently, based on information about Covid-19 vaccination statistics published by the National Health Service[4], current vaccination rate due to insufficient quantity of vaccines in the country is significantly lagging behind that, which is stipulated in the vaccination plan.

There is a possibility that the morbidity indices in Latvia might deteriorate again and, for the purposes of containing Covid-19, the Cabinet would need to continue and/or set additional restrictive measures that would, correspondingly, have an adverse effect on growth and fiscal indicators contained in the baseline scenario of this Stability Programme.

It must be noted that the national competitiveness is influenced by the volumes of fiscal stimuli in other European Union Member States, which, by keeping the general escape clause, enable the Member States to resolve upon the volume of stimuli irrespective of when the national gross domestic product returns to the pre-crisis level. Under such circumstances, it would not be correct to form Latvian fiscal policy strategy in 2022, observing the standard fiscal rules.

Therewith, in the fiscal policy strategy of this Stability Programme, it is assumed that, also in 2022, the general escape clause of the Stability and Growth Pact remains activated, the deviation rule of Section 12 of the *Fiscal Discipline Law* continues operating and the amount thereof is not being limited in quantitative terms. Fiscal policy remains supportive and is being implemented so as to ensure targeted temporary support to national economy and population, mitigating the socio-economic harm of Covid-19, as well as to ensure the necessary circumstances and funding for adequate functioning of health system.

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[3] See https://www.ecdc.europa.eu/en/publications-data/data-national-14-day-notification-rate-covid-19

[4] See. https://covid19.gov.lv/index.php/covid-19/covid-19-statistika/covid-19-vakcinacijas-statistika

In turn, as regards 2023 and 2024, according to the Communication from the European Commission of March 3 this year it is assumed that in 2023 and 2024 the escape clause is not applied and therewith the deviations of Section 12 of the *Fiscal Discipline Law* are not applied, either.

3.1.1 Observance of fiscal rules in planning medium-term fiscal policy

In a general case, the *Fiscal Discipline Law* provides that, when defining objectives of general government structural budget balance, a multi-stage method is being applied and it should concurrently provide for the compliance with the national level fiscal rules (balance rule, expenditure growth rule and rule of expenditure inheritance), and the rules of the Stability and Growth Pact. In turn, in the situation, where the application of fiscal rules both Stability and Growth Pact and the *Fiscal Discipline Law* is temporarily suspended, for the purposes of this Stability Programme, the maximum permissible structural deficit is determined according to a different method.

3.1.2. Structural Balance Objectives for 2022, 2023 and 2024

In 2022, assuming that the general escape clause of the Stability and Growth Pact and the deviation rule under Section 12 of the *Fiscal Discipline Law* are kept, the structural balance objective is being determined, based on the amount of nominal balance, considering the fiscal forecasts of this Stability Programme at constant policy, the decisions adopted by the Cabinet having fiscal impact in 2022, arising from the law *On the Medium - Term Budget Framework for 2021, 2022 and 2023*, as well as the forecasts of the Ministry of Finance regarding cyclical development of economy. The performed calculation algorithm is reflected in Table 3.1.

Table 3.1. **Structural balance objective for 2022**

		2022
(1)	**nominal balance**	**-2.69**
(2)	cyclical component of the balance	-0.34
(3)	one-off measures	0.00
(4)=(1)-(2)-(3)	structural balance	-2.34
(5)	fiscal security reserve	0.10
(6)=(4)-(5)	**structural balance objective**	**-2.44**
(7)	medium-term objective	-0.50
(8)=(6)-(7)	deviation from medium-term objective	-1.94

Correspondingly, Latvia’s structural balance objective in 2022 is -2.44% of gross domestic product. The structural balance to be planned in the draft budget law in accordance with the regulation of the Fiscal Discipline Law is -2.34% of gross domestic product. The difference of 0.1% of gross domestic product constitutes fiscal security reserve and is intended to consider the fiscal risks.

It should be noted that the structural balance objective in 2022 is of formal nature, because in this case it does constitute the indicator, under which the State budget of 2022 is to be developed. Considering the general escape clause, the general government budget deficit in 2022 can be as high as necessary for overcoming the consequences of crisis. The structural balance objective will be accordingly recalculated, using actual nominal balance.

In 2023 and 2024, only the national balance rule is applied for the purposes of determining the value of the structural balance objective and, therefore, the structural balance objective is equal to the medium-term objective and comprises -0.5% of gross domestic product.

Such simplified approach is being used, because due to a high uncertainty and the presence of general escape clause in 2022, it is difficult to apply the expenditure growth and expenditure inheritance rules and the results obtained on the basis thereof have low credibility. In turn, the application of fiscal rules of the Stability and Growth Pact after lifting the general escape clause currently entails number of unknown elements, for example, the pace of reduction of structural deficit and possible use of the derogations from balance rule specified in the Stability and Growth Pact.

The calculations show that the amount of the general government budget structural balance, at constant policy, in 2023, by 0.87 percentage points exceeds the medium-term objective, and in accordance with the rules of the *Fiscal Discipline Law* the budget consolidation is to be performed in the amount of the relevant deviation. It should be noted that, at the moment of preparation of the Stability Programme, the Cabinet does not have to resolve upon the preparation of the next year’s budget and medium-term budget framework. Likewise, currently there is a high uncertainty not only with respect to the accuracy of the year’s macroeconomic and fiscal forecasts, but also, to an even larger extent, with respect to the forecasts of further years. Therewith, in Autumn this year the fiscal forecasts for 2023 might differ substantially from the ones contained in the Stability Programme. Nevertheless, current forecasts point to a material risk of absence of a fiscal space in 2023.

The calculations carried out with respect to 2024 show that the general government budget structural balance, at constant policy, corresponds to the medium-term objective and there is a fiscal space available at disposal of the government for adopting new discretionary decisions.

3.2. Table Structural balance objective for 2023 and 2024

		2023	2024
(1)	**medium-term objective**	**-0.50**	**-0.50**
(2)	**structural balance objective**	**-0.50**	**-0.50**
(3)	cyclical component of the balance	-0.05	-0.01
(4)	one-off measures	0.00	0.00
(5)=(2)+(3)+(4)	**nominal balance**	-0.55	-0.51

(6)	nominal balance at constant policy	-1.32	-0.35
(7)=(6)-(3)-(4)	structural balance at constant policy	-1.27	-0.33
(8)	fiscal reserve	0.10	0.10
(9)=(7)-(8)-(1)	deviation from medium-term objective	-0.87	0.07

Objectives of General Government Budget for 2022, 2023 and 2024

Considering the calculations carried out herein above, the quantitative fiscal objectives for the medium term are set, namely, to ensure the general government budget structural balance at -2.44% of gross domestic product in 2022, -0.50% of gross domestic product in 2023, and -0.50% of gross domestic product in 2024.

Unlike the Stability Programmes that have been prepared in the pre-crisis time, this time the general government budgetary balance objectives are not being incorporated in the tables of annexes to the Stability Programme. If, up to now, in cases, when the structural balance at constant policy differs from the budgetary balance objective, the fiscal indicators of the Stability Programme were prepared in accordance with the budgetary balance objective and the available fiscal space, or consolidation amount was reserved for discretionary policy decisions within the process of budget preparation, then this time fiscal indicators in the tables of annexes to this Stability Programme are provided at a constant policy. This difference refers to 2023 and 2024. The reason for a different approach is high macroeconomic uncertainty as to these years and lack of decisions on how, within the scope of the Stability and Growth Pact, the transition would take place from the general escape clause circumstances in 2022 to the observance of fiscal rules of the Stability and Growth Pact in the following years, namely, what would be the requirements with respect to the speed of the structural balance convergence to the medium-term objective.

Discretionary measures

In between the Stability Programme 2020 - 2023 and this Stability Programme, fiscal policy decisions have been adopted. They include:

(i) measures included in the *Medium-Term Budget Framework Law for 2021, 2022 and 2023* and the *Annual State Budget Law for 2021*, as well as

(ii) the support measures for minimising the consequences of Covid-19 crisis approved (including conceptually) by the government and the Saeima up to 23 March this year.

The first set of measures is not separately described in this Stability Programme and it is available for review in the 2021 Draft budgetary plan of Latvia. In turn, the second set of measures is described in detail in Chapter 3.3 of the Stability Programme.

3.2. Current Fiscal Situation

According to the assessment of the Ministry of Finance, general government budget in 2020 was in a deficit in the amount of 1569.9 million euro or 5.4% of gross domestic product, which is considerably higher than the general government budget deficit stated in the law *On the State Budget for 2020* in the amount of 0.3% of gross domestic product, nevertheless, it should be considered that the law *On the State Budget for 2020* was adopted on 14 November 2019, when Covid-19 pandemic had not yet started. At the same time, the general government budget deficit is considerably lower than forecasted in Latvia's Stability Programme for 2020 - 2023, when, given high uncertainty due to Covid-19 pandemic, the general government budget deficit for 2020 was forecasted to reach 9.4% of gross domestic product.

Official data on the general government budget deficit for 2020 will be available at the end of April this year, when the calculations would be completed on all transactions of the general government sector, including, the performance of the general government reclassified enterprises, and the calculations of Covid-19 support measures would be adjusted, as well as the Statistical Bureau of the European Union *Eurostat* would have completed the process of clarification of the general government budget deficit and debt notification.

Last year, the general government budget deficit was affected by both decline in tax revenue and decisions adopted by the government to support national economy during Covid-19 pandemic. Overall, according to the estimates of the Ministry of Finance, the government decisions in 2020 ensured support to national economy in the amount of 4.5% of gross domestic product, while the impact of these measures on the general government budget deficit amounted to 3.7% of gross domestic product. Support to national economy were provided in the following directions – tax support, benefits, loans and guarantees, sectoral support, as well as the European Union funds support. See more detailed description of the support granted by the government during Covid-19 pandemic in Chapter 3.3 of this Stability Programme.

The analysis of contribution of the general government sub-sectors to the overall fiscal balance (see Figure 3.1), shows that the largest deficit was mainly formed in the central government, comprising 5.4% of gross domestic product in 2020, which was mainly due to the decisions of the government to support economy. Local government budget also demonstrated a deficit in the amount of 0.4% of gross domestic product, where, along with reduction in the personal income tax revenue, the total revenue of the local government declined considerably. In turn, the social security fund, notwithstanding the increase of the sickness and unemployment benefits, preserved budget surplus in the amount of 0.4% of gross domestic product.

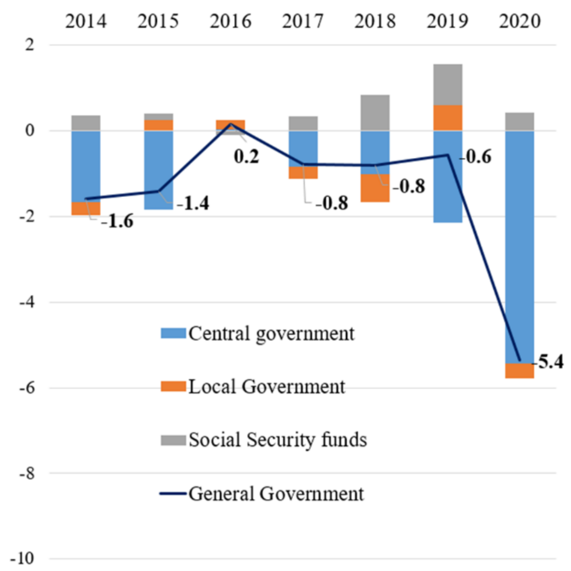


Figure 3.1. General government budget balance by subsector, % of GDP (Data source: Eurostat, Ministry of Finance)

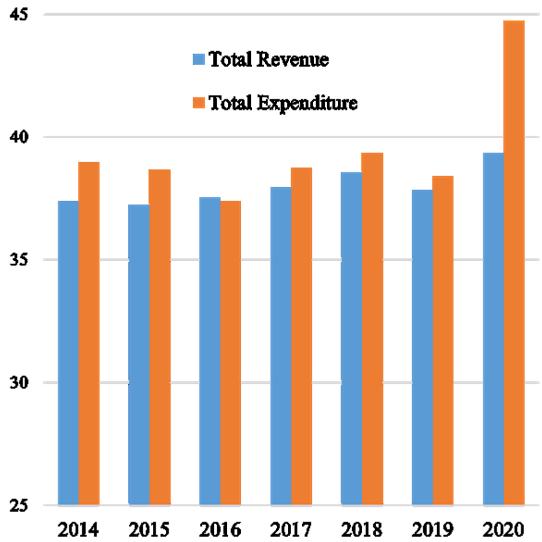


Figure 3.2. General government revenue and expenditure, % of GDP (Data source: Eurostat, Ministry of Finance)

In 2020, as compared to 2019, the general government budget revenue has grown only by 22.9 million euro or 0.2%, reaching 11.5 billion euro or 39.4% of gross domestic product (see Figure 3.2). Share of the general government budget revenue in gross domestic product, in 2020, has grown by 1.5 percentage points, as compared to 2019, however, such growth is attributable to the nominal gross domestic product drop by 3.6%. Revenue growth was ensured by the property revenue (D.4) that reached 0.7% of gross domestic product, being by 0.1 percentage point higher than in 2019, and other revenue, which, in 2020, reached 6.8% of gross domestic product, being by 0.7 percentage points higher than in 2019 (see Figure 3.3). Property revenue growth was ensured by the dividends received in the state budget, while the growth of other revenue was ensured by higher non-tax revenue, *inter alia*, proceeds from confiscation of funds from money laundering activities and higher revenue from the general government reclassified enterprises for provided services.

Tax revenue[5] comprises the largest part of revenue and, in 2020, it reached 31.9% of gross domestic product, being by 0.6 percentage points higher than in 2019, considering the drop of gross domestic product. In nominal terms, tax revenue reduced by 119 million *euro* or 1.9%. Significant decline in tax revenue

[5] Tax burden (D.2 (incl.EU share) +D.5+D.61+D91).

last year was observed in such sectors as accommodation and catering services, transport and storage, construction, arts, entertainment and leisure, as well as in the sector of real estate renting and administration. The largest drop in the amount of 97.1 million *euro* was observed for taxes on production and imports (D.2) that have decreased as a result of Covid-19 pandemic. Along with reduction of economic activity, the value added tax revenue in the state budget have declined by 103.7 million *euro* or 3.9%, which is attributable to decline in contributions and growth of tax refunds. If, in January and February 2020, the value added tax revenue grew, as compared to 2019, then in March 2020, as the state of emergency came into effect, the value added tax revenue started to decline considerably. Based on information provided by the State Revenue Service, the value added taxes paid in the sectors affected by the state of emergency the most - sector of accommodation and catering services, as well as the sector of arts, entertainment and leisure, declined by more than 50%, as compared to 2019. According to the data of the State Revenue Service the total transactional value, in 2020, declined the most for those taxpayers, who operated in the wholesale and retail sector, sector of cars and motorcycles repair, as well as transport and storage sector.

Current taxes on income and wealth (D.5) decreased by 21.8 million euro or 1%, as compared to 2019. However, the growth rate of current taxes on income and wealth was considerably affected by the low revenue of the corporate income tax in 2019. As of 1 January 2018, by introducing Tax Policy Guidelines for 2018 - 2021, both the rate and procedure for payment of the corporate income tax has been considerably reviewed. 2019 should be considered as transitional period, during which the corporate income tax revenue reached only 44.8 million *euro* in the state budget, in turn, in 2020, corporate income tax revenue grew by 162.7 million euro reaching 207.5 million euro. Current taxes on income and wealth have been significantly reduced by the drop in personal income tax revenue. Average gross wage, in 2020, continued to grow and reached 1143 euro, nevertheless, along with employment declining by 1.9% and unemployment growing to 8.1% of the economically active population, personal income tax revenue in the general budget reduced by 109.9 million euro or 5.7%. Negative labour market trends also affected the social contributions (D.61), which, as compared to 2019, decreased by 38.1 million euro or 1.2%.

As Covid-19 continued to spread, in the first two months of 2021, the general budget tax revenue, as compared to the relevant period of 2020, declined by 21 million euro or 1.4% and comprised 1517.8 million euro. Lower revenue is mainly related to the restrictions set for containing Covid-19 spread, which affect the economic activity, as well as the granted tax extensions. Starting from 1 January 2021, tax legislation has also been subject to changes that influence tax revenue - the rate of the mandatory state social security contributions was reduced by one percentage point, the maximum threshold to which the non-taxable minimum is applied has been increased to 1800 euro, as well as the non-taxable minimum for pensions has been increased to 330 euro.

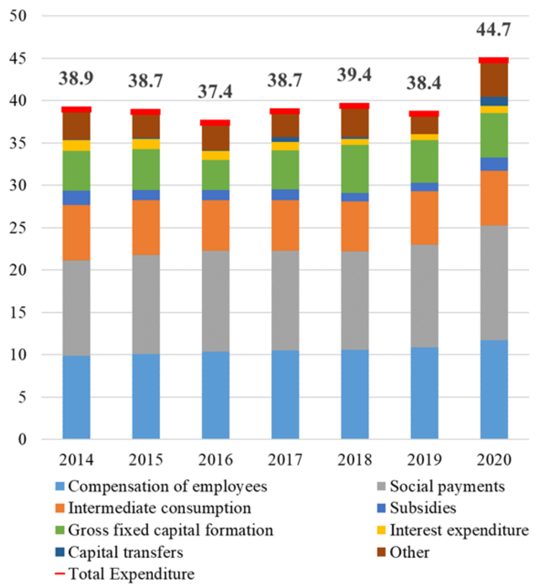


Figure 3.3. General government revenue structure,% of GDP (Data source: Eurostat, Ministry of Finance)

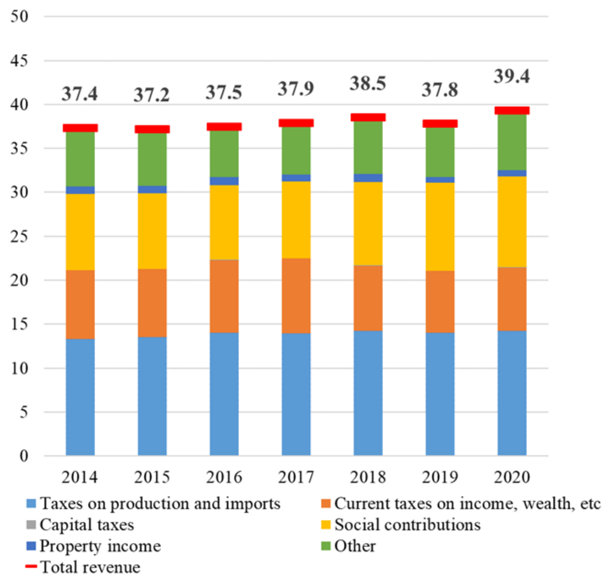


Figure 3.4. General government expenditure structure, % of GDP (Data source: Eurostat, Ministry of Finance)

The general government budget expenditure has grown by 1418.6 million *euro* or 12.1%, reaching 13.1 billion *euro* or 44.7% of gross domestic product (see Figure 3.4). The largest increase was ensured by other expenditure that has grown by 548.5 million *euro* or 77.4%. In general, the increase of this item was ensured by the general budget expenditure for subsidies and grants, which has grown by 362.7 million *euro* or 17.2%, determined by the Covid-19-related support granted to the Joint Stock Company Development Financial Institution Altum for ensuring aid programmes to merchants.

Total expenditure for compensation of employees (D.1) in 2020 has grown by 126.2 million *euro* or 3.8%, determined by increase of remuneration for those employed in the defence and health sector, as well as for teachers.

Expenditure for social benefits (D.632 and D.62) has grown by 286.3 million *euro* or 7.8%, determined by the growth of expenditure for pensions and other social benefits. Expenditure growth for pensions was affected by indexation, applying higher indices in October 2019 and 2020, while the steep growth of expenditure for other benefits is related to the increase of the average insurance contributions wage and Covid-19 impact. Last year, for the purposes of preserving employment, the disbursement of idle-time allowances has been granted in the amount of 61 million *euro*, and the expenditure has also grown significantly for unemployment benefits (by 43.4 million *euro* or 32.9%) and sickness benefits (by 42.2 million *euro* of 21.1%). According to the data of the State Social Insurance Agency, last year the number of recipients of the unemployment benefits has grown by 31.2% - from 32.5 thousand on average per month in 2019 to 42.6 thousand on average per month last year. The State Social Insurance Agency data also demonstrate the growth of the number of recipients of the sickness benefits by 5.8%, concurrently the number of paid days per one case of sickness period is growing even steeper (+6.7%), being indicative of a longer period of sickness.

The general government budget expenditure for gross fixed capital formation (P.51G) has grown by 17.4 million *euro* or 1.1%. The total expenditure growth in 2020 was ensured by the government decision to grant additional 75 million *euro* for improving road infrastructure, as well as raising local government borrowing limit by 150 million *euro*, thus ensuring the availability of borrowing for local governments for high-readiness investment projects important for national economy and reconstruction of the "*Mežaparks"* Grand Open-Air Stage. It must be noted that last year the slowdown was observed in the European Union funds' investments, which was largely related to restructuring the European Union funds in favour of investments targeted specifically to mitigating Covid-19 impact and promoting economic recovery, as a result the projects have been commenced later.

Expenditure for intermediate consumption (P.2) has declined by 54.6 million *euro* or 2.8%, which was, in general, determined by lower expenditure for goods and services in the local government budget. As compared to 2019, in the local government budget, expenditure has reduced for thermal energy, heating, motor fuel, as well as expenditure for catering, sustaining persons under the care, dependents and persons in service.

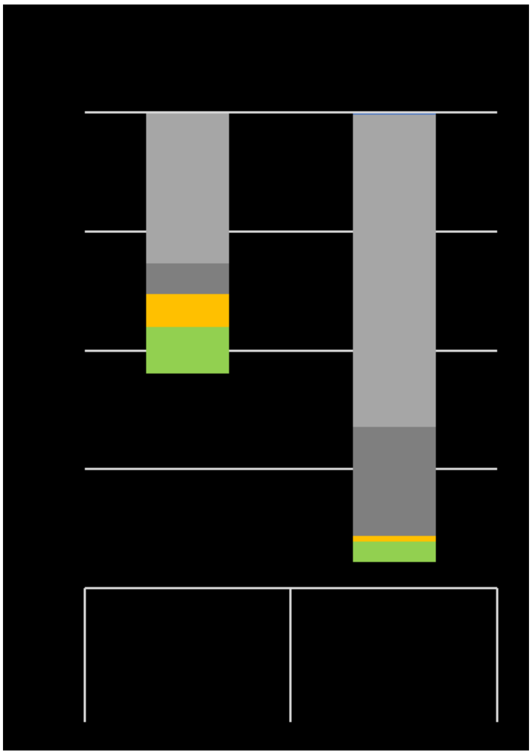
Subsidies (D.3) have grown by 165.4 million *euro* or 55.2%, attributable to additional subsidies to farmers in accordance with the decision of the government to provide additional aid to farmers for mitigating Covid-19 impact, as well as subsidies to enterprises providing public transport services.

Expenditure on capital transfers (D.9) in 2020 has grown by 288.7 million euro or more than 20 times. The growth is attributable to the decision of the government to provide support to the Joint Stock Company "*Air Baltic Corporation*" in the amount of 250 million euro, to the Joint Stock Company "*Latvijas gaisa satiksme*" - in the amount of 6 million euro and to the Joint Stock Company "*Latvijas Dzelzceļš*" - in the amount of 32.4 million euro.

3.3. Support measures for minimising the consequences of Covid-19

To ensure support to population and enterprises in Covid-19 crisis, the government has approved a substantial support package. The volume of support to national economy approved by 23 March this year (see Figure 3.5) in accordance with the assessment of the Ministry of Finance, based on information provided by the State Revenue Service, Joint Stock Company "*Attīstības finanšu institūcija Altum*" (Development Financial Institution Altum), and other institutions, has reached 4.4 billion euro, out of which 1.3 billion euro or 4.5% of gross domestic product was the actual support in 2020, 2.9 billion euro or 9.6% gross domestic product is the planned volume in 2021 and the planned volume of 0.1 billion euro in 2022.

When updating the general government budget balance for medium-term, the impact of support approved by 23 March this year on the budgetary balance was considered (see Figure 3.6). The volume of support measures creates a significant impact on the general government budget balance, with an adverse effect in 2020 comprising the amount of 1.1 billion *euro* or 3.7% of gross domestic product, but in 2021 the impact will increase to 1.9 billion *euro* or 6.2% of gross domestic product. For 2022, in its turn, the impact on the balance is assessed to a considerably lower extent - 0.2% of gross domestic product, mainly, through continuing to implement high-readiness investment projects to be commenced this year.



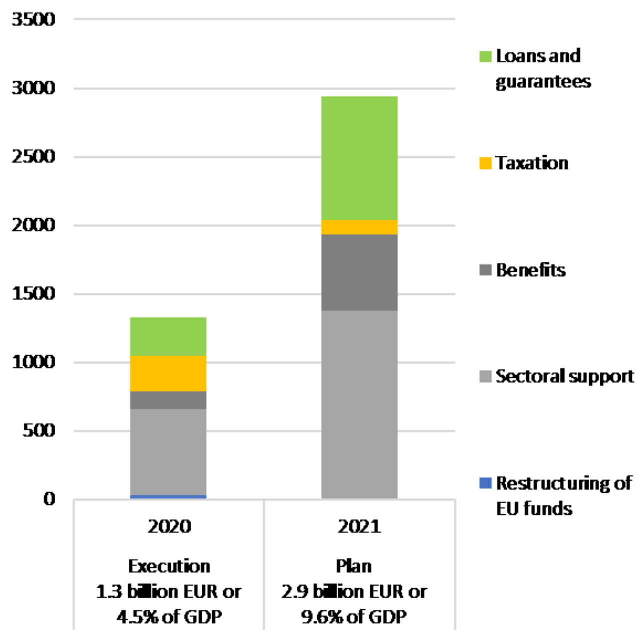


Figure 3.5. Total Covid-19 – related support to the national economy, mln euro (Data source: Ministry of Finance)

Figure 3.6. Impact of the support on the budget balance, mln euro (Data source: Ministry of Finance)

The adopted decisions on support measures for overcoming Covid-19 crisis, may be classified into five categories - support in the field of taxes, support in the field of benefits, support in the field of loans and guarantees, sectoral support, as well as European Union funding related support.

In the *Law on the Suppression of Consequences of the Spread of Covid-19 Infection,* several **tax support measures** have been defined, in order to mitigate the consequences of crisis for entrepreneurs and population. Support in the field of taxes entails such measures as extensions of the tax payment term; cancelling of advance payments of the personal income tax; refund of the overpaid value added tax within the period of 30 days; extension of the terms for payment of the real estate tax (up to now, the measure has no fiscal impact, as the transfer takes place only within the scope of 2020 and 2021).

Already last year, a legal framework had been adopted, defining additional support to population **for disbursement of benefits**, mitigating the consequences of the crisis caused by Covid-19. In 2020, the most voluminous benefits were the idle-time allowances and the wage subsidies. In 2020, the idle-time allowances in the amount of 61 million euro have been disbursed, however, in 2021, it is planned to disburse the idle-time allowances in the amount of 98 million euro, of which

67.4 million euro or 149.1 thousand allowances to 68.4 thousand natural persons had already been disbursed till 21 March 2021. Based on information from the State Revenue Service, the largest part of idle-time allowances has been disbursed to the representatives of such sectors as trade, accommodation and catering. According to the applications of the employers, the average idle-time support payment, from 1 December 2020 till 14 March 2021, comprised 416 euro. In 2021, the title planned support to population is several times exceeding the one granted in 2020, considering that, in addition to the employment support programmes, also one-off benefits to families with children will be disbursed (500 euro per each child), as well as 200 euro to pensioners and disabled persons.

3.3. table. Amount of support approved by the government to mitigate the effects of Covid-19, million euros

Measures	**2020**		**2021**			**2022**
	Execution	**Impact on budget balance**	**Plan 23rd March**	**Operative execution till 21st March**	**Impact on budget balance**	**Impact on budget balance**
AMOUNT OF SUPPORT	**1 329**	**-1 098**	**2 942**	**430.8**	**-1 893**	**-69**
% of GDP of respective year	**4.5**	**-3.7**	**9.6**	**1.4**	**-6.2**	**-0.2**
I Support to the field of taxation	256	-141.8	110	34.2	-24.0	36.5
Defferals of tax payment	161	-46.8	75	34.2	-24.0	1.5
II Aid in the field of benefits	130	-130	550	224.1	-456	0
Downtime allowance	61	-61	98	67.4	-98	0
Wage subsidies	47	-47	76	11.6	-25	0
Sickness benefit for childcare	0.1	0	55	1.2	-11	0
Unemployment assistance allowance	5.2	-5.2	10.7	3.3	-10.7	0
Payment of sickness benefit from the state budget from day 1-10	2.8	-2.8	13.3	13.3	-13.3	0
Allowance for families with children, 500 euro child	0.0	0	182	125.0	-182	0
Benefit for pensioners and persons with disabilities, 200 euro per person	0.0	0	112	0.0	-112	0
III Aid in the field of loans and guarantees	284	-195	903	18.6	-89	0
IV Sectoral support	632	-632	1 379	153.2	-1 315	-99
Health-care	133	-133	638	31.4	-586	0
Transport industry (including aviation industry and road-building)	408	-408	205	0.0	-190	0
Grant for current assets	0	-0.02	311	98.5	-311	0
Support for agricultural, forestry, fisheries and food production sectors	38	-38	46	0.0	-46	0
Culture	21.1	-21.1	27	0.0	-27	0
Science and education (including sport and distance-learning)	22	-22	36	18.1	-35	0
High readiness projects (without road-building)	0	0	62	0.0	-66	-99
V Support related to EU funds	27	0	-	0.7	-9	-7

Planned **support measures in the field of loans and guarantees** are ensured, mainly, via the Joint Stock Company *Development Financial Institution Altum*, and the type of support is mainly intended for improving the liquidity of enterprises, in order to overcome Covid-19 crisis. This group of support measures also entails increasing of the limit of borrowing of local governments in 2020 by 150 million euro. It also includes such measure as loans to current assets, loan guarantees, portfolio guarantees, investment fund of the Joint Stock Company *Development Financial Institution Altum* for modernisation, funding for support of large-scale merchants.

Support to sectors is intended for mitigating financial difficulties of the sectors, as well as ensuring medicinal aids and equipment and remote learning process. Sectors with the largest scope of support include health sector, transport sector and support to current assets in the form of grants. Support to sectors comprises almost one half of the total volume of support and, as compared to 2020, the planned volume of 2021 has doubled, having a direct impact on the budget deficit.

The EU funding support is intended for the purposes of ensuring the possibility to react more easily and quickly, when mitigating the consequences caused by Covid-19 for the most affected territories of the Member States and their population, allowing for amendments to the European Union funds operating programmes of the Member States. It also provides for allocating the support in the form of "overcommitments" of the state budget for increasing the investments of the European Union funds projects in the medium term and additional "overcommitments" for the support of crop-growing agricultural sector, allowing to assume overcommitments for project implementation, *inter alia*, by ensuring the expenditure of the total EU funds financing "envelope". In accordance with the decisions of the Cabinet, in 2020, the Cohesion Policy Funds have been restructured in the amount of 499 million euro and additional overcommitments, including the agricultural funds, have been assumed in the amount of 199.4 million euro. Data on implementation in 2020 and operative implementation in 2021 are specified, considering the actual payments.

3.4. Fiscal Development Scenario

General government budget projections for the medium term were prepared in March 2021, considering the macroeconomic development scenario, which had been prepared in February 2021 and approved by the Fiscal Discipline Council. The projections took note of the updated revenue, based on the approved macroeconomic development scenario, the approved state basic budget basic expenses for 2022 – 2023 and the projection for 2024, as well as the expected development in the local government budget and social security funds, in light of the current trends. Balances include the expected impact on the budget revenue and expenditure of the support to national economy for mitigating the impact of Covid-19 approved by the government till 23rd March this year. Covid-19 support measures significantly affect the budget expenditure of 2020 and 2021, and they will also increase the expenditure of 2022 in addition to the already budgeted volume.

The general government budget deficit in 2021 is expected to comprise 9.3% of gross domestic product, which, along with the increase of the approved support to national economy for mitigating the consequences of Covid-19, is considerably larger than forecasted when preparing the budget for 2021. In case of successful implementation of the vaccination plan, with economic development accelerating and tax revenue increasing, it is forecasted that the general government budget deficit in the medium term will reduce, and will comprise 2.7% of gross domestic product in 2022, 1.3% of gross domestic product in 2023 and 0.3% of gross domestic product in 2024 (see Figure 3.7).

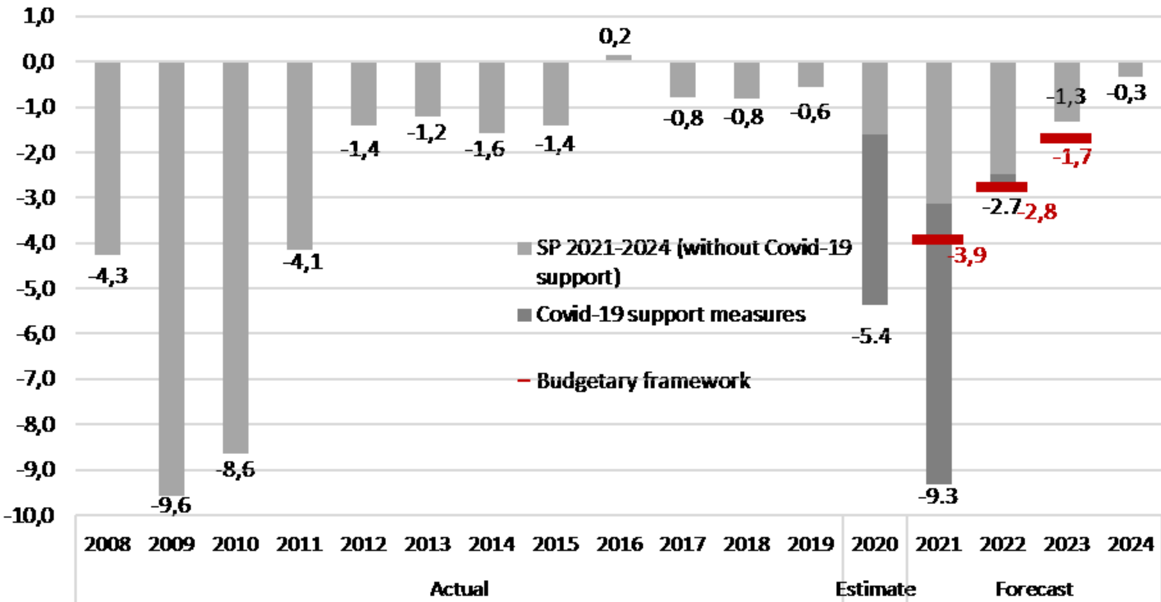


Figure 3.7. General government budget balance, % of GDP (Data source: Eurostat, Ministry of Finance)

According to the forecasts, the share of general government revenue in gross domestic product in 2021 will increase and will comprise 39.3% of gross domestic product. Even higher revenue level is expected in 2022, namely, 39.9% of gross domestic product, while in 2023 and 2024 it will reduce to, correspondingly, 39% and 38.6% of gross domestic product. Higher level in 2022 will be determined by the growth in foreign financial assistance flows, as well as in the personal income tax revenue, because no further growth is expected in the non-taxable revenue base. In turn, reduction of the share of revenue in 2023 will be affected by decline in the amount of European Union funds' investments, while, in 2024, property revenue will be smaller in percentage to gross domestic product. In nominal terms, the amount of revenue will grow over the medium term. The general government expenditure share in gross domestic product, following the considerable growth in 2021, when extensive support to national economy approved by the government is intended for mitigating the consequences of Covid-19, over the medium term is expected to reduce on an annual basis in proportion to gross domestic product. Reduction of the share of expenditure over the medium term is attributable to the fact that decisions on additional expenditure initiatives are being adopted, as the current annual budget approval is approaching.

***Table 3.4.* Fiscal development baseline scenario at a constant policy**

		2020	2021	2022	2023	2024
	ESA	**% of gross domestic product**				
Net lending (+) or borrowings (-) (B.9) by sub-sectors						
General government	S.13	-5.4	-9.3	-2.7	-1.3	-0.3
incl., merchants[6]		-0.2	-0.4	-0.2	-0.2	0.1
Central government	S.1311	-5.4	8.6	-2.5	-1.2	-0.2
incl., merchants		-0.2	-0.2	-0.2	-0.2	0.0
Local government	S.1313	-0.4	-0.4	-0.1	-0.1	-0.1
incl., merchants		-0.1	-0.1	0.0	0.0	0.1
Social security funds	S.1314	0.4	-0.3	-0.1	0.0	0.0
General government (S.13)						
Total revenue	TR	39.4	39.3	39.9	39.0	38.6
Total expenditure	TE	44.7	48.6	42.5	40.3	39.0
Interest expenditure	D.41	0.8	0.7	0.8	0.8	0.7
Cyclical development						
Cyclical component of the budgetary balance[7]		-1.5	-1.2	-0.3	0.0	0.0
One-off measures[8]		-0.2				
Cyclically adjusted balance		-3.9	-8.2	-2.3	-1.3	-0.3
Cyclically adjusted primary balance		-3.0	-7.5	-1.6	-0.5	0.3
Structural balance		-3.7	-8.2	-2.3	-1.3	-0.3

Central government budget

- Support to national economy approved by the government for mitigating the consequences of Covid-19 affects the most the central government budget, where a deficit of 8.6% of gross domestic product is planned in 2021. In turn, in the coming years at a constant policy the reduction of the deficit is expected

[6] Commercial companies controlled and financed by the State and local government entities (Ministry of Finance sample survey result). Full list of merchants is available on the website of the Central Statistical Bureau [6]https://www.csb.gov.lv/lv/statistika/klasifikacijas/institucionalo-sektoru-klasifikacija/kodi.

[7] In the calculation of a cyclical component of a budgetary balance, there was budgetary semi-elasticity of 0.378 used (Data source: *G.Mourre ao. European Commission. The Semi-Elasticities Underlying the Cyclically-Adjusted Budget Balance: An Update & Further Analysis. May 2019*).

[8] To facilitate data comparability between Latvia and the European Commission, the structural balance in 2020 a is reflected jointly with the reduction of the net revenue from tax reform by 0.3% of gross domestic product, which is short-term and is deemed as the one-off measure within the fiscal framework of Latvia, but the European Commission includes this effect in the structural balance, because the European Commission does not recognise the measures reducing revenue / increasing expenditure to be one-off/short-term measures. The improvement of 0.1% of the gross domestic product in 2020 is related to seizure of proceeds from crime.

- to 2.5% of gross domestic product in 2022, to 1.2% of gross domestic product in 2023 and to 0.2% of gross domestic product in 2024. In the central government budget, it is planned that the share of expenditure will reduce, starting from 2022, attributable to high expenditure level in 2021 for mitigating the consequences of Covid-19 and the fact that currently there are no decisions adopted on granting additional resources in the medium term (increase of the family state benefit, remuneration to medical persons and reform of the remuneration system of teachers, etc.). The amount of revenue, along with higher tax revenue, will grow, in nominal terms, on an annual basis, correspondingly, the central government budget balance at a constant policy will improve on an annual basis.

- 2021 is the last year, when the personal income tax revenue is expected lower than the year before, because no further changes in the non-taxable income base are approved. Corporate income tax revenue will also grow on an annual basis, following the reform, even though, in the medium term, not yet reaching the pre-reform level. In 2022, along with the forecasted exit from Covid-19 crisis, tax revenue will grow steeper, and the growth is expected in all of the most significant tax groups. In total, tax revenue growth will be ensured by increase of the wage fund and consumption.
- After 2021, when the growth of expenditure for remuneration, social expenditure and intermediate consumption is largely affected by additional expenditure for Covid-19 support measures, starting from 2022, expenditure in these items will grow at much slower pace. It should be noted that the medium-term forecasts do not consider the potential additional expenditure, for example, for family state benefit, remuneration of medical persons, etc., where the decisions are not yet adopted.
- Expenditure for fixed asset formation, along with increasing flows of the European Union funds' investments, will grow in 2021 - 2022. European Union funds' investments in the central government budget, following the decline in 2020, when a significant restructuring of the European Union funds was carried out, reallocating them in the amount of almost 0.5 billion euro for mitigating Covid-19 impact, will grow in 2021 - 2022. This will also be promoted by commencement of 2021 - 2027 programming period and inflow of the European Recovery and Resilience Facility funds into Latvia, which is being included in the forecasts. Increase in investments in 2021 and 2022 will also be determined by the approved funding for high-readiness projects, in order to mitigate the impact of Covid-19 on national economy. Considering that the funding of the significant infrastructure project *Rail Baltica* has, up to now, been granted in a limited amount in accordance with concluded agreements, in 2023, its funding is already being planned with considerable

reduction, which, to a large extent, will determine also lower volume of investments in the central government budget, as compared to 2022.

Social security fund

- In the social security fund, following several years with a surplus, in 2021, a deficit of 0.3% of gross domestic product is expected. Deficit formation was affected by deterioration of economic situation, when, under the impact of Covid-19, both short-term benefits (sickness, unemployment) grow, and the growth of tax contributions decelerates. Tax revenue growth is influenced by reduction of the rate of mandatory state social security contributions by 1 percentage point starting from 2021, therewith, the growth of the volume of revenue continues, however, at a slower pace. Along with economy recovering, already in 2023 and 2024, a well-balanced budget is being forecasted in the social security fund.
- In 2021, the grow in expenditure for pensions is expected, in light of both the rise in average contributions wage and larger indices. According to an updated macroeconomic scenario, in 2021, recalculation of the indexation coefficients of pensions would have to be performed, thus additional expenditure is forecasted for pension indexation, starting from 1 October 2021, also affecting expenditure for old-age pensions in the coming years. Expenditure for pensions would grow even steeper, if the reform of retirement age would not be implemented, introduced in 2014 and providing for increase of the retirement age by three months annually, until reaching the age of 65 years in 2025, as a result the number of pension recipients decreases, and it is currently forecasted that it will continue decreasing also in the medium term. In 2021, persons who have reached the age of 64 years will be entitled to receive the state old-age pension. Persons whose insurance period is at least 30 years are eligible to retire earlier - two years before reaching the general retirement age, thus, in 2021, persons who have reached the age of 62 years are entitled to retire prematurely.
- Considering the judgment of the Constitutional Court regarding the amounts of minimum pensions, starting from 2021, new minimum amount of an old-age pension is determined, which will henceforth depend upon each year of the insurance period of a person. The minimum old-age pension will be calculated, by applying a coefficient of 1.1 to the minimum old-age pension calculation base of 136 euro. For each following year, exceeding 15 years necessary for granting an old-age pensions, the amount will be increased by two percent of the minimum old-age pension calculation base.
- The minimum amount of disability pension has been increased starting from 1 January 2021. The set new minimum amount of disability pension depends upon the disability pension calculation base, comprising 136 or, for persons

with disability from childhood, 163 euro. The minimum amount of pension for persons with Group 1 and Group 2 disability will be calculated, by applying an increasing coefficient.

- When preparing the expenditure forecasts in the social security fund, it was considered that expenditure for unemployment benefits will grow significantly in 2021, but, in the medium-term, will decline on an annual basis. This will mainly be attributable to the changes in the number of the recipients of unemployment benefit, providing that in 2021, as compared at 2020, it will grow to 40.3 thousand recipients, and the growth is projected for the second half of the year, when the idle-time allowance will no longer be granted, and part of enterprises might not be able to resume operating. In turn, in the medium term, the reduction of the number of recipients is forecasted to 29 thousand persons in 2024, which would, correspondingly, determine the reduction of expenditure in the medium term. The average amount of the benefit, to a large extent, correlates with the expected changes in the average wage in the country, which are, on an annual basis, planned with an increase. From 1 January 2021, the unemployment benefit has been increased for those unemployed, for whom it was determined in the amount of 60% of double amount of the state social security benefit. These changes, following the decision of the Constitutional Court, are related to increase of the state social security benefit from 64.03 euro to 109 euro. It should be noted that, from 1 January 2020, changes have been introduced also in the period of disbursement and amount of the unemployment benefit, shortening it from 9 to 8 months, and also reviewing the amount of benefit disbursement in proportion to a person's wage.
- The expected changes in the number of recipients and average amount of sickness benefit have also been considered. Under the impact of Covid-19 pandemic, the government has also approved support for payment of sick-leave certificates - in case of suspected Covid-19, a sick-leave certificate is being paid for already from the 1st day of temporary incapacity till the 3rd day of temporary incapacity case of a positive Covid-19 test, it continues, as necessary (under standard procedure, the state pays for temporary incapacity only from the 11th day thereof). According to the forecasts of the Ministry of Welfare, in 2021, the number of Covid-19 diseased persons will reach 10% of the total number of socially insured persons, therefore, it is expected that, in total, in 2021, expenditure for sickness benefits will exceed the level of expenditure of 2020 by 16.4%. In the medium-term, even though the number of recipients is planned with an annual reduction, the average amount of benefits is, nevertheless, forecasted with an increase, therefore also the total expenditure for sickness benefits would grow, on an annual basis.

Local government budget

- In 2021, the deficit in the local government budget will remain at the level of 2020 (0.4% of gross domestic product). In 2021, budget deficit is largely attributable to the planned lower personal income tax revenue, as compared to 2020, mainly due to legislative changes. As of 1 January 2021, the non-taxable minimum for pensioners and the non-taxable revenue base for income are being increased. It is forecasted that, in 2022 - 2024, the deficit in the local government budget would reduce to 0.1% of gross domestic product, projecting an annual increase of the personal income tax revenue.
- Transfers in the local government budget are forecasted with a growing trend, to be ensured by increase of a special grant to local governments, which, since the introduction thereof has been providing the local government revenue to a certain extent in the previous years. Likewise, also the earmarked grants are increasing, *inter alia*, to teachers, and the transfers of classified merchants to local governments grow, as well.
- Local government budget expenditure, in 2021, in total, will increase moderately, however, in the medium term, a steeper increase of expenditure is expected. Annual growth is forecasted in expenditure for remuneration, intermediate consumption, subsidies, as well as social expenditure. Expenditure for fixed asset formation will be largely determined by the cycles of the European Union funds' investments. In 2021, decline in expenditure is attributable to completion of the European Union funds' 2014 - 2020 programming period, while starting from 2022 expenditure is to grow, on an annual basis, due to introduction of the European Union funds' 2021-2027 period. A positive impact on investment volume in 2020 and 2021 creates the limit of borrowings of local government in the Treasury increased for the local governments by 150 million euro.

3.5. Development Trends of Government Debt in the Medium Term

The key principles and medium-term objectives of the central government debt management are defined in the Central Government Debt and Cash Management Strategy approved by the Minister for Finance. In accordance with the strategy, the purpose of government debt and cash management is to ensure, in a timely manner, the availability of cash for financing requirement at the lowest possible debt servicing costs while hedging financial risks and at the same time contributing to the development of the domestic financial market.. For meeting the central government debt obligations and fulfilling budget liabilities, a strategic approach to ensuring borrowing and debt management process is applied, maintaining the greatest possible flexibility in the choice of borrowing conditions on financial markets (time of borrowing, instrument, amount, maturity). It allows limiting financial risks in the medium term, as well as ensuring the resources necessary to cover the total financing requirement at as favourable and attractive conditions as possible.

Covid-19 outbreak has brought along the need to ensure funding in a considerable amount in 2020 for mitigating the impact of Covid-19 outbreak and economic support to economy in the state of emergency, implementing borrowing in financial markets, borrowing from international financial institutions and the European Commission (SURE), resulting in considerable growth of the general government debt. According to the preliminary assessment, at the end of 2020, the general government debt, according to the methodology of the European System of National and Regional Accounts in the European Union, reached 12.7 billion euro or 43.5% of gross domestic product[9]. The general government debt level is mainly affected by the central government debt, which at the end of 2020 was 12.4 billion euro[10].

Under the circumstances of Covid-19 outbreak, necessary financing for government decisions for mitigating the impact of Covid-19 outbreak and support to economy in the state of emergency, was ensured in 2020 by borrowing in the amount of 2.230 million euro in domestic and international financial markets. To minimise the impact of debt servicing costs (interest expenditure) on the central government budget, the Treasury raised resources in the financial markets for comparatively short terms and at possibly lower interest rates, concurrently not increasing the central government debt refinancing risks in the coming years.

In 2020, resources in the amount of 1.550 billion euro were raised in the international financial markets, tapping Eurobonds with maturity in 2026 in the amount of 550 million euro and a coupon rate of 0.375% and the issue of new 3-year Eurobonds in the amount of 1 billion euro with a coupon rate of 0.125%.

In 2020, the largest volume of borrowing for the last years has been made in the domestic financial market (680 million euro), by organising 2, 5 and 7-year T-bond auctions at a coupon rate of 0% (reaching negative yield in some auctions). Latvia's outstanding Eurobonds were tapped in domestic financial market via primary dealers as well, expanding the range of liquid instruments available to local investors (in 2020, additional issues of Eurobonds with maturity in 2026 have been issued in the amount of 40 million euro, reaching historically lowest yield of the relevant tenor).

In parallel, also additional borrowing possibilities from international financial institutions and the European Commission are ensured. On 8 April 2020, the loan agreement has been concluded with the Nordic Investment Bank, within the scope whereof, a long-term funding is available in the amount of 500 million euro for measures for mitigating and suppressing the consequences of Covid-19, and, within the scope whereof, the loan resources in the amount of 250 million euro have been

[9]Information about the actual fulfilment of the general government debt will be available in April 2021 in accordance with the general government budget and debt notification.

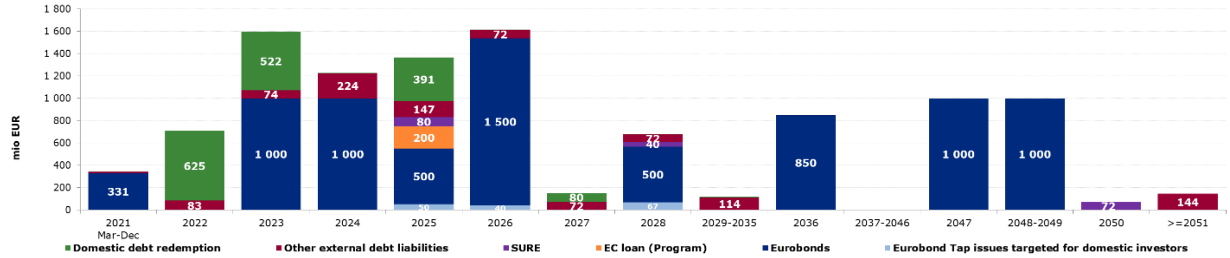
[10] Nominal value, taking into account derivatives linked to the central government debt administered by the Treasury

received in September and October 2020, receiving the remaining 250 million in January 2021. The borrowing possibility in the amount of 400 million euro from the European Investment Bank within the scope of concluded agreements is kept, as well as the additional borrowing possibility from the European Investment Bank is approved in the amount of 100 million euro and borrowing possibility from the Council of Europe Development Bank in the amount of 150 million euro. Likewise, also in accordance with Council Implementing Decision (EU) 2020/1351 of 25 September 2020, the borrowing of the support mechanism to mitigate unemployment risks in the emergency *(SURE)* in the amount of 192.7 million euro is available to Latvia from the European Commission. The first part of SURE financing in the amount of 120 million euro was received in November 2020, with the remaining 72 million euro being received in February 2021. On 11 March 2020, Latvia applied for additional borrowing in the amount of 113 million euro, within the scope of SURE.

The funding for support to economy and mitigating the consequences of Covid-19 outbreak will be ensured in the necessary amount also henceforth, by borrowing in domestic and international financial markets, as well as by using financially beneficial borrowing possibilities from the international financial institutions (European Investment Bank, etc.) and the European Commission financing mechanisms (SURE, European Recovery and Resilience Facility). Raising resources in domestic financial market is ensured by tapping of Eurobonds, utilising the potential of domestic financial market and possibility to borrow at historically lowest, incl., negative, interest rates. It is planned to ensure borrowing in international financial markets by public long-term benchmark Eurobond and sustainable (for example, "green") bond issues, preserving possibly more extensive and flexible options for choosing the most financially beneficial borrowing instrument.

In March 2021, the 10-year Eurobond was issued in international financial markets in the amount of 1.250 billion euro with the yield of 0.105% and fixing the coupon rate at 0.000%, being historically the lowest yield and coupon level of the issues of Latvian debt securities of such a long tenor ever achieved in international financial markets. As a result of the transaction, the availability of resources was ensured for financing the measures for mitigating the impact of Covid-19 outbreak and support to economy, and for funding also other budgetary needs and fulfilment of the central government debt obligations. In turn, in domestic financial market, in January - March 2021, Eurobonds with maturity in 2025, 2026 and 2028 have been tapped in the amount of 141.8 million euro, achieving negative yields.

Taking into account the central government debt obligations outstanding as of 28 February 2021, in accordance with the central government debt repayment schedule in the period between March 2021 – December 2024 the central government debt obligations should be refinanced in amount of ~3.9 billion euro (see Figure 3.8). Majority of the amount of debt to be refinanced within the referred to period consists of Eurobonds issued in international financial markets, the maturity whereof will become due (see Figure 3.8).

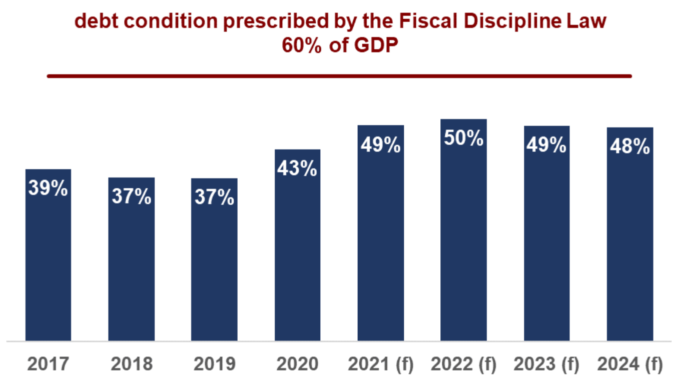


* *does not include sectors S130130, S130140, S130330, S130340, as well as on-demand and short-term deposits; according to ECB FX rates of 28 February 2021*

Figure 3.8. Central government debt repayment schedule *(liabilities outstanding as of 28 February 2021, nominal value)*

Continuous implementation of new measures for mitigating the impact of Covid-19 outbreak and support to economy in 2021 will further impact the general government debt, because financing of these measures will have to be ensured through the borrowings in domestic and international financial markets, additionally using the financially beneficial borrowing opportunities from the international financial institutions and the European Commission.

According to the latest forecast prepared under the circumstances of still high uncertainty, it is expected that the need to ensure financial resources for the measures for the prevention the spread of Covid-19 will give rise to the growth of the general government debt up to ~49% of GDP in 2021 and up to ~50% of GDP in 2022 (see Figure 3.9). After the repayment of the central debt planned in 2022 - 2023, as well as along the stabilisation of the situation with respect to the impact of Covid-19 outbreak on the state budget fiscal indicators, starting from 2023, the volume of general government debt is expected to slightly reduce and become stable in proportion to GDP (see Figure 3.9).



f - forecast

Figure 3.9.. General government debt development trends (% of gross domestic product)

Notwithstanding the growth of the level of the general government debt, influenced by the need of financing Covid-19 - related measures, this impact would be of a short-term nature, which, in the medium term and in the long term, would not create risk to sustainability of the general government debt. It is expected that the debt rule specified in the *Fiscal Discipline Law* will be observed both in 2021 and in the medium term.

4. Sensitivity Analysis and Comparison

4.1. Macroeconomic Scenario Risks

Medium-term macroeconomic development scenario is based upon conservative assumptions regarding economic development in the medium period and bottom-up and top-down macroeconomic development scenario risks, in total, are well-balanced, even though the uncertainty arising out of Covid-19 containing measures and the effectiveness thereof, remains high.

Therewith, the Ministry of Finance, when developing its medium-term forecasts of macroeconomic indicators, has identified and assessed several internal and external risks, upon occurrence whereof the economic growth in Latvia may turn out to be sharper or slower than expected in the baseline scenario. Based on the macroeconomic risks outlined herein below, two alternative macroeconomic development scenarios are developed for 2021 – 2024.

The main negative risks are related to the failure of the vaccination plan of the Ministry of Health to succeed to a planned extent, for example, disturbances in supplies of Covid-19 vaccines are possible or the population vaccination rates might turn out to be insufficient, as well as virus mutation can give rise to a new wave of pandemic, starting from October 2021. Therewith, the government would be forced to extend the restriction, which would not only decelerate the economic growth, but also, given the absence of serious support measures, would create bankruptcies of enterprises, upon exhausting the internal reserves of the enterprises, besides, the growth of shadow economy might emerge as a side effect here. In addition to Covid-19 restrictions, construction sector might face lack of capacity, trying to implement the large-scale government-funded projects, which would trigger the rise in prices. External negative risks for Latvia are currently also related to a still high geopolitical uncertainty in the region, which might limit the economic development.

Positive risks, in turn, are mainly related to emergence of risks opposite to negative risks, for example, should the vaccination plan be successfully implemented and should the pool immunity obtained by the society allow for lifting all restrictions earlier, already in Summer, furthermore also steeper economic recovery of our trade partner countries would promote steeper growth of the entire region. Other internal positive risks are related to steeper growth of investments, by successfully implementing the panned large-scale projects, as well as more successful implementation of the European Union Recovery and Resilience Facility plan in Latvia.

4.2. Sensitivity Analysis

4.2.1. Optimistic Scenario

Impact on economy

Overall, 2020 ended better than previously forecasted. Economy has adapted to the new circumstances, which would manifest themselves also as the recovery of private consumption level in the third quarter of 2021. Besides, successful implementation of the vaccination plan of the Ministry of Health and emergence of pool immunity would create the circumstances, suitable for faster lifting of the introduced restrictions.

Thus, improvements of the increases of economic activity will be felt in all fields - both in demand and in income growth, and, as a result, in case of optimistic scenario, the growth of Latvia's gross domestic product, at constant prices in 2021, would be, on average by 1 percentage point steeper, and, in 2022, by 0.6 percentage points steeper than in the baseline scenario.

Table 4.1. Optimistic macroeconomic scenario

	Optimistic Scenario				Deviation from the baseline scenario			
	2021	2022	2023	2024	2021	2022	2023	2024
GDP growth at current prices, %	5.5	7.1	5.2	5.0	1.1	0.7	0.0	0.0
GDP growth at constant prices, %	4.0	5.1	3.2	2.8	1.0	0.6	0.0	0.0
Private consumption, growth at constant prices, %	5.0	10.5	4.0	2.6	1.0	0.4	0.0	0.0
Public consumption, growth at constant prices, %	2.5	2.5	2.4	2.4	0.1	0.1	0.0	0.0
Gross fixed capital formation, growth at constant prices, %	5.5	9.0	2.5	2.5	1.4	1.4	0.0	0.0
Export of goods and services, growth at constant prices, %	4.5	4.7	4.0	4.0	0.2	0.0	0.0	0.0
Import of goods and services, growth at constant prices, %	4.9	5.4	4.0	5.0	0.0	0.0	0.0	0.0
Average wage in national economy growth at current prices, %	4.5	5.5	5.0	5.0	0.0	0.5	0.5	0.0
Employment growth, %	-0.2	1.5	0.3	0.0	0.0	0.2	0.5	0.0
Unemployment rate, %	8.2	6.5	5.7	5.3	0.0	-0.1	-0.6	-0.6

Impact on the general government budget

Upon implementation of the optimistic scenario, where the tax and non-tax revenue increases, as well as interest expenses reduce, the general government budget balance would improve. As compared to the baseline scenario, in case of the optimistic scenario the general government deficit in 2021 would decrease by 99.5 million euro or 0.4 percentage points of gross domestic product. By contrast, in 2022, 2023 and 2024 the general government balance would improve, respectively, by 0.6 (174.9 million euro), 0.6 (186.6 million euro) and 0.5 (196.4 million euro) percentage points of gross domestic product as compared to the baseline scenario.

Balance improvement will be influenced by larger tax revenue, as compared to the baseline scenario, mainly along with increase of the value added tax and mandatory state social security contributions revenue.

Table 4.2. ***Impact of the optimistic scenario on the general government budget, million euro***

	Optimistic Scenario				Deviation from the baseline scenario			
	2021	2022	2023	2024	2021	2022	2023	2024
General government budget balance, % of GDP	**-8.9**	**-2.1**	**-0.8**	**0.2**	**0.4**	**0.6**	**0.6**	**0.5**
General government budget balance	-2, 753.4	700.2	265.6	71.3	99.5	174.9	186.6	196.4
Tax revenue	9, 343.4	10, 217.0	10, 783.5	11, 293.8	93.8	167.3	178.4	187.2
Personal Income Tax	1, 806.1	1, 978.1	2, 060.9	2, 160.6	19.1	34.1	35.9	37.6
Corporate Income Tax	262.8	310.4	326.7	343.0	2.8	5.4	5.7	6.0
VAT	2, 764.9	3, 026.0	3, 239.9	3, 439.8	29.3	52.2	56.4	59.9
Mandatory state social security contributions[11]	2, 891.8	3, 195.6	3, 397.4	3, 550.7	30.6	55.1	59.1	61.8
Excise Duty	1, 129.4	1, 187.7	1, 226.4	1, 256.4	12.0	20.5	21.3	21.9
Non-tax revenue	648.5	557.2	548.7	514.6	5.6	7.5	7.4	6.7
Interest expenditure	262.2	242.1	239.1	236.7	0.0	-0.1	-0.9	-2.5
General government debt, % of GDP	**48.1**	**48.7**	**46.7**	**45.8**	**-0.8**	**-1.7**	**-2.2**	**-2.6**

Upon implementation of the optimistic scenario of the economic development, under the influence of the tax revenue increase the state budget financial balance would improve, as a result whereof the overall funding need would reduce and, correspondingly, also the lending volume for the respective period, as compared to the baseline scenario. Smaller borrowings would generate savings in the interest expenditure. In case of the optimistic scenario, the interest expenditure in 2021 would remain unchanged, but in 2022 they would be by 0.1 million euro smaller, in 2023 - by 0.9 million euro smaller and in 2024, correspondingly, by 2.5 million euro smaller than in the baseline scenario.

4.2.1. Pessimistic Scenario

Impact on economy

In accordance with the pessimistic scenario, Latvian economy may experience a sharper fall of growth rates, attributable to Covid-19 restrictions and thereby slower economic growth in the trade and other service sectors. This, similar to what could be observed in the second quarter of 2020, will mainly manifest itself in a larger decrease of private consumption that in the baseline scenario - by 10% in 2021 and 3.1% in 2022, or , correspondingly, by 7.2 and 4 percentage points more than envisaged in the baseline scenario. Such conduct of households is attributable to income reduction and, correspondingly, the wish to create savings. According to the pessimistic scenario, as the income of population decrease, the wage growth of the employed, in 2021 and 2022, would be, on average, by one percentage point smaller.

[11] Deducting contributions into the State funded pension scheme and contributions into the 3rd pension pillar

Uncertainty around the household income will also be triggered by employment reduction by 1% in 2021, which would follow an increasing wave of corporate bankruptcy.

Table 4.4. Pessimistic macroeconomic scenario

	Pessimistic Scenario				Deviation from the baseline scenario			
	2021	2022	2023	2024	2021	2022	2023	2024
GDP growth at current prices, %	1.1	6.0	5.2	4.9	-3.3	-0.4	0.0	0.0
GDP growth at constant prices, %	0.0	4.2	3.2	2.8	-3.0	-0.3	0.0	0.0
Private consumption, growth at constant prices, %	-3.1	6.1	4.0	2.6	-7.2	-4.0	0.0	0.0
Public consumption, growth at constant prices, %	2.9	2.4	2.4	2.4	0.5	0.0	0.0	0.0
Gross fixed capital formation, growth at constant prices, %	4.1	5.2	2.5	2.5	0.0	-2.4	0.0	0.0
Export of goods and services, growth at constant prices, %	4.0	3.3	4.0	4.0	-0.3	-1.4	0.0	0.0
Import of goods and services, growth at constant prices, %	3.5	4.4	4.0	4.0	-1.4	-1.0	0.0	0.0
Average wage in national economy growth at current prices, %	3.0	4.0	5.0	5.0	-1.0	-1.0	0.0	0.0
Employment growth, %	-1.0	1.0	1.0	0.0	-0.6	0.0	0.7	0.0
Unemployment rate, %	8.9	7.7	6.3	5.9	0.6	0.6	0.0	0.0

If the construction sector would not be able to solve the capacity problem, it would slow down investment volumes, especially in 2022, when the largest growth of the European Union funds inflow was planned. As a result, the growth of gross fixed capital formation in 2022 might be by 2.4 percentage points slower than in the baseline scenario. In turn, export would suffer more form decline in the total demand and restrictions in flows of goods, which would manifest itself more in 2022, along with the pandemic becoming topical again, while in 2021 these risks are very low.

In case of the pessimistic scenario, the real gross domestic product growth in 2021 would be by 3 percentage points less than in the baseline scenario and in 2022 – by 0.3 percentage points less.

Impact on the general government budget

Upon implementation of the pessimistic scenario, tax revenue would decrease significantly, and the general government budget balance would deteriorate. As compared to the baseline scenario, in case of the optimistic scenario the general government deficit in 2021 would increase by 292.4 million euro or 1.3 percentage points of gross domestic product. By contrast, in 2022, 2023 and 2024, the general government balance would deteriorate on a year-to year basis by 1.2 percentage points of gross domestic product as compared to the baseline scenario or, in nominal terms, correspondingly, by 349.1 million, 369.6 million euro and 395.9 million euro. General government deficit in case of pessimistic scenarios in 2021 would grow to 10.6% of gross domestic product, in 2022 - to 3.9% of gross domestic product, in

2023 - to 2.5% of gross domestic product, but in 2024 - to 1.5% of gross domestic product.

Table 4.5. Impact of the pessimistic scenario on the general government budget, million euro

	Pessimistic Scenario				**Deviation from the baseline scenario**			
	2021	**2022**	**2023**	**2024**	**2021**	**2022**	**2023**	**2024**
General government budget balance, % of GDP	**-10.6**	**-3.9**	**-2.5**	**-1.5**	**-1.3**	**-1.2**	**-1.2**	**-1.2**
General government budget balance	3, 145.3	1, 224.3	821.8	521.1	292.4	349.1	369.6	395.9
Tax revenue	8, 973.7	9, 715.9	10, 251.9	10, 729.2	-275.8	-333.8	-353.2	-377.4
Personal Income Tax	1, 730.7	1, 875.9	1, 954.0	2, 047.2	-56.3	-68.1	-71.0	-75.8
Corporate Income Tax	251.8	294.3	309.7	325.0	-8.2	-10.7	-11.3	-12.0
Value Added Tax	2, 649.5	2, 869.7	3, 071.9	3, 259.2	-86.1	-104.2	-111.6	-120.7
Mandatory state social security contributions[12]	2, 771.0	3, 030.5	3, 221.2	3, 364.2	-90.1	-110.0	-117.0	-124.6
Excise Duty	1, 082.2	1, 126.3	1, 162.8	1, 190.4	-35.2	-40.9	-42.3	-44.1
Non-tax revenue	626.3	534.6	526.7	494.3	-16.6	-15.0	-14.6	-13.5
Interest expenditure	262.2	242.5	241.7	244.2	0.0	0.3	1.8	5.0
General government debt, % of GDP	**51.5**	**54.2**	**53.6**	**54.3**	**2.6**	**3.9**	**4.8**	**5.8**

Upon implementation of the pessimistic scenario of the economic development, under the influence of the tax revenue decrease the state budget deficit would grow, as a result whereof the overall funding need would increase and, correspondingly, also the lending volume for the respective period, as compared to the baseline scenario. Additional borrowing would generate the interest expenditure growth. In case of the pessimistic scenario, the interest expenditure in 2021 would remain unchanged, but in 2022 they would be by 0.3 million euro larger, in 2023 - by 1.8 million euro larger and in 2024, correspondingly, by 5 million euro larger than in the baseline scenario.

4.3. Comparison of the General Government Budget Balance and Debt Forecasts with the Latvia's Stability Programme for 2020 – 2023

In 2020, the development of gross domestic product was better than envisaged by Covid-19 scenario of Latvia's Stability programme for 2020 - 2023. As previously forecasted, numerous restrictions for containment of Covid-19 pandemic left an adverse effect on economy, especially in the service sectors. Household spending decreased. Nevertheless, the scope of impact of the referred to restriction could not be fully assessed, because Latvian economy is facing such situation for the first time ever. Large fluctuations have been observed in number of macroeconomic indicators in the 2nd and the 3rd quarter of 2020. For example, in

[12] Deducting contributions into the State funded pension scheme and contributions into the 3rd pension pillar

the 2nd quarter private consumption decreased by 18%, whereas in the 3rd quarter the rise of private consumption was observed by 17% as compared to the previous quarter.

Forecasts for 2021 have also been made under the circumstances of large uncertainty and the correction of the growth of gross domestic product is related to base effects or the achieved level of gross domestic product, having a statistically positive impact on further periods. In turn, during the further periods gross domestic product converges to long-term growth level, being close to the assessment of the previous forecasts.

Table 4.7. Comparison with the forecasts of the Stability Programme for 2020–2023

	ESA code	2020	2021	2022	2023	2024
GDP growth (%)	B1y					
Year 2020 (Covid-19 impact scenario)		-7.0	1.0	3.5	2.4	-
2021		-3.6	3.0	4.5	3.2	2.8
Changes		3.4	2.0	1.0	0.8	-
Actual budget balance (% of GDP)	B.9					
Year 2020 (Covid-19 impact scenario)		-9.4	-5.0	-3.9	-2.7	-
2021		-5.4	-9.3	-2.7	-1.3	-0.3
Changes		4.1	-4.3	1.3	1.4	-
General government debt (% of GDP)						
Year 2020 (Covid-19 impact scenario)		51.7	52.2	53.3	53.1	-
2021		43.5	48.9	50.3	48.8	48.5
Changes		-8.2	-3.3	-3.0	-4.3	-

According to the assessment of the Ministry of Finance general government budget deficit in 2020 comprised 4.5% of gross domestic product, which is considerably lower than forecasted in Latvia's Stability Programme for 2020 - 2023, when, given high uncertainty with respect to the development of Covid-19 pandemic, the deficit for 2020 had been forecasted to amount to 9.4% of gross domestic product. Along with a steeper Covid-19 spread continuing at the end of 2020 and at the beginning of 2021, support measures create larger-than-forecasted impact this year, as a result, the general government budget deficit, in 2021, is forecasted higher, namely, in the amount of 9.3% of gross domestic product, instead of the previously planned 5.0% of gross domestic product. In case of a successful implementation of vaccination plan, along with the economic development accelerating and tax revenue growing, the general government budget deficit, in the medium term, would reduce.

General government debt forecast has been decreased in 2021 - 2023, as compared to the forecasts of the Covid-19 impact scenario of the Stability Programme for 2020 - 2023 (see Table 4.8). Changes were attributable to the fact that, considered Covid-19 outbreak, state budget balance and debt forecasts in Spring 2020 were prepared under the circumstances of an extremely high uncertainty. In turn, actual financial requirement in 2020 was smaller than forecasted, because the state budget fulfilment indicators were more positive than estimated at the beginning of Covid-19 pandemic, as well as the funding granted for implementing the support measures adopted by the government and the *Saeima* were spent gradually.

Medium-term general government debt forecast is being prepared under the circumstances of still high uncertainty, considering further impact of Covid-19 outbreak on the macroeconomic and state budget fiscal indicators.

5. Quality of Public Finances

5.1. Efficiency of the State Budget Resources and Expenditure Control

Procedures for the development, approval and implementation of the State budget and responsibilities within the budgeting process are determined by the Law on Budget and Financial Management.

According to the Law on Budget and Financial Management, the Minister for Finance shall ensure the development of the Draft Annual State Budget Law, on the basis of the Framework Law and budgetary requests. The Minister for Finance shall evaluate the conformity of the budgetary requests with the budgetary purposes and priority courses of development prescribed by the Framework Law, as well as with the principles of economy and efficiency and, if necessary, shall request necessary additional information. Based in the evaluation and the provided information, the Minister for Finance, until the submission of the Draft Annual State Budget Law to the Cabinet, shall take a decision regarding inclusion of the budgetary requests in the Draft Annual State Budget Law. The Minister for Finance may, at any stage of the examination of the Draft Annual State Budget Law, express their point of view; add the necessary opinions, as well as the results of separate audits.

The Minister for Finance shall also be responsible for the organisation and management of the State budget implementation process, as well as the supervision of the operation of the Treasury in accordance with the requirements of the Law on Budget and Financial Management.

The Minister for Finance during the development of the Draft Annual State Budget Law or amendments thereof shall inform the Budget and Finance (Tax) Committee of the *Saeima* on the course of the State budget planning, as well as no less than once in a quarter – on the course of implementation of the State budget.

According to the Law on Budget and Financial Management, heads of bodies financed from the budget, institutions non-financed from the budget and local governments, as well as of capital companies, in which a State or local government capital share has been invested, shall be responsible for the observance, implementation and control of the procedures and requirements prescribed by the above mentioned law, as well as for the efficient and economic utilisation of budgetary funds in conformity with purposes intended.

As of 1 January 2016, the Law on Budget and Financial Management requires the Cabinet to ensure the constant and systematic revision of State budget expenditure, allowing for a more efficient and economic implementation of State policy, as well as optimizing budget expenditure and evaluating the conformity thereof to the priorities and objectives set in the development planning documents. Accordingly, on an annual basis, the Minister of Finance submits to the Cabinet the results of the State budget spending review and proposals for the use of these results in the process of developing the Framework Law and the draft annual State budget law.

The scope for 2021 includes three main areas, which provide the analysis of financing policies under the supervision of line ministries, horizontal measures for the resource allocation in favour of the current priorities and improvement of processes and systems (see figure 5.1.).

Analysis of the financing policies under the supervision of line ministries

Horizontal measures for the resource allocation in favor of the current priorities

Carry out an analysis of the line ministry budgets, including the analysis of the funding of the sector policies and areas under the supervision of the line ministries and a **horizontal review of the state budget programs** to ensure more economical and efficient implementation of the functions financed by the state budget, reduce administrative burden and, if necessary, propose policy changes.

In accordance with Paragraphs 8.2, 8.9, 16, 18, 19, 20, 21, 22 and 32 of the Protocol Decision (No. 46 §46) of the Cabinet of Ministers sitting (August 18, 2020), **ministries until June 4, 2021** have to submit relevant proposals and information to the Ministry of Finance for inclusion in the Spending review report and proposals of the Spending review results for the use in the process of drafting the medium term budget framework law and the annual State budget law.

Process and system improvement

Improvement of the state budget planning and execution process management framework, including the introduction of preconditions for wider use of automated data processing systems in the budget management process (e.g. reviews, reports, information automation and exchange).

Figure 5.1.: Scope of Spending Review 2021

State budget consists of budget programmes where the structure is determined by the operational (action) course defined in the institution’s operational strategy or functions defined in the regulation of the ministry or other central State institution. Thus, the budget development is linked to the policy planning, as one of the institution’s operational strategy objectives in the medium term is to ensure that budget programmes provide the achievement of objectives, planned results and performance indicators, which are defined in the development planning documents. Each year, ministries and other central State institutions in their budget requests include operating results of the budget programmes, which, whenever possible, are developed in accordance with planned operating results and performance indicators of the development planning documents. By enhancing the content of the budget explanations aimed at providing information about the State budget as the policy implementation instrument and increasing the perceptibility of information contained in the budget explanations, the Policy and Resource Management

Scorecards have been introduced, providing an in-depth insight to invested resources (financial and human resources) to achieve sectoral policy outcomes and on the benefits for society as a result of sectoral activity.

In addition, the enhanced budget format has provided the possibility, in an interactive and demonstrative manner, to inform the population in Latvia about the fields where and the amount in which the taxpayers' money is being invested and what are the expected outcomes. Any interested person has access to the following on the Ministry of Finance website:

- Interactive budget infographics, which allows the user to get acquainted with nine budget investment areas (for example, health, education, social protection, etc.) and the allocated funding, as well as to find out detailed information on the investment directions in each area and funding sources. Additionally, information is provided on the results that can be expected from the investment of State budget funding into the relevant area;
- Budgets of the ministries and other central State institutions are visualised both in summarised form and in more detail. The user can view the fields of operation of the ministries, other central State institutions, and the financing allocated thereto, as well as to get an insight regarding the benefits for society in the result of sectoral activity. It is reflected in the Policy and Resource Management Scorecards, which in a summarised form provide possibly comprehensive and characteristic information on sectoral activity in the relevant field – the goal, inputs for the achievement thereof, expected operational outputs and the highest-level sectoral policy and quality outcomes to be achieved.

When preparing a report on the analysis on the State budget execution, ministries and other central State institutions shall provide explanations about previously planned results and performance indicators thereof, their implementation during the year, as well as explanations about the deviations in values of the achieved and planned performance indicators if they exceed 15 per cent (both in positive and negative terms). The Ministry of Finance aggregates, assesses, and ensures the accumulation of the outcomes specified in the Policy and Resource Management Scorecards and the performance indicators thereof, as well as the operational outputs of the State budget programmes (sub-programmes) and their performance indicators.

The Law on Budget and Financial Management prescribes the following organisational aspects of the State budget implementation:

- Persons implementing the State budget may make the budget expenditure or assume short-term liabilities only within the limits of the assignations determined by financing plans issued by the Treasury. In turn, the Treasury provides allocations for expenditure according to the appropriation stated in the Annual State Budget Law and ensures their execution according to the procedures prescribed by the Cabinet. Ministries and other central State authorities are responsible for the development of the system of control over the fulfilment of the appropriations determined in the Annual State Budget Law and for the control over expenditure of the State budget funds transferred into the current accounts of the Treasury in accordance with the purposes intended;

- State-financed institutions may undertake long-term liabilities of the State budget, not exceeding the ceilings of the State budget long-term liabilities for a financial year that are prescribed by the Law on the State Budget;
- State budget institutions for the receipt of assignations and for the making of expenditure from the State budget, funds shall open the State basic budget and State special budget accounts only with the Treasury. Institutions non-financed from the budget shall open current accounts only with the Treasury. Bodies financed from the budget, except for the State budget institutions, for the receipt of the State budget funds and for the making of expenditure financed therefrom shall open current accounts only with the Treasury, unless provided for otherwise in other regulatory enactments. Local governments, derived public persons partially financed from the State budget and capital companies in which a State or local government capital share is invested, may open current accounts with the Treasury for the cash funds not received from the State budget;
- ministries and other central State budget instructions and local government according to the procedures prescribed by the Cabinet, shall prepare and submit to the Treasury the quarterly reports, in turn, the Treasury shall arrange for the accounting of the State budget finances; The Treasury shall prepare regular official and operative statements and provide information regarding the State and local government budget execution, ensuring the informing of the Ministry of Finance, other institutions, as well as public regarding the process of the budget execution.

In order to strengthen the possibilities to control the utilization of resources, the Law on Budget and Financial Management provides that the Minister for Finance has the right to issue an order to the Treasury to delay or reduce assignations for a certain period if at least one of the following conditions exist:

- within the time period of three months, the actual revenues from the State budget taxes and non-taxes in respect to the anticipated revenues in the relevant period decreases by more than 0.5% of the forecast of the GDP determined in the annual State Budget Law or the actual accumulated State budget financial deficit within the time period of three months exceeds the State budget financial deficit anticipated for the relevant time period by more than 0.5% of the forecast of GDP determined in the annual State Budget Law, or there is no sufficient amount of funds in the budgetary accounts of the Treasury to cover payment commitments planned for the next month;
- if the Minister for Finance has received a written notification regarding the occurrence of the condition referred to in Clause 1 of this Section.

The Law on Budget and Financial Management provides for the following main sanctions in case of inappropriate utilization of budget resources:

- for late or incomplete payment of the amounts to the State budget into Treasury budget accounts, the Treasury, unless this is under the competency of another State agency, shall recover the amount not paid into revenue of the basic budget and may charge the late charges in the amount of 0.1% of the amount not paid in time for each late day of payment unless provided otherwise by regulatory enactments;
- in order to cover losses caused to the budget, the Treasury may include amounts in the basic budget revenue and withdraw or suspend assignations, if the reports on budget and financial management have not been submitted in time or are incomplete; the budgetary funds and transactions in such funds have not been registered in accordance with the procedures prescribed by law or notice has not been given regarding them; the accounting does not comply with the prescribed procedures and, thus, funds due to the budget are concealed; if a manager of a body financed from the budget has undertaken liabilities exceeding the assignation allocated by the Treasury;
- if bodies financed from the budget, institutions non-financed from the budget and local governments, as well as capital companies, in which a State or local government capital share has been invested, have violated financial management provisions provided for in the Law on Budget and Financial Management the Minister for Finance, the Treasurer or the heads of ministries and other central State institutions may in accordance with the competence withdraw for a period of time an authorisation to assign or deal with budgetary revenue or expenditures; set limitations on the use of accounts; withdraw or suspend the assignations in order that the illegally used funds be refunded or require refunding of the illegally used funds; submit a civil claim to a court or provide materials to competent officials for deciding on the issue of initiation of criminal proceedings; or withdraw or suspend payments;
- the Treasury, in accordance with the Law on Equalisation of Local Government Finances is entitled, by uncontested procedure, to recover from local government budget funds the amount, which the relevant local government has not in time or in full amount included in the local government finance equalisation fund, by writing off such amounts from the budget of the relevant local government.

In order to maintain general economic balance and to ensure a uniform State financial policy, the amounts of total increase in local government borrowings and guarantees shall be separately prescribed in the Annual State Budget Law.

The Treasury has the right to withhold the sums from the amount, which is due to the local government from personal income tax, or from a grant of the local government financial equalisation fund in the following cases and amount:

- if the local government does not ensure timely fulfilment of the liabilities specified in State loan agreements – in the amount of sum not paid timely;
- if local government does not ensure use of the State loan in compliance with the purpose specified in the loan agreement – according to the order of the Minister for Finance in the amount of the loan sum used in non-compliance with the purpose specified in the agreement.

5.2. Efficiency of Revenue Structure and System

In 2020, it was planned to develop and approve the National Tax Policy Guidelines for 2021 - 2025. Work on the development of the National Tax Policy Guidelines for 2021 - 2025 was suspended, because the spread of Covid-19 in the world and in Latvia, as well as the impact of the set restrictions on possible economic growth and national economy could not be clearly determined.

During Covid-19 infection crisis, several flaws of the existing tax system in the country were identified, *inter alia*, lack of social protection for those employed in the alternative tax regimes, the solution whereof required immediate decisions, as a result, on 2 September 2020, the informative notification was reviewed in the Cabinet "On the courses of development of tax policy for promoting social sustainability and economic competitiveness of the country", in order to solve the issue of insufficient state social security for a large part of society that has become topical under the crisis caused by Covid-19, as well as in order to improve the competitiveness of labour taxes and reduce income inequality among the working population by tax policy.

The following tax policy changes were introduced, in order to solve the identified problems:

- to reduce the labour tax burden and promote improvement of competitiveness of the enterprises, the rate of the state social security contributions was reduced from 35.09% to 34.09%, and the threshold for application of differentiated non-taxable minimum of the personal income tax was increased as well, - from 1, 200 *euro* to 1, 800 *euro* per month;
- to improve the social security of population, the introduction of the minimum amount of the mandatory state social security contributions and reorganisation of the alternative tax regimes has been performed.

Additionally, there were changes introduced also in other taxes:

- excise duty rates for tobacco products were increased;
- changes were introduced in the company car tax and vehicle operation tax.

Table 5.1. Tax Revenue in General Government Budget (S.13), million euro

	Code (ESA)	2020	2021	2022	2023	2024
Tax revenue						
1. Production and import taxes	D.2	4, 180.3	4, 436.1	4, 714.5	4, 950.4	5, 183.0
2. Current income and wealth taxes	D.5	2, 108.5	2, 175.3	2, 364.7	2, 465.5	2, 580.4
3. Capital taxes	D.91	11.5	11.7	12.3	12.8	13.2
4. Social contributions	D.61	3, 022,2	3, 100.7	3, 280.4	3, 465.4	3, 628.2
Of which actual social contributions	*D.611 and D.613*	2, 873.7	2, 952.2	3, 131.8	3, 316.8	3, 479.7

As a result of the introduced changes, the share of labour force taxes will decrease from 47.3% in 2020 to 46.4% in 2024, therefore, the share of revenue from consumption and capital taxes in total tax revenue will gradually increase from 52.7% in 2020 to 53.6% in 2024.

Therewith, the share of labour tax revenue in gross domestic product in 2024, as compared to 2020, will reduce by 0.3 percentage points, but consumption and capital tax revenue from gross domestic product will increase by 1.0 percentage point.

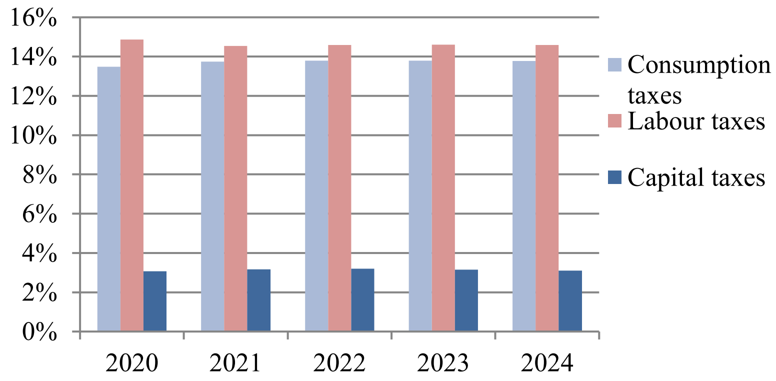


Figure 5.2. Tax Revenue by Economic Function, % of gross domestic product

As the crisis caused by Covid-19 infection continues also in 2021, the following support measures and measures restricting economic activity have been incorporated in the *Law on the Suppression of Consequences of the Spread of Covid-19 Infection*:

- the taxpayer, until 30 June 2021, may apply for the extension of the tax payment term for up to three years, if the delay in the term has been caused due to the spread of Covid-19;
- cancellation of the personal income tax advance payments in 2021;
- prohibition to organise gambling and lotteries (except for interactive gambling, numerical lotteries, and instant lotteries) and suspension of the licences to operate gambling. Tax is calculated in proportion to those calendar days of the month, when it is allowed to organise gambling;
- disbursement of one-off benefit in the amount of 500 euro for each child and disbursement of one-off benefit in the amount of 200 euro for a person born in Latvia, who, during the time period from 1 March 2021 till the end

of the state of emergency declared due to Covid-19 spread, is the recipient of the old-age, disability or survivor's pension or the recipient of a disabled child’s care benefit, or the recipient of a benefit for disabled persons requiring care.

Value Added Tax

In the baseline scenario, the dynamics of the value added tax revenue reflects the projected economic development of the country that is determined by the recovery of Latvia’s and global economy from Covid-19 and implementation of the European Recovery and Resilience Facility.

Value added tax revenue in 2021 will also be influenced by the amendments adopted in the previous years to the *Value Added Tax Law*, for instance, the rules for simplification of value added tax application in the field of e-commerce introduced as of 1 January 2021 and preservation of value added tax reduced 5% rate for fruits, berries and vegetables till 31 December 2023.

In addition to the above mentioned changes, the value added tax revenue is also influenced by other measures, which are not directly related to the changes in the *Value Added Tax Law*, but will contribute to the increase of the revenue, for example, changes in the application of the excise duty, increase of the monthly wage for medical persons and teachers and other (see Table 5.2 reflecting all the measures of tax policy influencing the value added tax revenue).

Table 5.2. Impact of the Changes in Tax Policy [13] on Value Added Tax Revenue, million euro

	2021	2022	2023	2024
Increase of the excise duty rates for alcoholic beverages and beer as of 1 March 2020	0.7			
VAT reduced 5% rate for fruits, berries and vegetables till 31 December 2020	3.8			
Measure for restricting shadow economy – Empowering the State Revenue Service to provide information about high-risk counterparties	0.3			
Clarification of the definition of interim products for the excise duty from the alcoholic beverages as of 1 May 2020	0.7			
Introduction of extensions of the terms under COVID-19 granted in 2021 for the period of three years	-7.3			
Change of procedure for VAT refunds	60.0			
Increase of the minimum monthly wage from 430 euro to 500 euro as of 2021	3.8			
Simplification of VAT application rules in the field of e-commerce	10.4			
Amendments to the *Receipt Lottery Law*	0.7			
Preservation of VAT reduced 5% rate for fruits, berries and vegetables till 31 December 2023	-3.0			3.0
Abolition of the excise duty exemption for natural gas, which is used for heat supply of covered areas (greenhouses) of agricultural land according and heat supply of industrial poultry holdings (poultry house) and incubators	0.01			
Increase and restructuring of the excise duty rates for cigarettes as of 1 March 2021, 1 January 2022 and 1 January 2023; increase of the rates for cigars, cigarillos, smoking, heated tobacco and e-cigarette liquids as of 1 January 2021, 2022 and 2023	1.3	1.1	0.6	
Total impact of changes:	**71.3**	**1.1**	**0.6**	**3.0**

Corporate Income Tax

As of 2018, a conceptually new corporate income tax payment regime has been introduced. The referred to model provides to postpone the moment of payment of tax till the time, when the profit is allocated or otherwise attributed to expenditure, which do not ensure further development of the company.

Corporate income tax revenue, in 2021 and the coming years, will be influenced by the previously adopted legislative changes with respect to increase of intensity of charitable donation allowance to 85% of the sum of charitable donation and not exceeding 30% of the tax amount for dividends (with a specified term by 2023).

[13] Here and in subsequent tables, showing the impact of tax policy changes, the annual impact of introduction is presented.

Table 5.3. Impact of the Changes in Tax Policy on Corporate Income Tax Revenue, million euro

	2021	2022	2023	2024
Increase of intensity of allowance for charitable donations (for a specified period of time till 2022)			+5.1	
Total impact of changes:			**+5.1**	

Excise Duty

Gradual increase of the excise duty on alcoholic beverages and beer had already been planned by the amendments to the Law on Excise Duties adopted in the Saeima on 27 July 2017, which stipulated to increase the rates as of 1 March 2018, 2019 and 2020. Nevertheless, given the policy of the excise duty on alcoholic beverages and beer in the rest of the Baltic States and the cross-border trade taking place in the Latvian-Estonian border area, by the amendments to the Law on Excise Duts adopted in the Saeima on 8 July 2019, the excise duty rate for other alcoholic beverages for the period of time from 1 August 2019 till 29 February 2020 had been reduced to 1, 564 *euro* per 100 litres of absolute alcohol.

To prevent the adverse effect from deceleration of the growth rate of consumption of alcoholic beverages on Latvian merchants, carrying out activities with alcoholic beverages, on 20 February 2020, the Saeima resolved, in lieu of the previously planned increase of the rates (by 29.5% for strong alcohol, and by about 10% for other types of alcoholic beverages and beer) as of 1 March 2020, to determine gradual increase of the excise duty rates - to increase the excise duty rates for all alcoholic beverages, except for fermented beverages with absolute alcohol content up to 6 volume percent, and for beer, on average, by 5 per cent in 2020 and 2021. Table 5.4 reflects the result of total changes with respect to alcoholic beverages and beer.

Table 5.4. Excise Duty Rates for Alcoholic Beverages and Beer

Type of alcoholic beverage	Effective date of the rate		
	1 March 2019	1 March 2020	1 March 2021
Wine, fermented beverages with pure alcohol content exceeding 6 volume percent and interim products with absolute alcohol content of up to 15 volume percent, euro per 100 litres	*101.0*	*106.0*	*111.0*
Fermented beverages with absolute alcohol content up to 6 volume percent, euro per 100 litres	*64.0*	*64.0*	*64.0*
Interim products with absolute alcohol content from 15 volume percent to 22 volume percent, euro per 100 litres	*168.0*	*176.0*	*185.0*
Other alcoholic beverages, euro per 100 litres of pure alcohol	*1, 840.0/ 1, 564.0**	*1, 642.0*	*1, 724.0*
Beer, euro per each volume percent of pure alcohol per 100 litres	*7.4*	*7.8*	*8.2*
Minimum level of excise duty, euro per 100 litres of beer	*13.6*	*14.4*	*15.2*

**the rate in effect from 1 August 2019*

According to the amendments to the law *On Excise Duties* adopted by the Saeima on 24 November 2020 the following excise duty changes are stipulated for tobacco products and liquids to be used in electronic cigarettes:

- as of 1 January 2021, the excise duty rate for liquids to be used in electronic cigarettes has been simplified and increased, prescribing the rate of 0.12 euro per millilitre of liquid, irrespective of the nicotine content, increasing it to 0.16 euro as of 1 January 2022 and to 0.20 euro per millilitre of liquid as of 1 January 2023. As of 1 January 2021, the excise duty shall be applied also to ingredients of liquids to be used in electronic cigarettes (propylene-glycol, flavourings, plant origin glycerine and nicotine extracts), being broadly offered in the Latvian market and acquired by consumers, in order to prepare the liquid to be used in electronic cigarettes, thus evading the excise duty payment;
- as of 1 January 2021, the excise duty rate has been increased for cigars, cigarillos, smoking and heating tobacco and tobacco leaves, with a further increase thereof being planned also as of 1 January 2022 and 2023;
- as of 1 January 2021, the excise duty rate is applied also to tobacco substitute products (for example, nicotine-containing pouches), with an increase thereof being planned also as of 1 January 2022 and 2023;
- as of 1 March 2021, the excise duty rate and the minimum level thereof has been increased for cigarettes, at the same time reducing the percentage share of tax from 20% to 15%. Increase of the rates, though without changing the percentage share of tax, is also planned as of 1 January 2022 and 2023.

Table 5.5 aggregates the excise duty rates for tobacco products.

Table 5.5. Excise Duty Rates for Tobacco Products in 2020 - 2023

Type of tobacco product	**2020**	**Effective date of the rate**		
Cigarettes	**1 July 2019**	**1 March 2021**	**1 January 2022**	**1 January 2023**
Tax rate per 1, 000 cigarettes, euro	78.70	92.50	98.00	104.00
Minimum level of tax per 1, 000 cigarettes, euro	114.70	121.40	128.40	135.90
Ad Valorem, %	20.0	15.0	15.0	15.0
Cigars, cigarillos	**1 January 2020**	**1 January 2021**	**1 January 2022**	**1 January 2023**
Tax rate, per 1, 000 pieces, euro	95.20	104.7	115.20	126.70
Smoking tobacco, tobacco leaves	**1 January 2020**	**1 January 2021**	**1 January 2022**	**1 January 2023**
Tax rate, per 1, 000 g, euro	75.00	80.25	85.90	91.90
Heated tobacco	**1 January 2020**	**1 January 2021**	**1 January 2022**	**1 January 2023**
Tax rate, per 1, 000 g, euro	75.00	160.00	207.00	218.00
Tobacco substitute products	**1 January 2020**	**1 January 2021**	**1 January 2022**	**1 January 2023**
Tax rate, per 1, 000 g, euro	-	80.00	100.00	120.00

According to the referred to amendments, for the period of time from 1 January 2021 till 31 December 2025, the excise duty for natural gas, used as a motor fuel, has been reduced from 9.64 euro per MWh to 1.91 euro per MWh. As of 1 January 2026, the rate is set in the amount of 10.0 euro per MWh. The reduction of the excise duty rate for natural gas to be used as motor fuel would not have a material adverse effect on the state budget revenue.

In turn, according to the amendments to the law *On Excise Duties*, adopted on 17 December 2020:

- as of 1 February 2021:
  - a reduced excise duty rate for biodiesel fuel used as a motor fuel was cancelled, and a minimum duty rate was applied in the amount of 330 euro per 1, 000 litres of biodiesel fuel fully obtained from biomass, and paraffin waxed diesel fuel obtained from biomass;
  - a reduced duty rate was increased from 152.7 euro to 360 euro per 1, 000 litres of unleaded petrol with high bio-ethanol content (from 70 - 85 volume percent) (fuel E85);
- as of 1 July 2021:
  - a reduced excise duty rate for biodiesel fuel used as a heating fuel will be cancelled, and a minimum rate will be applied in the amount of 21.0 euro per 1, 000 litres of biodiesel fuel fully obtained from biomass, and paraffin waxed diesel fuel obtained from biomass, providing that the referred to product are marked (labelled);
  - a single duty rate will be determined for oil products used as a heating fuel, applying 60.0 euro per 1, 000 litres, irrespective of biofuel admixture, if the relevant oil products are marked (labelled).

In addition to the above-mentioned changes in the excise duty rates, excise duty revenue in 2021 is also influenced by the amendments to the law *On Excise Duties* adopted on 6 February 2020:

- as of 1 May 2020, the definition of intermediate products was adjusted, preventing incorrect application of excise duty rate to alcoholic cocktails, thus evading the tax payment in full amount;
- as of 1 May 2020, the excise duty exemption was abolished for natural gas, which is used for heat supply of covered areas (greenhouses) of agricultural land and heat supply of industrial poultry holdings (poultry house) and incubators;
- as of 1 May 2020, a single approach was ensured to acquisition of diesel fuel with respect to fishermen. The procedure previously prescribed by laws and regulations will be preserved with respect to the border area fishermen - the possibility to acquire diesel fuel exempt of excise duty in port territories for the use thereof on fishing ships in coastal waters. In turn, as regards the fishermen of coastal and inland waters, who cannot find a possibility to acquire diesel fuel exempt of excise duty in port territories for the use thereof on fishing ships in coastal waters, application of reduced excise duty rate is prescribed for labelled diesel fuel for the use thereof on fishing ships in coastal and inland waters, concurrently introducing the excise duty refund for coastal waters' fishermen for the labelled diesel fuel with reduced excise duty rate used on their fishing ships.

By these amendments, it is envisaged to apply an increased excise duty rate for non-alcoholic beverages with sugar content from 8 grams per 100 millilitres - 14.00 euro per 100 litres, as of 1 January 2022.

Table 5.6. Impact of the Changes in Tax Policy on Excise Duty Revenue, million euro

	2021	2022	2023	2024
Increase of the excise duty for alcoholic beverages and beer as of 1 March 2018, 1 March 2019 and 1 March 2020	+3.2			
Slower increase of the excise duty rates for alcoholic beverages starting from 1 March 2020 and from 1 March 2021 (by 5% each year), instead of the previously planned 10% (the planned increase for strong alcohol comprised 29.5%)	+9.2	+1.1		
Slower increase of the excise duty rates for beer starting from 1 March 2020 and from 1 March 2021 (by 5% each year), instead of the previously planned 10%	+4.6	+0.3		
Clarification of the definition of the interim products	+3.3			
Abolition of the excise duty exemption for natural gas, which is used for heat supply of covered areas (greenhouses) of agricultural land according and heat supply of industrial poultry holdings (poultry house) and incubators as of 1 May 2020	+0.05			
Increase and restructuring of the excise duty rates for cigarettes as of 1 March 2021, 1 January 2022 and 1 January 2023 and increase of the rates for cigars, cigarillos, smoking, heated tobacco and e-cigarette liquids as of 1 January 2021, 1 January 2022 and 1 January 2023	+6.2	+5.2	+2.8	
Extensions of the terms granted in 2021 due to Covid-19 spread	-0.9			
Total impact of changes:	**+25.6**	**+6.6**	**+2.8**	

Personal Income Tax

Personal income tax revenue is mainly influenced by the number of population employed in national economic, income of the employed, the amount of the non-taxable minimum and exemptions of the personal income tax, minimum wage, as well as introduced legislative changes. Personal income tax revenue, like with other taxes, has been recently considerably affected by the crisis caused by Covid-19.

Personal income tax revenue will be affected also by the previously approved legislative changes with respect to increase of the non-taxable minimum for pensioners in 2021 up to 330 euro per month, as well as the increase of the minimum monthly wage as of 2021 up to 500 euro per month.

In addition to the above-mentioned, the personal income tax revenue, in the medium term, will be affected by the measures approved during the adoption of the annual budget for 2021, tax support measures approved during Covid-19 crisis, as well as the amendments to the *Law on Receipt Lottery*, prescribing to register for participation in the receipt lottery also the invoices regarding the payment for the received product or services.

Table 5.7. Impact of the Changes in Tax Policy on Personal Income Tax Revenue, million euro

	2021	2022	2023	2024
Increase of the differentiated non-taxable minimum threshold, up to which the differentiated non-taxable minimum applied, to 1, 800 euro per month.	-41.6			
Abolition of advance payments for economic operators in 2020 and 2021 taxation years	+35.0	+35.0	-35.0	
Increase of the non-taxable minimum for pensioners	-11.8			
Introduction of extensions of the terms under COVID-19 granted in 2021 for the period of three years	-3.5			
Reduction of the mandatory State social security contributions by 1 percentage point (from 35.09% to 34.09%).	+6.7			
Introduction of the minimum amount of the mandatory State social security contributions and reorganisation of the microenterprise tax regime	+17.2			
Amendments to the *Receipt Lottery Law*	+0.004			
Increase of the minimum monthly wage from 430 to 500 euro/per month, starting from 2021	+11.9			
Calculation of the personal income tax in cases, when there is information at disposal of the State Revenue Service about the outstanding tax amount	+1.0			
Abolition of restrictions of the operating expenses in the amount of 80% in 2020 and 2021 taxation year	-3.6		+3.6	
Total impact of changes:	**+11.2**	**+35.0**	**-31.4**	

Social Security Contributions[14]

The medium-term dynamics of revenue from social security contributions will be determined not only by the forecasted increase in the wage fund, but also by the changes in the legal framework.

As of 1 January 2021, the amendments to the solidarity tax took effect, providing that the solidarity tax rate is 25.0%, applied to income exceeding 62, 800 euro per year. During the taxation period, the solidarity tax object is taxed by the same rate as the one applied to the object of the mandatory State social security contributions, and the State Revenue Service, by September 1 of the post-taxation year, under the summing-up procedure, performs the solidarity tax refund (difference between the solidarity tax paid in the taxation period, calculated by applying higher rate of the state mandatory social insurance contributions, and the solidarity tax calculated under the summing-up procedure, calculated by applying the solidarity tax rate (25.0%)).

Considering that the solidarity tax rate has been reduced by 0.5 percentage points, as of 1 January 2021, the new sequence of allocation of the solidarity tax has also been set, granting priority to the solidarity-related components:

- in the amount of 1 percentage point for funding health care services;
- in the amount of 14 percentage points into the special budget of the State pensions (up to 2021, they were registered in the personal account of the taxpayer, in accordance with the *Law On State Pensions*. As of 2021, the

[14]Excluding contributions to the State-funded pension scheme.

solidary tax payments will be allocated into the special budget of State pensions in a non-personalised form);

- in the amount of 10 percentage points into the personal income tax account (reduced from 10.5 percentage points to 10.0 percentage points, as of 1 January 2021).

The rate of contributions into the State-funded pension scheme remains unchanged, comprising 6 percentage points of the total rate of mandatory State social security contributions. [15]

The adopted changes in the legal framework affecting the revenue from social security contributions in 2021:

- to reduce the labour tax burden and promote improvement of the competitiveness of enterprises, the rate of mandatory state social security contributions has been reduced by 1 percentage point (from 35.09% to 34.09%);
- as of 1 January 2021, the minimum monthly wage was increased from 430 euro to 500 euro per month;
- introduction of the minimum amount of the mandatory state social security contributions and reorganisation of alternative tax regimes (amendments to the law On the State Social Insurance developed by the Ministry of Welfare and adopted in the *Saeima* on 27 November 2020, based on Sub-clause 2.1, § 45, Minutes No. 51 of the 2 September 2020 Meeting of the Cabinet) and reorganisation of microenterprises tax regime;
- amendments to the *Law on Receipt Lottery*, prescribing to register for participation in the receipt lottery also the invoices regarding the payment for the received product or service.

Table 5.8. Impact of the Changes in Tax Policy on the Revenue from Social Security Contributions[16], million euro

	2021	2022	2023	2024
Increase of the minimum monthly wage from 430 euro to 500 euro as of 2021	+21.6			
Introduction of extensions of the terms under Covid-19 granted in 2021 for the period of three years	-8.3			
Amendments to the Law on Receipt Lottery	+0.02			
Reduction of the mandatory State social security contribution's rate by 1 percentage point	-82.3			
Introduction of the minimum amount of the mandatory State social security contributions and reorganisation of the alternative (*inter alia*, microenterprise) tax regimes	+59.2	+67.4		
Total impact of changes:	**-9.8**	**+67.4**		

[15] According to the methodology of the European System of National and Regional Accounts in the European Union, social security contributions that are being transferred to the State-funded pension scheme are not being accounted as the general government budget revenue.

[16] Except for contributions into State funded pension scheme and payment into the basic budget for funding healthcare

Previously adopted measures also influence the state social security contributions into the basic budget for health funding.

Table 5.9. Impact of the Changes in Tax Policy on the State Social Security Contributions into the Basic Budget for Health Funding, million euro

	2021	2022	2023	2024
Increase of the minimum monthly wage from 430 euro to 500 euro as of 2021	+0.8			
Introduction of extensions of the terms under Covid-19 granted in 2020 for the period of three years	+0.2	+0.5	+1.0	
Introduction of the extensions of terms under Covid-19 granted in 2021 for the period of three years	-1.0	+0.1	+0.2	+0.4
Introduction of the minimum amount of the mandatory State social security contributions and reorganisation of the alternative (*inter alia*, microenterprise) tax regimes	+1.9	+2.7		
Total impact of changes:	**+1.9**	**+3.3**	**+1.2**	**+0.4**

Lotteries and Gambling Tax

Lotteries and gambling tax revenue, in 2021 and henceforth, will mainly be affected by the measures adopted with respect to Covid-19 crisis, mentioning among the most significant ones the prohibition to organise gambling and lotteries (except for interactive gambling, numerical lotteries, and instant lotteries) and suspension of the licences to operate gambling during the state of emergency related to the spread of Covid-19, at the same time keeping accounts of the days, when the prohibition is in effect, within the scope of the relevant month.

Table 5.10. Impact of the Changes in Tax Policy on Lotteries and Gambling Tax Revenue, million euro

	2021	2022	2023	2024
Prohibition to organise gambling and lotteries during the emergency situation	+6.4	+9.8		
Prohibition to organise gambling and lotteries during the emergency situation, keeping accounts of the days, when the prohibition is in effect, within the scope of the relevant month	-4.7	+4.7		
Introduction of extensions of the terms under Covid-19 granted in 2020 and 2021 for the period of three years	-1.4	+1.2	+2.4	+0.8
Total impact of changes:	**+0.3**	**+15.7**	**+2.4**	**+0.8**

Natural Resources Tax

Payments of natural resources tax are directly linked to the economic activities of the Latvian enterprises and the environmental loads caused thereby, as well as the environmental protection measures taken. Therewith, the tax revenue both increases, as the total economic activity grows, and also reduces, as the enterprises and municipalities take the environmental protection measures.

In accordance with the changes in the *Natural Resources Tax Law* adopted by the *Saeima* on 14 November 2019:

- as of 1 January 2021, the natural resources tax rate for CO_2 emissions was increased from 9 euro to 12 euro per ton. It is planned to increase the rate also as of 1 January 2022 - to 15 euro per ton;
- as of 1 January 2021, the tax is also imposed for incineration of municipal waste.

In accordance with the amendments to the *Natural Resources Tax Law* adopted by the *Saeima* on 23 November 2020 there are also several other changes in the natural resources tax planned in 2021 - 2023:

- as of 1 January 2021, the exemption for CO_2 emissions for the use of peat in stationary technological plant is abolished;
- as of 1 January 2021, 2022 and 2023, the natural resources tax rates for disposal (burial) of municipal, production and hazardous waste are increased (see Table 5.11).

Table 5.11. Natural Resources Tax Rates for Waste Disposal in 2020 - 2023, euro

Type of waste	1 January 2020	1 January 2021	1 January 2022	1 January 2023
Municipal waste and production waste which are not deemed as hazardous waste, euro per ton	50.0	65.0	80.0	95.0
Hazardous waste and production waste which are deemed as hazardous waste, euro per ton	60.0	70.0	85.0	100.0

Concurrently, the tax revenue allocation among the state and local government budgets has been changed, by reducing the tax revenue share to be transferred into the state budget for hazardous waste disposal (burial) from 100% to 80%, in 2021, and by reducing the tax revenue share to be transferred into the state budget for municipal waste disposal (burial) from 100% to 90%, in 2022, reducing it further to 85%, in 2023.

- as of 1 January 2021, 2022 and 2023, the tax rates for air pollution are increased (see Table 5.12).
-

Table 5.12. Natural Resources Tax Rates for Air Pollution in 2020 - 2023, euro

	2020	1 January 2021	1 January 2022	1 January 2023
Particles PM_{10}, *euro* per ton	75.0	105.0	120.0	135.0
Ammonia (NH_3), hydrogen sulphide (H_2S) and other inorganic compounds, *euro* per ton	18.50	50.0	70.0	90.0
Sulphur dioxide (SO_2), nitrogen oxides (NOx – sum of nitrogen oxides, recalculated to NO_2), *euro* per ton	85.37	125.0	140.0	160.0

- as of 1 January 2021, 2022 and 2023, the fixed tax payment for C category polluting activity emissions is increased (see Table 5.13).

Table 5.13. Fixed Tax Payment for C Category Polluting Activity in 2020 - 2023, euro

	2020	1 January 2021	1 January 2022	1 January 2023
Fixed tax payment for C category polluting activity, euro	71.14	178.0	200.0	250.0

Table 5.14. Impact of the Changes in Tax Policy on Natural Resources Tax Revenue, million euro

	2021	**2022**	**2023**	**2024**
Increase of the natural resources tax rates for CO_2	+1.0	+1.0		
Imposition of natural resources tax for waste incineration	+0.2			
Increase of natural resources tax rates for municipal and hazardous waste	+2.6	+1.9	+1.7	
Abolition of the exemption for CO_2 emissions for the use of peat in stationary technological plants as of 1 January 2021 and increase of the rate in 2022	+0.05	+0.01		
Increase of natural resources tax rates for air pollution (PM_{10}, NX_3 and NO_x)	+0.6	+0.3	+0.3	
Increase of the fixed tax payment for C category polluting activity	+0.2	+0.1	+0.1	
Total impact of changes:	**+4.7**	**+3.2**	**+2.1**	

6. Sustainability of Public Finances

6.1. The Long-Term Development Scenario of Public Finances

Once every three years, the European Commission, in cooperation with the Member State, within the scope of the Working Group on Ageing Populations of the Economic Policy Committee, develops a long-term ageing-related budgetary expenditure forecasts. The latest budgetary expenditure forecasts, developed by the Working Group in the second half of 2020, will be published in *Ageing Report 2021*.

When updating the public expenditure forecasts till 2070, EUROPOP2019 demographic forecasts prepared by the Statistical Bureau of the European Union *Eurostat*, as well as the forecasts of the macroeconomic indicators for a long term prepared by the European Commission, has been considered. Forecasting methodology, being uniform for all Member State, has been discussed and approved by the Working Group of the Economic Policy Committee, as well as published in *Ageing Report 2021: Underlying Assumptions and Projection Methodologies.*

The base year in EUROPOP2019 forecasts is 2019, and in Latvia, at the beginning of 2019, the number of population comprised 1.92 million people, which is, for example, by 200 thousand less than in 2010. According to the baseline scenario of demographic forecasts, it is being forecasted that the number of population in Latvia will reduce to 1.26 million in 2060 and further on - to 1.08 million people in 2100.

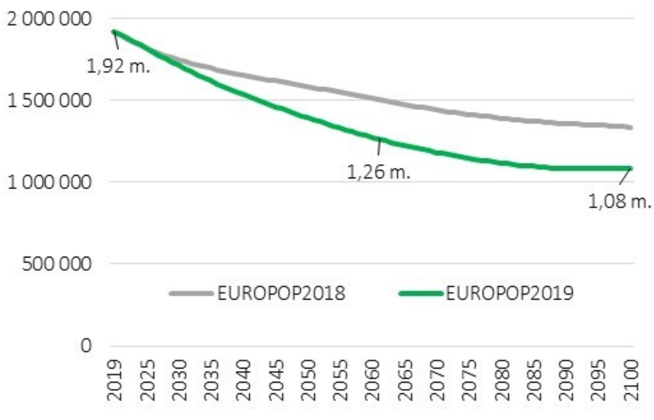


Figure 6.1. Number of population (Data source: Eurostat)

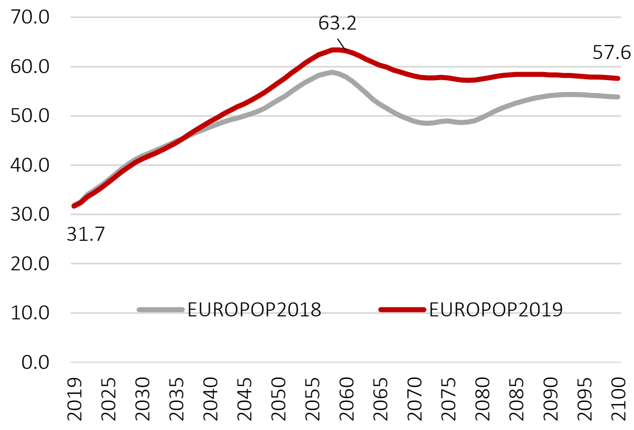


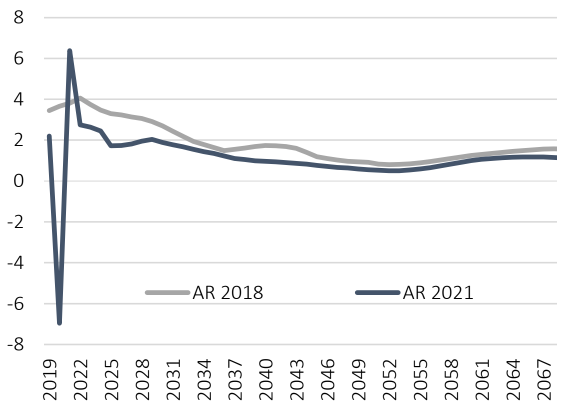
Figure 6.2. Share of population aged 65+, in the number of population aged 15-64, % (Data source: Eurostat)

It should be noted that, as compared to the previous forecast (see Figure 6.1), the updated forecasts of the number of population is more pessimistic, and it is attributable to:

- A lower birth rate than forecasted before. Even though the forecasted aggregated birth rate coefficient is lower, in the long run it will grow from 1.58 in 2019 to 1.73 in 2100. Current statistical data show that the number of new-born children in 2020 was 17.5 thousand and, as compared to 2019, it was by 1.3 thousand or 6.9% less.

- Even though the forecasted death rate is slightly lower than before, *Eurostat* forecasts that the natural growth in Latvia will protractedly remain negative - up to 2100. Current statistical data show that the number of deceased in 2020, as compared to 2019, grew from 27.7 thousand to 28.5 thousand, considering the death rate from Covid-19 infection increasing in the last months of the year. According to *Eurostat* forecasts the impact of Covid-19 on death rate will have a short-term (1 - 2 years) effect.
- Larger 65+ population share in the number of working age population (15-64) (see Figure 6.2) than forecasted before, reaching the highest share - 63.2% of the working age population in 2060. In the long term, increase of an elderly population share in the number of population aged 15-64 will be influenced by the increase of the lifespan, which according to *Eurostat* forecasts will grow on average from 70.6 years in 2019 to 87.6 years in 2100 for men, while for women it will grow on average, from 80.2 years in 2019 to 92.1 year in 2100. Likewise, also the proportion of population aged 65+ to population aged 15-64 population in the long term will be influence by decline in the number of working age population according to *Eurostat* forecasts.
- Changes in migration model. By applying new methodology to migration, all Member States are having more negative migration balance than forecasted before. For Latvia, till 2065, *Eurostat* forecasts that more population will leave the country than enter it, however, during the time period from 2065 till 2100 the forecasted migration balance is positive.

When preparing the long-term forecasts of macroeconomic indicators and using the assumptions approved by the Working Group of Economic Policy Committee, the European Commission forecasts that Latvia's gross domestic product will continue growing, on average, by 1.2% during the time period from 2019 till 2070. As compared to the previous forecasts, the growth is forecasted at a slightly slower rate (See Figure 6.3), mainly, considering the impact of economic crisis caused by Covid-19, as well as the reduction of the forecasted total number of hours worked in economy, on average, by 1.1% in 2019 - 2070, along with a steeper decline in the number of working age population than forecasted before. It should be noted that the European Commission forecasts that the employment rate during the time period from 2019 till 2032 will reduce from 72.5% to 68.2%, but will, nevertheless, gradually grow afterwards, until it reaches 71.3% in 2070. Notwithstanding the growth of employment rate, it is forecasted that, in total, the number of the employed will decrease, in the long term, along with decline in the number of working age population (See Figure 6.4).



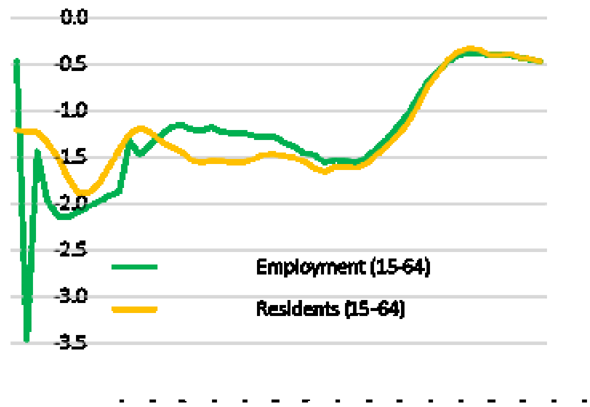


Figure 6.3. Growth of the real gross domestic product % (Data source: *Ageing Report 2021, Part I*)

***Figure 6.4.* Increase of the working population and employment, % (Data source: *Ageing Report 2021, Part I*)**

Demographic and economic, especially, labour market situation will have a long-term influence on the sustainability of public finances, creating impact on both the tax revenue and the budget expenditure. The amount of collected taxes will depend upon the long-term trends in the number of the employed, and the long-term growth of budget expenditure will also be affected by the obligations assumed already before for the disbursement of pensions and benefits, debt service expenses, as well as the growth in expenditure related to ageing of population.

The Working Group on Ageing Populations of the Economic Policy Committee, considering the updated long-term demographic and macroeconomic forecasts, has updated the forecasts of expenditure related to ageing of population up to 2070. In the nearest future, they will be published in the second part of Ageing Report 2021.

According to the baseline scenario ageing-related public expenditure in 2070, as compared to 2019, will reduce by 0.6 percentage points and will comprise 15.2% of gross domestic product (Figure 6.5). The tendency of long-term reduction of expenditure, in total, remains similar to that of the previous forecasts. It should be noted that the forecasts have been prepared at a constant policy scenario, namely, considering the legislative changes adopted till October 2020.

Forecasts of expenditure for pensions are based upon (see Figure 6.6) the forecasts prepared by the Ministry of Welfare, providing for reduction of the pension expenditure share in gross domestic product from 7.1% of gross domestic product in 2019 to 5.8% of gross domestic product on 2070. Reduction of expenditure, especially till 2025, is promoted by increase of the retirement age, resulting in decline in the number of recipients of pensions and the pre-retirement aged population staying longer in the labour market.

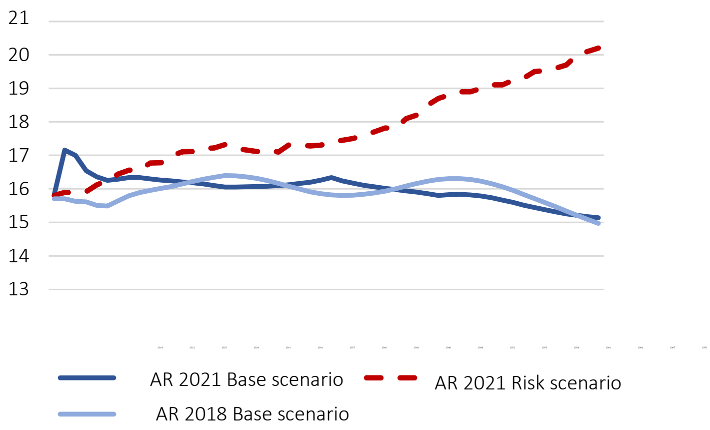


Figure 6.5. Ageing-related public expenditure in the baseline and risk scenario, % of gross domestic product (Data source: Working Group on Ageing Populations of the Economic Policy Committee)

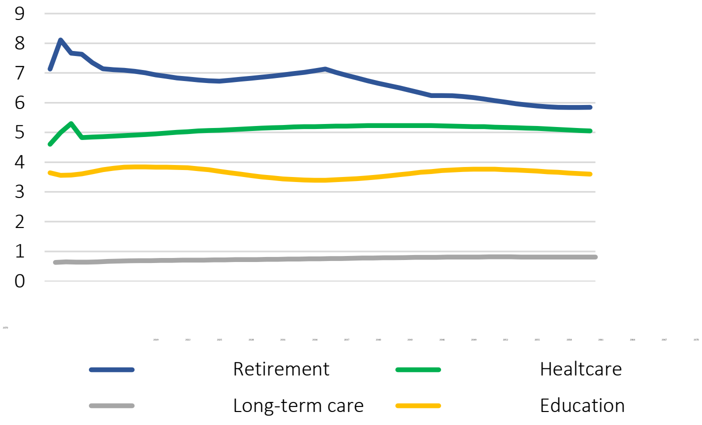


Figure 6.6. Ageing-related public expenditure by items, % of gross domestic product (Data source: Working Group on Ageing Populations of the Economic Policy Committee)

It should be noted that the long-term reduction of the share of pension expenditure in gross domestic product will, most likely, improve fiscal sustainability assessment, which the European Commission is still to prepare in the second half of this year, however, at the same time, the issue on sufficiency of pensions remains open.

When preparing the forecasts, mainly the following legislative changes were considered:

- Starting from 2014, the retirement age is being gradually increased - by three months annually, until the age of 65 years will be reached in 2025. Persons whose insurance period is at least 30 years are eligible to retire earlier - two years before reaching the general retirement age.
- From 2018, when the persons, whose insurance period is less than 15 years and who are not eligible to the state old-age pension, in accordance with the *Law on State Social Allowances*, reach the retirement age, they shall be granted by the State social security benefit disbursed from the state basic budget funds. The necessary insurance period as of 2025 - 20 years.
- From 1 October 2019, the actual consumer price index and 80% (previously - 70%) of the real growth percentage of the sum of wages of security (insurance) contributions will be applied in pension indexation for the old-age pensions calculated for 45 and more years of insurance period.
- From 1 October 2019, the amount of supplement per each year of insurance period accrued up to 31 December 1995 (1.50 *euro* for

pensions granted up to 1996 and 1 *euro* for pensions granted from 1997), is revised considering the actual consumer price index and 50% of the real growth of wages subject to insurance contributions.

- Starting from 2020, it is possible to leave the State-funded pension capital as inheritance or to add it to the pension capital of designated person, in case, if a person dies before the retirement age.
- On 1 October 2020, pensions and indemnities or the amount of the parts thereof not exceeding 454 euro per months were indexed. Old-age, invalidity, retirement and survivor's pensions and indemnities granted or recalculated until 30 September 2020 will be indexed.

It is forecasted that expenditure for health care will increase in the long term from 4.6% of gross domestic product in 2019 to 5.1% of gross domestic product in 2070, mainly, considering the ageing of population, with the lifespan and the need for health care services growing. In 2020 - 2021, the health expenditure share in gross domestic product, considering both the fall in gross domestic product and additional funding for combating Covid-19 - medicinal equipment, personal protection equipment, infrastructure improvement - will temporarily grow to 5.0 - 5.3% of gross domestic product.

In addition to the baseline scenario, the Working Group has also developed several alternative scenarios by different assumptions, and, in the risk scenario, it is forecasted that the public expenditure related to ageing of population, contrary to the baseline scenario, as compared to 2019, might increase by 4.4 percentage points, and reach 20.2% of gross domestic product in 2070. In the risk scenario, expenditure would mainly increase for health care and long-term care, considering both possible rise in costs, along with development of technologies, and with the costs per 1 recipient converging with the average indicators of the European Union.

6.2. State - issued guarantees

The law On the State Budget for 2020 did not provide for any new guarantees, but it, nevertheless, prescribed that in accordance with the law *On Agriculture and Rural Development* and the *Development Financial Institution Law*, the State shall be liable in the amount of 270.0 million euro for the guarantees issued by the Joint Stock Company Development Financial Institution Altum. Also, in order to ensure the possibility for population to keep their workplaces and the employers to keep their professionals on the job in the state of emergency caused by Covid-19, on the basis of the law *On Measures for the Prevention and Suppression of Threat to the State and Its Consequences Due to the Spread of Covid-19,* the guarantee of the Republic of Latvia to the European Commission has been issued regarding participation in the European Union support mechanism "For mitigation of unemployment risks in the emergency (SURE)" in the amount of 57.07 million euro.

At the end of 2020, the total amount of State guaranteed loans was 728.7 million euro, comprised of the disbursed but not yet repaid part of the State-guaranteed loan in the amount of 484.4 million euro and the non-disbursed part of the State-guaranteed loan in the amount of 244.3 million euro. Total State-guaranteed loans outstanding at the end of 2020 comprised 484.4 million euro or 1.6% of gross domestic product (see Figure 6.7), which is by 31.3 million euro less than at the end of 2019.

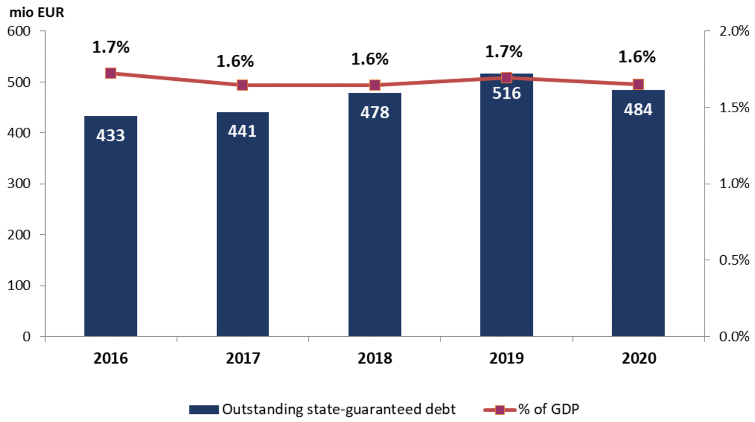


Figure 6.7. State-guaranteed loans outstanding at the end of respective year (million euro)

The largest share of the State-guaranteed loan portfolio is comprised of the State guarantees for the obligations of the Joint Stock Company Development Financial Institution Altum for implementation of the aid schemes (272.5 million euro), obligations of the guaranteed loans of medical institutions (128.7 million euro) and State guarantees for student and study lending (66.8 million euro). It is henceforth planned that an increasingly larger share in the guaranteed loan portfolio will consist of the support to small and medium-sized enterprises and implementation of the support programmes of other countries.

Given the probability that the obligations of the highest risk State-guaranteed loans or the part thereof might not be fulfilled within the maturity term, the law On the State Budget for 2021 prescribes the allowable expenditure limit for fulfilment of the obligations of the state-guaranteed debt. In 2021, having assessed the financial condition of the borrowers, previous credit history, liquidity and amount of the collateral, as well as other available information, the allowable expenditure limit for fulfilment of the obligations of the state-guaranteed debt have been set in the amount of 0.05 million euro.

Notwithstanding the economic downturn caused by Covid-19, the first Covid-19 wave did not cause a considerably impact on the fulfilment of the obligations of the State guarantee. It is currently not possible to estimate the impact on the State issued guarantees, as Covid-19 spread continues.

7. STATE FINANCE INSTITUTIONAL STRUCTURE

7.1. The Medium-Term Budget Planning

According to the Law on Budget and Financial Management, medium term State budget planning is a process in which the resources accessible for the medium term are determined and the use of these resources is ensured in conformity with the priorities determined by the government. A medium term shall mean a three-year period formed by the financial year for which the State budget is planned and the subsequent two financial years.

Since 2007, the Medium Term Macroeconomic Development and Fiscal Policy Framework (hereinafter – the Framework) has been prepared in the State for the next three financial years, in which there is an analysis of the medium-term State macroeconomic situation presented, as well as objectives of the government fiscal policy for medium term, forecasts on the State budget revenue and ceilings of the State budget total expenditure for each ministry and other central State institutions for the medium term. In view of the fact that the Framework did not have legally binding nature and it only indicated the ceilings of the State budget total expenditure for the medium term, a need arose to strengthen the medium-term budget planning system. Therefore, corresponding amendments to the Law on Budget and Financial Management have been made and since 1 January 2012 the Framework, which since 2007 had been approved by the Cabinet, is drafted as a Framework Law and approved by the *Saeima*. Therefore, the achievable financial indicators, included in the Framework Law, have legally binding force and the drafting of the Annual State Budget Law, as well as drafting of further Framework Laws shall be based on these indicators.

The Framework Law is developed every year for the next three-year period. For the first and the second year of each following period of the Framework Law, the indicators set in the previous Framework Law are used, adjusted in accordance with the cases stated in regulatory enactments, but the indicators planned for the third year are new. At the same time, the Framework Law is associated with development planning documents ensuring coherence of available resources with the priorities of the government policy in the medium term, and it complies with the fiscal rules prescribed by the Fiscal Discipline Law, providing for a transparent and responsible fiscal policy. Thus, the Framework Law is the main tool to ensure compliance with the fiscal discipline.

The first year of the Framework Law operating period is elaborated in detail in the Annual State Budget Law. For each year of the Framework Law period the medium term budget objectives and priority development directions determined in the National Development Plan are specified, formulation of the fiscal policy objectives of the government, the maximum permissible total amount of the State budget expenditure (also the maximum total amount for each budget sector), forecasts of the GDP, forecasts of the State budget revenue, the amount of the

State budget financial balance (maximum deficit level or minimum surplus level). According to the provisions of the Fiscal Discipline Law simultaneously with the Framework Law for 2015 – 2017 for the first time the Fiscal Risk Declaration was developed, aiming to ensure the overall management of fiscal risks, as well as stability of fiscal indicators in medium term. Even though the Law on Budget and Financial Management states that the Framework Law is to be developed in spring and submitted to the *Saeima* by May 15 of the relevant year, in fact, in accordance with the Transitional Provisions, the Framework Law is prepared in Autumn and submitted to the *Saeima* concurrently with the State Budget Law by October 15 of the relevant year.

Latvia as the European Union Member State is submitting the Stability Programme to the European Commission. Latvia, as the Eurozone Member State, prepares the Draft General Government Budget Plan of Latvia, specifying the forecasts of the key indicators of the next year's budget: revenue, expenditure, deficit and government debt, including the State budget, local government budget, the budget of the partially State budget-funded derived public persons and the commercial companies included in the general government sector. The purpose of the plan mentioned is to submit to the European Commission information, which would allow it assessing the compliance of the planned budget fiscal the norms of law of the European Union in the field of fiscal discipline. If the European Commission detects that the budget plan considerably violates the European Union fiscal discipline rules, it may reject the budget plan and request the Member State to introduce changes and submit the plan again. The European Commission, may, by the corresponding opinion, provide recommendation for improving the plan. The procedure prescribes that the national parliaments consider the opinion of the European Commission, when adopting the State budget in its final reading.

7.2. Budget Procedures

7.2.1. Budget procedures

The Constitution of the Republic of Latvia prescribes that the *Saeima* annually, before the beginning of a financial year, shall decide on the State revenue and expenditure budget, the draft of which is submitted to the *Saeima* by the Cabinet. The Annual State Budget Law shall be approved by the *Saeima*.

When planning the expenditure of the State budget, the base expenditure is calculated and agreed on first. Calculation of the base expenditure and the principles of its coherence with the Framework Law is determined by the 11 December 2012 Cabinet Regulation No. 867 Procedure for establishing ceilings on the total amount of the state budget expenditure and on the total amount of the State budget expenditure for each ministry and other central State institutions for the medium term. Thus, the necessary amount of expenditure is determined in order to ensure execution of the State functions at a constant level. Base expenditure shall be approved by the Cabinet.

Since 2016, a constant and systematic State budget expenditure revision has been introduced as an integral part of the budgetary process, explained in more detail in Chapter 5.1 herein above.

The ministries and other central State institutions shall prepare proposals for the priority measures to be supported, if in the relevant following economic years funds are available for development expenditure in accordance with the latest macroeconomic development forecasts. Proposals for the measures shall be prepared, based on the priorities and goals set by the National Development Plan, the National Security Concept and other development planning documents. Thus, linking of the national priorities with the resources available within the State budget for the medium term is ensured.

When calculating ceilings of the total amount of the State budget expenditure, consisting of base expenditure of the State basic budget and the State special budget and of the expenditure for development of the State basic budget and the State special budget, the Ministry of Finance shall rely on the Framework Law, forecasts of macroeconomic development, as well as observe fiscal conditions that are defined in the State. On the basis of the decisions approved by the Cabinet on the base expenditure and financing priority measures, the ministries and other central State institutions shall prepare and submit the budgetary requests to the Ministry of Finance. The Ministry of Finance shall prepare and submit the Draft Framework Law (with explanations, fiscal risks declaration, fiscal discipline supervision report of the Fiscal Discipline Council) and Draft Annual State Budget Law (with explanations) for the review to the Cabinet.

In order to provide the society with a clear idea of the resources involved in the execution of State basic functions and implementation of activities of the EU and other foreign policy instruments, the budget shall be prepared according to the following sections:

- execution of state basic functions (except projects and activities financed or co-financed by European Union policy instruments and other foreign financial aid);
- implementation of projects and activities financed or co-financed by European Union policy instruments and other foreign financial aid. Within the process of preparation of the Draft Annual State Budget Law, the following indicators shall be evaluated in an aggregated form and then presented in the State Budget Law:
- the State budget revenue divided according to the types of revenue (divided by responsible ministries);
- the State budget expenditure divided according to programmes (sub-programmes) and the types of expenditure according to the economic nature;

- the financial balance of the State budget;
- the maximum permissible amount of the government debt at the end of a financial year;
- the amount of guarantees to be issued on behalf of the State;
- total increase in State budget loans;
- the amount of state budget earmarked grants for local governments, as well as the amount of the State budget subsidy for the local government financial equalisation fund;
- total increase in local government borrowings and total increase in the guarantees provided by local governments;
- other conditions, such as the contribution rate and contribution sum to the State- funded pension scheme.

Explanations to the Draft Annual State Budget Law include a description of the macroeconomic development scenario, fiscal review, analysis of revenue forecasts, the most significant elements of the State budget expenditure planning, explanations of tasks of the ministries, State budget expenditure divided by functional, administrative and economic categories, as well as information about the planned investment projects, information about State financial obligations (summary) and information about the amendments made to the regulatory enactments within the package of draft budget laws. Ministries and other central State institutions in the budget explanations include the Policy and Resource Management Scorecards, the priority measures and the operating results and performance indicators in the result of their implementation, the optimization measures, as well for each programme (sub-programme) of the basic budget or special budget indicate the objective, main activities and performers, operating results and performance indicators, financial indicators and total expenditures changes.

Independent institutions (courts, the State Audit Office, Ombudsman and others) play a special role in the budget process. The Law on Budget and Financial Management stipulates that the Cabinet, when preparing the Draft Framework Law and the Draft Annual State Budget Law, shall hear the view of independent institutions about the financing sections of corresponding institutions, justify the opinion of the Cabinet in case of funding reduction, and inform the legislator about the results of the aforementioned negotiations in a form of a protocol attached to relevant draft laws.

During the process of development of the Draft State Budget Law and Draft Framework Law, negotiations between the Latvian Association of Local and Regional Governments and the Ministry of Finance are being held, as a result of which a Cabinet and Latvian Association of Local and Regional Governments Draft Protocol is being prepared, which is submitted for consideration at the extended session of the Committee of the Cabinet. In the Draft Protocol, there are questions included on the local governments' tax and non-tax revenue and other revenue forecasts, central government budget transfers to local governments, amount and conditions of the local governments' loans, guarantees and long-term obligations, local governments financial equalization, and other issues related to the operations and finances of local governments. The Protocol is attached to the Draft Annual State Budget Law and Draft Framework Law, when the Cabinet submits it to the *Saeima*.

If at the beginning of the economic year the Annual State Budget Law has not taken effect, the Minister for Finance shall approve the State budget expenditure necessary for the operation of the State, as well as the loan and borrowing limits, provided that the expenditure does not exceed the volume of the maximum permissible total State budget expenditure set for the relevant year by Framework Law for each Ministry and other central State institution, by introducing the corrections laid down in the Law on Budget and Financial Management.

In compliance with the Law on Local Government Budgets, local governments shall develop their budgets no later than within two months following the proclamation of the Annual State Budget Law.

If the local government budget is not approved by the beginning of the financial years, the local government expenditure per month shall not exceed one twelfth of previous year’s expenditure if the amount of functions to be fulfilled by the local government does not decrease.

The Law on Local Government Budgets prescribes strict conditions for the local government in the field of budget planning and execution – the local government budget assignations may not exceed the amounts planned in the budget.

The Cabinet has the right to determine additional conditions for planning and implementation of the State and local government budgets in order to ensure measures for reduction and prevention of impact of the increased fiscal, economic and social risks caused by macroeconomic processes and ensure implementation of the fiscal criteria determined in international commitments.

7.2.2. Management of Government Finance Statistics

The Central Statistical Bureau compiles government finance statistics in accordance with the requirements of Regulation (EU) No. 549/2013 of the European Parliament and of the Council (21 May 2013) on the European system of national and regional accounts in the European Union (hereinafter – the ESA 2010).

The framework of general government sector (S.13) in Latvia according to the ESA 2010 methodology consists of three sub-sectors: central government sub-sector (S.1311), local government sub-sector (S.1313) and social security sub-sector (S.1314).

In accordance with Paragraph 6 of Cabinet Regulation No. 1456 of 10 December 2013 "Regulation regarding the Classification of Institutional Sectors", the Central Statistical Bureau shall prepare and maintain a list of the general government sector. To prepare the list and decide on the units to be included, the Central Statistical Bureau ensures compliance with ESA 2010 requirements, as well as the principles defined in Eurostat (Statistical Office of the European Union) Manual on Government Deficit and Debt, which foresee that the capital corporations that are controlled and mostly financed by central and local governments belong to the general government sector.

As of 31 December 2019, the general government sector included 850 independent budgetary institutions, of which 224 institutions belonged to the central government sub-sector; 625 institutions belonged to the local government sub-sector, and one institution – to the social security fund sub-sector. Moreover, there were 147 capital corporations controlled and financed by the central and local governments, of which 57 capital corporations were controlled by the central, and 90 – by local governments.

Each quarter the Central Statistical Bureau prepares detailed information about the following general government sector indicators: revenue, expenditure, deficit, debt, and compiles quarterly financial accounts of general governments. The information is published on the Central Statistical Bureaus' home page, as well as sent to *Eurostat* three months after the end of the reporting period.

In addition, the Central Statistical Bureau each year within the set deadlines – by 1 April (provisional data) and by 1 October (final data) – prepares the general government budget deficit and debt notification (hereinafter – Notification) and submits it to *Eurostat*.

The Notification is drafted in accordance with the provisions of Cabinet Regulation No. 756 of 22 December 2015 "Procedure by Which the Notification of General Government Deficit and Debt Shall Be Prepared". The Central Statistical Bureau is the authority responsible for the preparation and submission of the Notification to *Eurostat*; it also conducts regular inter-institutional working group meetings. The following institutions are involved in the process of preparation of the Notification: the Ministry of Finance, the Treasury, the Central Finance and Contracting Agency, the Ministry of Defence and the State Social Insurance Agency. If needed, specialists from other institutions (the Ministry of Economy, the Ministry of Welfare, Riga City Council, etc.) are involved.

The results of the Notification are used for assessing how the countries observe the compliance of the fiscal indicators with respect to the requirements of the Stability and Growth Pact with an aim to pursue sound public finances and coordinate fiscal policies of the Member States.

Council Directive 2011/85/EU (8 November 2011) on requirements for budgetary frameworks of the Member States lays down the detailed requirements for the European Union Member States to strengthen the European Union fiscal and economic surveillance, and to avoid an excessive budget deficit. The fiscal data as envisaged within the Directive 2011/85/EU are published on the Ministry of Finance website. In addition, the website offers a detailed transition table for budget data from the cash flow data according to the national classification to general government data according to the ESA 2010 methodology. The following information is published on a regular basis:

- fiscal data (monthly and quarterly data);
- government guarantees (annual data);
- non-performing loans (annual data);
- outstanding liabilities related to off-balance public-private partnerships (annual data);
- liabilities of government controlled corporations classified outside general government (annual data);
- participation of government in the capital of corporation (annual data).

ANNEXES

Table 1a. Growth and Related Factors

	ESA code	2020	2020	2021	2022	2023	2024
		million euro	Growth %				
1. GDP at 2015 prices	B1*y	26, 555	-3.6	3.0	4.5	3.2	2.8
2. GDP at current prices	B1*y	29, 334	-3.6	4.4	6.4	5.2	5.0
GDP by expenditure at 2015 prices							
3. Private consumption	P3	14, 740	-10.0	4.0	10.1	4.0	2.6
4. Public consumption	P3	5, 056	2.6	2.4	2.4	2.4	2.4
5. Gross fixed capital formation	P51	6, 280	0.2	4.1	7.6	2.5	2.5
6. Changes in inventories and acquisition of valuables	P52+P53	1, 661	-	-	-	-	-
7. Exports	P6	16, 967	-2.7	4.3	4.7	4.0	4.0
8. Import	P7	18, 149	-3.3	4.9	5.4	4.0	3.3
Contribution to GDP growth							
9. Final domestic demand			-5.4	3.7	8.0	3.4	2.6
10. Changes in inventories and acquisition of valuables	P52+P53		1.3	-0.1	-2.7	-0.1	-0.1
11. Exports-imports balance	B11		0.5	-0.6	-0.7	-0.2	0.3

Table 1b. Consumer Price Changes

	ESA code	2020	2020	2021	2022	2023	2024
		level	Growth %				
1. GDP deflator			0.1	1.4	1.8	2.0	2.1
2. Private consumption deflator			0.8	1.4	2.0	2.0	2.0
3. HICP changes (year to year)			0.2	1.4	2.0	2.0	2.0
4. Public consumption deflator			0.4	-0.7	2.2	2.5	2.7
5. Investment deflator			1.2	4.0	5.0	5.0	3.6
6. Export (goods and services) deflator			-0.8	1.6	2.4	3.0	3.0
7. Import (goods and services) deflator			-3.5	1.5	3.0	3.9	4.0

Table 1c. Labour Market Development

	ESA code	2020	2020	2021	2022	2023	2024
		level	Growth %				
1. Employment, persons, thousands		893	-1.9	-0.4	1.0	0.3	0.0
2. Employment, work hours per employed		1, 441	-2.4	-0.4	1.0	0.3	0.0
3. Unemployment rate (%)			8.1	8.3	7.1	6.3	5.9
4. Labour productivity, per capita			-1.8	3.4	3.5	2.8	2.8
5. Labour productivity, per working hour			0.6	3.4	3.5	2.8	2.8
6. Remuneration of employees, million euro, at current prices	D.1	15, 330	1.5	5.2	6.1	5.3	5.0
7. Gross wage, euro		1, 143	6.2	4.0	5.0	5.0	5.0

Table 1d. Sectoral Balances

% of GDP	ESA code	2020	2021	2022	2023	2024
1. Current and capital account	B.9	4.7	4.5	4.4	2.8	2.8
of which:						
Balance of goods and services		1.2	0.8	0.1	-0.5	-0.6
- balance of income and transfers		1.8	1.6	1.8	0.9	1.0
Capital account		1.7	2.1	2.5	2.4	2.4
2. Net lending / borrowing in the private sector	B.9	10.0	13.8	7.1	4.1	3.1
3. Net lending / borrowing in the general government sector	EDP B.9	-5.4	-9.3	-2.7	-1.3	-0.3
4. Statistical discrepancy		*0*	*0*	*0*	*0*	*0*

Table 2a. General Government Budgetary Prospects[17]

	ESA code	2020[18]	2020	2021	2022	2023	2024
		million euro	% of GDP				
Net lending (+) or borrowings (-) (B.9) by sub-sectors							
1. General government	S.13	-1, 569.9	-5.4	-9.3	-2.7	-1.3	-0.3
2. Central government	S.1311	-1, 589.7	-5.4	8.6	-2.5	-1.2	-0.2
3. State government	S.1312						
4. Local government	S.1313	-104.4	-0.4	-0.4	-0.1	-0.1	-0.1
5. Social security funds	S.1314	124.1	0.4	-0.3	-0.1	0.0	0.0
General government (S.13)							
6. Total revenue	TR	11, 545.2	39.4	39.3	39.9	39.0	38.6
7. Total expenditure	TE	13, 115.2	44.7	48.6	42.5	40.3	39.0
8. Budget balance	B.9	-1, 569.9	-5.4	-9.3	-2.7	-1.3	-0.3
9. Interest expenditure	D.41	248.4	0.8	0.7	0.8	0.8	0.7
10. Primary balance		-1, 321.5	-4.5	8.6	-1.9	-0.6	0.3
11. One-off and other temporary measures		-55.0	-0.2				
Components of revenue							
12. Total taxes (12=12a+12b+12c)		6, 300.2	21.5	21.6	21.8	21.7	21.6
12a. Production and import taxes	D.2	4, 180.3	14.3	14.5	14.5	14.4	14.4
12b. Current income and wealth taxes	D.5	2, 108.5	7.2	7.1	7.3	7.2	7.2
12c. Capital taxes	D.91	11.5	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	3, 022,2	10.3	10.1	10.1	10.1	10.1
14. Property income	D.4	218.4	0.7	0.7	0.6	0.5	0.3
15. Other revenue		2, 004.4	6.8	6.9	7.5	6.7	6.6
16. Total revenue	TR	11, 545.2	39.4	39.3	39.9	39.0	38.6
Tax burden (D.2[19]+D.5+D.61+D.91-D.995)		9, 365.4	31.9	31.9	32.0	32.0	31.9
Components of expenditure							
17. Remuneration for employees and intermediate consumption	D.1+P.2	5, 318.1	18.1	18.3	17.4	16.6	15.9
17a. Remuneration for employees	D.1	3, 438.1	11.7	11.7	11.1	10.6	10.2
17b. Intermediate consumption	P.2	1, 880.0	6.4	6.6	6.3	5.9	5.7
18. Social payments (18=18a+18b)		3, 975.5	13.6	14.0	13.5	13.3	13.2
of which unemployment benefits		243.1	0.8	0.6	0.5	0.4	0.4
18a. Social transfers through market producers	D.6311, D.63121, D.63131	410.2	1.4	1.4	1.4	1.4	1.3
18b. Social transfers, other than transfers in kind	D.62	3, 565.3	12.2	12.6	12.1	11.9	11.9
19.=9 Interest expenditure	D.41	248.4	0.8	0.7	0.8	0.8	0.7
20. Subsidies	D.3	465.1	1.6	1.4	1.2	1.1	1.0
21. Gross total fixed capital formation	P.51	1, 547.6	5.3	6.0	6.4	5.5	5.8
22. Capital expenditure transfers	D.9	303.0	1.0	0.2	0.1	0.1	0.0
23. Other expenditure		1, 257.5	4.3	8.1	3.3	3.0	2.4
24.=7 Total expenditure	TE	13, 115.2	44.7	48.6	42.5	40.3	39.0
Government consumption	P.3	5, 773.8	19.7	20.0	18.9	18.1	17.3

[17] Considering information provided in Chapter 3.1.2, in this table budgetary indicators in 2023 and 2024 are reflected at a constant policy

[18] The assessment of the Ministry of Finance

[19] Including share of taxes collected by the EU budget

Table 2b. Forecasts at Constant Policy

	2020	2020	2021	2022	2023	2024
	million *euro*	% of GDP				
1. Total revenue at constant policy	11, 545.2	39.4	39.3	39.9	39.0	38.6
2. Total expenditure at constant policy	13, 115.2	44.7	48.6	42.5	40.3	39.0

Table 3. General Government Expenditure By Function

% of GDP	COFOG code	2019	2024[20]
1. General public services	1	3.8	3.9
2. Defence	2	1.9	2.1
3. Public order and safety	3	2.2	2.0
4. Economic affairs	4	5.3	5.6
5. Environmental protection	5	0.6	0.5
6. Housing and community amenities	6	1.0	1.0
7. Health	7	4.2	4.2
8. Recreation, culture and religion	8	1.5	1.4
9. Education	9	5.8	5.3
10. Social protection	10	12.1	13.0
11. Total expenditure	TE	38.4	39.0

Table 4. General Government Debt Developments and Contributions to Changes in the Debt in 2020 - 2024

% of GDP	ESA	2020	2021	2022	2023	2024
1. Gross debt		43.5	48.9	50.3	48.8	48.5
2. Changes in gross debt		5.1	7.3	4.3	1.0	2.0
Contributions to changes in gross debt						
3. Primary balance		-4.5	8.6	-1.9	-0.6	0.3
4. Interest payments	EDP	0.8	0.7	0.8	0.8	0.7
5. Stock-flow adjustments		-0.2	-2.0	1.7	-0.4	1.6
Implicit interest rate on government debt		2.2	1.7	1.7	1.6	1.4
Other variables						
6. Liquid financial assets		9.1				
7. Net financial debt (7=1-6)		34.3				
8. Debt amortisation		4.4	4.6	1.9	4.4	2.8
9. Share of debt denominated in foreign currency		3.7	1.0	1.0	0.9	0.9
10. Average maturity		8.09 years				

[20] Considering information provided in Chapter 3.1.2, in this table budget expenditure in 2024 is reflected at constant policy

Table 5. Cyclical development[21]

% of GDP	ESA code	2020	2021	2022	2023	2024
1. GDP growth at constant prices (%)	B1y	-3.6	3.0	4.5	3.2	2.8
2. Actual budget balance	B.9	-5.4	-9.3	-2.7	-1.3	-0.3
3. Interest expenditure	D.41	0.8	0.7	0.8	0.8	0.7
4. One-off and other temporary measures[22]		-0.2	-	-	-	-
5. Potential GDP growth (%)		1.8	2.0	2.2	2.4	2.8
input:						
- of employment		0.0	-0.1	-0.2	-0.3	-0.3
- of capital		0.8	0.9	1.0	1.0	1.0
- of total manufacturing factors productivity		1.0	1.2	1.4	1.7	2.2
6. Gap between actual and potential GDP (% of the potential GDP)		-4.0	-3.0	-0.9	-0.1	0.0
7. Cyclical component of the budgetary balance		-1.5	-1.2	-0.3	0.0	0.0
8. Cyclically adjusted balance (2-7)		-3.9	-8.2	-2.3	-1.3	-0.3
9. Cyclically adjusted primary balance (8+3)		-3.0	-7.5	-1.6	-0.5	0.3
10. Structural balance (8-4)		-3.7	-8.2	-2.3	-1.3	-0.3

Table 6. Comparison with the forecasts of the Stability Programme for 2020–2023

	ESA code	2020	2021	2022	2023	2024
GDP growth (%)	B1y					
Year 2020 (Covid-19 impact scenario)		-7.0	1.0	3.5	2.4	-
2021		-3.6	3.0	4.5	3.2	2.8
Changes		3.4	2.0	1.0	0.8	-
Actual budget balance (% of GDP)	B.9					
Year 2020 (Covid-19 impact scenario)		-9.4	-5.0	-3.9	-2.7	-
2021		-5.4	-9.3	-2.7	-1.3	-0.3
Changes		4.1	-4.3	1.3	1.4	-
General government debt (% of GDP)						
Year 2020 (Covid-19 impact scenario)		51.7	52.2	53.3	53.1	-
2021		43.5	48.9	50.3	48.8	48.5
Changes		-8.2	-3.3	-3.0	-4.3	-

[21] Considering information provided in Chapter 3.1.2, in this table budgetary indicators in 2023 and 2024 are reflected at a constant policy

[22] One-off measures -55 million *euro*, inter alia, the share of revenue in the amount of 33 million *euro* obtained from seizure of proceeds from crime and tax reform. To facilitate data comparability between Latvia and the EU, the structural balance in 2020 is reflected jointly with the reduction of the net revenue from tax reform by 0.3.% of GDP, which is short-term and is deemed as the one-off measure within the fiscal framework of Latvia, but the EC includes this effect in the structural balance, because the EC, as a rule, does not recognize the measures reducing revenue / increasing expenditure to be one-off/short-term measures.

Table 7. Sustainability of Public Finances[23]

% of GDP	2019	2030	2040	2050	2060	2070
Age -related general government budget expenditure	15.8	16.3	15.8	15.7	15.8	15.2
Pension expenditure (for State-funded pensions)	7.1	6.9	6.6	6.3	6.2	5.9
Old-age and premature pensions - contributions-based	6.4	6.3	6.0	5.8	5.7	5.3
Other pensions (incl., disability, survivor's pension)	0.7	0.6	0.6	0.5	0.5	0.6
Non-social security pensions (incl., ensuring minimum pensions and minimum income)	0.0	0.0	0.0	0.0	0.0	0.0
Healthcare expenditure	4.6	4.2	4.4	4.5	4.4	4.3
Long-term care expenditure	0.5	0.5	0.6	0.6	0.7	0.6
Education expenditure	3.6	3.8	3.5	3.5	3.8	3.6
Social security contributions to the State-funded pensions special budget	8.4	7.3	7.0	6.7	6.6	6.8
Systemic pension reforms						
Social security contributions to the State-funded pension scheme	1.9	1.8	1.8	1.8	1.8	1.8
Pension expenditure from the State-funded pension scheme	-	0.2	0.4	1	1.7	2.2
Assumptions						
Growth of labour productivity (per hour), %	3.3	3.1	2.2	2.0	1.8	1.5
Potential GDP growth at constant prices (%)	2.7	1.9	1.0	0.6	1.0	1.1
Participation rate, males (aged 20-64)	85.6	84.3	84.2	84.0	85.1	84.7
Participation rate, females (aged 20-64)	80.4	79.7	79.8	80.3	81.9	81.2
Total participation rate (aged 20-64)	82.9	82.0	82.0	82.2	83.6	83.0
Unemployment rate (aged 20-64)	6.4	8.9	7.9	6.9	6.8	6.8
Population (aged 65+), % of total population	20.7	13.8	13.7	13.7	12.5	13.6

Table 8. External Environment Basic Assumptions

	2020	2021	2022	2023	2024
Short-term interest rate in Eurozone (annual average)	-0.4	-0.6	-0.5	-0.4	-0.4
Long-term interest rate in Eurozone (annual average)	-0.5	-0.5	-0.4	-0.3	-0.3
EUR/USD exchange rate (annual average)	1.14	1.21	1.21	1.21	1.21
Nominal effective exchange rate in the European Union	3.9	2.3	0.0	0.0	0.0
World GDP, excluding European Union, growth at constant prices, %	-3.4	5.2	3.8	3.4	3.4
European Union GDP growth at constant prices, %	-6.3	3.7	3.9	2.0	1.2
World goods and services trade volumes changes on the European Union export markets, excluding European Union, %	-9.1	6.5	4.6	2.5	2.5
World goods and services import volumes changes, excluding European Union, %	-9.4	7.5	4.9	2.6	2.6
Oil price (Brent, USD/barrel)	43.4	54.7	52.4		

[23] Data source: *Working Group on Ageing Populations of the Economic Policy Committee, The 2021 Ageing Report: Underlying Assumptions and Projection Methodologies*.

Table 9a. Amount of guarantees

Measure		Date of approval	Maximum amount of indirect guarantees (% of GDP)	Actual amount (% of GDP)
COVID-19[24]	Loan guarantees	24 March 2020	1.0	0.3
	Portfolio guarantees	24 March 2020	0.9	0.0
	Guarantees to large-scale merchants	14 July 2020	0.2	0.0
	Total		2.1	0.3
Others[25]	Central government and local government guarantees			1.7
	Total			1.7
Total			**2.1**	**2.0**

Table 9b. Discretionary measures[26]

Support measure		ESA code	Date of approval	Impact on the balance, % of GDP (changes compared to the year before)			
				2020	**2021**	**2022**	**2023**
Temporary measures (Covid_19)	**Support in the field of taxes**			**-0.5**	**0.4**	**0.2**	**-0.1**
	Extension of the tax payment term or division thereof into terms up to 3 years	D2; D5; D61	20 March 2020	-0.2	0.1	0.1	0.0
	Possibility not to pay PIT advance payments	D5	20 March 2020	-0.1	0.1	0.1	-0.1
	Faster VAT surcharge refund	D2	20 March 2020	-0.2	0.2	0.0	0.0
	Support in the field of benefits			**-0.4**	**-1.1**	**1.5**	**0.0**
	Idle-time allowance for the employees of the enterprises, patent fee payers, self-employed persons	D7	26 March 2020	-0.2	-0.1	0.3	0.0
	Wage subsidies	D7	14 July 2020	-0.2	0.1	0.1	0.0
	Benefit for families with children	D7	16 February 2021	0.0	-0.6	0.6	0.0

[24] Gross domestic product of 2021 was used.

[25] As on 31 December 2020

[26] Except for the measures expected to be financed from the transfers of the European Recovery and Resilience Facility.

	Benefit for retired persons and disabled persons	D7	4 March 2021	0.0	-0.4	0.4	0.0
	Others			-0.1	-0.1	0.1	0.0
	Support in the field of loans and guarantees			**-0.7**	**0.4**	**0.3**	**0.0**
	Increase of the limit of borrowings of loan governments	P51	30 April 2020	-0.2	0.0	0.1	0.0
	Loans for current assets	D7	24 March 2020	-0.2	0.1	0.0	0.0
	Loan guarantees	D7	24 March 2020	-0.1	0.1	0.0	0.0
	Portfolio guarantees	D7	24 March 2020	-0.1	0.1	0.0	0.0
	Guarantees to large-scale	D7	14 July 2020	-0.1	0.1	0.0	0.0
	Loans and interest rate subsidies for large-scale merchants	D7	2 June 2020	-0.1	0.0	0.1	0.0
	Others			0.0	0.0	0.0	0.0
	Support to sectors			**-2.2**	**-2.2**	**4.0**	**0.3**
	Support to air transport sector	D9	8 May 2020	-0.9	0.8	0.1	0.0
	Health care related support	P2; P51; D1; D7	3 March 2020	-0.5	-1.5	1.9	0.0
	For reducing financial difficulties for agriculture, forestry, fishery and food production sectors	D3	17 April 2020	-0.1	0.0	0.2	0.0
	For construction of the State roads and repairs of the bridges	P51	29 April 2020	-0.3	-0.1	0.3	0.0
	Support to passenger and cargo carriers	D3; D7; D9	14 July 2020	-0.3	0.3	0.0	0.0
	Grant for current assets	D7	10 November 2020	0.0	-1.0	1.0	0.0
	High-readiness projects related to overcoming Covid-19 crisis and economic recovery	P51	18 March 2021	0.0	-0.4	0.1	0.3
	Others			-0.2	-0.2	0.4	0.0
	Support from the EU fund allocation			0.0	0.0	0.0	0.0
	Total			**-3.7**	**-2.5**	**6.0**	**0.2**

Table 10. Impact of the European Recovery and Resilience Facility

Revenue from the RRF transfers (% of GDP)							
	2020	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**
RRF revenue included in the general government	0.0	0.1	0.8	0.8	1.1	1.2	0.6
RRF reimbursement (cash flow) from the EU	0.0	0.7	0.5	0.8	0.9	1.1	0.6
Expenditure financed from the RRF transfers (% of GDP)							
	2020	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**
Current expenditure	0.0	0.03	0.3	0.3	0.4	0.4	0.2
Gross fixed capital formation P.51g	0.0	0.05	0.6	0.6	0.7	0.8	0.4
Capital transfer D.9							
Capital expenditure	0.0	0.05	0.6	0.6	0.7	0.8	0.4