2020

Latvia's Stability Programme for 2020-2023

RIGA, 2020

LATVIJAS REPUBLIKAS FINANŠU MINISTRIJA

CONTENT

Abbreviations

ALTUM	JSC “Development Finance Institution Altum”
Cabinet	Cabinet of Ministers
CIT	Corporate Income Tax
CPI	Consumer price index
CSB	Central Statistical Bureau of Latvia
EC	European Commission
ESA	European System of Accounts
EU	European Union
Eurostat	Directorate-General of the European Commission
FDL	Fiscal Discipline Law
Framework Law	Medium-Term Budget Framework Law
GDP	Gross domestic product
IMF	International Monetary Fund
JSC	Joint-stock company
LBFM	Law on Budget and Financial Management
MoF	Ministry of Finance
MoH	Ministry of Health
MTO	Medium-term objective of budget balance in structural terms
MTO SGP	Medium-term objective of budget balance in SGP terms
PIT	Personal Income Tax
PYLL	Potential years of life lost
SGP	Stability and Growth Pact
SRS	State Revenue Service
UK	United Kingdom
USA	United States of America
VAT	Value Added Tax

1. INTRODUCTION

The Stability Programme of Latvia has been prepared following the conditions and guidelines of the SGP implementation and prepared in accordance with the requirements of 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.

Even though there is Covid-19 pandemic spreading across the EU and it significantly affects the macroeconomic forecasts, as well as the Member States develop fiscal measures for containing the pandemic, for the support of the affected population and enterprises, and it can considerably affect the indicators of the Stability Programme, it was, nevertheless, resolved that the Stability Programme is to be prepared and submitted to the EC by April 30, as specified in the referred to Regulation. This would promote obtaining and analysis of information, allowing to better develop the EC forecasts and providing for at least the first approximate outlook on the EU economic and fiscal condition. This, in turn, would provide for the possibility to better manage the economic policy through the national and the EU fiscal mechanisms.

Therewith, this year, contrary to its name, this Stability Programme for 2020 - 2023 does not provide information regarding any safe macroeconomic forecasts or sound fiscal measures for overcoming the crisis. The Stability Programme has been prepared, based on the macroeconomic forecasts developed by the MoF in April this year, and contains fiscal measures adopted by the Cabinet up to 17 April this year. The work on the development of fiscal measures for minimising Covid-19 crisis is in progress, the work has started on the fiscal measures for warming up the economy. Macroeconomic forecasts contain many uncertainties, as well, as they largely depend upon the pace of Covid-19 pandemic in the world and the containment measures related thereto. Therewith, actual fiscal indicators will differ from the values forecasted by the Stability Programme much more than in other years.

Unlike the previous Stability Programmes, this time fiscal forecasts have been prepared, based on two scenarios of macroeconomic forecasts. The first - baseline scenario has been prepared in February this year, when Covid-19 pandemic has not yet reached this part of the continent, but the second scenario - Covid-19 scenario, as already mentioned herein above, has been prepared in April this year. For this scenario to consider as many data as possible with respect to the impact of Covid-19 pandemic on the economy of the state, the development of the Programme had been postponed for two weeks. Contrary to that which is specified in Section 28 of the LBFM that the Cabinet shall by April 15 each year submit to the Saeima Latvia's Stability Programme, the law *On Measures for the Prevention and Suppression of Threat to the State and Its Consequences Due to the Spread of Covid-19* provides that the date is changed to April 30, being the final term for the submission of the Stability Programme in accordance with the referred to Regulation. The development of two scenarios provides for the possibility to compare macroeconomic and fiscal indicators and ensures a better outlook on the impact of the crisis in our country.

In 2020, at constant prices, the fall of GDP is being forecasted in the amount of 7.0%, as opposed to the rise of 2.2%, in the case of the absence of the crisis, while in 2021 the GDP growth of 1.0% is forecasted, as opposed to the forecasts of the baseline scenario providing for the rise of 2.8%.

General government budget deficit this year is being forecasted in the amount of 9.4% of the GDP or by 9.0 percentage points more than in the baseline scenario, without considering the support measures under development. In turn, in 2021, at a constant policy, the deficit would reduce to 5.0% of the GDP, contrary to the deficit in the amount of 0.1% of the GDP forecasted in the baseline scenario.

In turn, the general government debt, in 2020, as opposed to 37.9% of the GDP forecasted in the baseline scenario, will grow to 51.7% of the GDP, and will achieve 52.2% of the GDP in 2021.

2. ECONOMIC SITUATION

2.1. EXTERNAL ECONOMIC ENVIRONMENT

Global economic growth, following the acceleration to 3.6% achieved in 2018, slowed down to 2.9% in 2019 and the situation was similar also in Eurozone, where the growth slowed down from 1.9% to 1.2%. Even though in the second half of 2019 there were warnings that both US and Eurozone economies may soon be in recession,, at the beginning of 2020 it was still expected that the economic growth in the world and in Europe would become slightly steeper this year. However, along with the outbreak of Covid-19 and increasingly expanding spread of the disease throughout the world, it has become clear that the global economy would face recession in 2020, whose depth and severity would depend upon the time required for containing the spread of the virus.

Based on the latest IMF forecasts, recession of the global economy will be even more severe than in 2009, when the global economy shrank by 0.1%. On 14 April 2020, the IMF forecasted that the global economy this year would shrink by 3.0%, with the growth restoring and the gross product increasing by 5.8% next year. Similar forecasts regarding the global growth were released also by other world leading organisations and financial companies. If the economic activity in China, initially being an epicentre of the spread of the virus, following the two-month paralysis, has already started to recover, elsewhere in the world, first of all, in Europe and the USA, the activity continues falling, and currently there are no firm forecasts when the restrictions imposed for containing the spread of the virus could be abolished. The IMF forecasts the 1.2% growth for Chinese economy this year, while forecasting the fall for the economy of Eurozone and the USA, respectively, in the amount of 7.5% and 5.9%.

For the largest foreign trade partner countries of Latvia - Estonia and Lithuania, the IMF has forecasted the fall of, respectively, 7.5% and 8.1%, in 2020, followed by the growth of 7.9% and 8.2% in 2021. Previously, for 2020, the central banks of the referred to countries had forecasted, respectively, more than 6% GDP fall for Estonia and 11.4% GDP fall as the central scenario for Lithuania.

In light of high uncertainty as to the time required for containing Covid-19, the economic development forecasts of both the world and the main export partner countries of Latvia has undergone quite harsh corrections over the last month and a half and such corrections cannot be ruled out in the future as well.. The forecasts of Latvian macroeconomic indicators have been developed at the beginning of April, considering the then available information and forecasts about the development of global economy and using the technical assumptions of forecasts of March 25 of the EC, stipulating that the global economy, excluding EU, would increase by 1.1% in 2020, which was by 2.2 percentage points less than the EC had stipulated in its forecasts of Autumn of 2019.

The raid spread of Covid-19 and the threats to economy caused thereby have created a progressing volatility in the global financial markets, triggering the fall in prices of commodities, steep fluctuations in currency rates and stock prices. Oil prices have dropped to the lowest level since 2003, as the *Brent* crude oil price fell from 66 US dollars per barrel at the beginning of the year to 27 US dollars per barrel in the middle of April. The prices of industrial metals and agricultural products, though to a smaller extent, have also decreased. Steep fluctuations have been experienced in the global stock markets, initially facing a very steep fall, followed by partial recuperation.

In response to harsh deterioration of economic situation, the central banks of the countries of the world have strengthened the monetary stimulus. On March 15, the US Federal

Reserve System reduced its benchmark interest rate to 0-0.25% and on March 23, announced the acquisition of government securities in unlimited amount to help overcome the effects of Covid-19 crisis. On March 19, the European Central Bank, in its turn, launched a new asset purchase programme of private and public sector bonds s in the amount of 750 billion euro.

2.2. CURRENT ECONOMIC DEVELOPMENT

After the acceleration of the economic growth of Latvia in 2017 and 2018 to, respectively, 3.8% and 4.3%, facilitated by the growing external demand and restoration of investment flow, in 2019, the economic growth rate became slower again. Last year, Latvia's GDP, at constant prices, increased by 2.2%.

The slowdown of growth rates in 2019 was determined by both deteriorating external environment and several one-off internal factors - weather conditions that negatively affected energy sector in the first half of the year, fall of transit, as well as reduction of the export of financial services. While economic growth in 2019, was ensured by the growing domestic demand, as the private consumption increased by 2.9%, facilitated by continuously growing wages and reduction of unemployment rate. At the same time, public consumption grew by 2.6%. As the EU funds' investment flow became more stable, last year gross fixed capital formation grew about five times slower than in 2018 - by 3.1%. Steeper export growth, in its turn, was hindered by the slowdown of the global economic growth and global trade, as well as a steep drop in re-exports of goods. Meanwhile, the exports of goods produced in Latvia grew, which was especially positively influenced by high volumes of grain crop export. Besides, in 2019 a stable rise was registered also in the exports of services. Thus, in 2019, the total exports of goods and services was by 2.0% higher than in 2018. At the same time, the rise in imports of goods and services was steeper than the export, with the growth comprising 2,3%, therewith, net export contribution to the Latvia's economic growth last year was negative.

Sectoral development

Latvia's economic growth last year was determined by a stable private consumption, thus, in sectoral breakdown, the largest contribution to economic growth was ensured by a stable development of domestic market based sectors. Thus, the value added of trade sector at constant prices grew by 4.1% in 2019, facilitated by a steep growth of wholesale volumes. In the retail trade, in turn, the rise was slower, reaching 2.4%. Higher growth in retail trade was limited by weak increases of food and fuel sales volumes, while the growth rate of retail trade of non-food products, except for fuel, was faster and corresponded to the real net wage increase in the country in 2019. At the beginning of this year, the growth of retail trade volumes was steeper than the average performance last year, with the retail trade turnover at constant prices increasing by 3.3% in the first two months of 2020, as compared to the corresponding time period of 2019. It was ensued by the steeper rise in sales of both non-food products, except for fuel, and food products - by 5.3% and 3.8% respectively. At the same time, the trade of motor fuel decreased - by 3.3% over the year. With respect to the spread of Covid-19 in Latvia and the restrictions pertaining thereto, sales volumes in food product stores are expected to grow steeply. In turn, the volumes of retail trade in other product groups will be adversely affected by physical distancing requirements, as well as by other consequences caused by the spread of the virus, for example, as the uncertainty regarding the financial situation increase, consumers could reduce their consumption and save more.

In 2019, considerable contribution to the Latvia's economic growth was also ensured by other **service sectors** related to the domestic market. In 2019, the value added generated in the healthcare and social work sector grew by 9.5%, in accommodation and catering services - by 8.0%, professional, scientific and technical services, along with the operation of administrative and maintenance services demonstrated value added growth by 6.5%. Nevertheless, similar to trade, also service sectors, especially, accommodation and catering, arts and entertainment, will severely suffer amid the spread of Covid-19. The added value generated by **information and communication services** last year grew slower than during the previous three years, with the growth comprising 2.0% in 2019. In turn, further prospects of the sector are not clear. On the one hand, this year, due to the growing need for IT solutions in order to ensure remote work opportunities, sector's growth could increase. At the same time, if the crisis related to the spread Covid-19 was to endure and enterprises were to face serious financial problems, demand for information and communication services might as well decrease.

The value added of **agriculture** (including agriculture, forestry and fishery) last year grew by 12.8%, thus the agricultural sector demonstrated the steepest growth among all sectors of Latvia's national economy. Thanks to the weather conditions favourable to crop production, in 2019, the historically highest grain harvest was yielded which was by 46.4% higher than in 2018. The volume of cattle production, in its turn, last year decreased by 1.1%. At the same time, the volumes of forestry and logging increased by 5.9%, however the drop was registered in fishery which constitutes rather small share of Latvia's agriculture.

Construction last year demonstrated considerably slower growth than in the previous two years, as the value added at constant prices increased by 2.9%. The slowdown of growth rates in construction sector was mainly attributable to the stabilisation of the EU funds' investments flow, which determined the growth of engineering construction volumes by only 1.0%. The volumes of specialised construction works, including wiring, installation of pipelines, completion of construction works, remained at the level of the previous year. At the same time, the construction growth was positively influenced by the growth of construction of buildings by 7.8%. It should be noted that the EU funds' investments this year will remain approximately at the level of the previous year, therewith, to ensure growth of construction sector in 2020, implementation of private investment projects will be crucial. Nevertheless, the latest construction confidence indicator demonstrated significant deterioration which could be attributed to the events and uncertainty regarding the spread of Covid-19 in Latvia, thus the overall construction prospects and implementation of new investment projects related to construction in Latvia this year could be endangered..

In 2019, moderate growth in the amount of 2.1% was demonstrated by the **manufacturing**, the development whereof last year was hindered by weakening of the global economic growth and decreasing demand in external markets, as well as unfavourable situation in the largest manufacturing subsector - wood processing. Wood processing output last year decreased by 0.2%, affected by the drop of demand in export markets and falling prices. The drop in production volumes was registered also in the second largest manufacturing subsector - manufacture of food products (-1.0%). At the same time, manufacture of fabricated metal products and electrical equipment, as well as production of computers and electronic products demonstrated strong growth. The total industrial production growth in 2019 was adversely affected by the decrease in **electricity and gas supply** by 4.4%, determined by the significant drop in electricity production volumes in the first half of last year due to the weather conditions unfavourable for electricity generation. At the beginning of this year, industrial production sector continued to demonstrate negative developments, when the total industrial production output decreased by 4.5% in January, as compared to the corresponding month the year before. It has been the steepest fall of the sector since the end of 2009. It was affected by both the fall of energy sector by 11.0% and the fall of manufacturing by 3.6%, when due to the base effect the wood processing output decreased significantly. It should be noted that the developments in the world, including

Latvia, with respect to rapid spread of Covid-19 disease will also affect the further development of manufacturing industry this year. The novel coronavirus has been a large shock to the economic activity in the world, resulting in disruptions of international supplies and reduction of the already weakened global trade. Likewise, also Latvia’s industrial enterprises, respecting the precautionary measures and responding to this situation, have to adapt their production processes and follow the changes in demand.

In 2019, a drop by 4% was registered in the t**ransport and storage sector**. It was determined by the drop in cargo transit through Latvian ports as Russia redirects the cargoes to its Baltic Sea ports and the demand for Russian coal dropping in global markets. As a result, in 2019, cargo turnover in ports was by 5.7% lower than in 2018, whereas the volume of cargoes carried by rail dropped by 15.8% last year. Cargo turnover in transport by road remained at the level of the previous year, decreasing by 0.2% in 2019. In recent years, air transport, in its turn, was the one to support the transport sector, and the number of passengers serviced in Riga International Airport in 2019 had grown by 10.5%. Besides, in January this year, as compared to January the year before, number of passengers in Riga International Airport grew by 12.2%. However, further prospects of transport sector are critical - the implementation of cargo carriage policy of Russia will continue adversely affect the transit. This is confirmed by the latest transport data about cargo carriage at the beginning of this year, when in the first two months of 2020, as compared to the relevant time period in 2019, cargo turnover in Latvian ports decreased by 32.2%, and the volume of cargoes carried by rail reduced even by half - by 50.0%. In turn, the number of passengers carried by air transport is still expected to increase in February, however, amid the spread of Covid-19 disease, already at the beginning of March the situation in the sector faced harsh changes. At the beginning of the month Latvian national airline *air Baltic* reduced the number of flights and stopped the flights to and from several destinations. Moreover, in order to contain the spread of Covid-19 in Latvia more effectively, all international passenger transportation through airport, ports, by busses and by rail transport has been suspended in March 17. These restrictions will severely affect passenger carriers and the transport sector as a whole, which will also be reflected in economic growth figures this year.

In 2019, the drop was demonstrated also by the **financial and insurance sector**. As the non-resident servicing business declined and the export of financial services decreased, the value added of the sector has reduced by 8.8% last year. Therewith, the share of the sector in the economy has reduced considerably, comprising 3.2% in 2019. Drop of the value added in the sector was attributable to Latvia’s efforts to improve the financial crime prevention system by fulfilling all of the Financial Action Task Force recommendations, thus the non -resident deposits have considerably reduced. The volume of non-resident deposits in Latvian commercial banks at the end of 2019, as compared to the end of 2018, had decreased by 24.6% and comprised 23% of the total deposits, which is less than half of non-resident deposit share registered in 2015, when the share of non-resident deposits in Latvia had achieved 58%. At the same time, it should be noted that resident deposits have continued to grow in 2019, reaching 14 billion euro, which was by 7.5% more than the year before.

Investments

In 2019, **gross fixed capital formation or investments** showed an increase, but, as compared to the previous two years, the growth of investments can rather be deemed symbolic, because, over the year, investments increased only by 3.1%. Nevertheless, the increase of investments was steeper than the total GDP growth and ensured 0.7 percentage points contribution to the real GDP growth in 2019. The slowdown of growth rate of investments is mainly related to the lower construction activity, demonstrated also by weaker performance of the construction sector in 2019.

Notwithstanding the considerable decrease in construction activity last year, investments are still mainly allocated to the construction of offices, housing, warehouses and other buildings, as well as renovation of already existing buildings and structures. In 2019, investments into buildings and structures comprised 50.9% of total investments or 3 332 million euro. Increase of volume of investments into buildings and structures is recorded in several sectors of national economy, however the largest input was ensured by two sectors, namely, real estate operations, as well as public administration and defence. Overall, investments into buildings and structures last year were by 2.8% larger than in 2018.

The investments growth in machinery and equipment also slowed down, with the rise last year comprising only 2.0%, as opposed to the rise of 13.1% in 2018. Therewith, the volume of investments in machinery and equipment in 2019 reached 2.8 billion euro. Nevertheless, despite the rise in investments into these assets registered in the recent years, the current level of investments in machinery and equipment is deemed to be too to significantly boost productivity growth and ensure the introduction of innovations. For example, investments in machinery and equipment in 2019, in total, were by 1 billion less than in the period of 2007 - 2008. The amount of investments into other investments assets is also lower than before the financial crisis of 2009, however the GDP, in total, has exceeded the pre-crisis level already in 2017. It is indicative of the entrepreneurs being cautious about making investments and expanding their entrepreneurial activity. The data of business surveys regarding the factors affecting performance of investments is not pleasing, either, demonstrating that the majority of performed investments is directed towards replacement of the old machinery and equipment and optimisation of production processes, and only one third of investments is oriented towards expansion of production.

The EU funds' investments also played a significant role in the growth of investment activity over the recent years. State budget expenditure for the EU funds' investment projects last year comprised 712 million euro, out of which 350 million euro were capital expenditure or investments directly influencing the volume of the gross fixed capital formation in economy. Nevertheless, both total state budget expenditure for the EU funds' investment projects and capital expenditure in 2019 practically remained at the level of the previous year, thus creating no additional impetus for a steeper growth of investments in national economy as a whole. Considering the latest forecasts, the state budget expenditure for the EU funds investment projects is expected to remain at the level of the previous year also in 2020.

Based on the most recent situation - the decline in external demand, which begun to be reflected in Latvia's export data in the middle of the last year, and the consequences of the spread of the new coronavirus, would have an adverse effect on the volume of investments in 2020. The closure of state borders, drop in the flow of foreign tourists, as well as self-isolation and introduction of the quarantine requirements will reduce the economic activity of population, which will directly reflect in lower corporate income. Furthermore, sudden disruption of supply chains might adversely affect the supply side of production, increasing the prices of production raw materials. Therewith, enterprises will face a considerable fall in income and the implementation of investment projects might be postponed for indefinite period of time.

Foreign trade

In 2019, Latvia's **export of goods and services** at constant prices grew only by 2.0%, representing the weakest rise since 2014. Considering that also Latvian real GDP growth rate slowed down last year, amounting 2.2%, the share of export in GDP remained practically unchanged, as compared to the previous years, and comprised 63.2%. In 2019, the development of export was concurrently adversely affected by the set of several factors. One of the main factors was the trade tension and introduction of mutual import tariffs between the two largest global economies or USA and China, causing an adverse effect on global trade and global economic growth. Therewith, last year the global GDP demonstrated the weakest growth in the last decade, while the EU growth had been at the lowest level since 2014.

The EU is the largest export market for Latvian goods and services. In 2019, 72.3% of total export of goods and 66.9% of total export of services of Latvia has been exported to the EU. Thus, along with the slowdown of domestic consumption in the EU, the growth rates of Latvia's export started to reduce, as well. For example, the value of export of Latvia's goods to the EU at current prices in 2019 increased by 1.8%, while the value of export of services grew by 7.9%.

2019 was full of challenges for the exporters of Latvia's goods, because the contraction in external demand, uncertainty related to UK withdrawal from the EU, drop in timber prices on global markets and decrease in re-export volumes have slowed down the development of export of Latvia's goods. Export of goods have been balancing on the verge of fall throughout 2019, and over the year, as a whole, the value of export of goods was only by 0.2% larger than in 2018, thus reaching 12.8 billion euro.

In 2019, changes in the value of export of goods were mainly affected by the reduction in export of machinery and mechanical appliances by 28.2%, attributable to decrease in re-export of turbojet engines to the USA by 343 million euro. This factor should be viewed as an exception, describing neither the changes in external demand, nor the competitiveness of Latvian exporters, as it was affected by the restoration of the aircraft fleet of *air Baltic* airline and the related technical inspection and repairs of aircrafts in 2018. If we exclude the re-export of turbojet engines from the total value of export of goods, then the growth of export of goods in 2019 would reach 2.8% instead of 0.2%.

In 2019, another factor adversely affecting the value of export of goods, especially wood export, was the drop in wood prices. In 2019, drops in the value of wood export were recorded to several countries - UK, Germany, Sweden, being the most significant wood export markets. Decrease in wood prices in global markets was determined by the changes in demand and supply - on the one hand, the slowdown of development rates of global economy reduced the wood demand, but, on the other hand, - due to unfavourable weather conditions in the previous years more extensive logging works have been performed in number of countries of Western Europe, thus increasing the wood supply. Additionally, fluctuations in wood export were determined by uncertainty regarding the UK withdrawal from the EU and possible trade tariffs between the UK and the EU. At the beginning of 2019, this factor had a beneficial effect on the export of wood goods, because the UK was forming the stock of these goods, however, starting from the second quarter of 2019, the wood export to the UK started to reduce. Considering that the UK is the largest export market for wood products manufactured in Latvia, this had a negative impact on the overall dynamics of wood export. Thus, the total wood export value in 2019 was by 3.1% lower than in 2018.

In 2019, the value of export of mineral products reduced by 13.0%, along with significant decrease in export of petroleum oil and electricity. The drop in petroleum oil export was affected by the drop in prices in global markets, while the reduction of electricity export was attributable to the drop in electricity prices in the European electricity stock exchange *Nord Pool Spot.*

At the same time, export data for 2019 had also shown several positive features, mitigating the adverse effects of the above-mentioned factors. Notable export growth rates during the entire 2019 have been demonstrated by the export of cereals and oil seeds, due to the high volumes of harvest of these products in 2019. Thus, in 2019, the value of cereals export grew by 43.4%, as compared to the year before, while the export of oil seeds almost doubled. Out of food products, exports of dairy products and alcoholic beverages also showed an increase. Overall, in 2019, the export of agricultural and food products increased by 14.8% or 350 million euro.

A comparatively steep rise in export was recorded also for chemical industry products. In 2019, the export of this product group grew by 8.9%, which was mainly ensured by the rise in export of pharmaceuticals to Russia and the Baltic States. At the same time, it should be noted that, in the last two months of 2019, the export of pharmaceuticals dropped, which might be indicative of weakening of external demand for these goods.

Contrary to the development of export of goods, in 2019, export of services showed quite stable increase by 6.8% or 358 million euro, thus achieving 5 627 million euro. It was possible to achieve such a strong growth of export of services, despite the considerable decrease in export of financial services (-42.5% y-o-y). The largest contribution to the growth of export of services was ensured by transport services, with the value of exports increasing by 3.7% at current prices. It was possible to achieve the growth of export of services, thanks to the growth of revenue from the cargo transport by road services, while the amount of revenue from sea and rail transport services decreased last year. Transport services comprise the largest group of export of services, making up 39.0% share in the total export of services in 2019.

As compared to the previous years, in 2019, the growth rate of expenditure of foreign tourists slowed down, with the rise comprising only 1.2% last year. The slowdown of foreign tourist expenditure was related to the deceleration of the flow of foreign tourists in 2019. The number of serviced foreign guests and the time spent by them in Latvian hotels last year increased, correspondingly, by 1.1% and 2.9%, comprising a considerably lower increase than in the previous years. Exports of information and computer services continued positively contribute to the total export of services, where, in 2019, like in the previous years, the increase is to be measured with two-digit number - by 11.3%. The steepest export rise among all service groups last year was demonstrated by the export of construction services, increasing by 27.2% over the year.

Similar to export, the growth of **import of goods and services** also slowed down in 2019. Along with the slowdown of Latvian economic growth, the demand for imported goods reduced, as well, especially with respect to intermediate goods applied in the manufacturing process. Total value of import of goods and services s in 2019 grew by 2.3% at constant prices, which is slightly faster than the growth of export, therewith the net export contribution to the real GDP growth last year was negative, namely, - 0.3 percentage points.

In turn, in current prices, the total import value increased by 1.7%, meaning that the prices of import of goods and services last year were slightly lower than in 2018. Assessing the total foreign trade balance, in 2019, a surplus of 25 million euro was recoded, as opposed to the deficit of 54 million euro in 2018.

In 2019, as compared to the year before, the value of import of goods in current prices decreased by 0.3%. The drop in import of goods was largely determined by two product groups, machinery and mechanical appliances, as well as mineral products, the import value whereof dropped, correspondingly, by 17.6% and 15.1%. Decrease in import of machinery and mechanical appliances was affected by the already referred to situation with respect to the service and repairs of turbojet engines in *air Baltic* airline. The import of mineral products, in its turn, was affected by reduction in the value of import of oil, gas and electricity with respect to the fall in prices of these energy resources. Imports value of metals and their products reduced by 7,2% At the same time, in 2019, a comparatively significant increase of value of import was recorded for such goods as food, chemical industry goods and vehicles, allowing to almost fully compensate the adverse effects of reduction of import of machinery and mechanical appliances.

Similar to the export of services, in 2019, quite a strong rise was recorded also in import of services, overall, by 5.2%, as compared to the year before. The growth was recorded in all service groups, except for telecommunication and financial services, as the import value thereof reduced, correspondingly, by 17.5% and 11.5%. The largest rise in import was recorded for information and computer services - by 19.7%, in total. The import of transport services was by 3.9% higher than the year before, but the spending of Latvian tourists abroad increased by 0.9%. The import of services is closely related to the development of Latvia’s exports and economic growth in general. As the external and domestic consumption, as well as investment activity in Latvia decrease, the demand for foreign or import services becomes weaker, as well. Thus, although import of services increased last year, it was the weakest growth for the last five years.

Current account

In 2019, Latvia’s balance of payments current account recorded a deficit of 163 million euro, which was by 35 million euro smaller than in 2018. Foreign trade affected the changes in the current account, however, the decisive role in formation of the deficit in the current account in 2019 was played by the primary income account, due to the foreign residents’ high income level from financial assets in Latvia. Therewith, the current account balance in 2019 stood only at -0.5% of the nominal GDP of Latvia, which is by 0.2 percentage points less than the year before, when the amount of deficit comprised 198 million euro. Even though the current account balance in the last two years was negative, in general, the current account can by assessed as sustainable and does not indicative any imbalances in the development of Latvian economy. Figure 2.1 reflects the dynamics of the current account of Latvia's balance of payments by components.

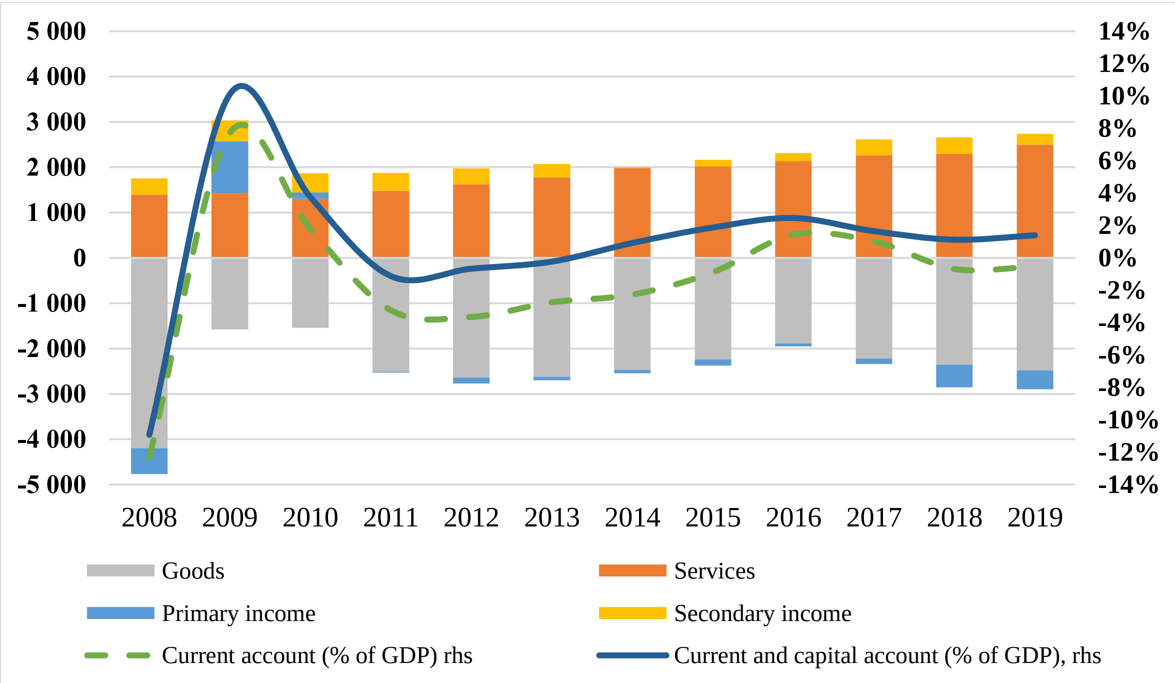

Figure 2.1. Components of the current account of Latvia’s balance of payments (million *EUR*) and current and capital accounts in percentage of GDP[1]

[1] Data source: Bank of Latvia

As the import of goods grew steeper than the export of goods, the goods account deficit grew by 130 million euro to 2 481 million euro. Nevertheless, the services account surplus to a full extent covered the goods account deficit, thus levelling out the trade account balance. In 2019, the services account surplus comprised 2 499 million euro, increasing by 202 million euro over the year.

The deficit of primary income account reduced from 502 million euro in 2018 to 414 million euro in 2019. Deficit reduction was positively influenced by higher income of Latvian residents abroad, as well as lower income obtained by foreign investors for the previously made investments in Latvia. Nevertheless, it should be noted that the comparatively high deficit in this account is preserved exactly by income of foreign investors. In 2019, the surplus was preserved in the secondary income account, however it was by 124 million euro smaller than the year before, triggered by higher contributions of Latvia into the EU budget and smaller cash transfers of Latvian households and enterprises from abroad. Overall, the surplus of secondary income account comprised 234 million euro.

Inflation

In 2019, as compared to the previous year, **consumer prices** in Latvia grew by 2.8%, with the prices of both goods and services rising, correspondingly, by 2.7% and 3.0%. The achieved increase in consumer prices corresponds exactly to the MoF forecasts developed in June 2019.

In 2019, the range of increase of consumer prices was comparatively broad in breakdown by months, mainly determined by the base effects, increase in excise duty and tariffs of administratively regulated services in separate months, as well as comparatively volatile food prices. While in the first half of the last year inflation was close to 3%, in the second half of the year there was a slowdown in price growth.. Figure 2.2 reflects the changes in consumer prices by months.

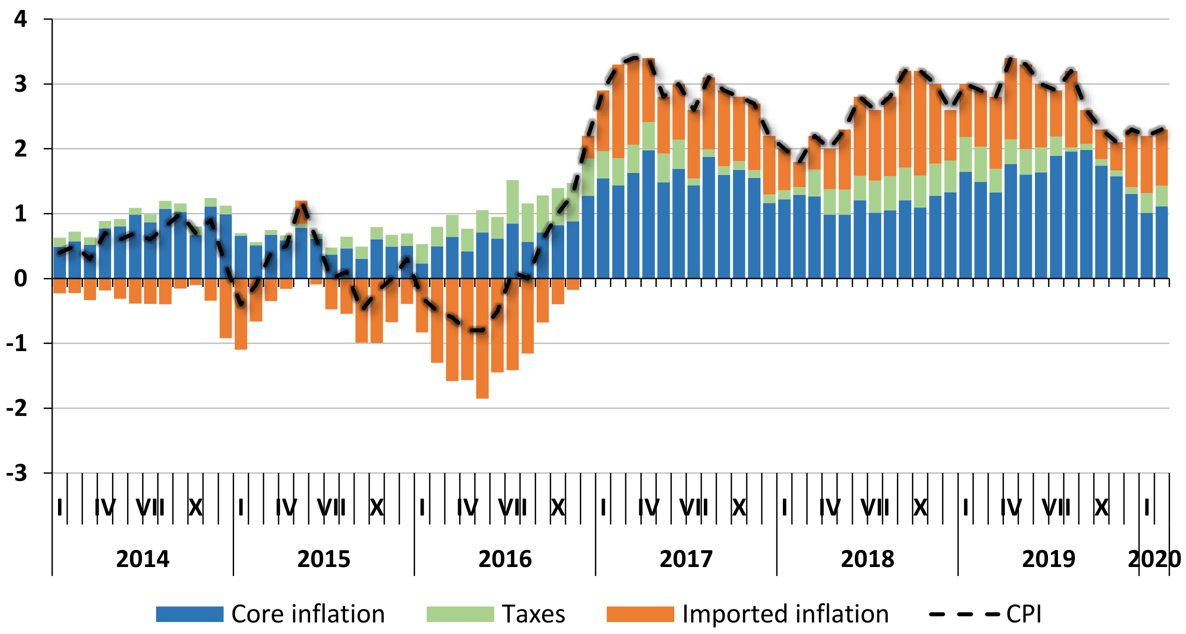

Figure 2.2. Annual inflation according to a source of origin[2]

[2] Data source: CSB, MoF calculations

In 2019, increase of consumer prices was mainly determined by the rise in prices of food by 3.3%. The rise in food prices was affected by more expensive bread and grain crop, vegetables and pork. In 2019, the prices of these goods on average were, correspondingly, by 6.1%, 11.8% and 7.8% higher than in 2018. While the prices of grain crop and vegetables were affected by dry weather conditions both in 2018 and in Summer last year in number of European countries, the price of pork, in its turn, was affected by the pork deficit in China with respect to the spread of African swine fever in this country. Considering that China is the largest producer, as well as the consumer of pork in the world, the decrease in pork supply in China considerably affected the prices thereof on a global scale.

The rise in consumer prices in 2019 was largely affected by the rise in prices of public utilities. For example, electricity was by 9.0% more expensive than the year before. Such a sharp price increase was determined by significant rise in prices in *Nord Pool Spot* stock exchange in 2018 (+44% as compared to the year before). It should be noted that, at the end of 2018, new electricity supply contracts for 2019 have been concluded for the majority of households, which considered the sharp rise of electricity prices in stock exchange.

In 2019, the price of gas increased by 5.7%. However, if in the first half of the year the rise in prices had achieved almost 20%, then in the second half of the year the price of gas fell by 7.0%, as compared to the relevant period last year. Sharp rise in gas prices in the first half of 2019 was determined by two factors. First, on 1 January 2019, new two-tier tariffs of natural gas distribution system services took effect, introducing a fixed fee for connection in accordance with the permissible load of the connection, irrespective of the amount of the natural gas consumption. Secondly, the gas price was also affected by a sharp rise in oil prices in the world in 2018. Nevertheless, considering that the oil prices on the world stock exchanges in the first half of 2019 were lower than the year before, following the revision of gas tariffs for the second half of 2019, the gas price for households reduced.

The prices of other services related to housing maintenance grew noticeably, as well. For example, in 2019, waste collection was by 17.0% more expensive than the year before, triggered by increased tax rates for waste burial (disposal), starting from 1 January 2019. The rise in water supply service prices by 6.0%, in turn, was influenced by the new tariffs for water management services of *Rīgas ūdens*, which took effect already on 1 June 2018. Thus, the augmentative impact was recorded only till the middle of 2019.

The rise in prices of alcoholic beverages and tobacco products, correspondingly, by 4.9% and 6.7%, also had an augmentative impact on consumer prices in 2019. Rise in these prices was mainly affected by increase of the excise duty rates on alcohol in March last year and on cigarettes - in July last year.

Stable wage growth in all sectors of national economy, as well as the rise in prices of public utilities, which increased the entrepreneurship costs, directly affected also the prices of other services, especially, leisure and culture, health, as well as catering services. In 2019, the prices of these services were, correspondingly, by 3.1%, 2.1% and 4.1% higher than the year before.

In general, it should be concluded that the price increase in 2019 was maintained by internal economic processes, as confirmed by data on core inflation. Last year, the input of core inflation into the average rise of consumer prices comprised 1.7 percentage points, thus ensuring more than a half of the rise in consumer prices. The impact or input of external factors into the price rise, mainly reflecting through higher gas and thermal energy, as well as food prices, comprised 0.9 percentage points. In turn, due to the changes in tax rates, the inflation rate in 2019 grew by 0.3 percentage points.

Labour market

Along with the slowdown of economic growth in 2019, the employment growth in Latvia practically came to a standstill, with the unemployment rate concurrently continuing to steeply decline, triggered by reduction in the number of working age population. In 2019, the amount of population employed in the national economy, as compared to the previous year, had grown by 0.1% and comprised 910.0 thousand. The unemployment rate, in its turn, declined to 6.3% and was by 1.1 percentage point lower than the year before.

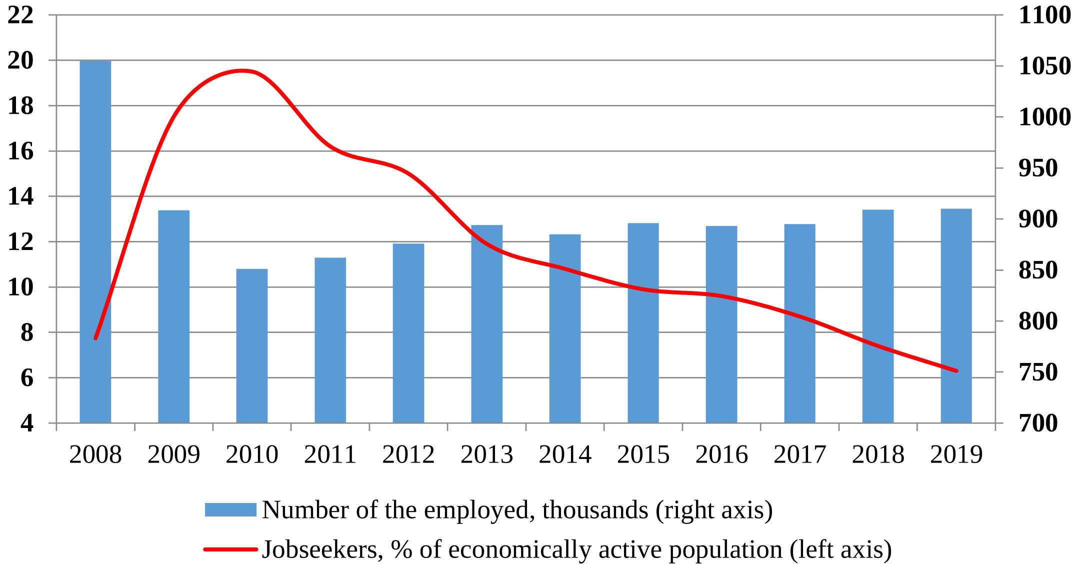

Figure 2.3. Employment and unemployment in 2008 - 2019

Data on the occupied workplaces show that, in 2019, the most significant increase in the number of workplaces was in the sector of administrative services - by 4.7%, accommodation and food service activities - by 3.9%, health and social work activities - by 3.3% and in the construction sector - by 2.4%. In turn, the number of workplaces decreased in the electricity and gas supply sector - by 3.1%, public administration sector - by 1.7%, as well as in the sectors of manufacturing and financial services - by 0.1% in both.

In the first months of 2020, the trend of the previous year continued, as the unemployment rate continued to decline. The registered unemployment rate over the period of 2019 had declined by 0.4 percentage points to 6.1%, at the end of February of 2020 it comprised 6.3% and was still by 0.4 percentage points lower than the year before. Nevertheless, following the global crisis caused by Covid-19 virus and sharp drop of economic activity, in March the unemployment rate started to grow, as the number of the unemployed registered over the month increased by 3 280 or 5.6% by April 1 and the registered unemployment rate grew to 6.7%. The number of job vacancies, after having demonstrated a steep rise over the period of 2019, has started to sharply decline under the impact of Covid-19 crisis, with the number of job advertisements on the portal of recruitment company *CV Online* decreasing by almost 50% over the month, by April 1.

In 2019, the average monthly gross wage, as compared to the year before, increased by 7.2% to 1 076 euro. This is a slightly slower increase than in the previous two year, when the wage had grown, correspondingly, by 7.9% in 2017 and by 8.4% in 2018. In the course of 2019, the wage growth rates gradually decreased, falling to 6.9% in the fourth quarter.

Last year overall the wage growth was steeper in the private sector, where the average monthly gross wage increased by 7.6%, while in the public sector it grew by 6.8%. Nevertheless, higher average wage level still remained in the public sector, where the average wage in 2019 was 1 103 euro, while in the private sector it comprised 1 067 euro. The real net wage in 2019, as compared to the year before, increased by 3.9%, representing a slower growth than in 2018, when the growth thereof by 7.2% was facilitated by reduction of the personal income tax starting from 1 January 2018.

The sharpest wage increase among the sectors was observed in the health care sector - by 13.2%, sector of administrative services - by 10.9% and construction - by 10.3%. The highest monthly gross wage was recorded in the sector of financial services - 2 083 euro, and in the sector of information and communication services - 1 731 euro. The lowest wage, in turn, was in the sector of accommodation and food service activities - 767 euro.

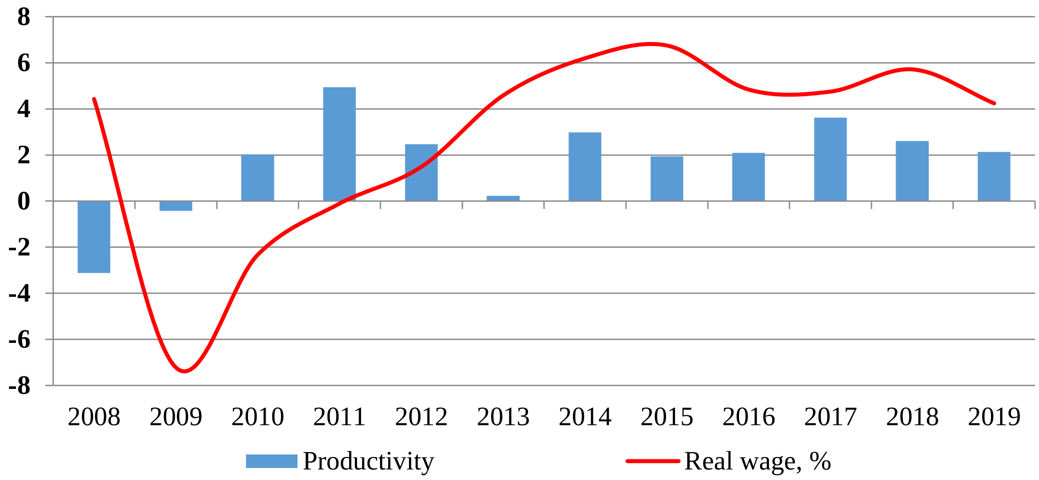

Figure 2.4. Changes in productivity and real wage, % against the previous period

The wage growth has been exceeding the productivity growth ever since 2013, creating concerns that too steep increase of costs may weaken the external competitiveness of Latvian enterprises and limit the export, however, in the previous years, such adverse effect on reduction of the export market share was not yet observed. It should be mentioned that in the previous years the wage growth was influenced also by several one-off factors, *inter alia*, sharp increase of the minimum wage and income legalisation, along with the reduction of shadow economy, and the real rise in costs of entrepreneurs was not as steep as data on average wage growth shows. Increase of labour costs was also mitigated by the tax reform implemented from 2018, which included the reduction of personal income tax.

2.3. Macroeconomic Development Scenario

2.3.1. Baseline scenario

The initial medium-term macroeconomic development baseline scenario for 2020 - 2023 has been drafted in February 2020, when Covid-19 pandemic has not started yet. These forecasts have been developed, by consulting the experts of the Bank of Latvia and the Ministry of Economics, as well as the EC and the IMF. Forecasts of the macroeconomic indicators were approved by the Fiscal Discipline Council, by publishing its opinion on February 17, 2020. The latest forecasts of the EC and the IMF at the time - 2020 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, underlying the Latvia's export forecasts.

This scenario considers that the Latvian economy has entered the cyclical slowdown phase, evidenced by the fact that Latvian economic growth rates last year slowed down to 2.2%. The baseline scenario stipulated that in 2020 the GDP will grow by 2.2% or will be by 0.6 percentage points lower, as compared to the June 2019 forecasts . Thus decrease has been determined by more unfavourable situation in external markets, as well as less favourable development in several economic sectors significant to Latvia, including transport and construction. In turn, the GDP growth forecasts for 2021 and 2022 has not been changed, assuming that the global trade will recuperate following the slowdown of several years, as projected by the EC and the IMF in their respective forecasts.

The scenario stipulated that a strong personal income growth and low unemployment rate will be preserved. Private consumption will be the main economic growth driver in 2020, increasing by 3.3%. Investment growth will be slower than in the previous years and the export growth rates will remain at quite moderate level of 2.5%, due to limited demand in external markets and reduction of export of transit services. In the coming years, along with improvement of the situation in external markets, Latvian economic growth will stabilise at the level of 2.8%, which is close to the potential growth rate.

In 2020, average annual inflation is projected at 2.3%, decreasing from 2.8% last year. Inflation rate will continue declining also in the coming years to 2.0% by 2023. Lower growth of consumer prices in 2020 will be determined by a slower global economic growth, weakening the growth of oil and food prices in global markets, while internal factors, *inter alia*, stable wage increase, will continue determining the rise in service prices.

Consumer prices will be influenced in an upward direction by increase in prices of alcoholic beverages and tobacco products, as well as the rise in prices of health care, catering, culture and leisure services. Unlike the factors affecting inflation last year, at the beginning of this year, corrections to the consumer price dynamics have been introduced by the fall in prices of separate public utilities, on the one hand, and the rise in fuel prices, on the other hand. In the first two months of 2020, the average price increase for goods comprised 1.9% yoy, while the service prices, on average, grew by 2.9%.

Table 2.1. Growth and Related Factors

(baseline scenario as at February 2020)

	ESA code	2019	2019	2020	2021	2022	2023
		million euro	Growth %				
1. GDP at current prices	B1*y	30 476	4.9	5.0	5.3	5.1	4.6
2. GDP at 2010 prices	B1*y	27 497	2.2	2.2	2.8	2.8	2.4
GDP by expenditure at 2010 prices							
3. Private consumption	P3	16 515	2.9	3.3	3.2	3.2	3.0
4. Public consumption	P3	5 005	2.6	2.2	2.8	2.6	2.9
5. Gross fixed capital formation	P51	6 550	3.1	3.0	4.5	3.0	1.8
6. Changes in inventories and acquisition of valuables	P52+P53	467	-	-	-	-	-
7. Exports	P6	17 387	2.0	2.5	3.5	3.4	2.6
8. Import	P7	18 426	2.3	3.0	4.4	3.7	3.0
Contribution to GDP growth							
9. Final domestic demand	P3+P51		2.9	3.1	3.6	3.2	2.8
10. Changes in inventories and acquisition of valuables	P52+P53		-0.5	-0.4	0.0	0.0	0.0
11. Exports-imports balance	B11		-0.3	-0.4	-0.8	-0.4	-0.4

The largest input to the consumer price increase in the first two months of this year was ensured by the rise in food prices by 3.9%, explaining more than one third of the total growth of consumer prices. The rise in prices was expressly high for fresh fruit, meat and meat products, rice, mainly determined by external factors (incl., demand in China).

In turn, the inflationary pressure will be mitigated by the fall in prices of energy resources. The scenario assumes that gas, electricity and solid fuel prices will decline in 2020. Correspondingly lower prices of public utilities will mitigate the price pressure also for such services as health care, catering and accommodation.

Already at the beginning of the year it was expected that in January the fuel price will increase - it increased by 8.8% yoy. In turn, in February, the fuel price rise was smaller by 4.8% yoy. Thus, the pressure of the fuel price rise on inflation reduced and will continue so at least till the middle of this year. The rise in fuel prices at the beginning of this year determined two factors - first, on January 1 this year, the excise duty rate increased for oil products, and second, the oil price was higher in global markets. Nevertheless, since the beginning of the year, the oil price demonstrates downward dynamics, which is largely due to reduction of consumption of energy globally. The scenario assumes that the oil price will decline in the first six months of the year and will stabilise over the second half of the year, thus the average oil price in 2020 might be close to the level of 2019.

The augmentative impact of taxes on consumer prices will be ensured by increase of excise duty rates for alcoholic beverages from March this year. Excise duty rate for tobacco products this year remain unchanged, however the prices of tobacco products in the first half of this year will still be affected by the excise duty rate increased in July last year.

According to the baseline scenario the wage increase in 2020 will be slightly lower than in the previous years, determined by a slower economic growth, but it will, nevertheless, remain quite strong, due to base effects and decreasing labour force supply. Average monthly gross wage in 2020 will increase by 6.0% and reach 1 147 euro. In the coming years, the wage increase rates will gradually slow down, with the planned increase of minimum wage to 500 euro still positively influencing the increase in 2021, and the average wage increase will comprise 5.5.%, but afterwards it will stabilise at 5% level, being close to productivity growth.

2.3.2. Covid-19 impact scenario

The rapid spread of coronavirus in the world and Europe, as well as the introduced measures for containing the pandemic have seriously affected the economic development around the world in 1Q 2020. Thus in April 2020, the MoF has developed new medium-term macroeconomic development scenario considering both the adverse effect of Covid-19 on economic growth and the support measures of the Latvian government for mitigating the consequences of the crisis. The scenario forecasts the drop of Latvian GDP by 7% in 2020. The scenario has been based on technical assumptions of the EC of Spring 2020 forecast, published on March 25, *inter alia*, forecasts of world's economic growth. The MoF forecasts have also assumed that the average oil price in 2020 will comprise 38 US dollars per barrel, which is by 41% less than on average in 2019.

The macroeconomic development scenario is based on the assumption that the viral pandemic will be contained in the first half of 2020 and that economic activity will gradually recover thereafter. This assumption underlies the macroeconomic projections of all international institutions, based on the latest data and results on the prevalence of Covid-19 in China and the improvement in Italy. The scenario assumes that GDP will decline by 1% to 1.5% yoy in the first quarter. The largest economic downturn is expected in the second quarter, with value added in some sectors declining by more than 50% yoy. In the third and fourth quarters, the decline will be about half as small as in the second quarter. In the sectors most affected by the crisis: transport, accommodation and catering, arts, entertainment and recreation, professional services, output volumes will not return to the level of 2019 by the end of 2020. On the expenditure side, the largest decline in 2020 is expected in investments, where, as the entrepreneurs abstain from investments and postpone the investment projects, the gross fixed capital formation would be by 18% lower than in 2019. Export and private consumption will decline by 9% and 6% respectively, while the overall economic downturn will be slightly mitigated by 2% increase in public consumption maintaining this year's planned expenditure.

Over the coming years, the economic growth will gradually recover, with the GDP increase of 1% in 2021 and 3.5% in 2022, but not yet returning to the level of 2019 and exceeding it only in 2023.

As compared to the inflation forecast in the baseline scenario, in Covid-19 impact scenario, the inflation forecast for 2020 has been reduced by 1.9 percentage points to 0.4%. The forecast for 2021 has been reduced by 0.4 percentage points to 1.7%. Correction for 2020 is related to the revised price forecasts of fuel, gas, thermal energy, leisure and culture, as well as restaurant services.

Table 2.2. Growth and Related Factors

(Covid-19 impact scenario of April 2020)

	ESA code	2019	2019	2020	2021	2022	2023
		million euro	Growth %				
1. GDP at current prices	B1*y	30 476	4.9	-7.9	2.4	5.6	4.4
2. GDP at 2010 prices	B1*y	27 497	2.2	-7.0	1.0	3.5	2.4
GDP by expenditure at 2010 prices							
3. Private consumption	P3	16 515	2.9	-6.0	1.0	3.9	3.0
4. Public consumption	P3	5 005	2.6	2.0	2.0	2.9	2.5
5. Gross fixed capital formation	P51	6 550	3.1	-18.0	3.0	4.9	2.0
6. Changes in inventories and acquisition of valuables	P52+P53	467	-	-	-	-	-
7. Exports	P6	17 387	2.0	-9.0	1.0	4.0	3.3
8. Import	P7	18 426	2.3	-10.0	1.9	4.5	3.7
Contribution to GDP growth							
9. Final domestic demand	P3+P51		5.6	-8.4	3.0	6.1	4.7
10. Changes in inventories and acquisition of valuables	P52+P53		-0.5	-0.5	0.0	0.0	0.0
11. Exports-imports balance	B11		-0.3	1.0	-0.6	-0.5	-0.4

Oil price forecast in the world and its impact on fuel and gas prices in Latvia has been reduced. In March this year, *Brent* crude oil price plummeted to 24.5 US dollar per barrel (the lowest level since 2003), halving the price of oil in two weeks. While at the beginning of the year the global oil supply surplus and the deteriorating economic sentiment due to the rapid spread of Covid-19 in China had a downward effect on oil prices, then in early March, OPEC and Russia failed to agree on oil extraction to stabilize oil production oil supply in line with falling demand. Following the OPEC+ meeting, Saudi Arabia announced that it would reduce its oil price for April supplies to 25 US dollars per barrel, bringing oil prices down by 30% in one day. It is expected that by April, when Saudi Arabia will actually supply oil at the above quoted price, the oil price in global markets will range from 25 to 30 US dollars per barrel. The closure of national borders, cancellation of flights and introduction of quarantine will adversely affect the volume of tourism and passenger transportation, which, in turn, will reduce the demand for oil. Therewith, it is expected that the oil price in the first half of this year will range from 25 to 40 US dollars per barrel. Thus, fuel prices in Latvia, at least till the middle of this year, will be lower than in corresponding period of the last year.

Along with the sharp decrease in oil prices, also steeper reduction of gas tariffs is forecasted in Latvia, starting from the second half of this year. Thus, the gas price drop in Latvia also in the second half of this year could be very similar to the first half of the year, when the gas price fell by 18.4%. Due to lower prices of energy resources this year from April 1, the heat energy tariff of *Rīgas siltums* will also decrease by 7.4%, which would also reduce the average heat energy price in 2020. Lower fuel, gas and heat energy prices will also reduce the prices of such services as health care, catering and accommodation services. Even though the share of fuel, gas and thermal energy prices is only 10.6%, a significant drop in fuel and gas prices and the indirect effects thereof on the prices of services will considerably reduce the inflation forecast for 2020 compared to the baseline scenario. Fall in fuel prices in some months of 2020 might range from 15 to 20%. Furthermore, the consequences caused by Covid-19, which would reflect in declining income, would reduce demand for culture, leisure, entertainment and restaurant services, thus decelerating the increase in prices of these services. Nevertheless, the average inflation in 2020 will be positive driven by rising food prices.

The spread of Covid-19 on a global scale might affect the food prices. Even though many countries of the world are closing their borders, to minimise the movement of persons and spread of the virus, nevertheless these restrictions do not apply to cargo transportation. This will continue to ensure the flow of goods between countries, including the flow of food. However, the rapid increase in the number of infected people and quarantine will have a negative impact on the ability of carriers to provide the required amount of food. Therewith, it is expected that food prices both in Europe and in Latvia will continue to grow in the coming months of this year. It should also be noted that the food group accounts for one-fifth of total consumption in the basket. It is the largest group of consumer products, so the increase of food prices will cover the effects of the drop in prices of energy resources on inflation and will ensure a slight increase in consumer prices in 2020.

Along with the global crisis caused by Covid-19 and sharp decline of economic activity in Latvia in March and April, the unemployment rate has started to grow steeply, with the number of registered unemployed increasing by 10 616 or 18.2% in a month and a half until April 17 and the registered unemployment rate reaching 7.4%. According to the Ministry of Welfare, by April 17, the collective redundancy statements have been filed by 28 enterprises, in total, regarding 4 118 employees. In turn, allowances for idle time, since April 6, have been received by 15 064 employees. The number of job vacancies, after having demonstrated a sharp rise over the period of 2019, has started to sharply decline over the period of March and April this year, with the number of job advertisements on the portal of recruitment company *CV Online* decreasing by approximately 50% over the month, by April 17. Covid-19 impact scenario assumes that, due to the spread of the virus and measures to control it, the number of employment in the economy will decrease on average by 45 thousand or 5% in 2020, losing part of the workforce in the directly affected, including transport, trade, accommodation and catering, professional and administrative services, as well as a slight decrease in the number of employees in the indirectly affected sectors. Accordingly, the unemployment rate in 2020 is expected to increase by 4.9 percentage points to 11.2% compared to 2019. In 2021 and 2022, as economic growth resumes, the number of the employed will slightly increase, stabilising at 883 thousands by 2023.

According to the Covid-19 impact scenario, the average monthly wage will decline by 3,0% in 2020, as the strong wage growth still remaining in the first quarter of the year, but afterwards the entrepreneurs would no more be able to maintain the existing wage level under the circumstances of steep economic downturn. In the coming years, the wage increase will gradually recover, with the average monthly wage increasing by 3.0% and subsequent stabilizing at a level close to overall productivity growth in the economy.

It should be noted that Covid-19 impact scenario has been developed under the very high uncertainty and the risks to the scenario are tilted downwards. If the containment of coronavirus spread endures, the fall in the GDP and employment indicators would be steeper than projected in Covid-19 impact scenario.

3. GENERAL GOVERNMENT BUDGET BALANCE AND DEBT

3.1. FISCAL POLICY STRATEGY AND MEDIUM-TERM OBJECTIVE

Covid-19 pandemic has triggered significant changes in the previously implemented fiscal policy, which is based on the compliance with the structural budget deficit objective - 0.5% of GDP.

The EC has adopted the decision on application of maximum flexibility to the SGP rules, entailing both the opinion that the measures for mitigating adverse effects of Covid-19 are recognised as unusual events outside the control of the governments, and by announcing on March 20 that the consequences caused by Covid-19 are to be deemed as a period of severe economic downturn in the Euro area and the EU as a whole, and therefore it is subject to the condition of Article 5(1) of Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies:

"In the case of an unusual event outside the control of the Member State concerned which has a major impact on the financial position of the general government or in periods of severe economic downturn for the euro area or the Union as a whole, Member States may be allowed temporarily to depart from the adjustment path towards the medium-term budgetary objective referred to in the third subparagraph, provided that this does not endanger fiscal sustainability in the medium term."

In fact, this means that the Member States may depart from the deficit objectives to an extent, which is not limited in quantitative terms. The sole restriction is the rule that the amount of deviation must not endanger fiscal stability, nevertheless this rule is not being quantified. In fact, it is prescribed by the potential reaction of financial markets to the budgetary deficit and the level and dynamics of central government debt.

The FDL provides for the possibilities, under emergency circumstances, to depart from the permissible deficit level. Section 12 of the Law states that:

"(1) In drawing up the draft framework law, deviation from the condition of Section 10 of this Law can be made in the following cases:

1) measures for rectification of material damages caused by natural disasters, accidents and other nature or social processes are to be implemented if the forecasted costs in one financial year exceed 0.1 per cent of the GDP of the relevant year;

2) threat referred to in Section 62 of the Constitution is to be rectified;

3) during a severe economic downturn. In this Law the term "a severe economic downturn" is used in the same meaning as in the Council Regulation (EC) No 1056/2005 of 27 June 2005 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure.

(2) The amount of deviation may not exceed the amount of necessary costs in the cases referred to in Paragraph one, Clauses 1 and 2 of this Section.

(3) In the case referred to in Paragraph one, Clause 3 of this Section the deviation shall be permissible in the amount which is necessary for overcoming of a severe economic downturn and it may not exceed the forecasted decrease in revenues. When determining the amount of deviation, an opinion of the Fiscal Council shall be assessed."

In accordance with Section 9 and observing Clause 4, Paragraph one of Section 5 of the FDL, the rule of Clause 1, Paragraph one, Section 12 of the FDL refers to the cases, when it is allowed not to observe the expenditure ceiling prescribed by the medium - term budgetary framework law within the process of budget implementation.

Measures for combating Covid-19 pandemic and mitigating the adverse effects thereof are to be deemed as the case referred to in Section 12, Paragraph one, Clause 1, and the adverse fiscal impact of these measures can be financed, exceeding the expenditure ceiling specified by the medium-term budgetary framework law, as well as, both within the process of budget implementation and at the stage of preparation of the next medium-term budgetary framework law, can exceed the permissible level of structural budget deficit.

Furthermore, Section 27 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* states that the conditions of Section 7, Paragraph three and Section 9 of the FDL are not applied in relation to the measures for the mitigation of the impact of the emergency situation related to the spread of Covid-19, and Section 28 thereof states that, in relation to the application of the norms of the FDL, measures for the mitigation of the impact of the emergency situation related to the spread of Covid-19 are one-off measures which are not included in the structural budget balance of the general government.

It should be noted that the scope of applicability of the term "measures for the mitigation of the impact of the emergency situation related to the spread of Covid-19" in the law *On Measures for the Prevention and Suppression of Threat to the State and Its Consequences Due to the Spread of Covid-19* is broader than the "measures for rectification of material damages caused by natural disasters, accidents and other nature or social processes" referred to in Section 12, Paragraph one, Clause 1 of the FDL and also entail the potential measures to stimulate the economy.

In light of the above mentioned, in 2020, both the measures directly related to reduction of Covid-19 pandemic and support to the affected persons and enterprise for overcoming the crisis (corresponding to the conditions of Section 12, Paragraph one, Clause 1 of the FDL) and potential measures to stimulate the economy (corresponding to the conditions of Section 12, Paragraph one, Clause 3 of the FDL) can be financed above expenditure ceiling laid down in the medium-term budgetary framework and exceeding the permissible deficit level.

The issue regarding the possibilities to depart from the permissible deficit and expenditure ceiling will depend upon the lifting of the state of emergency declared in the state and upon the decision on lifting the SGP general escape clause, as well as upon further action of the EC with respect to the date of commencement of the excessive budget deficit procedure and the requirements set therein with respect to reduction of the deficit level.

In this fiscal policy strategy it is assumed that the state of emergency and the legal regulation related thereto is lifted in 2021, while the SGP general escape clause is lifted from 2022, because the feature of severe downturn would still be present in 2021: "a very low annual GDP amount growth is existing as compared to the growth potential." It is forecasted that the output gap in 2021 in the negative volume would even exceed the output gap of 2020 and would comprise - 10.4% of GDP. Therewith, there are grounds to preserve the general escape clause in Latvia in 2021.

As regards 2022 and 2023, there is a high uncertainty existing with respect to the potential decisions of the EC on lifting the escape clause, therewith, applying conservative budget forecasting principle, it is assumed that the escape clause is not being applied in 2022 and 2023 and, therewith, the deviations of Section 12 of the FDL are not applied, either. Therewith, it is assumed that in these years the general government budgetary balance objectives are determined under the general procedure.

3.1.1. Objectives of Structural Balance for 2021, 2022 and 2023

In this Stability Programme, in light of the activation of general escape clause provided for in the SGP, due to the impact of Covid-19 pandemic on the economic development and public finance of the EU countries, the approach applied to determination of the objectives of the general government structural budget balance differs from the one applied up to now.

Like in the previous Stability programmes, 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), as defined in the FDL. Nevertheless, testing of the objectives of structural balance is not carried out in this Stability Programme in accordance with the methodology applied by the EC. More detailed algorithm for setting the objectives is explained herein below.

Initially, the objectives of structural balance are calculated by means of the balance rule. For the verification of the balance rule, unlike the approach applied up to now, only the scenario with the national MTO is being developed, considering the absence of the EC fiscal forecasts at the moment of preparation of this Stability Programme, as well as the activation of the general escape clause of the SGP.

FDL prescribes that compliance with the balance rule is not the only fiscal rule. When setting the objective of structural balance, also the expenditure growth rule has to be taken into account, as prescribed by Regulation No 1175/2011 (Regulation (EU)of the European Parliament and of the Council No 1175/2011 (16 November 2011) amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies), which is also prescribed by Section 13 of the FDL. This rule, in the general case, may determine stricter objectives of the general government structural budget balance. The FDL also provides that the central government expenditure is determined in the *Framework Law* for the three subsequent years and this is legally binding (rule of expenditure inheritance). Therewith, a situation may occur that retention of the central government expenditure at the level prescribed by the previous *Framework Law* can change the objective of the general government structural budget balance. However, changes are restricted by a provision of the FDL that if deviations of expenditure exceed 0.1% of GDP, expenditure is not preserved, but is recalculated in compliance with the structural general government budget balance and expenditure growth rules.

The aforementioned fiscal conditions set the objective of the general government structural budget balance and the nominal balance (the maximum permissible general government deficit or the minimum permissible general government budget surplus) in compliance with the *top-down planning method of a budget balance.* At the same time, there is also the *bottom-up planning method of a budget balance* applied according to which the general government budget balance is forecasted **in case of a constant policy**[3].

In a general case, general government budget balances differ according to both methods. If pursuant to the first method, a general government budget balance is larger than the balance set as a result of the second method, there is the so-called fiscal space or

[3] It should be noted that in this Stability Programme two scenarios are being formed - the baseline scenario, which has been prepared in February this year and provided for further GDP growth, and Covid-19 scenario, entailing the decisions adopted by the government for mitigating the consequences of Covid-19 pandemic and for the support of national economy, as well as providing for the economic fall, as compared to the baseline scenario, but not yet entailing the government decision within the context of preparing the state (central government) budget for the next year.

possibilities at disposal of the government to increase expenditure for the new priorities of expenditure policy or to reduce revenue for new tax policy initiatives. If according to the first method, a general government budget balance is smaller than by the second method, the government shall carry out consolidation measures, taking discretionary measures for reducing expenditure or increasing revenue.

Deviation from the MTO in 2021

In 2021, the rule of Clause 3, Paragraph one, Section 12 of the FDL is applied, stating that, during a severe economic downturn, in drawing up the draft framework law, deviation can be made from the minimum planned structural balance stipulated in Section 10 of the FDL, namely, - 0.5% of GDP. Paragraph three, Section 12 of the FDL, in its turn, states that the deviation shall be permissible in the amount which is necessary for overcoming of a severe economic downturn and it may not exceed the forecasted decrease in revenues. Decrease in revenues is measured in monetary terms (and not in percentage of GDP) and determined against the forecasted revenue in the baseline scenario. It should also be noted that part of the revenue decrease has already been considered in the automatic stabiliser and it should be excluded. Therewith, in 2021, the deviation is permissible from the minimum planned structural balance in the amount of 1.1% of GDP (see Table 3.1).

Table 3.1. Structural balance deviation in 2021 according to the rule of Paragraph three, Section 12 of the FDL

(1)	General government budget revenue in a baseline scenario, million euro	12 297
(2)	General government budget revenue in a baseline Covid-19 scenario, million euro	10 835
(3)=(2)-(1)	changes in revenue, million euro	-1 462
(4)	GDP in current prices in Covid-19 scenario	28 725
(5)=(3)/(4)*100	Changes in general government budget revenue, % of GDP	-5.1
(6)	output gap % of GDP in a baseline scenario	0.2
(7)	output gap % of GDP in Covid-19 scenario	-10.4
(8)=(6)*0.378	cyclical component in a baseline scenario, % of GDP	0.1
(9)=(7)*0.378	cyclical component in Covid-19 scenario, % of GDP	-3.9
(10)	MTO, % of GDP	-0.5
(11)=(10)+(8)	nominal balance in a baseline scenario by MTO, % of GDP	-0.4
(12)=(11)-(5)	nominal balance, should the forecasted fall occur, % of GDP	-5.5
(13)=(12)-(9)	structural balance by the forecasted revenue decrease, % of GDP	-1.6
(14)=(13)-(10)	FDL permissible deviation, % of GDP	**-1.1**

Paragraph three, Section 12 of the FDL also states that the amount of permissible deviation shall be coordinated with the Fiscal Discipline Council. This rule refers to the preparation of the Framework Law and will be performed, when developing the Framework Law in Autumn this year.

Balance objectives according to the balance rule

First, the objectives of structural balance are calculated by verifying their conformity to **the balance rule**. As already mentioned herein above, for verification of the balance rule only the scenario with the national MTO is developed, which is determined as -0.5% of GDP. Table 3.2 herein below reflects future adjustments.

Table 3.2. Structural balance objective according to national methodology

		2021	2022	2023
(1)	**MTO**	**-0.5%**	**-0.5%**	**-0.5%**
(2)	deviation from MTO (Clause 3, Paragraph one, Section 12 of the FDL)	-1.1%	-	-
(3) = (1)+(2)	**structural balance objective**	**-1.6%**	**-0.5%**	**-0.5%**
(4)	cyclical component	-3.9%	-3.7%	-3.8%
(5)=(3)+(4)	cyclically adjusted balance	-5.5%	-4.2%	-4.3%
(6)	one-off measures	0.2%	0.2%	0.3%
(7)=(5)+(6)	**nominal balance**	**-5.3%**	**-4.0%**	**-4.0%**

For the purposes of determining the structural balance objective for 2021, the deviation from MTO defined in Clause 3, Paragraph one, Section 12 of the FDL is additionally applied, observing the rule of Paragraph three, Section 12 of the FDL. By adding the amount of deviation to the MTO, the maximum permissible structural balance is obtained. As in this Stability Programme the scenario with the MTO SGP is not being developed for verification of the balance rule, then in this case, correspondingly, **the structural balance objective** is obtained, comprising **-1.6%, -0.5% and -0.5%, respectively, in 2021, 2022 and 2023.**

As it is necessary to clarify also the amount of general government budget nominal balance arising out of the structural balance objective, required for defining the fiscal space, further calculations are performed.

The cyclical component of the balance is calculated, by multiplying the output gap with the elasticity coefficient of 0.38, applying the output gap forecasted by the MoF. The calculated cyclical component of the balance is -3.9%, -3.7% and -3.8%, respectively, in 2021, 2022 and 2023.

In this scenario, the support measures with fiscal impact adopted by the government for minimising the influence of the emergency situation related to the spread of Covid-19 are deemed to be one-off measures and are not included in the structural balance. Such approach is provided for in accordance with the conditions of Section 28 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 approach applied by the MoF with respect to exclusion of the impact of support measures from the structural balance is symmetric. In 2020, the support measures cause material adverse effect on the general government nominal budget balance on the side of both budget revenue and budget expenditure and in accordance with the referred to approach are excluded from the structural balance, by improving it. In turn, in 2021 - 2023 the support measures of the budget expenditure side are not continued, because, in line with the government decisions, they are specified in time by the end of this year, but the support measures of the revenue side implemented in 2020 create positive effects on both nominal and structural balance in 2021 - 2023. Respectively, as in 2020 it is assumed that the impact caused by the budget revenue side is of one-off nature, it is excluded from the structural balance also in 2021 - 2023.

Thus, by applying the previously determined structural balance objective, the MoF forecasts on the output gap and the one-off measures, the nominal balance is obtained, which in 2021 is -5.3% of GDP, in 2022 is -4.0% of GDP and in 2023 is -4.0% of GDP.

Setting the balance objectives in accordance with expenditure growth rule and rule of expenditure inheritance

Then the obtained results are verified, to ensure also the fulfilment of the expenditure growth rule and rule of expenditure inheritance.

Like in the previous Stability Programmes, when structural general government budget balance objectives are checked in accordance with the **expenditure growth rule**, expenditure adjustments are subject to MoF forecasts of public debt servicing expenditure, investment expenditure, expenditure for EU programmes fully matched by EU funds revenue, discretionary revenue and one-off measures, as well as the GDP deflator and the potential GDP growth. Acceleration of the expenditure growth is determined so that it would correspond to the 10-years average potential GDP growth. Additionally, in 2021, the maximum permissible acceleration of the expenditure growth is adjusted by the MTO deviation.

Having performed the verification of the objectives of the general government budget structural balance in accordance with the expenditure growth rule, it is obtained that the real adjusted expenditure growth in 2021 allowed for by the expenditure growth rule is 5.65%, 2.79% in 2022 and in 2.78% in 2023. The previously determined general government budget structural balance objective in accordance with the balance rule, in turn, states that the real adjusted expenditure can increase by 0.97% in 2021, by -0.30% in 2022 and by 2.72% in 2023. Having performed the verification of the rule of expenditure inheritance, it was detected that no additional adjustments are needed.

Thus, the structural balance objectives in accordance with the balance rule are preserved for 2021 - 2023.

Objectives of General Government Budget for 2021, 2022 and 2023

Considering the verification of the fiscal rules carried out herein above, the quantitative fiscal objectives for the next three years are set, namely, **to ensure the general government structural budget balance at -1.6% of GDP in 2021, -0.5% of GDP in 2022, and -0.5% of GDP in 2023. General government nominal balance, arising out of the structural balance objective, is set at: -5.3% of GDP in 2021, -4.0% of GDP in 2022, and -4.0% of GDP in 2023.**

Therewith, the fiscal space of 0.2% of the GDP is available in 2021 and of 1.3% of the GDP in 2023, but, in 2022, the structural balance at a constant policy coincides with the permissible structural balance, and no fiscal space is available.

In light of high uncertainty as to the assumptions applied for determining fiscal objectives, fiscal data incorporated in annexes to the Stability Programme is demonstrated only at a constant policy scenario.

3.1.2. Discretionary measures

In between the Stability Programme 2019 - 2022 and the Stability Programme 2020 - 2023, fiscal policy decisions have been adopted. They include

(i) measures included in the *Framework Law for 2020, 2021 and 2022* and the *Annual State Budget Law for 202*0, 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 17 April 2020. The first set of measures is not separately described in this Stability Programme, but it is available for review in the Draft Budgetary Plan of the Republic of Latvia 2020. The second set of measures, in its turn, is described in detail in this Stability Programme both in Chapter "Covid-19 Impact Scenario" and in Table 6 of the Annex thereto.

Decisions adopted during the development of the annual budget for 2020 are included both in the baseline fiscal scenario and Covid-19 impact scenario of this Stability Programme, while the support measures for minimising consequences of Covid-19 crisis are included only in Covid-19 impact scenario.

3.1.3. Fiscally significant structural reform within the meaning of Regulation No 1175/2011[4]

In the Stability Programme 2016 - 2019 Latvia declared reform of the health system as a significant structural reform with a long-term positive effect on the sustainability of public finances, with a view to use the possibility of deviation from MTO as provided in the EC Communication [5]. The EC reviewed Latvia's declaration and supported granting of the deficit deviation for the health system reform. In order to comply with the structural deficit safety margin with respect to the reference value prescribed by the Treaty on the Functioning of the EU in amount of 3% of GDP, the deficit deviation granted to Latvia comprises 0.13% of GDP in 2017, 0.40 % of GDP in 2018 and 0.50% of GDP in 2019, whereas in 2020 the deviations stops.

It should be noted that, in general, three reforms in the field of health care are being discussed in Latvia:

1. Reform to be implemented, based on the medium - term policy planning document Public Health Guidelines for 2014 - 2020;
2. Reform of the health funding;
3. Reform of the health system administration.

This Stability Programme describes the health care reform, which is based upon the implementation of the medium-term policy planning document Public Health Guidelines for 2014 - 2020 and, therewith, considering the practice introduced by the previous Stability Programme, the following subsections will outline the outcomes of the implementation of the reform in the previous year (namely, 2019).

Justification and implementation of the reform of the health care system

Deficit deviation has been requested and received for the reform being implemented, based on the medium - term policy planning document Public Health Guidelines for 2014 - 2020. The health care reform is being implemented from 2014 in accordance with the medium-term policy planning document Public Health Guidelines for 2014 - 2020, which was approved by the Cabinet, and the overriding aim thereof is to prolong the healthy years of life of the Latvian population and to prevent premature deaths, while maintaining, improving and restoring health. In Latvia, the achievement of the aforementioned aim is hindered by the weaknesses of the health system, mainly attributable to low public funding (see Figure 3.1), inequality in availability of medical care services and many premature deaths due to health problems.

It should be noted that these factors are interrelated. The low level of public funding causes a need to finance part of medical services through private funding, but it, in turn, discourages the citizens that cannot afford to invest their private funding to take timely treatment and increases the potential years of life lost.

[4]Regulation (EU)of the European Parliament and of the Council No 1175/2011 (16 November 2011) amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies.

[5] The 13 January 2015 EC Communication to the European Parliament, the Council, the European Central Bank, the Economic and Social Committee, the Committee of the Regions and the European Investment Bank regarding Making the Best Use of the Flexibility Within the Existing Rules of the SGP.

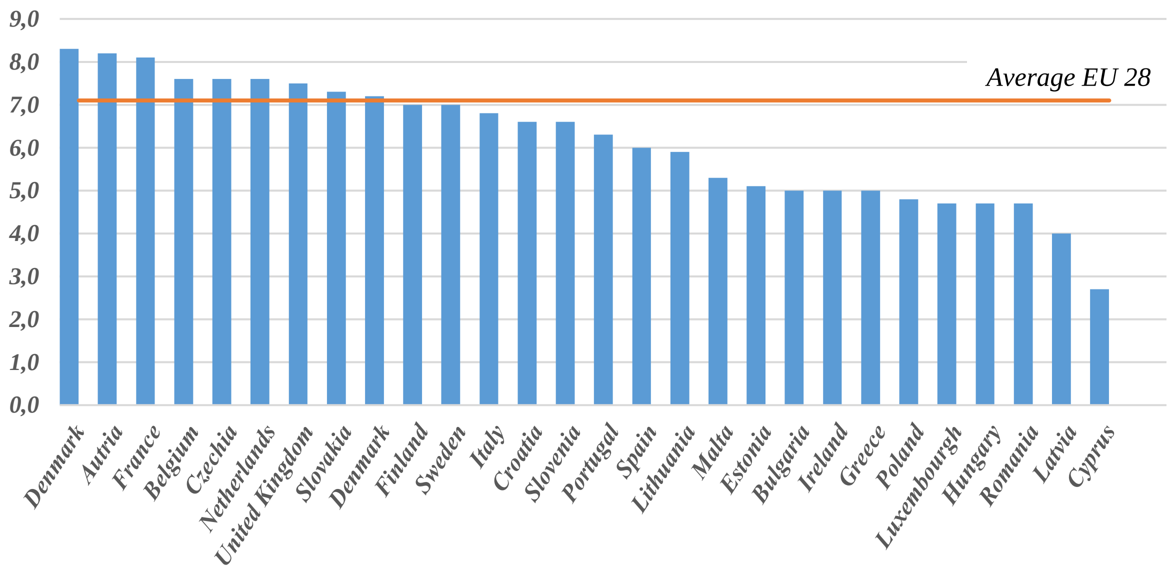

Figure 3.1. Public expenditure for health care in 2018 in the EU Member States[6], % of GDP

The EU Council already from 2014 has pointed out the afore-mentioned shortcomings of the Latvian health system, in the context of country specific recommendations, identifying annually that it is necessary to improve the availability, cost-effectiveness and quality of the health care system. Besides, it is pointed out that there is a clear public under-financing of the health care sector that negatively affects access to health care services for vulnerable members of society.

In the country-specific recommendations for the last three years, (2017 - 2019), **the Council appreciates the health care system reforms implemented by Latvia.** At the same time, it is noted that the public funding intended for health care is still far below the EU average. Timely and equal access to health care is limited. As a result, population itself specifies that their needs for care are largely not satisfied, as personal payments - especially for unprotected groups of population - are large, and equal opportunities are not ensured. The reforms continue to be aimed at improving effectiveness and quality of health care, nevertheless they are at an early stage and would need to be accelerated, including effective preventive measures, rationalisation of hospital sector, strengthening primary health care and solving quality management issues. Besides, the lack of health care sector labour force, especially nurses, are observed, hindering the state health care provision and endangering the successful pace of health care reforms.

As a result of the aforementioned, the EU Council recommends to Latvia to improve the availability, quality and cost-effectiveness of the health care system.

Implementation of the reform of the health care system in 2019

Deficit deviation funding for the period of 2017 - 2019, which is available due to implementation of the health care reform is being used for a group of certain health care measures, arising out of the Public Health Guidelines for 2014 - 2020. This group of measures is separated from the rest of measures for improvement of health care, stipulating a special procedure for granting and supervision of allocation of resources.

[6] Data source: *Eurostat*

At the same time, it should be noted, that, when choosing the health reform measures, for which the deficit deviation funding is to be used, the following criteria are set:

1. The measure must correspond to the "Public Health Guidelines 2014 - 2020". The outcome of the measure financed from the deficit deviation funding in the period of 2017 - 2019 must solve or considerably reduce a certain problem identified in the health care system. Measures, which provide for an insignificant effect in solving the problem, may not be financed - such intervention is not to be regarded as reform;
2. Problem to be solved must be recognised as a health care problem in the EC analytical documents.
3. It is possible to create a traceable system of inputs - outputs - outcome indicators.
4. The solvable problem provides an input to achieving a positive fiscal effect of the "Public Health Guidelines for 2014 - 2020".

It should be noted that the allocated financing within the reform for the period 2017 - 2019 was distinguished in the separate budget programme in the State budget law of the respective year, as the financing to be redistributed based on the result of the annual State budget execution. Only after the MoH's proposals regarding the use of funding were approved by the Cabinet, the reserved funding was reallocated to implement health reform.

For the funds to be reallocated for implementation of the health reform measures in 2019, the MoH, first of all, had to submit information regarding the measures taken and the outcomes achieved in 2018. To this effect, based on the report "On the outcomes of the implementation of the health reform measures in health care for 2018"[7], describing the implemented reform measures and the outcomes, it was concluded that it is necessary to continue the commenced interventions also in 2019, to ensure successful treatment of patients and achieve considerable reduction of the PYLL over a longer period of time. Losses to national economy have also been emphasised, caused to the country on an annual basis by premature deaths of population. At the same time, considering the available additional funding, comprising in 2019 0.5% of the budget deficit deviation allowed by the EC or 154.2 million euro, it was concluded that it is necessary not only to continue the commenced reforms, but also to expand them by new initiatives for the improvement of efficiency and sustainability of health care.

Therewith, in order to continue the health care reform, as well as to expand it and to implement new reform areas, the Cabinet approved the report "On implementation of the health reform measures in 2019" and in 2019 the funding in the amount of 154.2 million euro was granted to the MoH from the funds reserved under Programme 08.00.00 "Funding for the implementation of the health care system reform" of the budget line "74. Funds for redistribution during the state annual budget implementation process" for the health care reform (Clauses 3 and 4 of 33§ of Minutes No. 1 of the 8 January 2019 Meeting of the Cabinet and Clause 2 of 30§ of Minutes No. 56 of the 3 December 2019 Meeting of the CoM), in the following areas and the following established amount:

1. **For improving the availability of health care services and reduction of queues,** 58 163, 253 euro, including continuing the reduction of queues commenced in 2017;

[7] More detailed information about the outcomes of the implementation of the health reform in 2018 is available on the website of the MoF at – http://www.fm.gov.lv/lv/sadalas/tautsaimniecibas_analize/fiskala_politika/stabilitates_konvergences_programma

2. **For improving the availability of diagnostic and treatment of oncological diseases,** 30 492 825 euro, including continuing and expanding the activities commenced in 2017 and 2018;
3. **For reducing the spread of infectious diseases,** 15 843 002 euro, including continuing the reforms commenced in 2017 and 2018 for the provision of state reimbursable medicines for virus hepatitis C patients at F3-F4 stage;
4. **For improving the quality and availability of primary health care system,** 13 396 162 euro;
5. **For reducing cardiovascular morbidity and improving the efficacy of disease treatment,** 10 507 717 euro.
6. **For reform of the medical treatment institutions levels,** 6 433 916 euro*;*
7. **For strategic procurement of rehabilitation services in an in-patient facility,** 3 874 774 euro*;*
8. **For improving the accessibility of mental health care services,** 6 308 906 euro*;*
9. **Improvement of environment and increasing the effectiveness of infrastructure,** 7 548 747 euro.

Considering that for separate services, such as medicines of oncology and cardiovascular diseases, laboratory services, in accordance with the expenditure of the first half of 2019, it was detected that the overproduction of the provided services above the planned is expected, but for separate measures it was forecasted that the plan measures, for example, availability of paediatricians, family practitioners' quality fee, surgical profile of the Sigulda Hospital, ensuring the Stroke Unit of Jēkabpils Hospital and acute rehabilitation, would not be implemented in the initially planned volumes, the MoH submitted to the Cabinet a concept note on expenditure of funding of provision of separate health care services and the planned measures for continuing the health sector reform, in order to prevent the non-fulfilment on the EC deviation funding.

It should be noted that the allocation of funds for the measures for paediatricians, pain physicians, laboratory tests, as well as medical institution level reforms, rehabilitation and psychiatry, has been commenced from 1 April 2019, therewith the absorption of the measures started in April 2019, but the remaining absorption of funds had been commenced from the beginning of the year.

In Spring of 2020, based on the report developed by the MoH "On the outcomes of the implementation of the health reform measures in health care for 2019"[8], it was concluded, considering the timeframe required for commencement of reforms for change of the work organisational processes in the medical institutions and the funds to be allocated to out-patient services, **the implementation of the reform is to be assessed a successful.** Reduction of queues to specialist consultations, day patient facility services and rehabilitation services is observed, nevertheless, moderate increase of the queues is being observed in the segment of tests, attributable to the change of patient behaviour. Overall, the number of those residents reduced, who, due to queues, distance or finance, have not received the secondary outpatient health care services, as well as the number of non-received secondary outpatient health care services (due to queues, distance or finance) reduced.

In addition, it can be concluded that oncology performance indicators are exceeded, because the number of the performed specialist consultations has grown according to the set

[8] More detailed information about the outcomes of the implementation of the health reform in 2019 is available on the website of the MoF at – http://www.fm.gov.lv/lv/sadalas/tautsaimniecibas_analize/fiskala_politika/stabilitates_konvergences_programma

algorithms, and more patients are being sent to carry out secondary diagnostics and tests, allowing to more timely diagnose the illness and commence appropriate treatment, *inter alia*, the growth of availability of medicines has been ensured.

The reforms performed up to now for the formation of the Green Corridor for oncology have ensured that the patient's way up to determination of diagnosis and commencement of treatment has become considerably shorter, in majority of cases ensuring that, after the performance of reforms, the initial consultations are provided, tests are carried out and the treatment is commenced within the period for 10 days. Before the introduction of the Green Corridor patient was waiting, on average, 30 days for specialist consultation alone.

It has been proven that for successful introduction of new programmes (for example, strategic procurement of rehabilitation services in an in-patient facility, implementation of the measures incorporated in the Plan for Improvement of Accessibility of Mental Health Care for 2019 - 2020, cardiovascular programme) it takes a sufficiently long time for the service providers to be able to introduce changes in organisation of service provisions, and for the appointing persons, in their turn, to understand the benefits of the new procedure and to actively engage in using thereof, as well as for the possibility to introduce corrections in the developed procedure, which would improve the patient flows' organisation according to the actual situation. Therewith, in 2019, an increased attention was directed to the supervision of introduction of new measures, in order to promote effective absorption of the funds granted by the budget deficit deviation permitted by the EC.

When performing the summary of expenditure of funding of implementation of reforms, the unspent funding had formed in the programme for the pain therapist's (pain relief) services, acute rehabilitation, ensuring of biological therapy for Crohn's disease, ulcerative colitis and psoriasis and HIV/AIDS medication treatment, reimbursable medicines for treating hepatitis C, overall forming 0.40% unspent funding out of the granted 154.2 million euro for the availability of health care services. In oncology, in its turn, the overspending of the funding had formed, therewith the impact of the health reforms on timely patient diagnostics and application of treatment methodology has been observed, which, in general, facilitated the extension of the life expectancy.

In 2019, active work was continued in establishing the State Pathology Centre, so that already in the fourth quarter of 2020 the Centre could be able to start providing scheduled services to a full extent, facilitating high-quality tests. The processes of replacement of infrastructure of hospitals have also been developed, so as to improve the health care indicators at large, providing state-of-the-art services that facilitate faster determination of the diagnosis, shortening the time of commencement of the treatment and helping to sooner return to the labour market, preserving the quality of life.

It should be noted that Latvia demonstrates high cost-efficiency results. Reports "*Euro Health Consumer Index 2017 Report*"[9] and "*Euro Health Consumer Index 2018 Report*"[10], where, in order to evaluate the effectiveness of operation of the health care system, attempts are being made to make a peer comparison of the EU Member States with highly different financial resources, performing the correction of value form money with *per capita* expenditure on health care, allows concluding that Latvia, with one of the lowest *per capita* expenditure on health care, demonstrates high cost-efficiency results.

The funds of the budget deficit deviation permitted by the EC that have been contributed into the strengthening the health care system of Latvia for the period of three years for the purposes of ensuring the availability and quality of health care services,

[9] Björnberg, A., *Euro* Health Consumer Index 2017 Report, © Health Consumer Powerhouse Ltd., 2018.

[10] Björnberg, A., Phang, A.Y., *Euro* Health Consumer Index 2018 Report, © Health Consumer Powerhouse Ltd., 2019.

represent the investment into improvement of health and raising the welfare of population of Latvia, at the same time reducing health inequality and promoting the development of the health care system.

Investment into health sector enable reducing the potential years of life lost, increasing the involvement of population into labour market and total tax revenue, thus promoting the economic development and welfare of population. Better health can raise the return on investments into education and experience of employees, as the longer life expectancy increases the income period for contributions into human capital productivity.[11]

Predicting the potential gain (not lost) of life years in the case of absence of investment, it can be forecasted that the gradual improvement of the health of the population and taking into account minor improvements in previous periods, as well as improvement of the treatment process coordination, it is expected to slightly improve on the current situation. Ultimately, the referred factors will be reflected in data or the minimum recession or even stagnation of the number of PYLL. In turn, through the above reforms, the PYLL will decrease, as the life expectancy of the population will increase, and the number of premature deaths will decrease (see Table 3.3). Taking into account the projections for the reduction of the PYLL it is to **be concluded that it corresponds** to the reduction estimated in the **study "Evaluation for the Development of Public Health Guidelines for 2014 - 2020" .**

Table 3.3. PYLL forecast with investments made

	2014	2015	2016	2017	2018	2019	2020	2021
PYLL forecast, without investing *	93 374	88 297	84 670	83 876	83 037	82 207	81 385	80 571
PYLL forecast with investing					80 612	78 223	75 542	73 355
Gained PYLL					2 425	3 984	5 843	7 216
Improving the accessibility of health care services					518	932	1 553	1 631
Improvement of availability of diagnostics and treatment of oncological diseases					578	751	1 251	1 314
Reducing the spread of infectious diseases					534	1 181	1 645	2 748
Improving the quality and availability of primary health care system					102	114	216	227
Reduction of cardiovascular morbidity and improvement of the efficacy of disease treatment					693	836	929	975
Strategic procurement of rehabilitation services						104	116	122
Improvement of mental health care						66	133	199

Source: MoH and the Centre for Disease Prevention and Control

The previous Stability Programmes included the assessment of the fiscal impact of the "Public Health Guidelines 2014 - 2020". Correspondingly, in this Stability Program the assessment of the fiscal impact is being adjusted, considering the amount of adjusted expenditure in 2019 and the adjusted forecasts for 2020 - 2023.

[11] World Health Organization., 2009,. WHO guide to identifying the economic consequences of disease and injury. World Health Organization, https://apps.who.int/iris/handle/10665/137037

Table 3.4. Updated assessment of the macroeconomic impact of the "Public Health Guidelines 2014 - 2020"

Macroeconomic indicators	Annual and cumulative impact on GDP and other key macroeconomic variables [12]				
	X[13]+5 years	X+10 years	X+15 years	X+20 years	X+25 years
GDP[14]	0.55%	+2.21%	+4.77%	+7.87%	+11.24%
Gross fixed capital formation	-	-	-	-	-
Employment[15]	+0.24%	+0.62%	+1.02%	+1.41%	+1.81%
Direct fiscal impact on primary balance (10)[16]	-0.36%	-1.04%	-1.07%	-0.62%	+0.18%
Total impact on primary balance (11)[17]	-0.12%	-0.09%	+0.93%	+2.65%	+4.84%

3.2. Current Fiscal Situation

According to the data of the CSB, in 2019, the deficit of the general government budget comprised 63.2 million euro or 0.2% of GDP, which is to be assessed as a better performance than the permissible general government budget deficit of 0.5% of GDP stated in the law *On the State Budget* for 2019, and also better, as compared to the Stability Programme for 2019 - 2022, where in 2019, taking into account the concurrent time for drafting both documents, the statutory deficit had been reflected. Lower general government budget deficit, as compared to the previous planned, was determined by higher tax revenue and self-earned revenue, as well as lower expenditure in the local government and social security budget. It should be noted that the amount of deficit of 2019 can be adjusted, along with the CSB submitting notification to *Eurostat* in October this year.

The analysis of contribution of the general government sub-sectors to the overall fiscal balance, allows concluding that the largest deficit was mainly formed in the central government, comprising 1.7% of GDP in 2019. The surplus of the social security fund and local government, in turn, formed correspondingly, 0.9% and 0.6% of GDP in 2019 (see Figure 3.2).

As compared to 2018, the general government budget deficit has decreased by 0.6 percentage points. It should be noted that it was significantly improved by the local government budgetary balance, still showing deficit of 0.7% of GDP in 2018, but in 2019 the surplus was observed in this budget in the amount of 0.6% of GDP. Thanks to the steep increase of labour tax revenue, the overall revenue of local government has grown by 12.5%, as compared to 2018, while expenditure has grown only by 0.5%, attributable to the fact that, in the first quarter of 2019, local governments, observing the temporary budget rules, could borrow only for implementation of the projects co-financed by the EU and other foreign financial assistance. In turn, when adopting the law *On the State Budget for 2019*, the local government borrowing rules and the combined permissible increase of local government borrowings have been determined, as well as the criteria to be observed, when ensuring the

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[12] Discounted at values of 2014; cumulative effect.
[13] X means 2013.
[14] National economy output divided by GDP of 2014 at current prices.
[15] Employment growth divided by number of employed persons in age group 15 – 64 (2012).
[16] Direct fiscal impact applicable to the age group of 0 – 64 years.
[17] When assessing the indirect impact on budget, the budgetary balance flexibility is applied - 0.43 (for 5 years) and 0.41 (for 10 and more years).

resources available for the local governments, *inter alia*, for implementation of new investment projects.

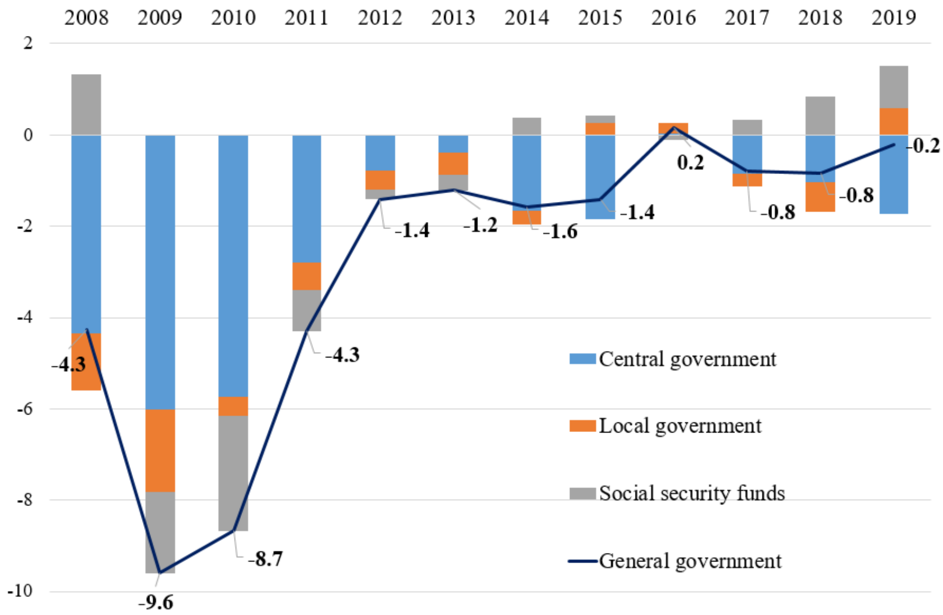


Figure 3.2. General government budget balance by sub-sectors, % of GDP (Data source: *Eurostat***)**

In 2019, as compared to 2018, general government budget revenue has grown by 560 million euro or 5.0%, reaching 11.8 billion euro or 38.7% of GDP (see Figure 3.3).

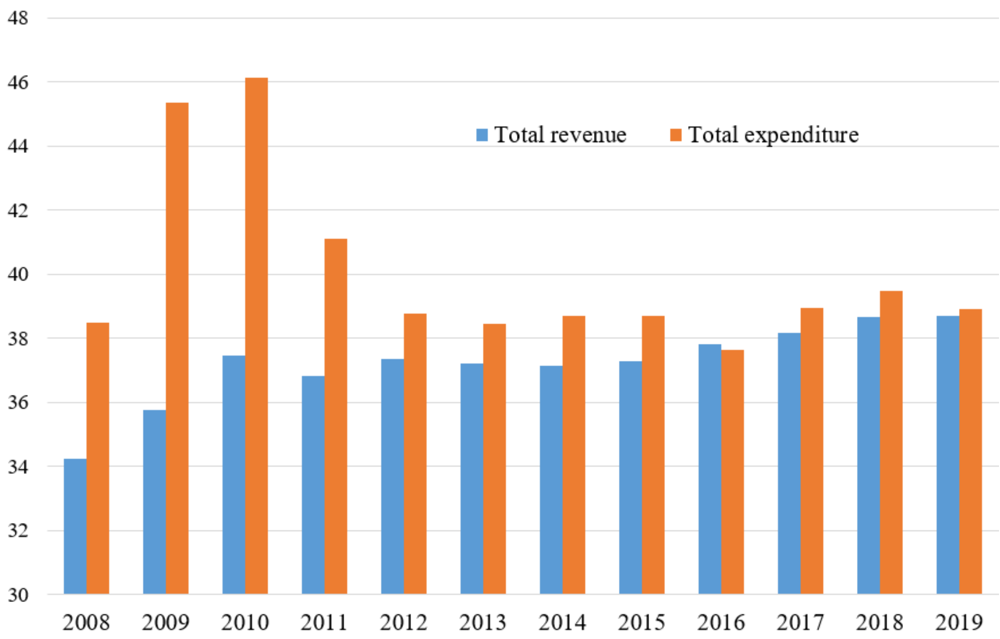


Figure 3.3 General government revenue and expenditure, % of GDP (Data source: *Eurostat)*

Revenue growth was promoted by the growth of tax revenue. Tax revenue [18] in 2019 reached 31.4% of GDP, which is by 0.1 percentage points less than in 2018. As compared to

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

2018, tax revenue has grown by 424.5 million. euro or 4.6%. The largest increase was ensured by the net social contributions (D.61), which, as compared to 2018, have grown by 285.5 million euro or 10.3%. Increase in social security contributions was facilitated by favourable situation in the labour market, as both the number of employed and the average amount of wage increased in 2019.

Taxes on production and imports (D.2), as compared to 2018, have grown by 162.2 million euro or 3.9%. As the economic activity increases, VAT revenue has grown by 191.4 million euro or 7.8%, and the excise duty revenue, in turn, has grown by 34.8 million euro or 3.4%. According to information provided by the SRS, in 2019, the total value of transactions grew the most for the taxpayers engaged in construction sector and processing industry, and, in turn, reduced for the taxpayers engaged in transport and storage sector. The growth of the excise duty revenue was limited by the excise duty policy in the Baltic States - unplanned reduction of the excise duty rates on alcoholic beverages and beer in Estonia, which significantly restricted the alcohol trade in the border area that had developed in the last years, and the reorientation of the fuel consumer flow from Latvia to Lithuania, amid lower fuel price.

The sole tax revenue position that has experience the drop in revenue, as compared to 2018, is current taxes on income and wealth(D.5), which have decreased by 20.1 million euro. Reduction is attributable to the CIT fulfilment - in 2019, the CIT revenue have reduced by 259.2 million euro or by 85.3%. This is attributable to the tax reforms that took effect on 1 January 2018, which prescribed that in the first half of 2018 the advance payments had to be made in accordance with the previous procedure for tax payment, while in 2019 such advance payments did not have to be made, but the CIT refunds have been performed in the amount of 125.1 million euro, which is 2.1 time more than in 2018. Tax reform influenced the CIT fulfilment also in 2019. As of 1 January 2019, the differentiated non-taxable minimum was increased from 200 to 230 euro, non-taxable minimum for pensioners was increased from 250 to 270 euro, as well as the allowances for dependent from 200 to 230 euro. Nevertheless, despite the changes, the positive effect from the labour market development fully compensated the lost revenue from increase of allowances. In 2019, PIT revenue, as compared to 2018, grew by 201.2 million euro or 11.6%, ensuring the largest positive effect in the local government budget. Based on the submitted statements of the sums disbursed to natural persons, [19] the PIT deducted from dividends in 2019 comprised 122.1 million euro, which is by 38.7% more than in 2018, attributable to the expiry of the transitional period - enterprises, which have gained profit by 31 December 2017, could allocate it, without paying the CIT, but paying the PIT in the amount of 10%.

General government budget expenditure has grown by 379.9 million euro or 3.3%, reaching 11.9 billion euro or 38.9% of GDP. The largest growth was ensured by expenditure for social benefits (D.632 and D.62), which has grown by 233.2 million euro or 6.9%, determined by the growth of expenditure for pensions and other social benefits. Rise in expenditure was influenced by the rise in the amount of average pension and benefits, increase in the number of the unemployed and recipients of the sickness benefits, as well as pension indexation starting form 1 October 2019, by applying larger indices.

Total expenditure for compensation of employees (D.1) in 2019 has grown by 220 million euro or 7.1% and the growth was mainly determined by disbursements of benefits carried out at the beginning of the year for the officials of the interior and justice institutions with special service ranks, which in accordance with the Law On Remuneration of Officials and Employees of State and Local Government Authorities is being disbursed for every five

[19] The sum declared in the reporting period of 2019 (in December 2018 and 11 months of 2019). Data as at 6 March 2020.

years of uninterrupted service. Increase in expenditure is observed also for the employed in the defence and health sector, as well as teachers and the staff of higher education institutions.

Expenditure for intermediate consumption (P.2) has grown by 190.7 million euro or 10.9%, with the main reasons of rise being the growth of expenditure for administrative costs of motorways and streets, expenditure for maintenance of information system and expenditure of reclassified enterprises for intermediate consumption.

Subsidies (D.3) have grown by 15.1 million euro or 5.1%, attributable to additional subsidies to reclassified enterprises providing public transport services, as well as subsidises to reclassified enterprises producing renewable energy resources.

The largest reduction of the general government budget expenditure is observed in expenditure for gross fixed capital formation (P.51G), which has reduced by 115.1 million euro or 7.1%. Reduction is attributable to lower expenditure for acquisition of military inventory, which has reduced by 121.8 million euro, as well as lower expenditure for gross fixed capital formation in the local government budget.

Expenditure of capital transfers (D.9) in 2019 has reduced by 46.7 million euro or 79.7%, significantly influenced by the discounted remuneration payment performed in 2018 in the amount of 51,7 million euro for the installed electricity capacities for the renewable electricity producers, which, in the medium term, would allow saving the central government budget funds.[20]

Given the successful government debt management and low interest rates, the interest expenditure (D.41) has reduced by 2.6 million euro or 1.2%.

In the first two months of 2020, the impact of coronavirus Covid-19 on tax revenue was not yet observed. PIT revenue and social insurance contributions, as compared to the first two months of 2019, according to the cash flow, grew by, correspondingly, 20.7% and 6.6%, while the VAT and excise duty demonstrated the growth of 3.7% and 0.7%. However, as operative data show, the VAT and excise duty revenue reduction can be observed already in March 2020. Excise duty, as compared to March 2019, has reduced by 8.7 million euro or 10.8%. VAT revenue has decreased by 19.6 million euro or 10.7%, but VAT euro refunds in March this year have grown by 13.2 million euro. PIT revenue has decreased by 13.2 million euro or 12.1%, attributable to the fact that the PIT refunds in March this year have grown by 16.3 million euro. Social insurance contributions continue demonstrating slight increase also in March, as compared to the revenue of the last year. It is to be projected that more outspoken tax revenue drop would be observed over the coming months, as a result of Covid-19 influence.

3.3. FISCAL DEVELOPMENT SCENARIO

3.3.1. Baseline scenario at a constant policy

General government budget projections at a constant policy for the medium term were prepared and finalised in March this year, considering the macroeconomic development scenario, which has been prepared in February 2020 and approved by the Fiscal Discipline Council. Considering the time of drafting the baseline scenario, it does not contain the impact of the global coronavirus Covid-19 pandemic. The projections took note of the updated

[20] There are discussions taking place between the CSB and Eurostat regarding the statistical accounting of the one-off transactions performed within the scope of the mandatory procurement system. Contrary to the existing accounting, when the unconditional compensation part is being accounted for in the relevant transaction year, Eurostat is of the opinion that this part of compensation in accordance with the economic essence of the transaction would have to be accounted proportionately up to the expiry of the support period. The changes offered by Eurostat would provide for reduction of expenditure by 140 million euro in 2017 and by 38.7 million euro in 2018, but the growth of expenditure in the amount of 18.3 million euro from 2019 till 2027 and 13.4 million euro in 2028.

revenue, based on the approved macroeconomic development scenario, the approved state basic budget basic expenses for 2021 - 2022 and the projection for 2023, as well as the expected development in the local government budget, in light of the current trends.

In the baseline scenario, the general government budget deficit in 2020 is being forecasted in the amount of 0.4% of GDP and it is by 0.1 percentage point higher than planned, when preparing the budget for 2020. The deterioration of the balance would mainly be affected by higher expenditure forecast for social benefits in the social security fund. **In the general government budget in the baseline scenario at constant policy, a deficit of 0.1% of GDP in 2021, a deficit of 0.1% of GDP in 2022 and a surplus of 1.0% of GDP in 2023 is being projected.**

Table 3.5. Fiscal development baseline scenario at a constant policy

		2019	2020	2021	2022	2023
	ESA code	**% of GDP**				
Net lending (+) or borrowings (-) (B.9) by sub-sectors						
General government	S.13	-0.2	-0.4	-0.1	-0.1	1.0
incl., reclassified enterprises[21]		-0.1	-0.1	-0.1	-0.2	0.0
Central government	S.1311	-1.7	-0.9	-0.7	-0.7	0.4
incl., reclassified enterprises		-0.2	0.0	0.0	-0.1	-0.1
Local government	S.1313	0.6	-0.2	-0.1	0.0	0.1
incl., reclassified enterprises		0.1	-0.1	-0.1	-0.1	0.1
Social security funds	S.1314	0.9	0.7	0.7	0.6	0.5
General government (S.13)						
Total revenue	TR	38.7	38.2	37.5	37.1	36.9
Total expenditure	TE	38.9	38.6	37.6	37.1	35.9
Interest expenditure	D.41	0.7	0.8	0.8	0.8	0.8
Cyclical development						
Cyclical component of the budgetary balance[22]		0.3	0.1	0.1	0.1	-0.1
One-off measures[23]		0.2				
Cyclically adjusted balance		-0.6	-0.5	-0.2	-0.1	1.1
Cyclically adjusted primary balance		0.1	0.3	0.6	0.6	1.8
Structural balance		-0.7	-0.5	-0.2	-0.1	1.1

According to the baseline scenario, it is projected that, in 2020, the share of general government revenue in GDP will comprise 38.2% of GDP. Lower revenue level than in 2019 is related to the lower PIT revenue in percentage of GDP. In 2021, 2022 and 2023, the general government revenue share will reduce to, correspondingly, 37.5%, 37.1% and 36.9% pf GDP. Reduction of the share of revenue is influenced by, in the medium term, lower than planned

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

[22]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. EC. The Semi-Elasticities Underlying the Cyclically-Adjusted Budget Balance: An Update & Further Analysis. May 2019).

[23] In 2019, a one-off transaction has been included in the one-off measure - revenue in the amount of 60.7 million euro or 0.2% of GDP from the auctioning of emission quotas in the secondary market. To facilitate data comparability between Latvia and the EU, the structural balance in 2019 and 2020 is reflected jointly with the reduction of the net revenue from tax reform, correspondingly, by 0.5% of GDP and 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 does not recognise the measures reducing revenue / increasing expenditure to be one-off/short-term measures.

for 2020 amount of received dividends from public sector companies, and also several other revenue positions (self-earned, non-tax revenue, general government corporations' revenue), in nominal terms, have been planned with moderate growth, but they decrease in percentage to GDP. It is expected that, in the medium term, the share of the general government expenditure in GDP, similar to revenue, will reduce on an annual basis, even though in nominal terms the amount of expenditure will grow. In 2023, exactly the base expenditure of the central government budget, being basically projected at the level of 2022 - without considerable additional funding, influence the formation of the surplus in the general government budget.

Central government budget

- In 2020, a deficit of 0.9% of GDP is planned for the central government budget at a constant policy, while a deficit of 0.7% of GDP is projected in 2021 and 2022, and a surplus of 0.4% of GDP - in 2023. Remuneration expenditure in the central government budget is forecasted with moderate increase, incl., expenditure for remuneration to medical personnel and teachers in the medium term mainly remains at the level of 2020, because there are no corresponding decisions adopted on raising the funding in 2021 - 2023. The level of expenditure for defence continue remaining in the amount of at least 2% of GDP, which, in the medium term, means the increase of expenditure in this sector.
- In 2020, a steeper tax revenue increase is forecasted, under the influence of the CIT revenue growth, along with the completion of the impact of the reform that determined low CIT revenue volume in 2019. Starting from 2021, the increase of the minimum wage is stipulated to 500 euro that would have a positive effect on tax revenue, concurrently also increasing the state basic budget expenditure for ensuring the remuneration at the relevant level. PIT revenue in 2020 will be lower than in 2019, attributable to the increase of the non-taxable minimum as of January 1 this year and high dividend disbursement in 2019. Over the coming years, along with the increase of the total wage fund, the PIT revenue will steadily increase.
- The growth rate of tax revenue will be affected by the forecasted decrease in property income, mainly due to received payments for the use of state capital, due to the fact that no revenue from dividends from JSC "Latvenergo" are included in the projections for 2021 - 2023, planning them in the law On the State Budget for the current year.
- The EU funds' investments in the central government budget have been performed on a constantly high level since 2018 (above 700 million euro) and they are forecasted in the similar amount also in 2020. In turn, starting from 2021, the growth of investment volume is expected, because of the concurrent implementation of the EU funds' investment projects for both 2014 - 2020 programming period and 2021 - 2027 programming period.
- In 2023, in the central government budget it is planned that the total amount of expenditure, in nominal terms, will be lower than in 2022, attributable to the fact that there are no decisions adopted at the moment on allocation of additional resources with respect to 2023. Correspondingly, the central government budget balance, at a constant policy, as compared to 2022, will improve considerably.

Social security fund

- Ever since 2014, a surplus is formed in the social security fund every year - in 2019, it achieved 0.9% of the GDP, thanks to favourable situation in the labour market and high employment rate. Nevertheless, in the medium term, the amount of surplus will reduce and in 2023 it will amount to 0.5% of the GDP, along with the slowdown in the growth rate of the social security contributions and constantly growing expenditure for pensions and other social benefits.

- In 2020, a steeper growth of expenditure for pensions is expected, given both the rise in the average wage and larger indices, based upon higher actual macroeconomic indicators, when indexing pensions up to 420 euro on 1 October 2019. 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 decrease and it is currently forecasted that it will continue decreasing also in the medium term.
- To motivate performance of social security contributions, from 2020, the inheriting of the funded pension capital is provided for. The participant of the funded pension scheme is entitled to choose, how their funded pension capital would be used, if the relevant participant dies prior to the day of requesting the old-age pension. It will be possible to transfer the accrued funded pension capital into the State-funded pension special budget or to add to the funded pension capital of a person designated by the participant of the funded pension scheme, or to inherit it under the procedure prescribed by the *Civil Law*.

- From 2020, the duration of disbursement of the unemployment benefit is reduced from nine to eight months, and the monthly percentage breakdown of the amount of the unemployment benefit to be disbursed has been reviewed, as well. It is planned that during the first two months the unemployment benefit is disbursed in the granted amount, in the third and fourth month - 75% of the granted amount, in the fifth and sixth month - 50% of the granted amount, in the seventh and eighth month - 45% of the granted amount of the benefit. Before coming into force of this norm less favourable for the potential recipients of the unemployment benefit, at the end of 2019, increase in the number of recipients of the benefit was observed, as result whereof, in January 2020, 7 729 benefits have been disbursed for the first time (newly granted), exceeding the average indicator of the previous year by 57%. Besides, the average amount of the newly granted benefit comprised 571.39 euro, exceeding the indicator of 2019 by 17%. The number of recipients of the unemployment benefit, based on the SSIA data, comprised 32.1 thousand persons in December 2019, 35.9 thousand persons in January 2020 and 37.3 thousand persons in February 2020.
- In the baseline scenario, when projecting the changes in the number of the recipients of the unemployment benefit in 2020, information disseminated in the public space was considered regarding the "plans" of the JSC *Latvijas Dzelzceļš* to terminate employment legal relationship with approximately 1 500 employees by the end of this year.

Local government budget

- Contrary to the budgetary surplus in 2019 (0.6% of GDP), in the baseline scenario of 2020 at a constant policy, the deficit in the amount of 0.2% of GDP is being forecasted in the local government budget. Deterioration of the budgetary balance is mainly attributable to lower PIT revenue, as compared to 2019. This, in turn, was affected by the increase of tax allowance in 2020, being continued within the scope of the tax reform, as well as the PIT payments for dividend disbursements to natural persons being forecasted in a significantly lower amount. Nevertheless, as compared to the previously planned, in light of the better tax performance in 2019, the tax revenue forecast was increased, resulting in reduction of the local government budget deficit, as compared to the plan.
- In 2020, as compared to 2019, higher deficit will also be affected by the increase of the amount of local government transfers to the state basic budget, attributable to the

statutory compensation of the local government of Riga (in 2020 - 38.0 million euro, in 2021 - 10.5 million euro) for adverse impact created by *Rīgas satiksme* on the general government budgetary balance, as well as the results of economic activity of local governments' commercial companies, which, as compared to 2019, are projected to be worse, mainly by *Rīgas satiksme* performing investments into public transport. Nevertheless, if compared to what was planned before, this year *Rīgas satiksme,* amid the deviation from the schedule of deliveries of new transport units, corrected the forecast of its economic activity. This year it is planned that new trolleybuses and trams will be delivered in Riga, and the tram infrastructure will be modernised, as well, while the delivery of new busses is postponed to 2021.

- When preparing the local government budget expenditure forecast for the medium term, it was assumed that, notwithstanding the high amount of outstanding funds of local government (budget surplus in 2019, as well as good PIT revenue performance in the first two months of this year), in general, expenditure will remain at the level of the previous year and will not significant grow. While a moderate growth is being forecasted in the expenditure for remuneration, goods and services, subsidies and grants, expenditure for investments, in general, are forecasted in the smaller amount than in 2018 and 2019, when the level thereof was consistently high, thanks to the active implementation of the EU funds' projects. Reduction of capital expenditure in the medium term will be determined by both the effective borrowing limits for investments for the fulfilment of core functions and the fact that the Riga local government by the approval of the budget may spend 1/12 part budget of the previous year per month, as well that the EU funds' 2014 - 2020 programming period is approaching to the closing stage thereof.
- It is forecasted that, in the medium term, local government budgetary balance will improve on a year-to-year basis, reaching the surplus of 0.1% of GDP in 2023.

3.3.2. Covid-19 impact scenario

Considering further development of the situation with respect to the spread of Covid-19 and the restrictions approved by the government from March 13 this year during the pandemic, at the beginning of April the MoF developed the Covid-19 impact macroeconomic development scenario, on the basis whereof the general government budgetary forecasts for 2020 and for the medium term were updated. Based on the updated macroeconomic scenario, providing for GDP fall of 7% in 2020, updates were introduced to the tax and non-tax revenue forecasts, expenditure for pensions and benefits in the state social security budget, interest expenditure and other separate budgetary positions, which have been adjusted since the development of the baseline scenario. Fiscal forecasts have taken note of the support measures for minimising the consequences of crisis approved (including conceptually) by the government and the Saeima up to April 17 this year. It should be noted that, in light of uncertainty of the situation and urgent process of adoption of legal framework under the circumstances of pandemic, the fiscal impact of support measures specified by the competent authorities in the abstracts of legal framework is corrected in separate cases, based on the actual fulfilment of the support measures.

In accordance with Covid-19 impact scenario, the general government budget deficit is forecasted in the amount of 9.4% of GDP in 2020, 5.0% of GDP in 2021, 3.9% of GDP in 2022 and 2.7% of GDP in 2023.

Table 3.6. Fiscal development scenario, considering Covid-19 impact

		2019	2020	2021	2022	2023
	ESA code	% of GDP				
Net lending (+) or borrowings (-) (B.9) by sub-sectors						
General government	S.13	-0.2	-9.4	-5.0	-3.9	-2.7
Central government	S.1311	-1.7	-6.9	-3.7	-3.1	-2.0
Local government	S.1313	0.6	-0.6	-0.8	-0.7	-0.5
Social security funds	S.1314	0.9	-1.9	-0.5	-0.1	-0.2
General government (S.13)						
Total revenue	TR	38.7	37.4	38.9	38.9	38.8
Total expenditure	TE	38.9	46.8	43.8	42.8	41.4
Interest expenditure	D.41	0.7	0.9	0.9	0.9	0.9
Cyclical development						
Cyclical component of the budgetary balance[24]		0.3	-3.3	-3.9	-3.7	-3.8
One-off measures[25]		0.2				
Cyclically adjusted balance		-0.6	-6.1	-1.0	-0.2	1.2
Cyclically adjusted primary balance		0.1	-5.2	-0.1	0.7	2.1
Structural balance		-0.7	-6.1	-1.0	-0.2	1.2

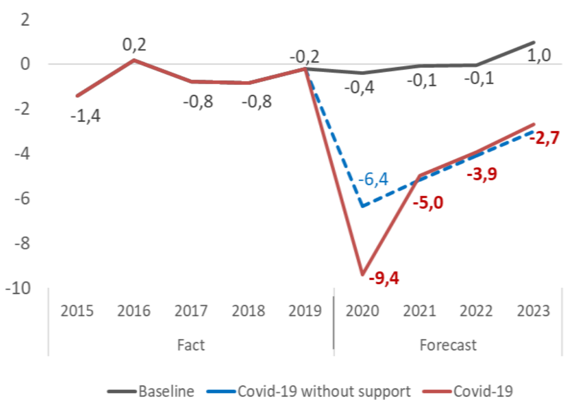


Figure 3.4. General government budget balance,
% of GDP
(Data source: *Eurostat,* MoF)

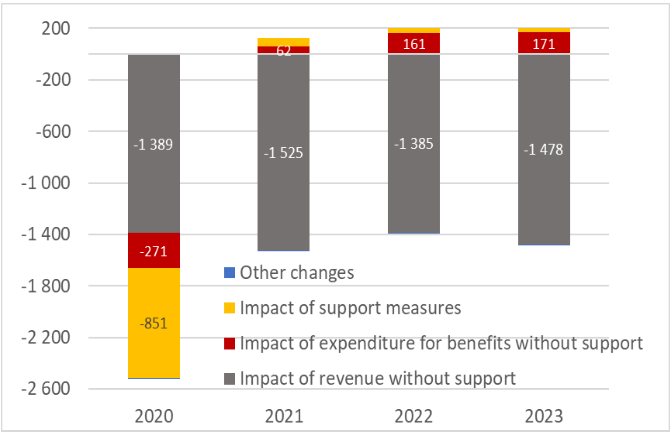


Figure 3.5. Factors affecting the changes in the balance against the baseline scenario, million euro
(Data source: MoF)

[24] 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).

[25] In 2019, a one-off transaction has been included in the one-off measure - revenue in the amount of 60.7 million euro or 0.2% of GDP from the auctioning of emission quotas in the secondary market. To facilitate data comparability between Latvia and the EU, the structural balance in 2019 and 2020 is reflected jointly with the reduction of the net revenue from tax reform, correspondingly, by 0.5% of GDP and 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 does not recognise the measures reducing revenue / increasing expenditure to be one-off/short-term measures. In addition, it should be noted that, within the fiscal framework of Latvia, the support measures with fiscal impact adopted by the government and the Saeima for minimising the influence of the emergency situation related to the spread of Covid-19 are deemed to be one-off measure, correspondingly - 3.0% of GDP in 2020, 0.2% of GDP in 2021, 0.2% of GDP in 2022 and 0.3% of GDP in 2023, and are not included in the structural balance. The EC approach, in its turn, does not provide for recognising Covid-19 support measures as one-off measures, therefor these measures in this Table are included in the structural balance.

As compared to the baseline scenario, the deterioration of the balance in the medium term (see Figure 3.5) is mainly affected by the forecasted reduction of the tax and non-tax revenue - on average, by 1.4 - 1.5 billion euro each year, without considering the fall in revenue due to introduced support measures - extension of the tax payment terms, cancellation of the PIT advance payments, faster refund of the overpaid VAT, etc. measures, as a result whereof the revenue would decrease even more. Revenue forecast is a conservative MoF assessment, considering the reduction of the economic growth and the adopted restrictions, which significantly decelerate the economic activity. Revenue, as compared to the baseline scenario, is also reduced by negative correction with respect to the "super-dividends" of JSC *Latvenergo* (the share of revenue from dividends received in the budget, which in accordance with ESA 2010 must be excluded, because the enterprise disbursed them from its income not related to economic activity), which was included in the forecast, considering the result of this year's notification regarding 2019.

Likewise, as the economic situation deteriorates and the unemployment rate grows, in 2020, significant increase of expenditure for unemployment benefits is forecasted, as well as, amid the growing Covid-19 morbidity rate and the number of people in quarantine, the number of recipients of sickness benefits would grow and, therefore, also the expenditure for sickness benefits. Expenditure for social benefits will be even more increased by the support measures.

Other changes in the balance, as compared to the baseline scenario, are insignificant. It should also be noted that, based on evaluation about better results of economic activity of *Rīgas satiksme*, in the nearest future it will be offered to the government to reduce the compensation of Riga local government from 38 million euro to 12.6 million euro in 2020, even though it would affect the balance as a whole, but merely by budget sub-levels.

A significant deterioration of the general government budgetary balance, as compared to the baseline scenario, is formed also by the fiscal impact from the support measures for national economy adopted by the government and the Saeima. In light of these decisions, in total, **the planned support (aid) for national economy reaches 1.7 billion euro or 6.1% of GDP with direct adverse effect on general government budgetary balance in the amount of 851.4 million euro or 3.0% of GDP in 2020**, in turn, in the medium term, mainly receiving in the budget revenue the taxes, the terms whereof have been extended, a positive effect on balance is being forecasted in the amount of 0.2% of GDP in 2021, 0.2% of GDP in 2022 and 0.3% of GDP in 2023. If we consider also the support offered by other organisations, for example, international financial sector institutions, then, in total, the support available for Latvian national economy for overcoming Covid-19 crisis might be larger.

The adopted decisions on support measures (as at 17 April 2020) for overcoming Covid-19 crisis, reflected in more detail in the Table in Annex to the Stability Programme, may be classified into four categories - support in the field of taxes, support in the field of benefits, support in the field of loans and guarantees, as well as the support to sectors.

Support in the field of taxes

Overall, the adverse effect of the support measures in the field of taxes on the general government budgetary balance in 2020 is being forecasted in the amount of 331.0 million euro or 1.2% of GDP, while in 2021, when the taxes with extended payment terms would be received in the budget, it is positive - 58.7 million euro or 0.2% of GDP, 47.3 million euro or 0,2% of GDP in 2022 and 94.6 million euro or 0.3% of GDP in 2023.

The law *On Measures for the Prevention and Suppression of Threat to the State and Its Consequences Due to the Spread of Covid-19*, which was adopted by the Saeima on March 20 this year, prescribed several support measures affecting the tax revenue, in order to minimise the consequences of crisis for entrepreneurs and population. Support in the field of taxes comprises such measures as:

- extension of the tax payment term;
- cancellation of PIT advance payments;
- overpaid VAT refund within the period of 30 days;
- extension of the real estate tax payment terms (this measure has no fiscal impact, as the terms are postponed only within the scope of 2020).

Based on the SRS data, by 21 April 2020, tax "holidays" have been granted to 2 544 enterprises in the amount of 39.4 million euro.

Support in the field of benefits

Overall, the adverse effect of the support measures in the field benefits on the general government budgetary balance in 2020 is being forecasted in the amount of 131.2 million euro or 0.5% of GDP. During the period of time from March 20 till April 16, several laws and regulations have been adopted, prescribing additional expenditure for benefits for the support to population, minimising the consequences of crisis caused by Covid-19.

The largest expenditure is planned for the following benefits:

- Payment of the sickness benefit from the State budget starting from the second day in the amount of 80% of the average insurance contributions wage of the recipient of the sickness benefit for those infected with Covid-19 and those subject to quarantine. The Ministry of Welfare, when projecting the fiscal impact of this measure, adopted the most pessimists scenario, where the number of those infected with Covid-19 and subject to quarantine, in total, could reach 50% of the total number of the socially insured persons.
- Allowances for idle time. Employee remuneration in case of idle time is being compensated on the part of the State in the amount of up to 75 per cent from the amount of the employee’s average remuneration of the previous six months but not more than 700 euro. The allowance for idle time is not taxable with PIT and state social security contributions. During the period of time from March 26 till April 9, several amendments to the Cabinet regulations have been adopted, extending the circle of recipients of the allowance for idle time - including therein the self-employed persons, recipients of royalties, microenterprise taxpayers, management board members, working pensioners, etc. By April 21, based on the SRS data, allowances for idle time have been disbursed in the amount of 5.4 million euro to 19 474 employees based on applications from 3 560 enterprises and 1 113 applications of self-employed persons. Even though, at the time of development of the measure, the competent authorities forecasted the maximum expenditure necessary for the disbursement of allowances for idle time even up to 170 million euro, nevertheless, in light of the cost trends and the average amount of allowance, which, in fact, comprises about 250 euro, the MoF assesses that the disbursement of allowances for idle time would require 30 million euro.

In turn, the forecasts consider the budget expenditure for the following measures in the field of benefits as having smaller fiscal impact:

- State earmarked grant for local government benefit in the crisis situation for the family (person) and supplements to this benefit for a dependent child in the amount of 50 euro;
- Supplement to the allowance for idle time for the dependent child in the amount of 50 euro;

- The term for receipt of parental allowance is extended;
- The circle of recipient of unemployment benefit is extended - rights to the status of the unemployed for the patent fee payers and microenterprise taxpayers. The norm was approved in the government and submitted to the Saeima on 14 April 2020.

It should be noted that the forecasts do not include the amendments to the law *On Unemployment Insurance* supported in the government on 21 April 2020, providing for introduction of the unemployed person's aid benefit. Such support mechanism provides for the disbursement of the unemployed person's aid benefit, where a person from March 12 till August 31 this year, following the expiry of the period of disbursement of the unemployment benefit, would not have found a job and would not carry out economic activity. Maximum amount of such aid would be not more than 130 euro (namely, it will be disbursed in the amount a person received, correspondingly, in the eighth or ninth month, but not more than in the amount of 130 euro). The amount of the benefit was determined, based upon the level of income of a needy family (person) laid on in laws and regulations or 128.06 euro, and according to the Mow information it could be ensured to approximately 18 653 persons. Based on such parameters, it is estimated that the total of 21.8 million euro would be necessary for this purpose.

Support in the field of loans and guarantees

The planned support in the field of loans and guarantees comprises 3.3% of GDP, however the adverse effect thereof on the general government budgetary balance is assessed in the amount of 100.8 million euro or 0.4% of GDP in 2020.

The planned support measures are ensured via the Financial Institution ALTUM and this type of support is mainly intended for a short-term improvement of liquidity of enterprises.

- Loans to current assets;
- Loan guarantees;
- Portfolio guarantees.

Support to sectors

The adverse effect of these support measures on the general government budgetary balance is assessed in the amount of 288.4 million euro or 1.0% of GDP, intended for mitigating financial difficulties of the sectors, as well as ensuring the medical aids and remote learning process. In separate cases, preserving the conservative forecasting approach, the forecasts also included the impact from the conceptually adopted decisions. The following sectors were supported:

- Support to air transport sector;
- Support related to the health care (acquisition of personal protective equipment, sanitation, medicinal equipment in the institutions of the MoH, the MoI, the MoD, increase of the share capital of hospital, supplements to medical personnel for work under Covid-19 circumstances, etc.);
- Support to media and informing the public;
- Support to remote learning process;
- Support to agriculture, forestry, fishery and food production sectors.

3.4. DEVELOPMENT TRENDS OF GOVERNMENT DEBT IN THE MEDIUM TERM

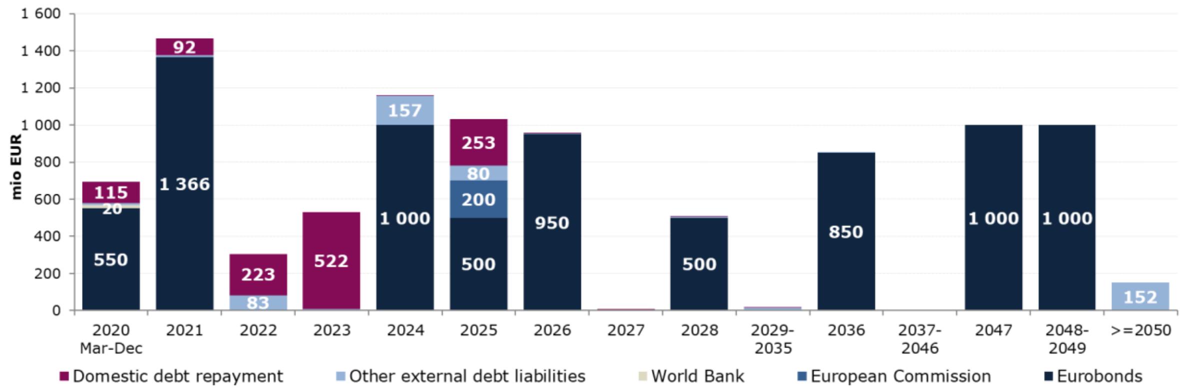
The key principles and medium-term objectives of the central government debt management are defined in the Central Government Debt and Cash Management Strategy approved by the Minister for Finance. In accordance with the Central Government Debt and Cash Management Strategy, the purpose of government 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 state borrowing and debt management process is applied, maintaining the greatest possible flexibility in the choice of borrowing conditions on financial markets (time of borrowing, currency, amount, maturity). It allows limiting financial risks in the medium term, as well as ensuring the amount of necessary resources to cover the total financing requirement at as favourable and attractive conditions as possible.

According to the general government budget deficit and debt notification data of April 2020, prepared in accordance with the ESA 2010 methodology, the general government debt at the end of 2019 reached 11.2 million euro or 36.9% of GDP. The general government debt level is mainly affected by the central government debt, which at the end of 2019 was 10.6 billion euro[26]. In February 2019, the domestic debt securities (T-bonds) have been redeemed in the amount of 229.8 million euro and, in April 2019, the EC loan in the amount of 500 million euro have been repaid, using the resources attracted in the international financial markets by Eurobonds issued in 2018 and in February 2019. In February and May of 2019, the 30-year Eurobond issues have been performed in the amount of 1.0 billion euro, ensuring the resources for the financing requirement of both 2019 and 2020, incl., for the redemption of the US dollar denominated bonds in January of 2020.

In the domestic market, the 5-year T-bond programme launched in 2018 was continued up to June 2019, reaching the amount of 250 million euro in circulation in nominal value. Also, the new 5-year T-bond programme launched in July of 2019, achieved 232 million euro at the end of 2019. The demand for Latvian government domestic debt securities remained high in 2019, which means that a high investors' competition in all auctions ensured attraction of resources on financially advantageous terms. Also in 2019, the yields in the government domestic debt securities auctions (for the 5 -year T-bonds) were at historically lowest, reaching even negative levels, but for the 5-year T-bond programme launched in July 2019, the coupon of 0.000% was recorded for the first time.

Taking into account the central government debt obligations outstanding as of 29 February 2020 (before the beginning of coronavirus Covid-19 pandemic), in accordance with the central government debt repayment schedule, the amount of the central government debt obligations to be refinanced in the period between March 2020 - December 2023 comprises 3.0 billion euro (see Figure 3.6). Majority of the amount of debt to be refinanced within the referred period consists of Eurobonds issued in international financial markets, the maturity whereof will become due.

[26] Nominal value, including derivatives linked to the central government debt administered by the Treasury



** 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 2020*

Figure 3.6. Central government debt repayment schedule
(liabilities outstanding as of 29 February 2020, nominal value)

3.4.1. General government debt forecasts in the medium term in Baseline Scenario

In order to cover the total financing requirement in the Baseline Scenario for 2020 - 2023, it was planned to perform timely borrowing in financial markets, so as, by ensuring proper management of the debt refinancing risk in accordance with the Central Government Debt and Cash Management Strategy, to refinance the outstanding government debt liabilities under favourable conditions in terms of borrowing rates and maturity. Investor confidence in the creditworthiness of Latvia and a stable country's investment grade credit rating ensures a stable ground for successful refinancing of the outstanding debt liabilities in the next years.

Taking into account the strategic approach to borrowing in order to manage government debt refinancing risk and optimization of government debt servicing costs in the long-term, the Baseline Scenario provided that in the coming years, foreign borrowing instruments will provide major share of the total funding. Borrowing in international financial markets would also henceforth be based on public transactions in global financial markets, issuing the medium term and long-term benchmark Eurobonds mainly in the European financial market, as well as addressing other regional investors. The domestic financial market also an offer of securities consistent with the demand would be maintained within the framework of the primary dealers' system, thus promoting activity and liquidity of the government debt securities market.

Since 2017, the stabilising and decreasing trend of the general government debt to GDP had been projected. Central government debt comprises the largest share of the general government debt amount, therefore the general government debt trends are mainly determined by the changes in the central government debt, affected by borrowing and central government debt repayment. Baseline scenario prescribed that, in 2023, the general government debt level to GDP could reach the lowest level since 2009, which would mainly be determined by a comparatively small volume of the central government debt obligations to be refinanced in 2022, considering that the central government debt obligations to be fulfilled in 2021 would be refinanced by the borrowings to be made in 2020 - 2021. In the medium term the stabilisation and further reduction of the general government debt level to GDP was projected, confidently complying with the debt rule prescribed by the FDL (see Figure 3.7).

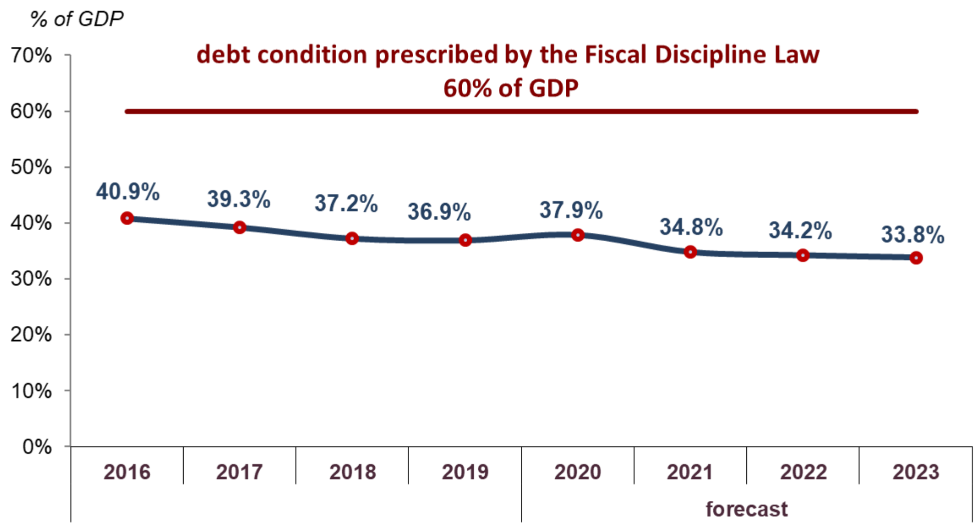


Figure 3.7. General government debt development trends in the Baseline Scenario (% of GDP)

3.4.2. General government debt forecasts in the medium term in Covid-19 impact scenario

The spread of Covid-19 and the restrictions for mitigating the consequences thereof are expected to significantly impact the development and fiscal indicators of global economy, incl., economy of Latvia, however, for the time being it is not possible to credibly assess the scope and duration of this impact, nor is it possible to exactly forecast the full fiscal impact of the spread of Covid-19 in 2020 and in the medium term. The spread of Covid-19 in March and April 2020 invoked the need to expediently carry out borrowing in domestic and international financial markets, *inter alia*,:

- tapping Eurobonds with maturity in 2026 in the amount of 550 million euro and a pre-fixed interest (coupon) rate of 0.375% (yield 0.406%);
- new Eurobond issue with maturity in 2023 in the amount of 1 billion euro and a fixed interest (coupon) rate of 0.125% (yield 0.209%);
- issue of domestic debt securities (T-bonds) with maturity in 2022 in the amount of 304.5 million euro and a fixed interest (coupon) rate of 0% (five releases with the yield from (-0.129%) to 0.099%).

Persistently high Latvia’s country's credit rating of A category promotes investor activity and interest in the transactions, however, under the circumstances of volatility and uncertainty of financial markets, caused by the global spread of Covid-19, the credit risk mark-up levels of countries increased. To minimise the impact of debt servicing costs (interest expenditure) caused by borrowing under such financial market conditions on the government budget, resources have been raised for comparatively short terms and at possibly lower interest rates, concurrently observing the principles of the central government debt portfolio and not increasing the central government debt refinancing risk in the coming years (see Figure 3.8).

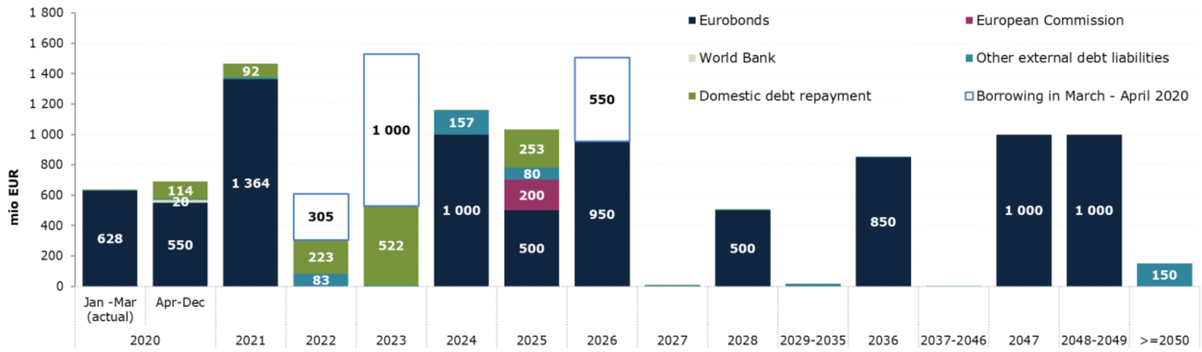


Figure 3.8. Central government debt repayment schedule
(Liabilities assumed by 23 March 2020, nominal value)

In parallel, also additional borrowing possibilities from international financial institutions are ensured. On 9 April 2020, the loan agreement with the Nordic Investment Bank has been concluded, within the scope whereof it is possible to raise long-term funding in the amount of 500 million euro for Covid-19 response and overcoming measures, and negotiations with the Council of Europe Development Bank and the European Investment Bank are in progress.

In addition to the global financial markets and support mechanisms developed by the EC, the European Stability Mechanism and other international financial institutions, the niche markets are also monitored, on a regular basis, which are to be assessed in terms of availability, borrowing terms and the volume or resources to be attracted, as well as in terms of diversification of investor base.

Therewith, the country already has a funding available in significant amount for mitigating the impact of the spread of Covid-19 and support to economy in the emergency situation. As soon as the situation in the financial markets stabilises, the attraction of resources will be continued for the overall financing requirement of this year, incl., for the fulfilment of the central government debt obligations planned by the end of 2020 and at the beginning of 2021, funding of increasing central government budget deficit and net lending. It is mainly planned to base borrowing on the issues of debt securities, choosing as a priority longer tenors, to eliminate financial risks and to fix low central government debt (public) servicing costs in the long term.

Amid a considerable growth in borrowing volumes caused by the need to finance the measures performed and planned for mitigating the consequences of the spread of Covid-19 and supporting the economy, based on the current forecast, which has been prepared under the circumstances of especially high uncertainty, indicatively, it is expected that the general government debt level could increase to 52% of GDP in 2020 (see Figure 3.9), which is, on average, by 17 percentage points more than the debt level forecasted in the baseline scenario. Despite the projected debt increase in the medium term, it is expected that the debt rule defined by the FDL will be complied with.

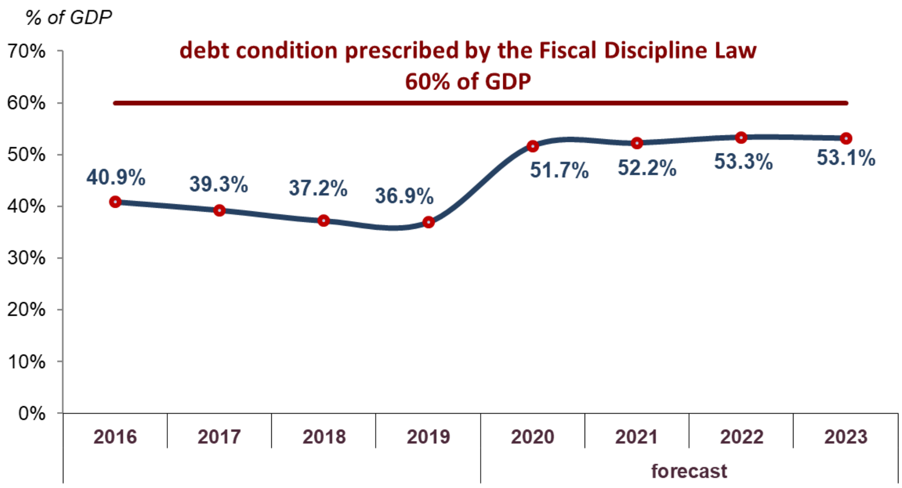


Figure 3.9. General government debt development trends in Covid-19 impact scenario (% of GDP)

3.5. COMPARISON OF THE GENERAL GOVERNMENT BUDGET BALANCE AND DEBT FORECASTS WITH THE LATVIA'S STABILITY PROGRAMME FOR 2019 - 2022

GDP growth in 2019 has been slower than envisaged by the baseline scenario of the Latvia's Stability Programme for 2019 - 2022 scenario. Slower-than-planned economic growth last year was mainly attributable to a stronger slowdown of economic cycle that reduced the export growth. This was additionally triggered by the growth of protectionism between the USA and its trade partners. This was felt not only in the transit sector, but also in the sector of processing industry. Gross fixed capital formation, in its turn, grew only by 3.1%, as opposed to 15.8% in 2018, as the EU funds inflow remained practically at the level of 2018. The overall economic slowdown was reflected also in the growth rates of private and public consumption, which were, on average, by 1.5 percentage points smaller than the year before.

In turn, the forecasts for 2020, are significantly affected by the restrictive measures introduced along with the spread of Covid-19. Therefore, the forecast for 2020 has been reduced from 3.0% (Stability Programme for 2018 - 2021 and the Stability Programme for 2019 - 2022, baseline scenario) to -7%, expecting gradual recuperation in the following years that would start in the second half of 2020. The scenario has been drafted in the circumstances of very high uncertainty, when it is not possible to foresee the duration of the introduced measures.

General government debt forecast has been significantly increased in 2020 - 2022, as compared to the forecasts of the Stability Programme for 2019 - 2022 (see Table 3.7). The changes were determined by significant increase of borrowing volumes, caused by the need to finance the measures performed and planned for mitigating the consequences of the spread of Covid-19 and supporting the economy, as well as the macroeconomic scenario of Covid-19 impact, providing for significant GDP fall in 2020 and gradual recuperation in the medium term.

Table 3.7. Comparison with the forecasts of the Stability Programme for 2019 - 2022

	ESA code	2019	2020	2021	2022	2023
GDP growth (%)	B1y					
2019		3.2	3.0	2.9	2.9	-
2020 (Covid-19 scenario)		2.2	-7.0	1.0	3.5	2.4
Changes		-1.0	-10.0	-1.9	+0.6	-
Actual budget balance (% of GDP)	B.9					
2019		-0.5	-0.4	-0.2	-0.3	-
2020 (Covid-19 scenario)		-0.2	-9.4	-5.0	-3.9	-2.7
Changes		+0.3	-9.0	-4.8	-3.6	-
Total general government debt (% of GDP)						
2019		37.4	36.1	33.5	33.1	-
2020 (Covid-19 scenario)		36.9	51.7	52.2	53.3	53.1
Changes		-0.5	+15.6	+18.7	+20.2	-

Considering the developed Covid-19 impact macroeconomic scenario, resulting in significant reduction of tax revenue and increase of social security budget expenditure, as well as the decision adopted by the Saeima and the government for introduction of support measures for prevention of Covid-19 impact, the general government budget deficit for 2020 and coming years is being forecasted considerably higher than in the previous Stability Programmes. The general government budget deficit is forecasted in the amount of 9.4% of GDP in 2020, 5.0% of GDP in 2021, 3.9% of GDP in 2022 and 2.7% of GDP in 2023.

3.6. STATE - ISSUED GUARANTEES

The law On the State Budget for 2019 did not provide for any new government 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 *ALTUM*.

At the end of 2019, the amount of State guarantees was 731.0 million euro, comprised of the disbursed but not yet repaid part of the State-guaranteed loan in the amount of 515.7 million euro and the non-disbursed part of the State-guaranteed loan in the amount of 215.3 million euro.

Total State-guaranteed loans outstanding at the end of 2019 comprised 515.7 million euro or 1.7% of GDP (see Figure 3.10), which is by 38.1 million euro more than at the end of 2018. In 2019, like in 2018, new State guarantees were granted only for ensuring the study and student lending programme.

The largest share of the State-guaranteed loan portfolio is comprised of the State guarantees for the obligations of the State association *ALTUM* for implementation of the aid schemes (275.9 million euro), obligations of the guaranteed loans of medical institutions (134.2 million euro) and State guarantees for student and study lending (73.8 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.

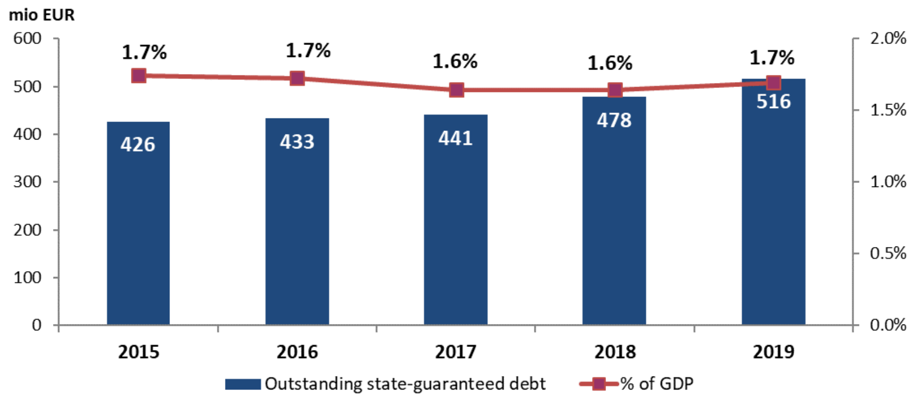


Figure 3.10. State-guaranteed loans outstanding at the end of respective year (million euro)

Given the probability that the obligations of the highest risk State-guaranteed loans or the part thereof might not be fulfilled within the original maturity, the law On the State Budget for 2020 prescribes the allowable expenditure limit for fulfilment of the obligations of the state-guaranteed debt. In 2020, 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 debthave been set in the amount of 2.1 million euro.

At present, the global economy has been affected by the shock caused by coronavirus Covid-19. Under the impact of Covid-19, on 11 March 2020, the World Health Organisation declared pandemic, as a result, on 12 March 2020, the emergency situation was declared throughout the territory of the Republic of Latvia for the purposes of containing the spread of Covid-19 virus. As a result of containment of spread of this virus, the financial situation has significantly deteriorated in many sectors not only in Latvia, but also on a global scale, therefore, there is a risk that the recipients of the State guarantee would incur financial difficulties to cover the outstanding obligations, including the recipients of the loans issued by the Nordic Investment Bank and the European Investment Bank guaranteed by the Republic of Latvia as the member state of the Nordic Investment Bank and the European Investment Bank. Despite the fact that the current market practice shows that commercial banks offer various allowances (grace periods on loans, reduced interest rates), at the moment it is not possible to assess the impact the crisis caused by this virus would have on the State-issued guarantees. Up to now, no information has been received from the recipients of guarantees on the possible impact of the crisis, either.

4. QUALITY OF PUBLIC FINANCE

4.1. 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 LBFM.

According to the LBFM 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, till 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 his or her 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 LBFM.

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 LBFM, 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.

Starting from 1 January 2016 the LBFM includes the provisions prescribing for the Cabinet to ensure constant and systematic revision of the State budget expenditure, allowing for more efficient and economic implementation of the State policy, as well as optimising of the budget expenditure and evaluating the conformity thereof to the priorities and objectives set in the development planning documents. The Cabinet, on an annual basis, adopts the decision on the scope of revision of the State budget expenditure, concurrently with the approval of the schedule for preparation of the budget. The Minister of Finance, in turn, in accordance with the referred to schedule, submits to the Cabinet the results of the State budget expenditure revision and proposals regarding the use of these results within the process of development of the Draft Framework Law and the Draft Annual State Budget Law.

Three thematic blocks are included in the scope for 2020, providing for the fundamental analysis of the functions financed by the State budget, analysis of the financing policies under the supervision of line ministries and analysis of the medium-term expenditure revision results (see Figure 4.1).

Fundamental analysis of the functions financed by the State budget

Matrix of strategic revision of the State budget programmes and sub-programmes, applicable to the level of detail of functions and activities

Assessment of payments and grants allocated to public persons for implementation of certain tasks and functions

Analysis of the financing policies under the supervision of line ministries

To ensure more cost-efficient and rational implementation of the State functions and, if necessary, to provide proposals for policy changes

Medium-term expenditure revision results, incl.

Possibilities for centralisation of support functions

Enhancing the field of information and communication technologies

Ensuring the linking of expenditure to the origin of resources

Figure 4.1: Scope of for the Spending Review 2020

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 in the budget explanations, the Policy and Resource Management Cards 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 for the possibility, in an interactive and demonstrative manner, to inform the population in Latvia about the fields and amountin which the taxpayers' money is being invested and what are the expected outcomes. Any interested person has access to the following on the MoF website:

- interactive budget infographics, letting the user to review nine budget contribution fields (for example, health, education, social protection, etc.) and the financing allocated thereto, as well as to get to know detailed information on directions of contribution in each of the sectors and sources or financing. Additionally, information on outcomes to be expected from contributing the State budget financing into the relevant field is provided;
- budgets of the ministries and other central state institutions are visualised both in summarised form and in more detail. The user can review the fields of operation of the ministries and 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 Cards, 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 MoF aggregates, assesses, and ensures the accumulation of the outcomes specified in the Policy and Resource Management Cards and the performance indicators thereof, as well as the operational outputs of the State budget programmes (sub-programmes) and their performance indicators.

The LBFM 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. The Treasury in turn 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 pf 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 MoF, 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 LBFM 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 State Budget tax and non-tax actual revenue 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 gross domestic product 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 LBFM provides for the following main sanctions in case of inappropriate utilization of budget resources:

- for late or incomplete payment of the amounts due 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 good 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 LBFM 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 good 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.

4.2. Efficiency of Revenue Structure and System

4.2.1. Tax Revenue Forecasts of the Baseline Scenario of the Stability Programme

The *Tax Reform* took effect starting from 1 January 2018. The purpose of the *Tax Reform* is to ensure stable and foreseeable tax policy at least till 2021, therewith, in 2019, there have been no significant additional changes, taking effect starting from 2020, introduced to the tax policy. In turn, the changes introduced after the approval of the *Tax Reform* are to be classified as improvement and enhancement measures.

Table 4.1. Tax Revenue in General Government Budget (S.13), million euro

	Code (ESA)	2019	2020	2021	2022	2023
Tax revenue						
1. Production and import taxes	D.2	4 319.7	4 635.9	4 885.5	5 060.0	5 334.6
2. Current income and wealth taxes	D.5	2 129.5	2 182.4	2 349.4	2 466.0	2 589.6
3. Capital taxes	D.91	11.5	5.4	6.1	6.7	7.2
4. Social contributions	D.61	3 052.2	3 219.3	3 397.0	3 562.9	3 730.6
Of which actual social contributions	*D.611 and D.613*	2 904.8	3 111.2	3 288.9	3 454.8	3 622.5

In recent years, the tax policy was focussed on reducing the labour tax burden and income inequality.

One of the basic priorities of the Tax Reform was to reduce income inequality and the labour tax reform has been implemented within the scope thereof. The purpose of the labour tax reform was to reduce the personal income tax burden or the tax gap indicator and to increase income of population, by increasing the minimum wage, determining lower PIT rate for low income earners, as well as raising the differentiated non-taxable minimum, allowance for a dependent and a non-taxable minimum for pensioners. Labour tax reform in accordance with the adopted laws was introduced over the period of three years, reducing the tax burden by approximately 3 percentage points over this time period. Reduction of the burden is partially restricted by increase of the rate of mandatory State social security contributions by 1 percentage point, which was fully allocated as additional funding for the health care sector.

In addition to the changes in the labour taxes that reduced the overall tax revenue, measures were concurrently taken aimed at ensuring the redirection of the tax burden from the labour force to consumption and capital, and more active combating of shadow economy.

Value Added Tax

According to the forecasted national economic growth, as well as considering the increase of the share of the VAT revenue in the GDP over the recent years, in the baseline scenario a stable VAT revenue growth is expected.

In 2020, the VAT revenue will also be influenced by the amendments to the *VAT Law* adopted in the previous years, thus, for instance, starting from 1 July 2019, the scope of the VAT reverse charge procedure was narrowed down and separate services for ferrous and non-ferrous metals supplies have been excluded from the application thereof.

Forecasts also considered the planned changes in the *VAT Law*, providing for the change in refunds procedure, shortening the specified term by which the state has to perform the VAT refunds. It was planned to introduce the measure as from 2022 and it would create fiscal influence only on cash flow in the first year of implementation.

In addition to the above mentioned changes, the VAT revenue is also influenced by other measures, which are not directly related to the changes in the *VAT Law*, but will promote the increase of revenue, for example, changes in the application of the excise duty, increase if the minimum monthly wage (see Table 4.2 reflecting all the measures of tax policy influencing the VAT revenue).

Table 4.2. Impact of the Changes in Tax Policy[27] on VAT Revenue, million euro

	2020	2021	2022	2023
Narrowing of the scope for supplies of ferrous and non-ferrous metals subject to reverse charge procedure	-1.5			
Change of procedure for VAT refunds			-60.0	+60.0
Increase of the differentiated non-taxable minimum	+3.0			
Measure for restricting shadow economy - Enhancement of responsibility of board members	+2.4			
Measure for restricting shadow economy - Empowering the SRS to provide information about high-risk counterparties	+1.5	+0.3		
Raise of the monthly minimum wage from 430 euro to 500 euro as of 2021		+3.8		
Adjustment of the definition of the excise intermediate products	+1.4	+0.7		
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			+0.03	
Total impact of changes:	**+6.8**	**+4.8**	**-59.97**	**+60.0**

Corporate Income Tax

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

Changes influencing the CIT revenue in 2020 are related to increase in intensity of charitable donation allowance to 85% of the sum of the charitable donation and not exceeding 30% of the tax amount for dividends (with a specified term by 2023), as well as the increase

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

of the share of profit of the JSC *Latvijas valsts meži* and *Latvijas Loto* to be disbursed in dividends.

The CIT revenue, in 2020 and the coming years, will also be influenced by the previously adopted legislative changes with respect to the tax support measures for debt payments, measures for combating shadow economy in the restrictions on the use of cash and receipt lottery solution.

Table 4.3. Impact of the Changes in Tax Policy on CIT Revenue, million euro

	2020	2021	2022	2023
Increase of the share of profit of *Latvijas valsts meži* to be disbursed in dividends	+1.0	-10.0		
Increase of the share of profit of *Latvijas loto* to be disbursed in dividends	+0.04		-0.04	
Increase of intensity of allowance for charitable donations	-5.1			+5.1
Restrictions on the use of cash	+0.1			
Tax support measures	-1.3			
Receipt lottery solution	+0.3			
Total impact of changes:	**-5.0**	**-10.0**	**-0.04**	**+5.1**

Excise Duty

Within the scope of the Tax Reform**, on 27 July 2017, the amendments to the law On Excise Duties have been adopted, stipulating changes with respect to the** excise duty rates for alcoholic beverages, tobacco products and oil products used as fuel, in 2018 - 2020.

The referred to amendments stipulated the increase of the **excise duty for oil products** used as fuel, starting from 1 January 2018 and 1 January 2020 (see Table 4.4).

Table 4.4. Excise Duty Rates on Oil Products

Excise duty object	01.01.2018.	01.01.2020
Unleaded petrol, euro per 1 000 litres	476.0	509.0
Leaded petrol, euro per 1 000 litres	594.0	594.0
Diesel fuel, kerosene, fuel oil*, euro per 1,000 litres	372.0	414.0
Diesel fuel, used inagriculture, euro per 1 000 litres**	55.8***	62.1
Liquefied petroleum gas, euro per 1 000 kg	244.0	285.0

** for fuel oil, the colorimetric index of which is less than 2.0 and the kinematic viscosity of which at 50°C is less than 25 mm2/s, and the substitute products and components thereof*
***labelled (marked) diesel fuel (gas oil), used for producing agricultural products, cultivating agricultural land and cultivating forest or marshland where cranberries or blueberries are cultivated, as well cultivating land under fishing ponds*
**** rate is in effect as of 1 July 2018. Till 30 June 2018, the rate is 50.0 euro per 1, 000 litres.*

As regards **tobacco products**, the following increase of excise duty has been established:

- **for cigarettes,** starting from 1 July 2019, the specific rate of the excise duty was increased to 78.7 euro per 1 000 cigarettes, but the minimum duty level - to 114.7 euro per 1 000 cigarettes;
- **for cigars and cigarillos**, starting from 1 January 2020, the excise duty rate was increased from 88.0 euro to 95.2 euro per 1 000 cigars or cigarillos;
- **for smoking tobacco**, starting from 1 January 2020, the excise duty rate was increased from 70.0 euro to 75.0 euro per 1 000 grams of tobacco.

Table 4.5 aggregates the excise duty rates for tobacco products.

Table 4.5. Excise Duty Rates for Tobacco Products

Excise duty object	Effective date of the rate	
Cigarettes	**01.07.2019.**	
Duty rate, euro per 1 000 pieces	78.7	
Minimum duty level, euro per 1 000 pieces	114.7	
Percentage rate of the retail trade price	20%	
Cigars and cigarillos	**01.01.2019**	**01.01.2020**
Duty rate, euro per 1 000 pieces	88.0	95.2
Smoking tobacco	**01.01.2019**	**01.01.2020**
Finely cut tobacco, other smoking tobacco, tobacco leaves, heated tobacco, euro per 1 000 g	70.0	75.0

In addition to the above-mentioned, in accordance with the amendments adopted on 4 April 2019 to the law *On the Handling of Tobacco Products, Herbal Products for Smoking, Electronic Smoking Devices and Their Liquids*, starting from 1 October 2020, in retail outlets it will be prohibited to place tobacco products, herbal products for smoking, electronic smoking devices and their refill containers in the place visible to customers.

In turn, based on Directive 2014/40/EU of the European Parliament and of the Council, which was adopted on 19 May 2014, the trade of menthol-flavoured cigarettes and roll-your-own tobacco products will be banned in the EU starting from 20 May 2020.

Within the scope of the *Tax Reform*, gradual increase of the rates has also been set for the excise duty for **alcoholic beverages and beer**, stipulating the increase of the rates starting from 1 March 2018, 2019 and 2020.

Due to significant differences in the excise duty rates in Latvia and Estonia, the trade of alcoholic beverages and beer in the border area of Latvia - Estonia developed already in 2017 and 2018. Even though previously it was planned to continue increasing the excise duty rates for alcoholic beverages and beer in Estonia also in 2019 and 2020, nevertheless, at the end of 2018, it was resolved to keep them at the level of 2018. In turn, on 13 June 2019, the government of Estonia decided to reduce the excise duty rates by 25% for other alcoholic beverages, fermented beverages with pure alcohol content below 6 volume percent and beer.

Considering that the decision of the Parliament of Estonia to reduce the excise duty rates by 25% for cerain types of alcoholic beverages would worsen the competitiveness of Latvia as compared to neighbouring countries and would adversely affect the circulation of alcoholic beverages in Latvia, especially, in the Latvian-Estonian border area, should Latvia preserve the previously planned excise duty rates, on 8 July 2019, the Saeima adopted the amendments to the law *On Excise Duties*, reducing the excise duty rate for other alcoholic beverages for the period of time from 1 August 2019 till 29 February 2020 to 1 564 euro per 100 litres of absolute alcohol.

In 2019, the total growth rate of consumption of alcoholic beverages and beer was slower than forecasted, when preparing the revenue plan, and the border area trade volumes, as compared to 2018, reduced as well. As a result, considering also the reduction of the excise duty rate for the strong alcoholic beverages as of 1 August 2019, in 2019 the excise duty revenue plan shortfall amounted to 28.4 million euro.

To prevent the adverse effect from deceleration of the growth rate of consumption of alcoholic beverages on Latvian merchants, performing 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% in 2020 and 2021. Table 4.6 reflects the result of total changes with respect to alcoholic beverages and beer.

Table 4.6. Excise Duty Rates on 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.	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*

In addition to the referred to changes in the excise duty rates, in line with the amendments adopted on 6 February 2020 to the law *On Excise Duties*:

- as of 1 May 2020, the definition of intermediate products will be adjusted, preventing incorrect application of excise duty rate to alcoholic cocktails, thus evading the tax payment in full amount;
- as of 1 May 2020, a single approach will be 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;
- as of 1 January 2022, the excise duty exemption will be abolished 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 January 2022, an increased excise duty rate shall be determined for non-alcoholic beverages with sugar content from 8 grams per 100 millilitres - 14.00 euro per 100 litres.

Table 4.7. Impact of the Changes in Tax Policy on Excise Duty Revenue, million euro

	2020	2021	2022	2023
Reduction of the excise duty rates for other alcoholic beverages from 1 840 to 1 564 euro per 100 litres from 1 August 2019 till 29 February 2020.	-2.8			
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%)	-10.1	+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%	-4.7	+4.6	+0.3	
Definition of the intermediate products made more accurate	+6.7	+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			+0.1	
Total impact of changes:	**-10.9**	**+17.1**	**+1.5**	

Personal Income Tax

PIT revenue is mainly influenced by the amount of population employed in national economic, income of the employed, the amount of the non-taxable minimum and exemptions of the PIT, minimum wage, as well as introduced legislative changes.

Changes, which will influence the PIT revenue in 2020, are related to steeper increase of the differentiated non-taxable minimum, as well as the measure for restricting shadow economy stipulating enhancement of responsibility of board members, while the increase of the minimum monthly wage, in its turn, will influence the PIT revenue starting from 2021.

Table 4.8. Differentiated Non-Taxable Minimum for 2020

	2020 (tax reform)	2020 (latest current changes)
Maximum non-taxable minimum	250	300
Minimum non-taxable minimum	0	0
Maximum limit of taxable income	1 200	1 200
Minimum limit of taxable income	440	500

In 2020, the PIT revenue will still be influenced by the *Tax Reform* measures:

- increase of allowance for dependents - 250 euro per month in 2020;
- increase of the non-taxable minimum for pensioners by 300 euro per month in 2020;
- changes in the dividend policy with respect to introduction of the reinvested profit regime in the corporate income tax;
- measures for reducing and improvement of administration of shadow economy.

The PIT revenue will also be influenced by the previously approved legislative changes with respect to increase of the non-taxable minimum for pensioners by 330 euro per month in 2021.

Medium-term macroeconomic development forecasts in baseline scenario for 2020 and henceforth provide for a stable increase in the wage fund, which, in turn, will increase labour tax revenue over the period of subsequent years, and the PIT revenue will be also influenced by the legislative changes made.

Table 4.9. Impact of the Changes in Tax Policy on PIT Revenue, million euro

	2020	2021
Increase of the differentiated NTM	-55.2	
Increase of the allowance for a dependant	-12.5	
Increase of the non-taxable minimum for pensioners	-11.5	-11.8
Transitional period for disbursement of a dividend from retained profit of previous years in the amount of 10%	-74.4	
Measures for combating shadow economy	+0.6	
Possibility for the period of up to 2 years to repay the debt, as a result discharging the late interest and fine	-4.3	
Solution for organising receipt lottery	+0.1	
Raise of the minimum monthly wage from to 500 euro/per month, starting from 2021		+11.9
Total impact of changes:	**-157.3**	**+0.1**

Social Security Contributions[28]

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 legislative changes and changes in the State-funded pension scheme.[29]

Within the scope of the Tax Reform, as of 2018 transformations have been introduced to the solidarity tax introduced from 2016 and aimed at preventing regressive labour tax system that had occurred as a result of restoration of the maximum amount of the object of mandatory state social security contributions (on 1 January 2014, the maximum amount of the object of mandatory state social security contributions was restored, making the tax burden smaller for the taxpayers with income exceeding the stipulated maximum amount of the object of contributions, as compared to the persons performing tax payment from the entire labour income). In 2016 and 2017, the solidarity tax, to a full extent, has been transferred into the State basic budget, however, as of 1 January 2018, the tax with 35.09% rate for income exceeding 55 000 euro per year, has been correspondingly divided into several components:

As of 3 January 2019, the amendments to the solidarity tax took effect, providing that the solidarity tax rate is 25.5%, 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 insurance contributions, and the SRS, 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 (25.5%)). Starting from 3 January 2019, the new sequence of allocation of the solidarity tax has also been set, granting priority to the solidarity-related chapters:

- in the amount of 1 percentage point for funding health care services (in 2018 - 1 percentage point);
- in the amount of 14 percentage points - into the State pension special budget (in 2018 - 13.59 percentage points);
- in the amount of 10.5 percentage points - into the personal income tax account (in 2018 - 10.5 percentage points).

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

[29]According to ESA 2010, social security contributions that are being transferred to the State-funded pension scheme, are not being accounted as the general government budget revenue.

Solidarity tax revenue are no longer transferred into the second and third pension pillar, as it was in 2018.

In accordance with the 11 October 2018 amendments to the *Law on State-Funded Pensions*, starting from 1 January 2020, the contributions into the funded pension scheme constitute a part of the actually performed contributions for the State pension insurance, except for the mandatory contributions from the social insurance special budgets and the State basic budget. The State Social Insurance Agency, with respect to the persons prescribed by Section 6, Paragraph four of the law *On State Social Insurance* (for example, persons receiving unemployment benefit, maternity, paternity or sickness benefit) and subject to pension insurance, shall transfer the entire 20 percentage points paid into the pension capital only into the first pension pillar (personal account of a person), therewith having a positive impact on the revenue from social insurance contributions.

The rate of contributions into the State-funded pension scheme remains unchanged, comprising 6 percentage points of the total rate of mandatory state social insurance contributions.

In accordance with the *Law on the Support Provided for Taxpayers for the Extinguishment of Late Payment Charge and Penalty*, adopted on 27 July 2017, the support measures aimed at alleviating the tax debt burden incurred by the taxpayers and increasing the budgetary revenue, expired on 31 December 2019.

Legislative changes adopted in 2019, affecting the revenue from social insurance contributions:

- as of 1 January 2020, the amendments to the law *On Taxes and Duties* took effect, stipulating the enhancement of responsibility of board members;
- as of 1 January 2021, the minimum monthly wage will be increased from 430 euro to 500 euro per month.

Table 4.10. Impact of the Changes in Tax Policy on the Revenue from Social Security Contributions[30], million euro

	2020	2021
Possibility for the period of up to 2 years to repay the debt, thus discharging the late payment charge ad penalty	-3.2	
Changes in the structure of the State-funded pensions as of 2020	+42.8	
Enhancement of responsibility of board members	+0.8	
Raise of the monthly minimum wage from 430 euro to 500 euro as of 2021		+21.6
Total impact of changes:	**+40.3**	**+21.6**

The above-mentioned measures adopted in 2019 also influence the state social security contributions into the basic budget for health funding.

Table 4.11. Impact of the Changes in Tax Policy on the State Social Security Contributions into the Basic Budget for Health Funding, million euro

	2020	2021
Enhancement of responsibility of board members	+0.03	
Raise of the monthly minimum wage from 430 euro to 500 euro as of 2021.		+0.8
Total impact of changes:	**+0.03**	**+0.8**

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

Lotteries and Gambling Tax

As of 1 January 2020, the amendments to the law *On Lotteries and Gambling Fee and Tax* took effect, providing for increased gambling tax rates for gaming machines (for each gambling place of each gaming machine) for the calendar year from 4 164 euro to 5 172 euro, as well as for roulette and card and dice game (for each table) for calendar year from 23 400 euro to 28 080 euro. The distribution of the gambling tax revenue among the state (central government) and local government budgets has been changed, as well, prescribing to transfer the gambling tax revenue (except for the gambling tax revenue for the object referred to in Section 3, Paragraph five of the law *On Lotteries and Gambling Fee and Tax)* - in the amount of 95% into the state basic budget, and transfer it in the amount of 5% into the budget of the local government, in whose territory the gambling is operated.

Table 4.12. Impact of the Changes in Tax Policy on Lotteries and Gambling Tax Revenue, million euro

	2020
Increase of the gambling tax rate for slot machines and gaming tables, in breakdown by budgets	
State basic budget	+13.89
Local government budget	-7.30
Total impact of changes:	**6.59**

In addition to the amendments to the law *On Lotteries and Gambling Fee and Tax*, on 16 July 2019, Cabinet Regulation No 333 was adopted - *Regulation on the Register of Persons who have Self-Denied Gambling and Interactive Lotteries*, issued in accordance with Section 4^1, Paragraphs eight and nine, Section 36, Paragraph six of the law *On Gambling and Lotteries*. The Regulation prescribes that, starting from 1 January 2020, a natural person is entitled to request in writing to be excluded from participation in gambling in the Republic of Latvia, *inter alia*, interactive gambling, and participation interactive lotteries, and to include them on the register of self-denied persons.

The purpose of the register of self-denied persons is to protect the public interest and the right of natural persons to refrain from excessive gambling activities, including interactive gambling, or participation in interactive lotteries. The exclusion applies to participation in all statutory gambling and interactive lotteries.

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 amendments to the Natural Resources Tax Law, adopted on 15 December 2016, gradual increase of the natural resources tax for waste disposal was stipulated (see Table 4.13).

Table 4.13. Natural Resources Tax Rate for Waste Dispose In 2019 - 2020, euro

Type of waste	01.01.2019	01.01.2020
Municipal waste and production waste which are not deemed as hazardous waste, euro per ton	43.0	50.0
Hazardous waste and production waste which are deemed as hazardous waste, euro per ton	55.0	60.0

In accordance with the 3 April 2019 amendments to the *Natural Resources Tax Law*, starting from 13 April 2019, by paying the natural resources tax in the amount of 165.0 *euro*, a possibility is ensured to write off (deregister) the vehicle, if it is impossible to receive the certificate of destruction of the end-of-life vehicle due to the absence of the vehicle. By the referred to amendments, as of 1 July 2019, also the natural resources tax exemption for disposable tableware and accessories manufactured from plastic (polymers) and composite materials thereof (laminates) is no longer applied.

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

- as of 1 January 2020, the natural resources tax rates have been increased for:
  - coal, coke and lignite - from 0.38 euro to 0.76 euro per GJ/ton with thermal input indicated in accompanying documents. For coal, coke and lignite with thermal input not indicated in accompanying documents, the rate has been increased from 10.65 euro to 21.30 euro per ton;
  - sand - from 0.21 euro to 0.36 euro per m^3;
  - CO_2 emissions - from 4.50 euro to 9.00 euro per ton. It is also planned to increase the rate from 1 January 2021 - to 12.0 euro, and from 1 January 2022 - to 15.00 euro per ton;
- as of 1 January 2020, the distribution of the revenue among the budgets has been changed, increasing the share to be transferred into the state (central government) budget:
  - for waste disposal (burial) - from 40% to 100%;
  - for emissions of carbon dioxide (CO_2) - from 60% to 100%;
  - for extraction or use of natural resources and pollution of environment - from 40% to 60%.
- as of 1 January 2020, the natural resources tax exemption was abolished for coal, coke and lignite, if it is used for the production of electricity or combined heat and power production (cogeneration);
- as of 1 January 2021, the tax will also be imposed for incineration of municipal waste.

Table 4.14. Impact of the Changes in Tax Policy on Natural Resources Tax Revenue, million euro

	2020	2021	2022	2023
Abolition of the natural resources tax exemption for disposable tableware and accessories manufactured from plastic and composite materials, and possibility to write off (deregister) the vehicle without a certificate of destruction of the end-of-life vehicle.	+1.6			
Increase of the natural resources tax rates for sand	+0.4			
Increase of the natural resources tax rates for CO_2	+1.0	+1.0	+1.0	
Increase of the natural resources tax rates for coal, coke and lignite	+0.8			
Imposition of natural resources tax for waste incineration		+0.2		
Total impact of changes:	**+3.8**	**+1.2**	**+1.0**	

4.2.2. Tax revenue forecasts in Covid-19 scenario

When developing the revenue forecasts of the updated scenario, the updated macroeconomic forecasts have been considered, providing for a significant fall in macroeconomic indicators. It is forecasted that, in 2020, the GDP, as compared to the year before, will reduce by 7.9% (the growth forecasted in the medium-term budget framework comprised +5.6%). As a result, the general budget tax revenue is forecasted with the reduction of - 1.5 billion euro, as compared to the medium-term budget framework forecast for 2020.

The forecasts also include the support measures and measures restricting economic activity contained in 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 change of procedure for VAT refunds, which was previously prescribed as of 2022, has been introduced already as of 1 April 2020;
- extension of the tax payment term for up to three years, where the delay in the term has been caused due to the spread of Covid-19;
- cancellation of PIT advance payments in 2020;
- prohibition to organise gambling and lotteries (except for interactive gambling, numerical lotteries, and instant lotteries) and suspension of the licences to operate gambling.

Value Added Tax

The VAT forecast of the scenario updated amid the impact of Covid-19 crisis has been affected by the forecasts of such macroeconomic indicators as the GDP, domestic demand, import and export. The table below summarises the forecasts of the referred to indicators that have been used in forecasting the plan for 2020 in June 2019 and the ones, which have been updated in April this year, already considering the adverse effect of Covid-19 on economy.

Table 4.15. VAT forecasts

Macro indicator	Forecast for 2020, June 2019	Forecast for 2020, April 2020	Comparison
GDP	+5.6%	-7.9%	-13.5%
Domestic consumption	+5.9%	-5.7%	-11.6%
Import	+5.4%	-15.0%	-20.3%
Exports	+5.3%	-13.6%	-18.9%

As a result of drop in the forecasts of macro indicators, the VAT forecast against the plan has been reduced by 452.7 million euro or 15.7%.

In addition to the changes in the updated macroeconomic indicators, the VAT revenue will be affected by two support measures adopted on 22 March 2020 and provided for in 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 change of procedure for VAT refunds, which was previously prescribed as of 2022, has been introduced already as of 1 April 2020. Changes in legislation have been introduced to ensure immediate refund of the approved overpaid VAT sum, deferred to the next taxation period up to the end of the taxation year, thus creating free financial resources for overcoming the crisis caused by Covid-19 virus;
- extension of the tax payment term for up to three years, where the delay in the term has been caused due to the spread of Covid-19;

Table 4.16. Impact of the Changes in Tax Policy on VAT Revenue, million euro

	2020	2021	2022	2023
Change of procedure for VAT refunds	-60.0	+60.0		
Grating of extension of terms	-67.5	+74.3	+6.8	+13.5
Total impact of changes:	-127.5	+134.3	+6.8	+13.5

Considering both the impact of macro indicators and the introduced support legislative changes, the VAT forecast against the plan of 2020 has been reduced by 580.2 million euro or 20.1%

Excise Duty

The excise duty forecasts took note of the updated forecasts of macroeconomic indicators that have significantly deteriorated, as compared to the forecasts of macroeconomic indicators used, when preparing the tax revenue forecasts included in law *On the Medium Term Budget Framework for 2020, 2021 and 2022*. The forecasted GDP growth rate has reduced by 13.5 percentage points in 2020, by 2.9 percentage points in 2021, but it has grown by 0.4 percentage points in 2022. The forecasted wage growth rate has reduced by 9.0 percentage points in 2020, by 2.0 percentage points in 2021, and it will remain at the previously forecasted level in 2022. The forecasted private consumption growth rate has reduced by 11.6 percentage points in 2020, by 2.7 percentage points in 2021, but it has grown by 0.7 percentage points in 2022.

In addition to the changes in the updated macroeconomic indicators and laws and regulations enumerated in Chapter 4.2.1, the excise duty revenue will be influenced by the possibility provided on 22 March 2020 in the law *On Measures for the Prevention and Suppression of Threat to the State and Its Consequences Due to the Spread of Covid-19* to extend the tax payment term for up to three years, where the delay in the term has been caused due to the spread of Covid-19.

It is forecasted that with respect to the excise duty, in 2020, the extensions of the terms in the amount of 20.3 million euro would be requested, the majority whereof would be granted for alcoholic beverages, but the rest - for oil products (see Table 4.17).

Table 4.17. Impact of the Changes in Tax Policy on Excise Duty Revenue, million euro

	2020	2021	2022	2023
Granting of extension of the terms for excise duty for alcoholic beverages	-18.3	+20.1	+1.8	+3.7
Granting of extension of the terms for excise duty for oil products	-2.0	+2.2	+0.2	+0.4
Total impact of changes:	-20.3	+22.4	+2.0	+4.1

Personal Income Tax

The forecasts considered the updated forecasts of macroeconomic indicators providing that the increase of the wage fund, as compared to the one planned in the Medium Term Framework for 2020 - 2022, would reduce by 14.0 percentage points in 2020, by 0.7 percentage points in 2021, and would grow by 1.2 percentage points in 2022.

In addition, the personal income tax revenue will be affected by two support measures adopted on 22 March 2020 and provided for in the law *On Measures for the Prevention and Suppression of Threat to the State and Its Consequences Due to the Spread of Covid-19:*

- cancellation of PIT advance payments in 2020;
- extension of the tax payment term for up to three years, where the delay in the term has been caused due to the spread of Covid-19.

Table 4.18. Impact of the Changes in Tax Policy on PIT Revenue, million euro

	2020	2021	2022	2023
Cancellation of PIT advance payments in 2020	-35.0	+70.0	-35.0	
Grating of extension of terms	-57.2	+62.9	+5.7	+11.4
Total impact of changes:	**-92.2**	**+132.9**	**+29.3**	**+11.4**

Social Security Contributions[31]

The forecasts of social security contributions considered the updated macroeconomic forecasts providing that the wage fund indicators, as compared to the ones planned in the Medium Term Framework for 2020 - 2022, would reduce by 14.0 percentage points in 2020, by 0.7 percentage points in 2021, and would grow by 1.2 percentage points in 2022.

In addition to the changes in the laws and regulations enumerated in Chapter 4.2.1, the revenue from social security contributions will be influenced by the changes in the laws and regulations adopted on 22 March 2020 in the law *On Measures for the Prevention and Suppression of Threat to the State and Its Consequences Due to the Spread of Covid-19,* providing for the extension of the tax payment term for up to three years, where the delay in the term has been caused due to the spread of Covid-19.

Table 4.19. Impact of the Changes in Tax Policy on the Revenue from Social Security Contributions[32], million euro

	2020	2021	2022	2023
Extension of the term for up to three years, where the delay in the term has been caused due to the spread of Covid-19	-88.0	+96.1	+8.8	+17.7
Total impact of changes:	**-88.0**	**+96.1**	**+8.8**	**+17.7**

The above-mentioned measure adopted in 2020 also influences the state social security contributions into the basic budget for health funding.

Table 4.20. Impact of the Changes in Tax Policy on the State Social Security Contributions into the Basic Budget for Health Funding, million euro

	2020	2021	2022	2023
Extension of the term for up to three years, where the delay in the term has been caused due to the spread of Covid-19	-3.0	+3.3	+0.3	+0.6
Total impact of changes:	**-3.0**	**+3.3**	**+0.3**	**+0.6**

Lotteries and Gambling Tax

In addition to the changes in the updated macroeconomic indicators and laws and regulations enumerated in Chapter 4.2.1, lotteries and gambling tax revenue will be influenced by the prohibitions prescribed on 22 March 2020 in Sections 8 and 9 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* to organise gambling and lotteries (except for interactive gambling, numerical lotteries, and instant lotteries), as well as suspension of the licence to operate gambling both in physical locations where gambling is organised and in the interactive environment and (or) using the intermediation of electronic communications services for the period of validity of this law.

As regards lotteries and gambling tax, fiscal impact in 2020 is forecasted in the amount of 12.8 million euro, assuming that the prohibition to organise gambling and lotteries (except for interactive gambling, numerical lotteries, and instant lotteries), as well as suspension of the licence to operate gambling will endure for three months. Furthermore, considering that the impact of emergency situation and Covid-19 on buying power of Latvian and other national economies and population is significant and will persist for a long time after the expiry of the formal term of emergency situation, it is forecasted that within the

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

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

nearest months after the end of the emergency situation the gambling institutions and casinos would not be able to ensure the number of clients that would come close to the number of clients before the declaration of the emergency situation. Therewith, as compared to 2019, it is forecasted that, after the end of emergency situation, the total reduction of number of operated gambling machines will comprise 8.8% and the total reduction of number of operated gaming tables will comprise 21.0%.

Table 4.21. Impact of the Changes in Tax Policy on Lotteries and Gambling Tax Revenue, million euro

	2020	2021	2022	2023
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 emergency situation related to the spread of Covid-19, in breakdown by budgets				
State basic budget	-12.16	+12.16	0.0	0.0
Local government budget	-0.64	+0.64	0.0	0.0
Total impact of changes:	**-12.80**	**+12.80**	**0.0**	**0.0**

Table 4.22. Changes of tax revenue forecasts of the updated scenario by cash flow, as compared to the baseline scenario forecasts, %

	Updated scenario forecast / Baseline scenario forecasts, %			
	2020	2021	2022	2022
VAT	*-19.3%*	*-17.2%*	*-14.8%*	*-15.8%*
Corporate Income Tax	*-27.2%*	*-23.3%*	*-11.1%*	*-11.4%*
Personal Income Tax	*-17.0%*	*-12.6%*	*-12.0%*	*-11.7%*
Social security contributions to the State special budget	*-13.6%*	*-13.8%*	*-12.8%*	*-12.2%*
State social security contributions to the basic budget for health funding	*-13.3%*	*-13.9%*	*-12.9%*	*-12.4%*
Customs Duty	*-7.8%*	*-10.4%*	*-9.1%*	*-6.9%*
Excise Duty	*-8.1%*	*-5.4%*	*-4.7%*	*-3.7%*
Vehicle Operation Tax	*-2.9%*	*-3.0%*	*-3.0%*	*-3.0%*
Company Vehicles Tax	*-12.1%*	*-10.0%*	*-5.0%*	*-0.8%*
Electricity Tax	*-12.4%*	*-12.4%*	*-12.4%*	*-12.4%*
Natural Resources Tax	*-15.2%*	*-12.0%*	*-9.1%*	*-9.4%*
Lotteries and Gambling Tax	*-27.0%*	*-3.0%*	*-3.3%*	*-3.3%*
Real Estate Tax	*-5.3%*	*-2.3%*	*-1.3%*	*-0.4%*
In the general budget	***-15.4%***	***-13.4%***	***-11.8%***	***-11.8%***

ANNEXES

A. ANNEX. BASE SCENARIO

Table 1a. Macroeconomic prospects

	ESA code	2019	2019	2020	2021	2022	2023
		mln euro	Growth %				
1. Real GDP (at prices of the year 2010)	B1*g	27 497	2.2	2.2	2.8	2.8	2.4
2. Nominal GDP	B1*g	30 476	4.9	5.0	5.3	5.1	4.6
Real GDP by expenditure (at Prices of the year 2010)							
3. Private consumption expenditure	P3	16 515	2.9	3.3	3.2	3.2	3.0
4. Government consumption expenditure	P3	5 005	2.6	2.2	2.8	2.6	2.9
5. Gross fixed capital formation	P51	6 550	3.1	3.0	4.5	3.0	1.8
6. Changes in inventories and net acquisition of valuables	P52+P53	467	-	-	-	-	-
7. Exports of goods and services	P6	17 387	2.0	2.5	3.5	3.4	2.6
8. Imports of goods and services	P7	18 426	2.3	3.0	4.4	3.7	3.0
Contribution to real GDP growth							
9. Final domestic demand			2.9	3.1	3.6	3.2	2.8
10. Changes in inventories and net acquisition of valuables	P52+P53		-0.5	-0.4	0.0	0.0	0.0
11. External balance of goods and services	B11		-0.3	-0.4	-0.8	-0.4	-0.4

Table 1b. Price developments

	ESA Code	2019	2019	2020	2021	2022	2023
		level	Growth %				
1. GDP deflator			2.6	2.7	2.4	2.3	2.2
2. Private consumption deflator			2.9	2.3	2.1	2.0	2.0
3. HICP			2.7	2.3	2.1	2.0	2.0
4. Public consumption deflator			2.9	2.0	2.0	2.0	2.0
5. Investment deflator			3.2	1.9	1.8	1.7	1.7
6. Export price deflator (goods and services)			0.2	1.0	1.3	1.3	1.3
7. Import price deflator (goods and services)			-0.5	0.5	0.9	0.9	0.9

Table 1c. Labour market development

	ESA code	2019	2019	2020	2021	2022	2023
		Level	Growth (%)				
1. Employment. persons		910	0.1	-0.1	-0.1	-0.1	-0.1
2. Employment. hours worked		1 623.6	0.9	-0.1	-0.1	-0.1	-0.1
3. Unemployment rate (%)			6.3	6.4	6.2	5.8	5.7
4. Labour productivity, persons			2.1	3.3	2.5	2.9	2.5
5. Labour productivity, hours worked			1.3	3.3	2.5	2.9	2.5
6. Compensation of employees	D.1	15 173	8.6	6.0	5.5	5.0	5.0
7. Compensation per employee		1 076	7.2	6.0	5.5	5.0	5.0

Table 1d. Sectoral balances

% of GDP	ESA code	2019	2020	2021	2022	2023
1. Net lending/borrowing vis-a-vis the rest of the world	B.9	1.4	1.3	1.1	1.0	0.9
of which						
- Balance on goods and services		0.1	0.1	-0.2	-0.2	-0.2
- Balance of primary incomes and transfers		-0.6	-0.2	-0.1	-0.5	-0.9
- Capital account		1.9	1.5	1.4	1.6	1.9
2. Net lending/borrowing of the private sector	B.9	1.6	1.7	1.2	1.1	-0.1
3. Net lending/borrowing of general government	EDP B.9	-0.2	-0.4	-0.1	-0.1	1.0
4. Statistical discrepancy		*0*	*0*	*0*	*0*	*0*

Table 2a. General government budgetary prospects

	ESA code	2019	2019	2020	2021	2022	2023
		mln euro	% of GDP				
Net lending (+) or borrowing (-) (B.9) by sub-sector							
1. General government	**S.13**	**-63.2**	**-0.2**	**-0.4**	**-0.1**	**-0.1**	**1.0**
2. Central government	S.1311	-526.5	-1.7	-0.9	-0.7	-0.7	0.4
3. State government	S.1312						
4. Local government	S.1313	179.9	0.6	-0.2	-0.1	0.0	0.1
5. Social security funds	S.1314	283.4	0.9	0.7	0.7	0.6	0.5
General government (S.13)							
6. Total revenue	**TR**	**11 790.1**	**38.7**	**38.2**	**37.5**	**37.1**	**36.9**
7. Total expenditure	TE	11 853.3	38.9	38.6	37.6	37.1	35.9
8. Net lending/borrowing	B.9	-63.2	-0.2	-0.4	-0.1	-0.1	1.0
9. Interest expenditure	D.41	210.7	0.7	0.8	0.8	0.8	0.8
10. Primary balance		147.5	0.5	0.4	0.7	0.7	1.7
11. One-off and other temporary measures		60.7	0.2				
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		**6 460.8**	**21.2**	**21.3**	**21.5**	**21.3**	**21.4**
12a. Taxes on production and imports	D.2	4 319.7	14.2	14.5	14.5	14.3	14.4
12b. Current taxes on income, wealth, etc.	D.5	2 129.5	7.0	6.8	7.0	7.0	7.0
12c. Capital taxes	D.91	11.5	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	3 052.2	10.0	10.1	10.1	10.1	10.1

14. Property income	D.4	188.8	0.6	0.7	0.3	0.2	0.2
15. Other		2 088.3	6.9	6.1	5.7	5.5	5.1
16. Total revenue	TR	11 790.1	38.7	38.2	37.5	37.1	36.9
Tax burden (D.2[33]+D.5+D.61+D.91-D.995)		9 568.7	31.4	31.6	31.8	31.5	31.7
Selected components of expenditure							
17. Compensation of employees and intermediate consumption	D.1+P.2						
17a. Compensation of employees	D.1	3 309.1	10.9	10.9	10.5	10.2	9.8
17b. Intermediate consumption	P.2	1 937.5	6.4	5.4	5.4	5.2	4.9
18. Social payments (18=18a+18b)		3 621.3	11.9	12.3	12.3	12.3	12.4
of which Unemployment benefits		130.4	0.4	0.4	0.4	0.4	0.4
18a. Social transfers through market producers	D.6311. D.63121. D.63131	389.5	1.3	1.3	1.3	1.3	1.3
18b. Social transfers which are no transfers in kind	D.62	3 231.8	10.6	11.1	11.1	11.0	11.1
19.=9. Interest expenditure	D.41	210.7	0.7	0.8	0.8	0.8	0.8
20. Subsidies	D.3	308.7	1.0	1.2	1.2	1.1	1.0
21. Gross fixed capital formation	P.51	1 495.9	4.9	5.0	4.7	5.0	4.7
22. Capital transfers	D.9	11.9	0.0	0.0	0.0	0.0	0.0
23. Other		958.4	3.1	2.9	2.6	2.5	2.3
24.=7. Total expenditure	TE	11 853.3	38.9	38.6	37.6	37.1	35.9
Government consumption	P.3	5 560.2	18.2	18.4	18.1	17.6	16.9

Table 4. General government debt developments

% of GDP	**ESA code**	**2019**	**2020**	**2021**	**2022**	**2023**
1. Gross debt		36.9	37.9	34.8	34.2	33.8
2. Change in gross debt ratio		1.4	2.7	-1.2	1.1	1.1
Contributions to changes in gross debt						
3. Primary balance		0.5	0.4	0.7	0.7	1.7
4. Interest expenditure	EDP D.41	0.7	0.8	0.8	0.8	0.8
5. Stock-flow adjustment		1.2	2.3	-1.3	1.1	2.1
Implicit interest rate on debt		1.9	1.9	1.9	1.9	1.9
Other relevant variables						
6. Liquid financial assets		8.1				
7. Net financial debt (7=1-6)		28.8				
8. Debt amortization (existing bonds) since the end of the previous year		1.2	3.7	4.3	0.6	1.4
9. Percentage of debt denominated in foreign currency		10.0	1.3	1.3	1.3	1.2
10. Average maturity		9.03 years				

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

Table 5. Cyclical development

% of GDP	ESA code	2019	2020	2021	2022	2023
1. Real GDP growth (%)	B1g	2.2	2.2	2.8	2.8	2.4
2. Net lending of general government	B.9	-0.2	-0.4	-0.1	-0.1	1.0
3. Interest expenditure	D.41	0.7	0.8	0.8	0.8	0.8
4. One-off and other temporary measures[34]		0.2				
5. Potential GDP growth (%)		3.0	2.9	2.9	2.8	2.9
contributions:						
- labour		0.1	0.0	-0.1	-0.1	-0.1
- capital		0.9	1.0	1.0	1.1	1.1
- total factor productivity		2.0	1.9	1.9	1.8	1.8
6. Output gap. % of potential GDP		0.9	0.2	0.2	0.2	-0.3
7. Cyclical budgetary component		0.3	0.1	0.1	0.1	-0.1
8. Cyclically-adjusted balance (2-7)		-0.6	-0.5	-0.2	-0.1	1.1
9. Cyclically-adjusted primary balance (8+3)		0.1	0.3	0.6	0.6	1.8
10. Structural balance* (8-4)		-0.7	-0.5	-0.2	-0.1	1.1

Table 7a. Contingent liabilitie

% of GDP	2019
Public guarantees	1.4%

Table 8. Basic assumptions

	2019	2020	2021	2022	2023
Short-term interest rate (annual average)	-0.4	-0.4	-0.4	-0.4	-0.4
Long-term interest rate (annual average)	-0.3	-0.2	-0.1	-0.1	-0.1
EUR/USD exchange rate (annual average)	1.12	1.11	1.11	1.11	1.11
Nominal effective exchange rate	-1.2	-1.3	0.0	0.0	0.0
World excluding EU. GDP growth	3.8	3.3	3.4	3.4	3.4
EU GDP growth	1.3	1.2	1.2	1.2	1.2
Growth of relevant foreign markets	0.6	2.1	2.5	2.5	2.5
World import volumes. excluding EU	0.4	2.1	2.6	2.6	2.6
Oil prices (Brent. USD/barrel)	**64.1**	**66.0**	**63.0**		

[34] In 2019, a one-off transaction has been included in the one-off measure - revenue in the amount of 60.7 million euro or 0.2% of GDP from the auctioning of emission quotas in the secondary market. To facilitate data comparability between Latvia and the EU, the structural balance in 2019 and 2020 is reflected jointly with the reduction of the net revenue from tax reform, correspondingly, by 0.5% of GDP and 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 does not recognise the measures reducing revenue / increasing expenditure to be one-off/short-term measures.

B. ANNEX. COVID-19 SCENARIO

Table 1a. Macroeconomic prospects

	ESA code	2019	2019	2020	2021	2022	2023
		mln euro	Growth %				
1. Real GDP (at prices of the year 2010)	B1*g	27 497	2.2	-7.0	1.0	3.5	2.4
2. Nominal GDP	B1*g	30 476	4.9	-7.9	2.4	5.6	4.4
Real GDP by expenditure (at Prices of the year 2010)							
3. Private consumption expenditure	P3	16 515	2.9	-6.0	1.0	3.9	3.0
4. Government consumption expenditure	P3	5 005	2.6	2.0	2.0	2.9	2.5
5. Gross fixed capital formation	P51	6 550	3.1	-18.0	3.0	4.9	2.0
6. Changes in inventories and net acquisition of valuables	P52+P53	467	-	-	-	-	-
7. Exports of goods and services	P6	17 387	2.0	-9.0	1.0	4.0	3.3
8. Imports of goods and services	P7	18 426	2.3	-10.0	1.9	4.5	3.7
Contribution to real GDP growth							
9. Final domestic demand			2.9	-8.4	3.0	6.1	4.7
10. Changes in inventories and net acquisition of valuables	P52+P53		-0.5	-0.5	0.0	0.0	0.0
11. External balance of goods and services	B11		-0.3	1.0	-0.6	-0.5	-0.4

Table 1b. Price developments

	ESA Code	2019	2019	2020	2021	2022	2023
		level	Growth %				
1. GDP deflator			2.6	-1.0	1.3	2.0	1.9
2. Private consumption deflator			2.9	0.3	1.7	2.0	2.0
3. HICP			2.7	0.4	1.7	2.0	2.0
4. Public consumption deflator			2.9	1.0	1.0	2.0	2.0
5. Investment deflator			3.2	-1.7	1.1	1.9	1.9
6. Export price deflator (goods and services)			0.2	-5.0	1.0	2.5	2.4
7. Import price deflator (goods and services)			-0.5	-5.5	1.5	3.0	3.0

Table 1c. Labour market development

	ESA Code	2019	2019	2020	2021	2022	2023
		level	Growth %				
1. Employment. persons		910	0.1	-5.0	1.2	1.0	-0.1
2. Employment. hours worked		1 623.6	0.9	-5.0	1.2	1.0	-0.1
3. Unemployment rate (%)			6.3	11.2	10.1	9.0	8.6
4. Labour productivity, persons			2.1	-2.1	-0.2	2.5	2.5
5. Labour productivity, hours worked			1.3	-2.1	-0.2	2.5	2.5
6. Compensation of employees		15 173	8.6	-3.0	3.0	5.0	5.0
7. Compensation per employee		1 076	7.2	-3.0	3.0	5.0	5.0

Table 1d. Sectoral balances

1. Net lending/borrowing vis-à-vis the rest of the world	B.9	1.4	2.2	1.5	1.0	0.4
of which:						
- Balance on goods and services		0.1	1.0	0.2	-0.3	-0.9
- Balance of primary incomes and secondary incomes		-0.6	-0.5	-0.3	-0.6	-1.0
- Capital account		1.9	1.7	1.7	1.9	2.3
2. Net lending/borrowing of the private sector	B.9	1.6	11.6	6.5	4.9	3.1
3. Net lending/borrowing of general government	EDP B.9	-0.2	-9.4	-5.0	-3.9	-2.7
4. Statistical discrepancy		*0*	*0*	*0*	*0*	*0*

Table 2a. General government budgetary prospects

	ESA code	2019	2019	2020	2021	2022	2023
		mln euro	% of GDP				
Net lending (+) or borrowing (-) (B.9) by sub-sector							
1. General government	**S.13**	**-63.2**	**-0.2**	**-9.4**	**-5.0**	**-3.9**	**-2.7**
2. Central government	S.1311	-526.5	-1.7	-6.9	-3.7	-3.1	-2.0
3. State government	S.1312						
4. Local government	S.1313	179.9	0.6	-0.6	-0.8	-0.7	-0.5
5. Social security funds	S.1314	238.4	0.9	-1.9	-0.5	-0.1	-0.2
General government (S.13)							
6. Total revenue	**TR**	**11 790.1**	**38.7**	**37.4**	**38.9**	**38.9**	**38.8**
7. Total expenditure	TE	11 853.3	38.9	46.8	43.8	42.8	41.4
8. Net lending/borrowing	B.9	-63.2	-0.2	-9.4	-5.0	-3.9	-2.7
9. Interest expenditure	D.41	210.7	0.7	0.9	0.9	0.9	0.9
10. Primary balance		147.5	0.5	-8.5	-4.1	-3.0	-1.7
11. One-off and other temporary measures		60.7	0.2				
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		**6 460.8**	**21.2**	**20.3**	**22.0**	**22.1**	**22.3**
12a. Taxes on production and imports	D.2	4 319.7	14.2	14.0	14.9	14.9	14.9
12b. Current taxes on income, wealth, etc.	D.5	2 129.5	7.0	6.3	7.1	7.2	7.3
12c. Capital taxes	D.91	11.5	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	3 052.2	10.0	9.9	10.2	10.3	10.4
14. Property income	D.4	188.8	0.6	0.6	0.3	0.3	0.3
15. Other		2 088.3	6.9	6.6	6.3	6.2	5.8
16. Total revenue	TR	11 790.1	38.7	37.4	38.9	38.9	38.8

Tax burden		9 568.7	31.4	30.4	32.4	32.6	32.8
Selected components of expenditure							
17. Compensation of employees and intermediate consumption	**D.1+P.2**	**5 246.6**	**17.2**	**18.9**	**18.6**	**18.0**	**17.2**
17a. Compensation of employees	D.1	3 309.1	10.9	12.4	12.3	11.9	11.5
17b. Intermediate consumption	P.2	1 937.5	6.4	6.5	6.3	6.1	5.7
18. Social payments (18=18a+18b)		3 621.3	11.9	15.3	14.2	13.8	13.9
of which Unemployment benefits		130.4	0.4	0.9	0.7	0.6	0.6
18a. Social transfers through market producers	D.6311, D.63121, D.63131	389.5	1.3	1.5	1.5	1.5	1.5
18b. Social transfers which are no transfers in kind	D.62	3 231.8	10.6	13.9	12.7	12.3	12.4
19.=9. Interest expenditure	D.41	210.7	0.7	0.9	0.9	0.9	0.9
20. Subsidies	D.3	308.7	1.0	1.6	1.5	1.3	1.2
21. Gross fixed capital formation	P.51	1 495.9	4.9	5.7	5.5	5.8	5.4
22. Capital transfers	D.9	11.9	0.0	0.6	0.1	0.1	0.1
23. Other		958.4	3.1	3.8	3.0	2.9	2.7
24.=7. Total expenditure	TE	11 853.3	38.9	46.8	43.8	42.8	41.4
Government consumption	P.3	5 560.2	18.2	21.4	21.2	20.6	19.7

Table 4. General government debt developments

% of GDP	**ESA code**	**2019**	**2020**	**2021**	**2022**	**2023**
1. Gross debt		36.9	51.7	52.2	53.3	53.1
2. Change in gross debt ratio		1.4	11.6	1.7	3.9	2.0
Contributions to changes in gross debt						
3. Primary balance		0.5	-8.5	-4.1	-3.0	-1.7
4. Interest expenditure		0.7	0.9	0.9	0.9	0.9
5. Stock-flow adjustment		1.2	2.2	-3.3	0.0	-0.7
Implicit interest rate on debt		1.9	2.2	1.8	1.9	1.8
Other relevant variables						
6. Liquid financial assets		8.1				
7. Net financial debt (7=1-6)		28.8				
8. Debt amortization (existing bonds) since the end of the previous year		1.2	4.2	5.0	0.7	1.6
9. Percentage of debt denominated in foreign currency		10.0	1.1	1.0	1.0	0.9
10. Average maturity		9.03 years				

Table 5. Cyclical development

% of GDP	**ESA code**	**2019**	**2020**	**2021**	**2022**	**2023**
1. Real GDP growth (%)	**B1g**	**2.2**	**-7.0**	**1.0**	**3.5**	**2.4**
2. Net lending of general government	B.9	-0.2	-9.4	-5.0	-3.9	-2.7
3. Interest expenditure	D.41	0.7	0.9	0.9	0.9	0.9
4. One-off and other temporary measures[36]		0.2				

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

5. Potential GDP growth (%)		3.0	2.9	2.9	2.8	2.9
contributions:						
- labour		0.1	0.0	-0.1	-0.1	-0.1
- capital		0.9	1.0	1.0	1.1	1.1
- total factor productivity		2.0	1.9	1.9	1.8	1.8
6. Output gap. % of potential GDP		0.9	-8.8	-10.4	-9.8	-10.2
7. Cyclical budgetary component		0.3	-3.3	-3.9	-3.7	-3.8
8. Cyclically-adjusted balance (2-7)		-0.6	-6.1	-1.0	-0.2	1.2
9. Cyclically-adjusted primary balance (8+3)		0.1	-5.2	-0.1	0.7	2.1
10. Structural balance (8-4)		-0.7	-6.1	-1.0	-0.2	1.2

[36] In 2019, a one-off transaction has been included in the one-off measure - revenue in the amount of 60.7 million euro or 0.2% of GDP from the auctioning of emission quotas in the secondary market. To facilitate data comparability between Latvia and the EU, the structural balance in 2019 and 2020 is reflected jointly with the reduction of the net revenue from tax reform, correspondingly, by 0.5% of GDP and 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 does not recognise the measures reducing revenue / increasing expenditure to be one-off/short-term measures. In addition, it should be noted that, within the fiscal framework of Latvia, the support measures with fiscal impact adopted by the government and the Saeima for minimising the influence of the emergency situation related to the spread of Covid-19 are deemed to be one-off measure, correspondingly - 3.0% of GDP in 2020, 0.2% of GDP in 2021, 0.2% of GDP in 2022 and 0.3% of GDP in 2023, and are not included in the structural balance. The EC approach, in its turn, does not provide for recognising Covid-19 support measures as one-off measures, therefor these measures in this Table are included in the structural balance.

Table 6. National economy support measures for suppressing Covid-19 and the impact thereof on the general government budget balance (as on 17 April 2020), changes as compared to the year before

% of GDP	Description of the measure	ESA code	Status	2020	2021	2022	2023	2020	2021	2022	2023
				million euro				% of GDP			
1. Support in the field of taxes											
- Extensions of the tax payment term	Entrepreneurs affected by the crisis may ask to divide or postpone tax payments for the period of up to 3 years, as well as to grant the extension of the term for those overdue tax payments, the payment term whereof has already been extended in accordance with the law *On Taxes and Duties*, provided that the delay has occurred as a result of Covid-19.	D.2, D.5, D.61	Approved 20 March 2020	-236.0	259.7	23.6	47.3	-0.8	0.9	0.1	0.1
- Cancellation of PIT advance payments	The PIT payer does not perform the PIT advance payments with respect to the income from economic activity for the taxation year 2020. The condition is applicable to advance payments starting from 1 January 2020. PIT advance payments for the taxation year 2020 may be made on a voluntary basis.	D.5	Approved 20 March 2020	-35.0	70.0	-35.0	0.0	-0.1	0.2	-0.1	0.0
- Overpaid VAT refund within the period of 30 days	The overpaid VAT amounts are reviewed and refunded to all taxpayers within the period of 30 days, without accruing them till the end of the taxation year; the norm takes effect on 1 April 2020.	D.2	Approved 20 March 2020	-60.0	60.0	0.0	0.0	-0.2	0.2	0.0	0.0
- Extension of the RET payment terms	Local governments are entitled to set the real estate tax payment terms that differ from those specified in the law *On Real Estate Tax*, postponing them for a later time.	D.5	Approved 20 March 2020	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2. Support in the field of benefits											
- Benefit to families (person) in the crisis situation	State budget earmarked grants to local governments. The local government will grant to the family (person) the benefit in the crisis situation, based on the emergency situation, where the family (person) has no income, has incurred additional expenses that cannot be covered by the family (person) itself, when being in self-isolation or	D.7	Approved 20 March 2020 16 April 2020	-2.9	2.9	0.0	0.0	0.0	0.0	0.0	0.0

	having been in the quarantine and it has no means of subsistence (in the amount of 50 percent of the benefit disbursed to the family (person) in the crisis situation, but not more than 40 euro per month per person over the period of three months).										
- Supplement to the benefit for the dependent child	State budget earmarked grants to local governments. The local government will grant the benefit during the emergency situation, and for one calendar month after the end of the emergency situation, which will be compensated to local governments by the State in the amount of 100 percent (for the supplement to the benefit in the crisis situation for the dependent child in the amount of 50 euro).	D.7	Approved 16 April 2020	-1.4	1.4	0.0	0.0	0.0	0.0	0.0	0.0
- Payment of the sickness benefit from the State budget starting from the second day	The sickness benefit to a person, whom the sick-leave certificate has been issued with respect to Covid-19 or staying in quarantine from 22 March 2020 till 30 June 2020, is granted and disbursed for the period of time from the second day of temporary incapacity (in the amount of 80% of the average insurance contributions wage).	D.632, D.62	Approved 20 March 2020	-86.3	86.3	0.0	0.0	-0.3	0.3	0.0	0.0
- Allowances for idle time	Employee remuneration in case of idle time is compensated from the State budget in the amount of up to 75 % of the amount of the employee's average six months' remuneration (up to 700 euro). Support for the self-employed persons (75%, up to 700 euro) or recipients of royalties, or microenterprise taxpayers (50%, up to 700 euro), who have not gained income from economic activities during the period of idle time.	D.7	Approved 26 March 2020 31 March 2020 2 April 2020 9 April 2020	-30.0	30.0	0.0	0.0	-0.1	0.1	0.0	0.0
- Supplement for the employees to the allowance for idle time for children	For the employee receiving the allowance for idle time - supplement in the amount of 50 euro per each dependent child under 24 years of age, for whom the employee receives PIT allowance as on the day of granting of the allowance for idle time.	D.7	Approved 16 April 2020	-2.9	2.9	0.0	0.0	0.0	0.0	0.0	0.0
- Rights to the status of the unemployed for	Up to 31 December 2020, the rights to the status of the unemployed are granted also to a person, who has lost the status of the employed and, on the day of losing the	D.632, D.62	Approved 9 April 2020	-1.4	1.4	0.0	0.0	0.0	0.0	0.0	0.0

the patent fee payers and microenterprise taxpayers	status of the employed, is registered as a patent fee payer, employee of the microenterprise, being the owner of the microenterprise, or the self-employed person, who has opted for the microenterprise tax payment, and whose monthly income in this field of activity does not reach the amount of the minimum monthly wage determined by the CoM.										
- The term for receipt of parental allowances is extended	A person, for whom the term of the granted allowance expires during the time, when the emergency situation is declared, and who cannot return to work, may ask to continue the disbursement of the granted allowance after the child has reached the age of one year or one and a half years. For the period from 12 March 2020 till the day, when a person starts gaining income as an employee or a self-employed person, but not longer than by the end of the emergency situation declared due to Covid-19 (up to 700 euro).	D.7	Approved 9 April 2020	-6.3	6.3	0.0	0.0	0.0	0.0	0.0	0.0
3. Support in the field of loans and guarantees											
- Loans to current assets	Current asset loan: - for merchants, farmers and fish farmers, whose activities have been affected by Covid-19; - up to 1 million euro with the term of up to 3 years.	D.7	Approved 24 March 2020	-50.8	54.0	-0.7	-1.7	-0.2	0.2	0.0	0.0
- Loan guarantees	Guarantee for the grace periods on loans: - the loan guarantee is available for the SMEs and large - scale enterprises facing objective difficulties to perform loan payments in the banks due to the spread of Covid-19, which would enable the bank to postpone the payment of the principal amount; - available for the economic operators, farmers and fishery and aquaculture sector.	D.7	Approved 24 March 2020	-25.0	25.0	0.0	0.0	-0.1	0.1	0.0	0.0
- Portfolio guarantees	Crisis portfolio guarantees are aimed at promoting the availability of funding for the entrepreneurs for financial services of up to 0.5 million euro. Guarantee will be provided for the new or existing current asset loans, if the credit institution would postpone the payments of the principal amount for at least 3 months or extend the term	D.7	Approved 24 March 2020	-25.0	25.0	0.0	0.0	-0.1	0.1	0.0	0.0

	of operation of the agreements for at least 3 months. Guarantee will also be provided for the existing investment loans and financial lease.										
4. Support to sectors											
- Support to air transport sector	Increase of the share capital of the companies in air traffic sector.	D.9	Approved / conceptually 24 March 2020 25 March 2020	-156.0	156.0	0.0	0.0	-0.6	0.5	0.0	0.0
- Health care related support	Acquisition of the protective equipment, medicines, and other medicinal equipment. Supplements to medical personnel and the employed for work under the circumstances of the increased risk and load.	P.2, D.1	Approved/ Planned 3 March 2020 20 May 2020 27 March 2020 9 April 2020	-80.9	80.9	0.0	0.0	-0.3	0.3	0.0	0.0
- Support to remote learning process	Funds for creation and dissemination of the audio-visual content intended for remote learning process. For the acquisition of smartphones and tablet computers necessary for remote learning process.	P.2	Approved 12 March 2020 19 March 2020 24 March 2020	-0.6	0.6	0.0	0.0	0.0	0.0	0.0	0.0
- Support to media and informing the public	For the costs of JSC *Tet* related to ensuring communication and creation of a website for crisis coordination. For *Latvijas Radio*, *Latvijas Televīzija* and commercial mass media, to ensure possibly broader public address and alert system of Latvian population and effective informing and educating of the public as to the topicalities with respect to Covid-19. For the Society Integration Fund, to ensure the operation of the Media Support Fund and the possibility for the public to receive comprehensive information and opinions regarding overcoming Covid-19 crisis, as well as to ensure the safety of the public information space in the printed press and commercial internet news portals, to provide support with respect to the costs of delivery of the subscription press (to the State JSC *Latvijas Pasts*) and program broadcasting costs of electronic mass media. For the National Electronic Mass Media Council, to ensure the possibility for the public to receive	P.2, D.7	Approved 19 March 2020 7 April 2020 17 April 2020	-2.4	2.4	0.0	0.0	0.0	0.0	0.0	0.0

	comprehensive information and opinions regarding overcoming Covid-19 crisis, as well as to ensure the safety of the public information space in commercial electronic mass media.										
- For reducing financial difficulties for agriculture, forestry, fishery and food production sectors	Support for the primary agriculture producers, agriculture and food processing enterprises, as well as enterprises and institutions providing catering services in the educational institutions. The support is intended for mitigating financial difficulties occurred under the influence of Covid-19, by supporting the availability of current assets, partially covering the reduction of income, costs of storage of stock of ready-made goods, reduction of turnover, as well as by compensating the value of the destroyed or donated products, which could not be used for provision of catering services in the educational institutions during the emergency situation.	D.3	Approved 17 April 2020	-45.5	45.5	0.0	0.0	-0.2	0.2	0.0	0.0
- Other	Supplements for work to the officials of the authorities under subordination of the Ministry of the Interior (from March 12 till May 31). Also, exemption from the lease payment for the premises or the reduction thereof. State and local government institutions as well as derived public persons and capital companies controlled by a public person, free ports, and special economic areas, for the period of crisis, exempt merchants of the sectors affected by the crisis from lease payment for a public person property and a property of a capital company controlled by a public person or decide on reduction of the lease payment and on the use of the public person property, and also do not apply late interest and contractual penalties in case of a late payment.	D.1, D.7	Approved 12 April 2020 16 April 2020	-2.6	2.6	0.0	0.0	0.0	0.0	0.0	0.0