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Recommendation for a

COUNCIL RECOMMENDATION

on the 2016 national reform programme of Latvia

and delivering a Council opinion on the 2016 stability programme of Latvia

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 5(2) thereof,

Having regard to the recommendation of the European Commission[2],

Having regard to the resolutions of the European Parliament[3],

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 26 November 2015, the Commission adopted the Annual Growth Survey[4], marking the start of the 2016 European Semester of economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 17-18 March 2016. On 26 November 2015, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report[5], in which it did not identify Latvia as one of the Member States for which an in-depth review would be carried out. On the same day, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area[6]. This recommendation was endorsed by the European Council on 18-19 February 2016 and adopted by the Council on 8 March 2016. As a country whose currency is the euro and in view of the close interlinkages between the economies in

1 OJ L 209, 2.8.1997, p. 1.
2 COM(2016) 334 final.
3 P8_TA(2016)0058, P8_TA(2016)0059, and P8_TA(2016)0060.
4 COM(2015) 690 final.
5 COM(2015) 691 final.
6 COM(2015) 692 final.

the economic and monetary union, Latvia should ensure the full and timely implementation of the recommendation.

(2) The 2016 country report for Latvia[7] was published on 26 February 2016. It assessed Latvia's progress in addressing the country-specific recommendations adopted by the Council on 14 July 2015 and Latvia's progress towards its national Europe 2020 targets.

(3) On 14 April 2016, Latvia submitted its 2016 national reform programme and its 2016 stability programme. To take account of their interlinkages, the two programmes have been assessed at the same time.

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds for the 2014-2020 period. As foreseen in Article 23 of Regulation (EU) No 1303/2013, where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of this provision in guidelines on the application of the measures linking the effectiveness of the European Structural and Investment Funds to sound economic governance[8].

(5) In its 2016 stability programme, Latvia has requested a temporary deviation of 0.5 % of GDP from the required adjustment path towards the medium-term budgetary objective in 2017 to take account of major structural reforms with a positive impact on the long-term sustainability of public finances, notably for the ongoing health sector reform based on the Health Strategy for 2014-2020. The details of the reform are summarised in the stability programme. The objective is to increase public financing for the health sector to 4% of GDP by 2020 relative to 3% of GDP in 2015. The full implementation of the reform is estimated to increase employment by 0.6% and the GDP level by 2.2% by 2023, which will have a positive impact on the sustainability of public finances in the long run. The positive impact on growth and the long-term sustainability of public finances is assessed to be plausible. Latvia can currently be assessed as qualifying for the requested temporary deviation in 2017, provided that it adequately implements the agreed reforms, which will be monitored under the European Semester. However, the amount of the allowed temporary deviation is conditional on the respect of the minimum benchmark (i.e. a structural deficit of 1.7% of GDP). As a result, the Commission 2016 spring forecast indicates scope for an additional temporary deviation of 0.1% of GDP in 2017.

(6) Latvia is currently in the preventive arm of the Stability and Growth Pact. In its 2016 stability programme, the government plans a gradual improvement in the headline balance to reach 0.5% of GDP in 2019. The planned adjustment path towards the medium-term budgetary objective – a deficit of 1% of GDP in structural terms – takes into account the requested deviations related to the systemic pension reform in 2017 and 2018 and for the major structural reform in the healthcare sector in the period 2017-2019. According to the stability programme, the government debt-to-GDP ratio is expected to rise to 40% in 2016 before declining to 38% in 2018. The macroeconomic scenario underpinning these budgetary projections is plausible. However, the measures needed to support the planned deficit targets from 2017

[7] SWD(2016) 82 final.
[8] COM(2014) 494 final.

onwards have not been sufficiently specified. Based on the Commission 2016 spring forecast, the overall assessment points to a risk of some deviation in 2016 and, under unchanged policies, in 2016 and 2017 taken together. Based on its assessment of the stability programme and taking into account the Commission 2016 spring forecast, the Council is of the opinion that Latvia is expected to broadly comply with the provisions of the Stability and Growth Pact. Nevertheless, further measures will be needed to ensure compliance in 2016.

(7) The labour supply is constrained by a declining working age population and wage growth exceeds productivity, threatening cost-competitiveness. Measures to increase employability and improve human capital are therefore necessary to support competitiveness.

(8) Latvia's at risk-of-poverty and social exclusion rate is among the highest in the EU. Preparatory work is on-going to introduce a minimum income level, but its implementation is uncertain and its universal application is being diluted, due to fiscal costs. Furthermore, the adequacy of social assistance benefits has not been improved since 2009, preventing effective poverty reduction. The minimum income level reform is expected to reduce the current fragmentation of social assistance and provide an incentive for employment.

(9) The coverage of activation measures remains low, particularly for the long-term unemployed. In combination with poor health and insufficient social services, this hampers effective reintegration in the labour market. Increasing the take-up of activation measures would boost employment.

(10) The low public financing of healthcare, inherent structural weaknesses, high out-of-pocket payments and suboptimal cost-effectiveness leave much of the population with unmet healthcare needs. While access to healthcare for critical medical cases has been given priority, financial constraints limit the supply of services in general.

(11) While Latvia has made progress in reforming the higher education system, namely by providing incentives that reward quality and establishing an independent accreditation system, improvements of vocational education and training are necessary, particularly with respect to reforming curricula and setting up a regulatory framework for apprenticeship-type schemes, in order to improve their quality and availability. Social partners can play a role in the development of apprenticeship-type schemes, as outlined in the Vocational Education Law.

(12) Investments are being held back by innovation issues, shortcomings in the business environment and the shrinking size of the labour force. Poor innovation drive and a fragmented research base hamper Latvia's rapid and efficient transition towards higher value-added and more knowledge-intensive activities. Low protection for investors in the application of the insolvency system, coupled with inefficiencies in public administration, further inhibit investments.

(13) The government has taken steps to reduce the current fragmentation of the public research base, improve its quality and enhance the business sector's innovation capacity. Despite progress, both public and business investments in research and innovation remain very low compared with the EU average. The consolidation of the research base needs to be continued, along with increasing the number of reserchers and the quality of research. Full implementation of reforms based on the Smart Specialisation Strategy and the full use of all existing policy tools would incentivese private investments in innovation.

(14) The insolvency regime is perceived by business as an obstacle to investment, given that assets recovery rates are low and insolvency administrators are subject to little supervision.

(15) Latvia has introduced several successful initiatives to improve the efficiency and quality of the justice system. However, although it is comprehensive, the conflict of interest prevention regime for public officials is complex and rigid, prioritising formal compliance over the merits of individual cases. Moreover, the Corruption Prevention Office has been weakened by internal tensions, destabilising it and reducing public trust in its operations and its willingness to prioritise high profile cases.

(16) General inefficiencies in public administration, due largely to high staff turnover, delays in the public service reform and weak project management, are not conducive to a favourable investment environment. Public sector remuneration is not properly linked to responsibilities.

(17) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Latvia's economic policy and published it in the 2016 country report. It has also assessed the stability programme and the national reform programme and the follow-up given to the recommendations addressed to Latvia in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Latvia but also their compliance with EU rules and guidance, given the need to strengthen the EU's overall economic governance by providing EU level input into future national decisions. The recommendations under the European Semester are reflected in recommendations 1 to 3 below.

(18) In the light of this assessment, the Council has examined the stability programme, and its opinion[9] is reflected in particular in recommendation 1 below.

HEREBY RECOMMENDS that Latvia take action in 2016 and 2017 to:

1. Ensure that the deviation from the adjustment path towards the medium-term budgetary objective in 2016 and 2017 is limited to the allowance linked to the systemic pension reform and the major structural reform in the healthcare sector. Reduce the tax wedge for low-income earners by exploiting a growth-friendly tax shift towards environmental and property taxes and improving tax compliance.

2. Improve the adequacy of social assistance benefits and step up measures supporting recipients in finding and retaining work, including through increased coverage of activation measures. Speed up the curricula reform in vocational education, establish with the involvement of social partners a regulatory framework for apprenticeship-type schemes and increase their offer. Improve the accessibility, quality and cost-effectiveness of the healthcare system.

3. Pursue the consolidation of research institutions and provide incentives for private investment in innovation. Strengthen the conflict of interest prevention regime and set up a common legal framework for all public employees. Increase the accountability and public oversight of insolvency administrators.

[9] Under Article 5(2) of Council Regulation (EC) No 1466/97.

Done at Brussels,

For the Council
The President