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NOTE

From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
No. Cion doc.:	9413/22 - COM(2022) 619 final
Subject:	Recommendation for a COUNCIL RECOMMENDATION on the 2022 National Reform Programme of Latvia and delivering a Council opinion on the 2022 Stability Programme of Latvia

Delegations will find attached the abovementioned draft Council Recommendation, as revised and agreed by various Council committees, based on the Commission proposal COM(2022) 619 final.

COUNCIL RECOMMENDATION

of…

on the 2022 National Reform Programme of Latvia and delivering a Council opinion on the 2022 Stability Programme of Latvia

THE COUNCIL OF THE EUROPEAN UNION,

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

Having regard to 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,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

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

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

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1 OJ L 209, 2.8.1997, p. 1.

(1) Regulation (EU) 2021/241 of the European Parliament and of the Council[2] , which established the Recovery and Resilience Facility, entered into force on 19 February 2021. The Recovery and Resilience Facility provides financial support for the implementation of reforms and investment, entailing a fiscal impulse financed by the Union. It contributes to the economic recovery and to the implementation of sustainable and growth-enhancing reforms and investment, in particular to promote the green and digital transitions, while strengthening the resilience and potential growth of the Member States' economies. It also helps strengthen sustainable public finances and boost growth and job creation in the medium and long term. The maximum financial contribution per Member State under the Recovery and Resilience Facility will be updated in June 2022, in line with Article 11(2) of Regulation (EU) 2021/241.

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2 Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17).

(2) On 24 November 2021, the Commission adopted the Annual Sustainable Growth Survey, marking the start of the 2022 European Semester for economic policy coordination. It took due account of the Porto Social Commitment signed on 7 May 2021 to further implement the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The European Council endorsed the priorities of the 2022 Annual Sustainable Growth Survey on 25 March 2022. On 24 November 2021, on the basis of Regulation (EU) No 1176/2011 of the European Parliament and of the Council[3], the Commission also adopted the Alert Mechanism Report, which did not identify Latvia as one of the Member States for which an in-depth review would be needed. On the same date, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area and a proposal for the 2022 Joint Employment Report, which analyses the implementation of the Employment Guidelines and the principles of the European Pillar of Social Rights. The Council adopted the Recommendation on the economic policy of the euro area[4] ('2022 Recommendation on the euro area') on 5 April 2022 and the Joint Employment Report on 14 March 2022.

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3 Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances (OJ L 306, 23.11.2011, p. 25).

4 Council Recommendation of 5 April 2022 on the economic policy of the euro area (OJ C 153, 7.4.2022, p.1).

(3) Russia's invasion of Ukraine, in the wake of the global pandemic, has significantly altered the geopolitical and economic context. The impact of the invasion on Member States' economies has been felt through, inter alia, higher prices for energy, food and raw materials, and weaker growth prospects. The higher energy prices weigh particularly heavily on the most vulnerable households experiencing or at risk of energy poverty as well as on firms most vulnerable to energy prices hikes. The Union is also seeing an unprecedented inflow of people fleeing Ukraine. The economic effects stemming from Russia's war of aggression have impacted Member States asymmetrically. In this context, on 4 March 2022, Council Directive 2001/55/EC[5] was triggered for the first time by Council Implementing Decion (EU) 2022/382[6], granting displaced persons from Ukraine the right to legally stay in the Union, as well as access to education and training, the labour market, healthcare, housing and social welfare.

5 Council Directive 2001/55/EC of 20 July 2001 on minimum standards for giving temporary protection in the event of a mass influx of displaced persons and on measures promoting a balance of efforts between Member States in receiving such persons and bearing the consequences thereof (OJ L 212, 7.8.2001, p.12).

6 Council Implementing Decision (EU) 2022/382 of 4 March 2022 establishing the existence of a mass influx of displaced persons from Ukraine within the meaning of Article 5 of Directive 2001/55/EC, and having the effect of introducing temporary protection (OJ L 71, 4.3.2022, p. 1).

(4) Taking account of the rapidly changing economic and geopolitical situation, the European Semester resumes its broad economic and employment policy coordination in 2022, while evolving in line with the implementation requirements of the Recovery and Resilience Facility, as outlined in the 2022 Annual Sustainable Growth Survey. The implementation of the adopted recovery and resilience plans is essential for the delivery of the policy priorities under the European Semester, as the plans address all or a significant subset of the relevant country-specific recommendations issued in the 2019 and 2020 European Semester cycles. The 2019 and 2020 country-specific recommendations remain equally relevant also for the recovery and resilience plans revised, updated or amended in accordance with Articles 14, 18 and 21 of Regulation (EU) 2021/241, in addition to any other country-specific recommendations issued up to the date of submission of such revised, updated or amended recovery and resilience plans.

(5) The general escape clause of the Stability and Growth Pact has been active since March 2020. In its communication of 3 March 2021 entitled "One year since the outbreak of COVID-19: fiscal policy response", the Commission set out its view that the decision on the deactivation or continued application of the general escape clause should be taken as an overall assessment of the state of the economy, with the level of economic activity in the Union or euro area compared to pre-crisis levels (end of 2019) as a key quantitative criterion. Heightened uncertainty and strong downside risks to the economic outlook in the context of war in Europe, unprecedented energy price hikes and continued supply-chain disturbances warrant the extension of the general escape clause of the Stability and Growth Pact through 2023.

(6) Following the approach in the Council Recommendation of 18 June 2021[7] delivering a Council opinion on the 2021 Stability Programme of Latvia, the overall fiscal stance is currently best measured as the change in primary expenditure (net of discretionary revenue measures and excluding temporary emergency measures related to the COVID-19 crisis) but including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other Union funds, relative to medium-term potential growth[8]. Going beyond the overall fiscal stance, in order to assess whether national fiscal policy is prudent and its composition is conducive to a sustainable recovery consistent with the green and digital transitions, attention is also paid to the evolution of nationally financed[9] primary current expenditure (net of discretionary revenue measures and excluding temporary emergency measures related to the COVID-19 crisis) and investment.

7 Council Recommendation of 18 June 2021 delivering a Council opinion on the 2021 Stability Programme of Latvia (OJ C 304, 29.7.2021, p. 63).

8 The estimates on the fiscal stance and its components in this Recommendation are Commission estimates based on the assumptions underlying the Commission's 2022 spring forecast. The Commission's estimates of medium-term potential growth do not include the positive impact of reforms that are part of the recovery and resilience plan and that can boost potential growth.

9 Not financed by grants under the Recovery and Resilience Facility or other Union funds.

(7) On 2 March 2022, the Commission adopted a communication providing broad guidance for fiscal policy in 2023 ('the fiscal guidance') aimed at supporting the preparation of Member States' Stability and Convergence Programmes and thereby strengthening policy coordination. The Commission noted that, on the basis of the macroeconomic outlook of the 2022 winter forecast, transitioning from an aggregate supportive fiscal stance in 2020–2022 to a broadly neutral aggregate fiscal stance, while standing ready to react to the evolving economic situation, would appear appropriate in 2023. The Commission announced that the fiscal recommendations for 2023 should continue to differentiate between Member States and take into account possible cross-country spillovers. The Commission invited the Member States to reflect the guidance in their Stability and Convergence Programmes. The Commission committed to closely monitor the economic developments and adjust its policy guidance as needed and at the latest in its European Semester spring package of late May 2022.

(8) With respect to the fiscal guidance, the fiscal recommendations for 2023 take into account the worsened economic outlook, the heightened uncertainty and further downside risks, and the higher inflation compared to the Commission's 2022 winter forecast. Against these considerations, the fiscal response has to expand public investment for the green and digital transitions and energy security, and sustain the purchasing power of the most vulnerable households so as to cushion the impact of the energy price hike and help limit inflationary pressures from second-round effects via targeted and temporary measures. Fiscal policy has to remain agile so as to adjust to the rapidly evolving circumstances, including challenges that arise from Russia's war of aggression against Ukraine with regard to defence and security, and has to differentiate between Member Sates according to their fiscal and economic situation, including as regards their exposure to the crisis and the inflow of displaced persons from Ukraine.

(9) On 30 April 2021, Latvia submitted its national recovery and resilience plan to the Commission, in accordance with Article 18(1) of Regulation (EU) 2021/241. Pursuant to Article 19 of Regulation (EU) 2021/241, the Commission assessed the relevance, effectiveness, efficiency and coherence of the recovery and resilience plan, in accordance with the assessment guidelines set out in Annex V to that Regulation. On 13 July 2021, the Council adopted its Implementing Decision on the approval of the assessment of the recovery and resilience plan for Latvia[10]. The release of instalments is conditional on the adoption of a decision by the Commission, in accordance with Article 24(5) of Regulation (EU) 2021/241, stating that Latvia has satisfactorily fulfilled the relevant milestones and targets set out in the Council Implementing Decision. Satisfactory fulfilment presupposes that the achievement of preceding milestones and targets has not been reversed.

(10) Latvia submitted its 2022 National Reform Programme on 22 April 2022 andits 2022 Stability Programme on 26 April 2022, in line with the deadline established in Article 4 of Regulation (EC) No 1466/97. To take account of their interlinkages, the two programmes have been assessed together. In accordance with Article 27 of Regulation (EU) 2021/241, the 2022 National Reform Programme also reflects Latvia's biannual reporting on the progress made in implementing its recovery and resilience plan.

(11) The Commission published the 2022 country report for Latvia on 23 May 2022. It assessed Latvia's progress in addressing the relevant country-specific recommendations adopted by the Council in 2019, 2020 and 2021, and took stock of Latvia' s implementation of the recovery and resilience plan, building on the recovery and resilience scoreboard. On the basis of that analysis, the country report identified gaps with respect to those challenges that are not addressed or only partially addressed by the recovery and resilience plan, as well as new and emerging challenges, including those emerging from Russia's invasion of Ukraine. It also assessed Latvia's progress in implementing the European Pillar of Social Rights and in achieving the Union headline targets on employment, skills and poverty reduction, as well as progress in achieving the United Nations Sustainable Development Goals.

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10 ST 10157/2021; ST 10157/2021 ADD1.

(12) On 23 May 2022, the Commission issued a report under Article 126(3) of the Treaty. That report discussed the budgetary situation of Latvia, as its general government deficit in 2021 exceeded the Treaty reference value of 3 % of gross domestic product (GDP). The report concluded that the deficit criterion was not fulfilled. In line with the communication of 2 March 2022, the Commission did not propose to open new excessive-deficit procedures in spring 2022 and will reassess whether it is necessary to propose the opening of such procedures in autumn 2022.

(13) In its Recommendation of 20 July 2020[11], the Council recommended Latvia to take in 2020 and 2021 all necessary measures, in line with the general escape clause, to effectively address the COVID-19 pandemic, sustain the economy and support the ensuing recovery. It also recommended Latvia to pursue, when economic conditions allow, fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment. In 2021, according to data validated by Eurostat, Latvia's general government deficit increased from 4,5 % of GDP in 2020 to 7,3 %. The fiscal policy response by Latvia supported the economic recovery in 2021, while temporary emergency measures increased from 2,8 % of GDP in 2020 to 5,2 % in 2021. The measures taken by Latvia in 2021 were in line with the Council Recommendation of 20 July 2020. The discretionary budgetary measures adopted by the government in 2020 and 2021 were mostly temporary or matched by offsetting measures. At the same time, some of the discretionary measures adopted by the government over the period 2020 to 2021 were not temporary or matched by offsetting measures, mainly consisting of a reduction of the social security contribution rate, an increase in the threshold for personal income tax allowance, an increase in wages for medical personnel and teachers as well as an increase of minimum social benefits. According to data validated by Eurostat, general government debt incresed from 43,3 % of GDP in 2020 to 44,8 % of GDP in 2021.

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[11] Council Recommendation of 20 July 2020 on the 2020 National Reform Programme of Latvia and delivering a Council opinion on the 2020 Stability Programme of Latvia (OJ C 282, 26.8.2020, p.89).

(14) The macroeconomic scenario underpinning the budgetary projections in the 2022 Stability Programme is realistic in 2022 and cautious thereafter. The government projects real GDP to grow by 2,1 % in 2022 and 2,5 % in 2023. By comparison, the Commission's 2022 spring forecast projects a similar real GDP growth of 2,0 % in 2022 and a slightly higher growth of 2,9 % in 2023, mainly due to a more positive outlook for private consumption and exports. In its 2022 Stability Programme, the government expects that the headline deficit will decrease to 6,5 % of GDP in 2022 and to 2,8 % in 2023. The large deficit in 2022 mainly reflects measures included in the 2022 budget, namely an increase in income tax allowance, a sizeable investment package and an increase in wages for healthcare, interior and education sector employees. Moreover, broad government support to households and companies to mitigate the rise in energy prices, as well as projected slower growth of tax revenue due to the negative impact on the economy from the Russian invasion of Ukraine, will keep the deficit elevated, despite COVID-19 support to the economy being significantly lower in 2022 than in 2021. According to the 2022 Stability Programme, the general government debt-to-GDP ratio is expected to increase to 45,7 % in 2022, and to decline to 45,2 % in 2023. Based on policy measures known at the cut-off date of the forecast, the Commission's 2022 spring forecast projects a government deficit for 2022 and 2023 of 7,2 % of GDP and 3,0 % respectively. This is higher than the deficit projected in the 2022 Stability Programme, mainly due to additional policy measures included in the Commission's 2022 spring forecast, namely the creation of national energy supply security reserves according to recent amendments to the Energy Law (estimated fiscal impact of 0,6 % of GDP in 2022). The creation of the reserves has been credibly announced, but was not known at the time of the preparation of the 2022 Stability Programme. The Commission's 2022 spring forecast projects general government debt-to-GDP ratio of 47,0 % in 2022 and 46,5 % in 2023, above the 2022 Stability Programme projection. The difference is due to a higher deficit projection and a lower forecast of nominal GDP. According to the Commission's 2022 spring forecast, the medium-term (10-year average) potential output growth is estimated at 2.3 %. However, that estimate does not include the impact of the reforms that are part of the recovery and resilience plan and can boost Latvia's potential growth.

(15) In 2022, the government phased out the majority of measures taken in response to the COVID-19 crisis, such that the temporary emergency measures are projected to decline from 5,2 % of GDP in 2021 to 0,8 % in 2022. The government deficit is impacted by measures adopted to counter the economic and social impact of the increase in energy prices, which in the Commission's 2022 spring forecast are estimated at 0,9 % of GDP in 2022 and are expected to be phased out in in 2023.[12] Those measures mainly consist of price caps on energy prices to households and entrepreneurs, full-coverage of certain sub-components of electricity tariff by the State, as well as support to particular social groups and poorer households. Those measures have been announced as temporary. However, in the event that energy prices remain elevated in 2023, some of those measures could be continued. Some of those measures are not targeted, in particular the general price caps on energy prices. The government deficit is also impacted by the cost of offering temporary protection to displaced persons from Ukraine, which in the Commission's 2022 spring forecast is projected at 0,3 % of GDP in 2022 and 0,5 % of GDP in 2023[13], as well as the increased cost of defence expenditure by 0,1 % of GDP in 2022 and 0,3 % of GDP in 2023.

(16) In its Recommendation of 18 June 2021, the Council recommended that in 2022 Latvia maintain a supportive fiscal stance, including from the impulse provided by the Recovery and Resilience Facility, and preserve nationally financed investment. The Council also recommended Latvia to keep the growth of nationally financed current expenditure under control and to pursue, when economic conditions allow, a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring fiscal sustainability in the medium term and, at the same time, to enhance investment to boost growth potential.

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12 The figures represent the level of annual budgetary costs of those measures taken since autumn 2021, including current revenue and expenditure as well as – where relevant – capital expenditure measures.

13 It is assumed that the total number of persons displaced from Ukraine to the Union will gradually reach 6 million by the end of 2022, and their geographical distribution is estimated on the basis of the size of the existing diaspora, the relative population of the receiving Member State, and the actual distribution of displaced persons from Ukraine across the Union as of March 2022. For budgetary costs per person, estimates are based on the Euromod microsimulation model of the Commission's Joint Research Centre, taking into account both cash transfers people may be eligible for as well as in-kind benefits such as education and healthcare.

(17) In 2022, according to the Commission's 2022 spring forecast and including the information incorporated in Latvia's 2022 Stability Programme, the fiscal stance is projected to be supportive at -3,3 % of GDP, as recommended by the Council[14]. Latvia plans to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment as recommended by the Council. The positive contribution to economic activity of expenditure financed by grants under the Recovery and Resilience Facility and other Union funds is projected to increase by 0,8 % of GDP compared to 2021. Nationally financed investment is projected to provide an expansionary contribution to the fiscal stance of 0,3 percentage points in 2022[15]. Therefore, Latvia plans to preserve nationally financed investment, as recommended by the Council. At the same time, the growth in nationally financed primary current expenditure (net of new revenue measures) in 2022 is projected to provide an expansionary contribution of 1,5 percentage points to the overall fiscal stance. That significant expansionary contribution includes the additional impact of the measures to address the economic and social impact of the increase in energy prices (0,8 % of GDP) as well as the costs to offer temporary protection to displaced persons from Ukraine (0,3 % of GDP). Latvia broadly keeps under control the growth of nationally financed current expenditure in 2022, as the significant expansionary contribution of nationally financed current expenditure in 2022 is mainly due to the measures to address the economic and social impact of the increase in energy prices as well as the costs to offer temporary protection to displaced persons from Ukraine.

14 A negative (positive) sign of the indicator corresponds to an excess (shortfall) of primary expenditure growth compared with medium-term economic growth, indicating an expansionary (contractionary) fiscal policy.

15 Other nationally financed capital expenditure is projected to provide an expansionary contribution of 0,7 percentage points of GDP as Commission's 2022 spring forecast includes the fiscal impact of creation of energy supply security reserves according to recent amendments to the Energy Law.

(18) In 2023, the fiscal stance is projected in the Commission's 2022 spring forecast at +3,2 % of GDP on a no-policy-change assumption[16]. Latvia is projected to continue using the grants under the Recovery and Resilience Facility in 2023 to finance additional investment in support of the recovery. The positive contribution to economic activity of expenditure financed by grants under the Recovery and Resilience Facility and other Union funds is projected to increase by 0,9 percentage points of GDP compared to 2022. Nationally financed investment is projected to provide a contractionary contribution to the fiscal stance of 0,8 percentage points in 2023[17]. At the same time, the growth in nationally financed primary current expenditure (net of new revenue measures) in 2023 is projected to provide a contractionary contribution of 2,7 percentage points to the overall fiscal stance. This includes the impact from the phasing out of the measures addressing the increased energy prices (0,9 % of GDP) and additional costs to offer temporary protection to displaced persons from Ukraine (0,1 % of GDP).

(19) In the 2022 Stability Programme, the general government deficit is expected to gradually decline to 2,3 % of GDP in 2024 and to 1,7 % by 2025. Therefore, the general government deficit is planned to remain below 3 % of GDP over the programme horizon. These projections assume phasing out of support programmes and solid growth of tax revenue. According to the 2022 Stability Programme, the general government debt-to-GDP ratio is expected to decrease by 2025, specifically with a decrease to 44,5 % in 2024 and to 43,4 % in 2025. According to the Commission's analysis, debt sustainability risks appear low over the medium term.

16 A negative (positive) sign of the indicator corresponds to an excess (shortfall) of primary expenditure growth compared with medium-term economic growth, indicating an expansionary (contractionary) fiscal policy.

17 Other nationally financed capital expenditure is projected to provide a contractionary contribution of 0,6 percentage points of GDP which is due to the base effect, namely in Commission's 2022 spring forecast foresees the fiscal impact of creation of the energy supply security reserves but such measure is not projected for 2023.

(20) Latvia's tax revenue as a share of GDP is significantly below the Union average, limiting the funding to public services. Latvia collects the lowest revenue from corporate income taxes in the Union (0,7 % of GDP in 2020), while revenue from property taxes is 1,0 % of GDP compared with the Union average of 2,3 % of GDP. Moreover, while the tax wedge on an average earner is around the Union average, the implicit tax rate on labour is among the lowest in the Union, pointing to considerable scope for increasing the revenue from labour taxation through better collection and higher progressivity. Latvia's public expenditure on healthcare and social protection are particularly low compared to the Union average, hampering timely and equal access to healthcare and adequate social assistance. As a result, Latvia has some of the highest income inequality, lowest poverty reduction impact of social transfers and worst health outcomes in the Union. Despite recent increases, the minimum income, minimum pensions and disability benefits fall below the poverty line. Limited access to and quality of social assistance and services for vulnerable groups further hinder social inclusion. The long-term care system is underdeveloped, with a limited supply of home care and community-based services. Social housing is scarce and often does not provide adequate living conditions. Furthermore, social assistance varies across municipalities and is often not targeted enough. Higher taxation of property and capital and more progressivity of income taxation offer the best potential for increasing tax revenue as these sources remain underutilised compared to the Union average. Moreover, efforts to reduce the shadow economy should continue beyond the measures planned in the recovery and resilience plan.

(21) In accordance with Article 19(3), point (b), of Regulation (EU) 2021/241 and criterion 2.2 of Annex V to that Regulation, the recovery and resilience plan includes an extensive set of mutually reinforcing reforms and investments to be implemented with an indicative timetable for implementation to be completed by 31 August 2026. These help address all or a significant subset of the economic and social challenges outlined in the country-specific recommendations addressed to Latvia by the Council in the European Semester in 2019 and 2020, in addition to any country-specific recommendations issued up to the date of adoption of a recovery and resilience plan. In particular, Latvia's recovery and resilience plan includes measures addressing, to a varying extent, all six broad challenges – fiscal, human capital, public administration, productivity and the digital and green transitions. The recovery and resilience plan includes reforms related to the governance and financing of higher education institutions, the implementation of a comprehensive human resources strategy in healthcare and the introduction of indexation for minimum income benefits. Sizeable investments include the greening of the Riga metropolitan area transport system through, among other things, to the acquisition of clean public vehicles and the energy renovation of both private and public buildings and businesses. Significant investment is also planned to promote regional development: building schools, industrial parks and affordable housing and modernising hospitals. These measures are expected to boost the growth potential of the economy in a sustainable manner.

(22) The implementation of the recovery and resilience plan of Latvia is expected to contribute to making further progress on the green and digital transitions. Measures supporting the climate objectives in Latvia account for 37,6 % of the recovery and resilience plan's total allocation, while measures supporting digital objectives account for 21 % of the recovery and resilience plan's total allocation. The fully fledged implementation of the recovery and resilience plan, in line with the relevant milestones and targets, will help Latvia swiftly recover from the fallout of the COVID-19 crisis, while strengthening its resilience. The systematic involvement of social partners and other relevant stakeholders remains important for the successful implementation of the recovery and resilience plan, as well as other economic and employment policies going beyond the recovery and resilience plan, to ensure broad ownership of the overall policy agenda.

(23) Latvia submitted the Partnership Agreement provided for in Regulation (EU) 2021/1060 of the European Parliament and of the Council[18] on 25 May 2022 but the other cohesion policy programmes provided for in that Regulation have not yet been submitted. In line with Regulation (EU) 2021/1060, Latvia is to take into account the relevant country-specific recommendations in the programming of the 2021–2027 cohesion policy funds. This is a prerequisite for improving the effectiveness and maximising the added value of the financial support to be received from cohesion policy funds, while promoting coordination, complementarity and coherence between those cohesion policy funds and other Union instruments and funds. The successful implementation of the Recovery and Resilience Facility and cohesion policy programmes also depends on the removal of bottlenecks to investment to support the green and digital transitions and balanced territorial development.

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18 Regulation (EU) 2021/1060 of the European Parliament and of the Council of 24 June 2021 laying down common provisions on the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund and the European Maritime, Fisheries and Aquaculture Fund and financial rules for those and for the Asylum, Migration and Integration Fund, the Internal Security Fund and the Instrument for Financial Support for Border Management and Visa Policy (OJ L 231, 30.6.2021, p. 159).

(24) Beyond the economic and social challenges addressed by the recovery and resilience plan, Latvia faces a number of additional challenges including access to bank credit. Credit flow to the private sector has been negative for most of the last decade. It turned positive in 2016 but the growth rate of credit remained below the growth rate of GDP. In 2020, private sector debt stood at 66,5 % of GDP compared with 78,3 % of GDP 5 years earlier. Small and medium-sized enterprises have found it particularly difficult to get credit, partially due to their higher credit risk, but they also face a relatively high cost of credit and burdensome paperwork. Furthermore, poor liquidity of the assets offered for collateral, make it particularly hard to get credit outside of the Riga region. This presents a significant barrier both for mortgage lending and lending to businesses. Moreover, financing for consumer green technologies could be made more affordable through cheaper and longer-term credit products. Policy efforts have mainly focused on supporting lending by combining it with public grants. However, this comes with a significant cost to the government budget and is therefore not a sustainable way of boosting lending. Easing the credit supply constraints requires general improvements in transparency and trust in the business environment, including a reduction of the shadow economy. Furthermore, there is room for increasing the loan recovery rates, which would reduce the banks' costs associated with non-performing loans and which could be facilitated by a more efficient legal system. Targeted loan and guarantee schemes could help lower the liquidity risks faced by the banks when accepting collateral in relatively illiquid markets. Public lending schemes for strategically important investments, like the green transition and regional development, could increase effective competition in the banking market or fill a market gap where bank financing is either too expensive or not available. Moreover, public guarantee and lending schemes offer a significantly more cost-efficient way of supporting private borrowing than grant schemes. Besides the barriers to bank financing, the Latvian market for alternative sources of finance is underdeveloped and holds potential for improving firms' access to finance.

(25) In response to the mandate by the Union Heads of State or Government set out in the Versailles Declaration, the Commission's proposal for a REPowerEU plan aims to phase out the Union's dependence on fossil-fuel imports from Russia as soon as possible. For this purpose, the Commission intends to identify the most-suitable projects, investments and reforms at national, regional and Union level in dialogue with Member States. These measures aim to reduce overall reliance on fossil fuels and shift fossil-fuel imports away from Russia.

(26) According to 2020 data, oil products (33,8 %) and natural gas (21,6 %) constitute around half of Latvia's energy mix, the rest consists mainly of renewable energy (44,1 %). Russia supplied all of Latvia's natural gas imports (higher than the Union average of 44 % of Russian gas import dependence) and was a key source (20 %) of Latvia's oil product imports (largely in line with the Union average of 26 % of Russian oil import dependence).[19] Latvia's dependence on Russia's gas supplies is significantly reduced by its gas connection to Lithuania, which gives Latvia access to Klaipeda's liquefied natural gas terminal. Latvia is further connected to Estonia and Finland, making the four countries part of the same market for natural gas. A gas storage facility located in Latvia allows for smoothing out the seasonal mismatches in supply and demand and stores a security reserve for the Baltic market. New infrastructure and network investments related to gas are recommended to be future-proof where possible, in order to facilitate their long-term sustainability, through future repurposing for sustainable fuels. Completing the ongoing synchronisation with the continental power grid of the Union, ensuring sufficient capacity for the interconnections with neighbouring Member States and pursuing joint renewables projects should nevertheless remain a policy priority. Besides the improvements to gas infrastructure aimed at securing alternative sources of supply, reducing energy dependence on Russia will require Latvia to accelerate the deployment of renewables and increase energy efficiency, especially in the building and transport sectors. Latvia's recovery and resilience plan includes measures that aim to facilitate private investments in onshore wind energy.

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19 Eurostat (2020), share of Russian imports over total imports of natural gas, crude oil. For the EU27 average, the total imports are based on extra-EU27 imports. For Latvia, total imports include intra-Union trade. Crude oil does not include refined oil products.

Their earlier-than-planned implementation, as recently announced by the government, could help accelerate investments in onshore wind energy. However, increasing the share of renewables would also require Latvia to explore opportunities in offshore wind energy. Energy efficiency measures including deep renovation could be reinforced, in particular in buildings, transport and industry. To diversify the energy mix, Latvia is considering investing in nuclear energy in cooperation with neighbouring Member States. A further increase in ambition in respect of reducing greenhouse-gas emissions and increasing renewables and energy efficiency will be needed in order for Latvia to be in line with the 'Fit for 55' objectives.

(27) While the acceleration of the transition towards climate neutrality and away from fossil fuels will create significant restructuring costs in several sectors, Latvia can make use of the Just Transition Mechanism in the context of cohesion policty to alleviate the socio-economic impact of the transition in the most-affected regions. In addition, Latvia can make use of the the European Social Fund Plus, established by Regulation (EU) 2021/1057 of the European Parliament and of the Council[20], to improve employment opporunities and strengthen social cohesion.

(28) In the light of the Commission's assessment, the Council has examined the 2022 Stability Programme and its opinion[21] is reflected in particular in recommendation (1).

(29) In view of the close interlinkages between the economies of euro-area Member States and their collective contribution to the functioning of the economic and monetary union, the Council recommended that the euro-area Member States take action, including through their recovery and resilience plans, to implement the recommendations set out in the 2022 Recommendation on the euro area. For Latvia, this is reflected in particular in recommendations (1), (2) and (3).

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20 Regulation (EU) 2021/1057 of the European Parliament and of the Council of 24 June 2021 establishing the European Social Fund Plus (ESF+) and repealing Regulation (EU) No 1296/2013 (OJ L 231 30.6.2021, p. 21).

21 Under Article 5(2) of Regulation (EC) No 1466/97.

HEREBY RECOMMENDS that Latvia take action in 2022 and 2023 to:

1. In 2023, ensure that the growth of nationally financed primary current expenditure is in line with an overall neutral policy stance, taking into account continued temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. Stand ready to adjust current spending to the evolving situation. Expand public investment for the green and digital transitions, and for energy security taking into account the REPowerEU initiative, including by making use of the Recovery and Resilience Facility and other Union funds. pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions Broaden taxation**,** including of property and capital, and strengthen the adequacy of healthcare and social protection to reduce inequality.

2. Proceed with the implementation of its recovery and resilience plan, in line with the milestones and targets included in the Council Implementing Decision of 13 July 2021. Submit the 2021–2027 cohesion policy programming documents with a view to finalising the negotiations with the Commission and subsequently starting their implementation.

3. Improve access to finance for small and medium-sized enterprises through public lending and guarantee schemes aimed at facilitating investments of strategic importance, in particular the green transition and regional development.

4. Reduce overall reliance on fossil fuels and diversify imports of fossil fuels by accelerating the deployment of renewables, ensuring sufficient interconnection capacity, diversifying energy supplies and routes and reducing overall energy consumption through ambitious energy efficiency measures.

Done at Brussels,

For the Council

The President