

# European Semester

2012/2677(RSP) - 30/05/2012 - Follow-up document

**PURPOSE:** draft Recommendation for a COUNCIL RECOMMENDATION on Latvia's 2012 national reform programme and delivering a Council opinion on Latvia's convergence programme for 2012-2015.

**BACKGROUND:** the European Commission has adopted a **package of recommendations for budgetary measures and economic reforms** to enhance financial stability, boost growth and create employment across the EU.

The recommendations are **country-specific**, taking account of the individual situation of each Member State. The Commission has also issued recommendations for the euro area as a whole. The country-specific recommendations put forward by the Commission give operational guidance for Member States while preparing their budgetary policies and for economic reforms that should be enacted over the coming twelve months to boost competitiveness and facilitate job creation.

The adoption of the recommendations marks the **concluding of the second phase of the European Semester** of economic policy coordination, which was launched with the Commission's [Annual Growth Survey](#) on 23 November 2011.

The basis for these recommendations is a thorough assessment of the implementation of those adopted in 2011, combined with a detailed analysis of the national reform programmes and stability or convergence programmes that Member States submitted by 30 April 2012. The analysis underpinning the recommendations is presented in 28 Commission staff working documents.

**CONTENT:** on 30 April 2012, **Latvia** submitted its 2012 convergence programme covering the period 2012-2015 and its 2012 national reform programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

Based on the assessment of the 2012 convergence programme, the Council is of the opinion that the **macroeconomic scenario** underpinning the budgetary projections is **cautious in 2012 and plausible in 2013**. While macroeconomic projections for 2012 in the programme scenario are very close to those in the Commission's spring 2012 forecast (with GDP growth projections respectively at 2.0% and 2.2%), recent economic data indicates that the outturn may be higher.

**The objective of the budgetary strategy** outlined in the programme is to correct an excessive deficit by 2012 and to approach the medium-term budgetary objective (MTO) by the end of the programme period. The 2012 convergence programme has changed the medium-term objective from -1.0% to -0.5% of GDP; the new MTO adequately reflects the requirements of the Stability and Growth Pact. For 2013, the programme targets a headline deficit of 1.4% of GDP, although the planned expenditure reduction is not yet fully supported by measures.

**The general government debt ratio** is below 60% of GDP, increasing from 42.6% of GDP in 2011 to 46.7% of GDP in 2014, as the authorities pre-fund large repayments related to the international financial assistance programme that are due in 2014-2015, and falling to 38.9% in 2015 as these repayments are made.

According to the Commission, the **main policy challenges** for the country are as follows:

- The relatively high tax burden on low-wage earners and the high level of undeclared work indicate the need for appropriate labour-market policies, a review of the tax and benefit system and increased efforts to tackle the shadow economy. Environmental taxes remain relatively underdeveloped and are heavily dominated by motor-fuel taxation.
- In the process of the on-going reform of fiscal governance, Latvia is invited to ensure adoption of the Fiscal Discipline Law by the Parliament and to develop a medium term budgetary framework law to support the long-term sustainability of public finances.
- So as to ensure the continuity of the pension reform, Latvia should restore contributions to the mandatory funded private pension scheme at 6% of gross wages in 2013, from the current reduced level of 2% of gross wages.
- Latvia needs to strengthen and reform the social assistance system and tackle one of the highest unemployment rates in the EU.
- In 2011, 40% of the Latvian population is facing the risk of poverty which has implications for the employability of the workforce and future growth prospects.
- The challenges of long term unemployment and of youth unemployment became especially evident during the crisis. Most of the young unemployed do not possess professional qualifications. The number of young people not in employment, education or training (NEET's) is relatively high.
- The tax system does not provide sufficient incentives for reducing energy costs and shifting consumption and investment towards energy efficient products. Energy markets in Latvia remain dominated by monopolies. For historical reasons, the gas and electricity markets are largely separated from other EU member states.
- Inefficiencies in the civil justice system have a negative impact on business and the economic environment, as the risk and cost of doing business increases. There is a large backlog of proceedings in the first and second instance courts in civil and commercial cases.
- Despite the relatively high educational attainment, a significant share of the workforce does not possess professional qualifications and has limited access to higher education. A systematic and effective research and innovation strategy is lacking.

### **Recommendations proposed for Lithuania for the period 2012-2013:**

#### **Budgetary measures:**

- ensure planned progress towards the timely correction of the excessive deficit, to this end, implement the budget for the year 2012;
- thereafter, implement a budgetary strategy, supported by sufficiently specified structural measures, for the year 2013 and beyond;
- use better than expected cyclical revenue to reduce government debt.

#### **Taxation:**

- implement measures to shift taxation away from labour to consumption, property, and use of natural and other resources while improving the structural balance;
- ensure adoption of the Fiscal Discipline Law and develop a medium term budgetary framework law to support the long-term sustainability of public finances;
- restore contributions to the mandatory funded private pension scheme at 6% of gross wages from 2013.

#### **Employment, labour market:**

- take measures to reduce long-term and youth unemployment by fighting early school leaving, promoting more efficient apprenticeships and VET, enhancing the quality, coverage and effectiveness of active labour market policy and its training component and through an effective wage subsidy scheme;

- tackle high rates of poverty and social exclusion by reforming the social assistance system to make it more efficient, while better protecting the poor;
- ensure better targeting and increase incentives to work.

**Energy:**

- further encourage energy efficiency by providing incentives for reducing energy costs and shifting consumption towards energy-efficient products, including vehicles, buildings and heating systems;
- promote competition in major energy networks (electricity, natural gas, heating) and improve connectivity with EU energy networks.

**Legal system:**

- take measures to improve management and efficiency of the judiciary, in particular to reduce the backlog and length of procedures;
- take steps to improve the insolvency regime and the mediation laws.

**Education, research:**

- continue reforms in higher education, inter alia, by implementing a new financing model that rewards quality, strengthens links with market needs and research institutions, and avoids fragmentation of budget resources;
- design and implement an effective research and innovation policy encouraging companies to innovate, including via tax incentives, upgrading infrastructure and rationalising research institutions.

These recommendations should be endorsed by the European Council on 28-29 June 2012 and formally adopted by the Council in July 2012.