



# Amendments to the Latvia's Stability Programme for 2019 – 2022

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LATVIJAS REPUBLIKAS  
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## **SUBSTANCE OF THE AMENDMENTS**

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Latvia submits amendments to Latvia's Stability Programme for 2019-2022 (Stability Programme), which was submitted to the European Commission (EC) and Eurogroup on the 15<sup>th</sup> of April 2019.

The Ministry of Finance (MoF), in preparing the Stability Programme, assessed that the general government's budget deficit in 2018 would be 0.7% of gross domestic product (GDP). In turn, according to the information published on the 18<sup>th</sup> of April 2019 by the Central Statistical Bureau (CSB) on the results of the general government budget deficit and debt for 2018, the general government budget deficit in 2018 is 1.0% of GDP. Meanwhile, the general government's consolidated gross debt stood at 35.9% of GDP at the end of 2018.

Accordingly, the deficit of the general government budget for 2018, which is included in the Stability Programme, is by 0.3 percentage points lower than the provisional results compiled by the CSB. The main differences are based on a more negative result than the initial assessment of the activities of certain enterprises classified in the general government sector (0.18% of GDP), lower than previously forecasted European Union (EU) co-financing in EU structural funds projects implemented by municipalities (0.12% of GDP), and differences in the methodology used to recalculate the solidarity tax from the cash flow accounting principle to accrual accounting (0.12% of GDP).

The MoF has identified specific areas in the CSB's data accounting methodology, in which further research and development would be required. Consequently, the analysis of the above-mentioned differences in the assessment of the general government budget deficit in 2018 will be continued and, if necessary, adjustments will be made to the final assessment of the general government budget deficit and debt results for 2018 during the autumn notification in October of this year.

The difference between the 2018 general government budget deficit assessment covered by the Stability Programme and the notification results is considered to be significant, therefore, in order to ensure a consistent presentation of the Stability Programme's fiscal indicators, the MoF has prepared amendments to the Stability Programme, where:

- 1) Section 3.2 of the Stability programme "Current Fiscal Situation" is replaced by Annex 1 of these amendments;
- 2) Section 3.3 of the Stability programme "Fiscal Development Scenario" is replaced by Annex 2 of these amendments;
- 3) Section 3.4. of the Stability programme "Development Trends of Government Debt in the Medium Term" is replaced by Annex 3 of these amendments;
- 4) Section 4.3 of the Stability programme "Comparison of the General Government Budget Balance and Debt Forecasts with the Latvia's Stability Programme for 2018 – 2021" is replaced by Annex 4 of these amendments;
- 5) Tables 1d, 2a, 2b, 4, 5, 6 and 7a in the Annex to the Stability programme are replaced by Annex 5 of these amendments.

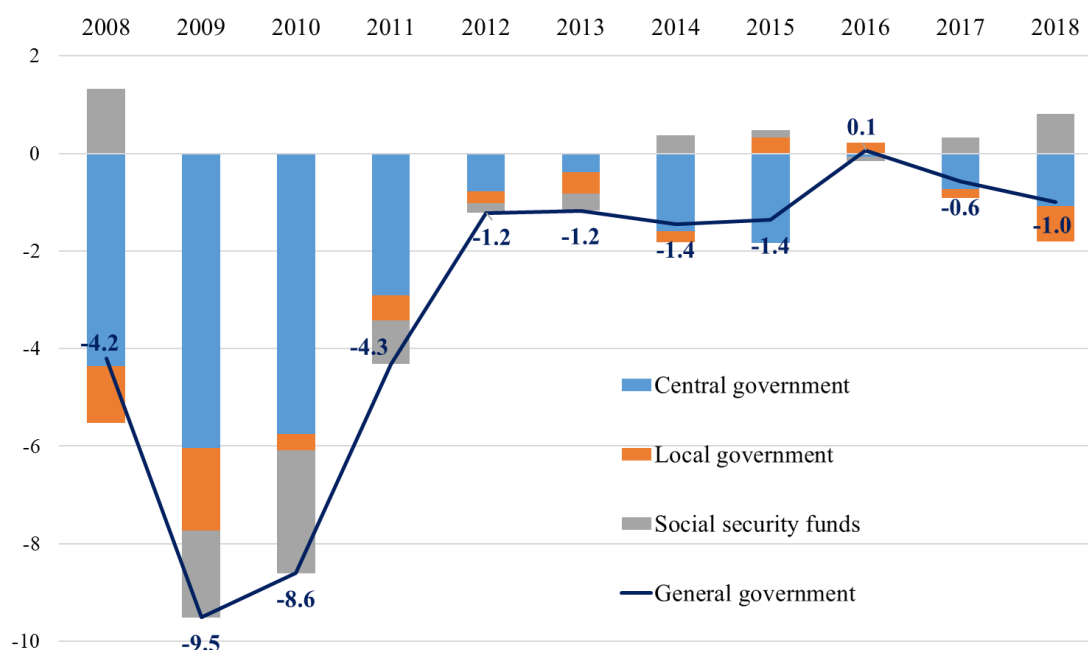
It should be noted that the reasons for the changes in the fiscal figures for 2018 do not have an impact on the fiscal indicators of further years, therefore amendments to the Stability Programme do not alter the fiscal forecasts for further years.

# ANNEX 1

## 3.2. CURRENT FISCAL SITUATION

According to the information published by the CSB on the results of the general government deficit and debt in 2018, the general government's nominal budget deficit was EUR 295.4 million or 1.0% of GDP. The size of the general government deficit was 0.1 percentage point higher than that indicated in the previous Latvian Stability Programme for 2018-2021. A higher general government deficit rate is due to higher spending on co-financing of EU funds projects, given that EU funds are implemented at a higher rate than initially planned, and the economic performance of general government enterprises was more negative than previously forecasted. General government budget revenue, meanwhile, showed an increase in all positions.

Here it is worth highlighting current taxes on income and wealth, the growth whereof was promoted by high revenue from CIT which in turn are attributable to the steeper rise in contributions according to submitted declarations for 2017. In addition, the VAT and excise tax revenue was higher than projected growing along the steeper economic growth. As compared to the previous Stability Programme the state special budget expenditure was spent in a smaller amount than planned mainly considering that the actual number of beneficiaries of the sickness, unemployment and childcare benefits was smaller than planned.



**Figure 3.3. Budgetary balance of the general government by sub-sectors, % of GDP (Data source: Eurostat)**

The analysis of contribution of the general government sub-sectors to the overall fiscal balance allows concluding that the negative balance was mainly formed by the central government and local government deficit, comprising, correspondingly, 1.1%

of GDP and 0.7% of GDP in 2018. In turn, the social security fund surplus comprised 0.8% of GDP in 2018 (see Figure 3.3).

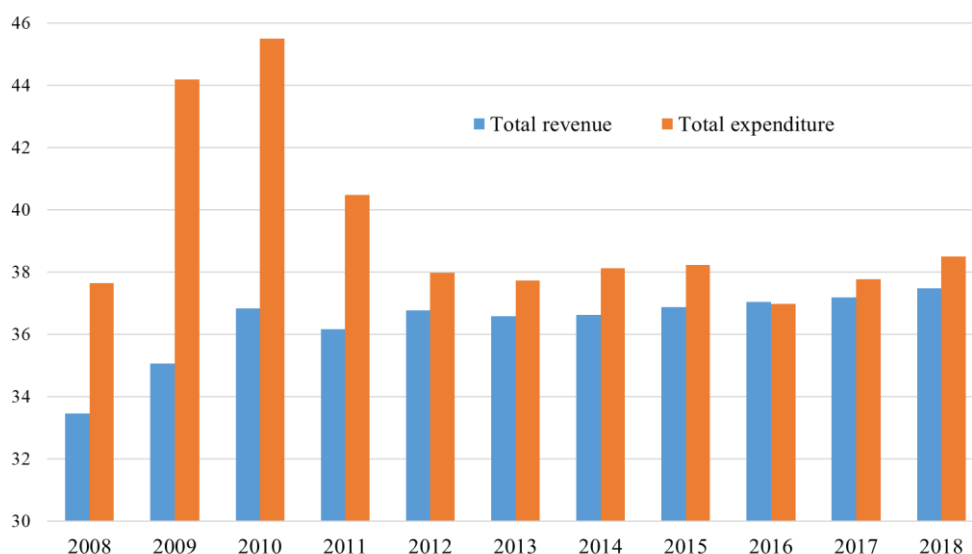
In 2018, as compared to the previous year, the general government budget deficit has grown by 0.4 percentage point. General government budget revenue has grown by 1, 002.0 million euro or 10.0% reaching 11.1 billion euro or 37.5% of GDP (see Figure 3.4). Revenue growth was promoted by the growth of tax revenue. Tax revenue<sup>1</sup> in 2018 reached 31.0% of GDP, which is by 0.4 percentage points less than in 2017. The fall in the share of the tax revenue in the GDP was affected by the tax reform within the scope whereof the revenue from the current taxes on income and wealth (D.5) reduced significantly reducing by 151.4 million euro or 6.6% as compared to 2017. As a result of the tax reform, both PIT and CIT revenue have been significantly affected. While the PIT revenue demonstrated growth in the amount of 1.6% or 27.7 million euro as compared to 2017, the CIT revenue declined by 28.6% or by 121.6 million euro. As a result of the PIT reform several changes were introduced, for example progressive income tax was introduced, differentiated non-taxable minimum as well as allowance for dependents and non-taxable minimum for pensioners was increased, also minimum wage was increased from 380 euro to 430 euro. In turn, because of the CIT reform, zero rate for reinvested profit was set and the CIT advance payments were not applied after 1 July 2018.

Taxes on production and imports (D.2) as compared to 2017 have grown by 402.2 million euro or 10.7%. As the economy develops and the purchasing power of population increases VAT revenue has grown by 285.3 million euro or 13.2% and the excise tax revenue in turn has grown by 117.4 million euro or 12.9%. Steep growth of the excise tax revenue, was also promoted by rise in the excise tax rates, active trade in the border area and restriction of illegal circulation of the excise goods. In turn, the growth of taxes on production and imports was slowed down by the revenue from the real estate tax for land and buildings which has decreased by 7.2 million euro and the subsidized electricity tax revenue which declined by 25.8 million euro because the subsidized electricity tax is no longer applied since 1 January 2018.

Social contributions (D.61) as compared to 2017 have grown by 402.3 million euro or 17.1%. The growth of social security contributions was promoted by a favorable situation in the labor market. In 2018, both the number of employees and the average amount of wage have grown and a considerable share of growth was ensured by the decision of the government, to increase the rate of the social security contributions by 1 percentage point from 1 January 2018. Extra funds obtained were allocated to the increase of remuneration for those working in the health sector.

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<sup>1</sup> Tax burden (D.2 (incl. EU part)+share) +D.5+D.61+D91).



**Figure 3.4. General government revenue and expenditure, % of GDP**  
(Data Source: Eurostat)

General government budget expenditure has grown by 1, 141.7 million euro or 10.0% reaching 11.4 billion euro or 38.5% of GDP. The largest share of growth was ensured by expenditure for gross fixed capital formation (P.51G) which has grown by 407.1 million euro or 34.2% and which in turn was facilitated by the growth of expenditure for the EU funds' investment projects. Total expenditure for remuneration (D.1) in 2018 have grown by 244.3 million euro or 8.9% and the growth was mainly determined by the increase of minimum wage from 1 January 2018, increase of remuneration for teachers and allocation of additional funding to increase the remuneration of those working in the health sector. Expenditure for intermediate consumption (P.2) has grown by 195.2 million euro or 12.7% with the main reason of rise being the growth of expenditure for goods and services in the National Armed Forces and local governments. Expenditure for social payments (D.632 and D.62) has grown by 225.5 million euro or 7.1%, which was 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, as well as pension indexation starting from 1 October 2018 by applying larger indices. Given the successful government debt management and low interest rates, the interest expenditure (D.41) has reduced by 41.4 million euro or 16.6%. Subsidies (D.3) have decreased by 42.5 million euro or 12.4% - related to lower net costs of purchasing electricity under mandatory procurement.

Expenditure of capital transfers (D.9) in 2018 has reduced by 107.4 million euro or 64.9% significantly influenced by the discounted compensation payment performed in 2017 – in the amount of 140 million euro for the installed electricity capacities for the renewable electricity producers. In 2018 a similar payment of 51.7 million euro was performed, which in the medium term will allow for saving up the state budget funds. Since the introduction of the MPC the fee for electricity has been constantly growing as a result whereof the Ministry of Economics in line with the task assigned by the government had prepared the solution for limiting further growth of the MPC after the abolition of the subsidized electricity tax. Thus, in 2017 one entity receiving guaranteed

fee for the electric capacity installed in the cogeneration electric station (combined heat and power plant) and whose installed electric capacity exceeded 100 MW partially refused from the guaranteed fee for the electric capacity installed in the cogeneration electric station for the remaining period, receiving the discounted payment, which was expressed as the discounted value of the state aid revenue not obtained in the future. The discounting factor of 9% was applied to the reduction of the capacity fee and for the remaining aid period it will continue to annually receive 25% of the previous amount of the aid. It should be noted that the discounted payment (except for the compensation payment for 140 million euro) is recognized as the proportionally general government budget expenditure and the corresponding revenue of the enterprise up to the end of the aid period. In turn, the transaction closed in 2018 for 51.7 million euro reduced the amount of the one-off payment to be received by the renewable electricity producer until the end of the aid period.

## ANNEX 2

### 3.3. FISCAL DEVELOPMENT SCENARIO

The general government budget **no-policy change** projections for the medium term were prepared in accordance with the updated macroeconomic scenario underpinning revenue and expenditure projections. The projections also took note of the approved central government basic expenses for the next three years as well as expected development in local government budgets taking into account current trends. It is expected that in 2019, the general government budget deficit will comprise 0.5% of GDP and it remains at the same level as forecasted when preparing the budget for 2019. In the medium term in the general government budget in the scenario at constant policy a deficit of 0.3% of GDP in 2020, a deficit of 0.4% of GDP in 2021 and a surplus of 0.2% of GDP in 2022 is being projected.

According to the forecasts, the share of the general government revenue in GDP in 2019 will comprise 36.2% of GDP whereas in 2020, 2021 and 2022 it will reduce correspondingly to 35.9%, 35.4% and 34.9% of GDP. Reduction of the revenue share will be affected by the fall in forecasted revenue in funding of rural and fishery programmes attributable to the closing stage of the 2014-2020 programming period. The share of the PIT revenue in proportion to GDP and the amount of the budgeted received dividends from public sector capital companies is reducing as well. It is expected that the share of the general government expenditure in GDP similar to revenue in the medium term will reduce on an annual basis, even though in nominal terms the amount of both revenue and expenditure will grow.

**Table 3.9. Medium term fiscal forecasts at no-policy change scenario, % of GDP**

		2018	2019	2020	2021	2022
	ESA code	% of GDP				
<b>Net lending (+) or borrowings (-) (B.9) by sub-sectors</b>						
General government	S.13	-1.0	-0.5	-0.3	-0.4	0.2
Central government	S.1311	-1.1	-0.9	-0.7	-0.7	-0.1
Local government	S.1313	-0.7	-0.3	-0.1	0.0	0.0
Social security funds	S.1314	0.8	0.7	0.4	0.3	0.3
<b>General government (S.13)</b>						
Total revenue	TR	37.5	36.2	35.9	35.4	34.9
Total expenditure	TE	38.5	36.7	36.3	35.8	34.6
Interest expenditure	D.41	0.7	0.7	0.8	0.8	0.8
<b>Cyclical development</b>						
<b>Cyclical budgetary component<sup>2</sup></b>		0.7	0.5	0.4	0.3	0.2
<b>One-off and other temporary measures<sup>3</sup></b>			0.1			

<sup>2</sup> In a calculation of cyclical budgetary component a semi-elasticity of 0.38 was used (Data: An update of the semi-elasticities of the budget balance based on new weights. Note to the attention of the members of the Output Gap Working Group).

<sup>3</sup> The share of revenue of EUR 18.2 million from the EU ETS sale of emission allowances, which took place in November 2018 and is attributable to the increase in volume, is included in the Stability Programme as a one-off measure. On the other hand, the increase in revenue from this transaction, which is attributable to price fluctuations in 2019, is not considered a one-off measure.



Cyclical component of the budgetary balance		-1.7	-1.1	-0.7	-0.6	0.1
Cyclically adjusted primary balance		-1.0	-0.3	0.1	0.1	0.9
Structural balance <sup>4</sup>		-1.7	-1.1	-0.7	-0.6	0.1

#### **In the central government budget:**

- In 2019, a deficit of 0.9% of GDP is planned for the central government budget at a no-policy change scenario while a deficit of 0.7% of GDP is projected in 2020 and 2021 and a deficit of 0.1% of GDP - in 2022. In 2019 and 2020 the revenue growth will be secured by taxes on production and imports which will be mainly driven by increases in the VAT and excise tax revenue.
- In 2019 the revenue and expenditure growth in central government budget is expected to be more moderate than in 2018. The amount of tax revenue growth in the medium term is volatile over the year attributable to broad changes in legislation with respect to the approved tax reform measures. It should be noted that the abolition of the CIT advance payments would considerably affect the amount of the CIT revenue in 2019, as they would reduce by one third as compared to the amount of the CIT revenue in 2018. The growth rate of revenue will continue to be affected by the forecasted decrease in property income mainly due to received payments for the use of state capital because no dividends from AS "Latvenergo" are planned in the projections for 2021 and 2022.
- In 2018, a sharper increase was observed in the foreign financial assistance revenues after a relatively lower revenue level in 2016 and 2017 attributable to the closure of the previous 2007 - 2013 EU funds programming period and the beginning of the new 2014 - 2020 programming period. In contrast, in 2019 it is expected that the foreign financial assistance revenue will be only slightly higher than in 2018.
- The growth of expenditure in the central government budget is triggered by raising remuneration to medical personnel as well as the disbursement of one-off benefits in 2019 to the officials of the institutional line of the interior and justice with special service ranks after each five years of uninterrupted length of service. To ensure the increase of funding of health sector inter alia for raising the remuneration of medical personnel starting from 2018 the SMSIC rate has been increased by 1 percentage point allocating the relevant additional revenue to funding health sector. Therewith the increase of the SMSIC rate resulted in receipt as additional revenue and allocation to the health sector of 85.6 million euro in 2018, but in 2019 another 97.8 million euro will be received in the basic budget from the SMSIC revenue.
- Capital expenditure in the central government budget in 2019 and henceforth will continue growing positively influenced by provision of expenditure to defense for 2% of GDP. In the medium term, expenditure for contributions to the EU budget also increases attributable to the amount of the GDP growth. Interest expenditure in 2019 will decrease in the state basic budget given the

<sup>4</sup> In order to facilitate data comparability, the structural balance in 2019 and 2020 is shown together with a reduction in net revenue from the tax reform 0.5% of GDP and 0.3% accordingly, which is temporary and recognised as a one-off measure from the perspective of Latvian fiscal framework, but the EC includes this effect in the structural balance, since revenue-reducing/expenditure-increasing measures by the EC as a rule are not recognised as one-off/short-term measures.

borrowing carried out in 2018 by refinancing the previously assumed government debt obligations at lower interest rates as well as updating the borrowing measures in the financial markets planned in the medium term.

- In 2018, the EU funds' investments from the state basic budget has been made at the highest level in the recent years (719 million euro) while in 2019 and for the entire medium term the growth of the EU funds' investments is not being forecasted, with the amounts thereof remaining approximately at the level of 2018.
- In 2022 in the central government budget, it is planned that the total amount of expenditure in nominal terms will be kept approximately at the level of 2021. It is attributable to the fact that currently no binding decisions are adopted on granting additional resources for 2022. At the same time, expenditure for defense also in 2022 is projected at the level of 2% of GDP. Central government budget balance at constant policy as compared to 2021 will improve considerably.

**In the social security fund:**

- The revenue mainly formed by the social security contributions will continue demonstrating growth. In 2019, it is forecasted that the revenue will grow by 7.5%.
- Ever since 2014 a surplus every year is in the social security fund and a surplus is also forecasted in 2019 and in the medium term. It is expected that in 2019, the amount for surplus in the social security fund will exceed the surplus of 2018, but in the medium term the amount thereof will reduce affected by constantly growing expenditure for pensions and other social benefits.
- In 2019, expenditure will be by 7.2% higher than in 2018. Starting from 2020 a steeper growth of expenditure is expected given the rise in the average wage which will influence the average amount of the disbursed pensions and benefits projected changes in the beneficiaries of pensions and benefits and given the changes in legislation that have come into force both in 2019 and before and will continue influencing the amount of expenditure in the medium term:
  - Starting from 2014 the retirement age is gradually increasing - by three months annually until the age of 65 years will be reached in 2025. In 2019 persons who have reached the age of 63 years and 6 months will be entitled to receive the state old-age pension. Persons whose insurance period is at least 30 years are eligible to retire earlier - two years before reaching the general retirement age, thus in 2019 persons who have reached the age of 61 years and 6 months are entitled to retire prematurely;
  - From 2017 the eligibility period for unemployment benefit has been extended from 9 months within the 12 months' period to 12 months within the 16 months' period introducing the eligibility period for the sickness benefit as well as other changes in order to restrict systematic abuse of the procedure for disbursement of unemployment and sickness benefits;
  - From 2018 when the persons whose insurance period is less than 15 years and who are not eligible to the state old-age pension in accordance with the *Law on State Social Allowances* reach the retirement age they shall be granted by the State social security benefit disbursed from the State basic budget funds;

- On 1 October 2018 the old-age disability length of service survivor's pensions and insurance allowances granted (recalculated) up to 30 September 2018 and the amount whereof does not exceed 382 euros have been revised (indexed) while as regards the pensions and insurance allowances the amount whereof exceeds 382 euro only the part thereof of 382 euro is indexed. At the same time, the following changes have been considered in the index calculation formula comprised of the actual CPI and the real growth percentage of the amount of wages of security (insurance) contributions. Where the insurance period of a person is from 30 to 39 years then the calculation formula takes note of 60% wage increase (previously - 50%), in turn where the insurance period is 40 and more years of work then 70% of the real wage increase (previously - 50%);
- From 1 October 2019 the actual CPI and 80% (previously - 70%) of the real growth percentage of the amount of wages of security (insurance) contributions will be applied in pension indexation for the old-age pensions calculated for 45 and more years of insurance period;
- From 1 October 2019, the amount of supplement per each year of insurance period accrued up to 31 December 1995 (1.50 euro for pensions granted up to 1996 and 1 euro for pensions granted from 1997) will be revised considering the actual CPI and 50% of the real growth of wages subject to insurance contributions;
- From 2019, in case of death of a pension recipient, the surviving spouse being the recipient of the old-age disability length of service or special state pension of the Republic of Latvia shall receive the benefit in the amount of 50% of the pension granted to the deceased spouse (including the supplement to the pension for insurance period, accrued up to 31 December 1995). They shall be entitled to receive the benefit for the period of 12 months from the day of death of the pension recipient;
- The inheritance of funded pension capital is planned to start from 2020. Participants of the funded pension scheme will be 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*. Concurrently with the referred to amendments the changes will come into force stipulating that the pension insurance contributions performed into the second pension pillar for the persons receiving the maternity, paternity, unemployment, sickness benefit and for the persons with disabilities will be henceforth allocated to the first pension pillar.

**In the local government budget:**

- In 2019, it is forecasted that the deficit of 0.3% of GDP will form in the local government budget. Given the increase of the non-taxable minimum and the allowance for dependents in 2019, the PIT revenue in the local government budget, forming the main source of revenue, will grow moderately and will stay approximately at the level of 2018. Lower deficit than in 2018 will be ensured by a steeper increase of the amount of the central government transfers, *inter*

*alia*, special grant from the State basic budget - compensation for the adverse effect of the tax reform on the PIT revenue. The amount of compensation will ensure the local governments' tax revenue for 19.6% (19.4% - in 2019) of the actual general budget tax revenue, excluding the SMSIC into the State basic budget for the health care funding.

- High level of capital expenditure in 2018 means that the middle stage of the EU funds' 2014 - 2020 programming period has been reached and in the following years the capital expenditure in the local government budget is forecasted at a lower level. In 2018 the capital expenditure of local government budget increased for both the core functions and the projects co-financed by the EU funds, and it is expected that in 2019 and in the medium term, in general, the capital expenditure will decrease, given both a lower intensity of implementation of the EU funds' projects and more rigid co-financing rules for the local governments for implementation of other projects. Starting from 2019, the co-financing of local government budget for the projects other than the EU funds' projects and the investment projects of educational institutions, where special rules apply, must be at least for 25%.
- In accordance with the forecasts, in 2019 and in the medium term, the expenditure for remuneration, goods and services, as well as subsidies and grants will continue growing. Expenditure for social benefits, in turn, will remain without considerable changes, approximately at the level of 2018. At the same time, in 2019 and in the medium term the local government budget expenditure, based on ESA 2010 methodology will be reduce by payments for the Southern Bridge construction, because expenditure was recognized already in previous years during the actual construction of the object.

In accordance with the conditions of fiscal discipline, the maximum allowable structural deficit of the general government budget and the resulting headline deficit is determined using the top-down budget planning method, which ensures setting of balance targets that meet both the FDL and the SGP requirements.

Under these conditions, at the moment of preparation of this Stability programme deficit in the general government budget in 2020 and 2021 shall be lower, while in 2022 a higher deficit is allowed than projected in the no-policy change scenario, namely in 2020 and 2021, the fiscal space is negative, but in 2022 it is a positive. Consequently, if at the current moment the next Annual State Budget Law and the Framework Law were drafted, the Government would have to take discretionary decisions in 2020 and 2021 by cutting general government budget expenditures and/or increasing revenues by 0.04% of GDP and 0.23% of GDP respectively. In turn, in 2022, the government would have access to resources at a level of 0.48% of GDP to finance budget priorities. In all years, the minimum fiscal security reserve as defined in the FDL in amount of 0.1% of GDP is taken into account in determining the fiscal space.

**Accordingly, the fiscal scenario foresees a general government deficit of 0.5% of GDP in 2019, 0.4% of GDP in 2020, 0.2% of GDP in 2021 and 0.3% of GDP in 2022.**

**Table 3.10. Medium term fiscal development scenario, % of GDP**

		2018	2019	2020	2021	2022
	ESA code	% of GDP				
<b>Net lending (+) or borrowings (-) (B.9) by sub-sectors</b>						
<b>General government</b>	S.13	-1.0	-0.5	-0.4	-0.2	-0.3
<b>Central government</b>	S.1311	-1.1	-0.9	-0.8	-0.5	-0.6
<b>Local government</b>	S.1313	-0.7	-0.3	-0.1	0.0	0.0
<b>Social security funds</b>	S.1314	0.8	0.7	0.4	0.3	0.3
<b>General government (S.13)</b>						
<b>Total revenue</b>	TR	37.5	36.2	35.9	35.4	34.9
<b>Total expenditure</b>	TE	38.5	36.7	36.4	35.6	35.2
<b>Interest expenditure</b>	D.41	0.7	0.7	0.8	0.8	0.8
<b>Cyclical development</b>						
<b>Cyclical budgetary component<sup>5</sup></b>		0.7	0.5	0.4	0.3	0.2
<b>One-off and other temporary measures<sup>6</sup></b>			0.1			
<b>Cyclical component of the budgetary balance</b>		-1.7	-1.1	-0.8	-0.5	-0.5
<b>Cyclically adjusted primary balance</b>		-1.0	-0.3	0.0	0.3	0.3
<b>Structural balance<sup>7</sup></b>		-1.7	-1.1	-0.8	-0.5	-0.5

The fiscal development scenario assumes that the budget consolidation required in 2020 and 2021 is carried out at the expense of the central government's spending cuts, while the fiscal space available in 2022 is used by the central government for additional spending. It is assumed that the fiscal safety reserve is used, i.e. fiscal risks in amount of 0.1% of GDP have materialized. Since the decisions on the development part of the budget are taken in the budgetary process and are currently unknown, the necessary spending cuts in 2020 and 2021 and the increase in expenditure in 2022 are carried out proportionally by expenditure categories over the years concerned, on the basis of the proportion of individual expenditure categories to total expenditure under a no-policy change scenario. When calculating the ratio of individual categories of expenditure to total expenditure under a no-policy change scenario, the following categories of expenditure are excluded from the calculation: interest expenditure and capital expenditure transfers. This approach is used because it is assumed that the decisions of the budget development section do not affect decisions on these expenditure categories.

<sup>5</sup> In a calculation of cyclical budgetary component a semi-elasticity of 0.38 was used (Data: An update of the semi-elasticities of the budget balance based on new weights. Note to the attention of the members of the Output Gap Working Group).

<sup>6</sup> The share of revenue of EUR 18.2 million from the EU ETS sale of emission allowances, which took place in November 2018 and is attributable to the increase in volume, is included in the Stability Programme as a one-off measure. On the other hand, the increase in revenue from this transaction, which is attributable to price fluctuations in 2019, is not considered a one-off measure.

<sup>7</sup> In order to facilitate data comparability, the structural balance in 2019 and 2020 is shown together with a reduction in net revenue from the tax reform 0.5% of GDP and 0.3% accordingly, which is temporary and recognised as a one-off measure from the perspective of Latvian fiscal framework, but the EC includes this effect in the structural balance, since revenue-reducing/expenditure-increasing measures by the EC as a rule are not recognised as one-off/short-term measures.

**Table 3.11. Fiscal space**

	<b>2020</b>	<b>2021</b>	<b>2022</b>
Objective of the general government budget balance. % of GDP	-0.4	-0.2	-0.3
General government budget balance at no-policy change. % of GDP	-0.3	-0.4	0.2
Fiscal safety reserve:% of GDP	0.1	0.1	0.1
<b>Fiscal space: % of GDP</b>	<b>-0.04</b>	<b>-0.23</b>	<b>0.48</b>
<b>Fiscal space EUR million</b>	<b>-11.9</b>	<b>-81.1</b>	<b>176.3</b>

## ANNEX 3

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### 3.4. DEVELOPMENT TRENDS OF GOVERNMENT DEBT IN THE MEDIUM TERM

According to the data of the notification of the state budget deficit and debt in April 2019, general government debt accordance with the ESA 2010 methodology, the general government debt at the end of 2018 reached 35.9% of GDP. The level of the general government debt is mainly affected by the government debt, which, at the end of 2018, comprised 10.0 billion euro<sup>8</sup>, having grown by 0.5 billion euro since the end of 2017. In 2018, the Eurobonds issued in 2008 for 400 million euro and the domestic debt securities (T-bonds) for 220.9 million euro have been redeemed, using the resources of Eurobonds issued in the international financial markets in 2017. In 2018, the Eurobond issues have been performed in the amount of 1.0 billion euro, ensuring the resources for the funding needs of both current and next year, incl., for the repayment of the government debt planned in the first half of 2019 (redemption of T-bonds in February in the amount of 229.8 million euro and the repayment of the EC loan in April in the amount of 500 million euro).

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 goal of government debt and cash management is to ensure the timely availability of financial resources to cover 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. A strategic approach is used for execution of central government debt and budget liabilities while maintaining as much flexibility as possible in selection of borrowing terms in 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 financial resources to cover the total financing requirement at as favorable and attractive conditions as possible.

The stabilization of the country's credit rating in a rating group, the investor appreciation on the accomplishments in the Latvian economy in the previous years and the confidence in the long-term development of the state, allows the country to borrow financial resources in the international markets at favorable conditions. This is also confirmed by the borrowing transactions concluded in 2018 in the international financial markets, by issuing, in May and September, the Eurobonds in the total amount of 1.0 billion euro, *inter alia*, 10-year Eurobonds with maturity in 2028 in the amount of 500 million euro, fixing the coupon rate of 1.125% and two additional issues of 30-year bonds with maturity in 2047 in the amount of 500 million euro and a pre-fixed coupon rate of 2.250%.

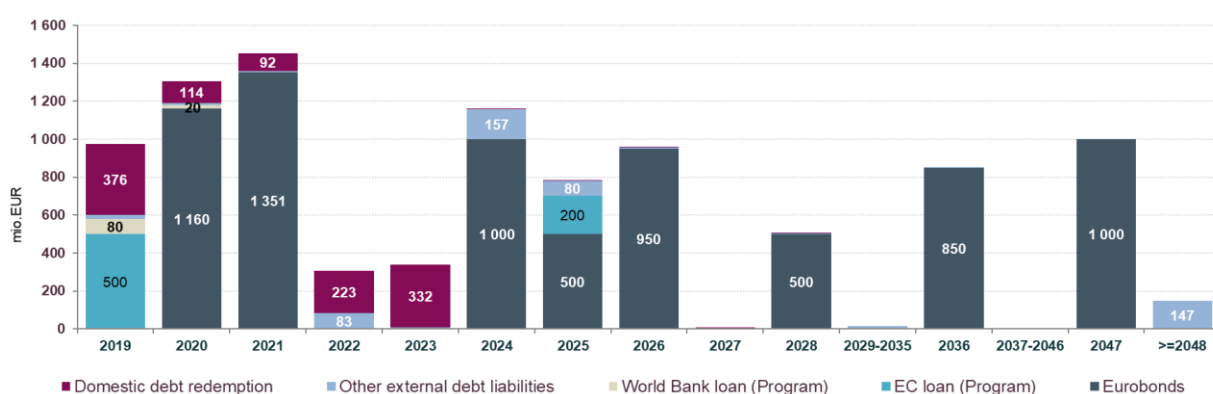
In the domestic market, in 2018, two new 5-year T-bond programmes have been launched. The 5-year T-bond programme launched in January, at the end of 2018, was the most liquid T-bond programme in circulation, achieving 250 million euro, but the new 5-year T-bond programme launched in November, continuing also in 2019, by the end of 2018 reached 80 million euro. Liquid T-bond programme facilitates the trading in the secondary market, which, in turn, positively influences the pricing of securities in the primary market. The demand for Latvian government debt securities remained high in 2018, which means that investors' competition in all auctions ensured attraction

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<sup>8</sup> Taking into account derivatives linked to the central government foreign borrowings and debt securities administered by the Treasury

of resources on financially advantageous terms. Yields at auctions remained close to historically lowest levels, attributable to the active participation of primary dealers in the auctions, high liquidity of Latvian credit institutions, as well as the continuation of the European Central Bank’s bond-buying programme until the end of 2018.

Taking into account, the central government debt obligations outstanding as of 31 March 2019, in accordance with the central government debt repayment schedule, the amount of the central government debt obligations to be refinanced in the period from April 2019 until December 2022 comprises 3.8 billion euro (see Figure 3.5). A significant portion of the debt to be refinanced consists of Eurobonds issued in international financial markets, as well as the funding received from the World Bank and the EC within the framework of the international loan programme, the resources for the repayment whereof has already been ensured.



**Figure 3.5. Central government debt repayment schedule**  
(Liabilities outstanding as of 31 March 2019, nominal value)

\*excl. sectors S130130, S130140, S130330, S130340, as well as on-demand and short-term deposits; according to ECB FX rates of 29 March 2019

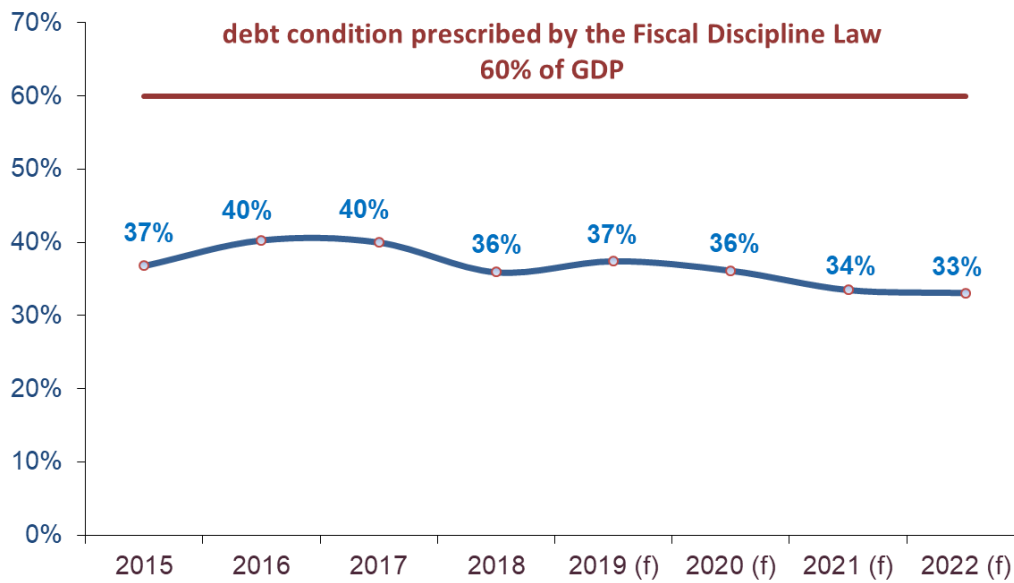
In order to cover the total financing requirement in 2019 – 2021, it is planned to organize timely borrowing in financial markets, so as, by managing the government debt refinancing risk in accordance with the Central Government Debt and Cash Management Strategy, to refinance the outstanding government debt liabilities under favorable conditions in terms of rates and maturity. Investor confidence in the creditworthiness of Latvia and a stable country’s credit rating ensures a stable ground for successful refinancing of debt liabilities in the next years.

Taking into account the borrowing strategy, in order to manage government debt refinancing risk, as well as ensure optimization of government debt servicing costs in the medium and long-term, in the coming years, foreign borrowing instruments will still provide the major share of the total funding. The Treasury, by issuing new 30-year Eurobonds in the amount of 700 million euro with the fixed coupon (interest) rate of 1.875% in February 2019, under favorable conditions has fulfilled the major part of the borrowing plan in the international markets for 2019, ensuring resources for both the financing requirement of the current year and the redemption of the Eurobonds denominated in the US dollars in the 533.5 million euro equivalent planned in January 2020. It is planned that borrowing in international financial markets will 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. It is planned to also henceforth maintain on the domestic financial market an offer of T-bonds, within the framework of the primary dealers system, consistent with the market demand thus promoting activity and liquidity of the government debt securities market.

In 2018, the decreasing trend of the general government debt ratio has been observed, facilitated by the GDP growth, government debt trends, as well as the reduction of debt liabilities of enterprises classified as the general government. Continuing the implementation of a sustainable fiscal policy, in the medium term, a stabilization and further reduction of the general government debt ratio in relation to GDP is projected, with a strong compliance with the debt condition set by the *FDL* (see Figure 3.6).



**Figure 3.6. General government debt development trends (% of GDP)**  
f - forecast

## ANNEX 4

### 4.3. COMPARISON OF THE GENERAL GOVERNMENT BUDGET BALANCE AND DEBT FORECASTS WITH THE LATVIA'S STABILITY PROGRAMME FOR 2018 - 2021

GDP growth in 2018 has been considerably steeper than envisaged by the Latvia's Stability Programme for 2018 - 2021 scenario. Steeper economic growth in 2018 was mainly attributable to stronger-than-forecasted growth of investment activity as the gross fixed capital formation increased by 16.4%, as well as more favorable-than-forecasted development in separate economic sectors, *inter alia*, transport and financial services. Growth of public consumption in 2018 has also been slightly steeper than envisaged by the scenario of Latvia's Stability Programme for 2018 - 2021. In turn, the private consumption and export growth rates have been slightly lower than forecasted in the scenario of the previous Stability Programme.

According to the latest growth scenario GDP increase forecast for 2019 is 3.2%, which is by 0.2 percentage points less than projected by the previous Stability Programme scenario. Reduction of the GDP growth forecast was mainly attributable to the economic growth slowdown in the world and main external markets of Latvia, as well as to the high basis achieved in 2018. The GDP growth forecasts for 2020 and 2021 are not changed and remain, correspondingly, at the level of 3.0% and 2.9%.

**Table 4.5. Comparison with the forecasts of the Stability Programme for 2018 - 2021**

	ESA code	2018	2019	2020	2021	2022
<b>GDP growth (%)</b>	B1g					
2018		4.0	3.4	3.0	2.9	-
2019		4.8	3.2	3.0	2.9	2.9
Difference		0.8	-0.2	0.0	0.0	-
<b>Actual budget balance (% of GDP)</b>	B.9					
2018		-0.9	-0.9	-0.4	-0.4	-
2019		-1.0	-0.5	-0.4	-0.2	-0.3
Difference		-0.1	0.4	0.0	0.14	-
<b>Total general government debt (% of GDP)</b>						
2018		38.4	37.4	38.0	35.6	-
2019		35.9	37.4	36.1	33.5	33.1
Difference		-2.5	-0.0	-1.9	-2.1	-

According to the information published by the CSB on the results of the general government deficit and debt for 2018, Latvia's general government deficit in 2018 was 1.0% of GDP, which is 0.1% of GDP higher than expected in the previous Stability Programme. Despite higher tax revenues than expected, a particularly rapid increase was observed in corporate income tax, and social benefits expenditure was carried out at a lower level, given that the actual number of sick, unemployed and elderly beneficiaries was lower than expected, higher deficits were attributed to higher national co-financing expenditure for EU funds projects, as well as more negative performance of economic operators in the general government sector than forecasted in the previous Stability Programme.

The updated medium-term forecasts foresees for the budget deficit of 0.5% of GDP in 2019, 0.4% of GDP in 2020, 0.2% of GDP in 2021 and 0.3% of GDP in 2022. General government budget forecasts are based on updated structural budget balance objectives, as well as considering the changes in the cyclical component of the budgetary balance.

## ANNEX 5

**Table 1d. Sectoral balances**

% of GDP	ESA code	2018	2019	2020	2021	2022
1. Net lending/borrowing vis-a-vis the rest of the world	B.9	0.1	-0.7	-1.6	-2.1	-3.1
of which						
- Balance on goods and services		-1.2	-2.5	-3.2	-3.8	-4.4
- Balance of primary incomes and transfers		-0.5	0.3	0.0	0.0	-0.3
- Capital account		1.7	1.6	1.6	1.7	1.6
	B.9	1.1	-0.2	-1.2	-1.9	-2.8
2. Net lending/borrowing of the private sector	EDP B.9	-1.0	-0.5	-0.4	-0.2	-0.3
3. Net lending/borrowing of general government		0	0	0	0	0

**Table 2a. General government budgetary prospects**

	ESA code	2018	2018	2019	2020	2021	2022
		mln euro		% of GDP			
Net lending (+) or borrowing (-) (B.9) by sub-sector							
1. General government	S.13	<b>-295.4</b>	<b>-1.0</b>	<b>-0.5</b>	<b>-0.4</b>	<b>-0.2</b>	<b>-0.3</b>
2. Central government	S.1311	-319.6	-1.1	-0.9	-0.8	-0.5	-0.6
3. State government	S.1312						
4. Local government	S.1313	-214.2	-0.7	-0.3	-0.1	0.0	0.0
5. Social security funds	S.1314	238.4	0.8	0.7	0.4	0.3	0.3
General government (S.13)							
6. Total revenue	TR	<b>11 066.3</b>	<b>37.5</b>	<b>36.2</b>	<b>35.9</b>	<b>35.4</b>	<b>34.9</b>
7. Total expenditure	TE	11 361.8	38.5	36.7	36.4	35.6	35.2
8. Net lending/borrowing	B.9	-295.4	-1.0	-0.5	-0.4	-0.2	-0.3
9. Interest expenditure	D.41	208.8	0.7	0.7	0.8	0.8	0.8
10. Primary balance		-86.6	-0.3	0.2	0.4	0.5	0.5
11. One-off and other temporary measures				0.1			
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		<b>6 320.5</b>	<b>21.4</b>	<b>20.7</b>	<b>20.9</b>	<b>20.8</b>	<b>20.6</b>
12a. Taxes on production and imports	D.2	4 160.3	14.1	14.1	14.3	14.2	14.0
12b. Current taxes on income, wealth, etc.	D.5	2 149.8	7.3	6.5	6.6	6.6	6.6
12c. Capital taxes	D.91	10.4	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	2 758.4	9.3	9.4	9.4	9.4	9.4
14. Property income	D.4	280.2	0.9	0.7	0.5	0.2	0.2
15. Other		1 707.2	5.8	5.4	5.2	5.0	4.7
16. Total revenue	TR	11 066.3	37.5	36.2	35.9	35.4	34.9
Tax burden (D.2*+D.5+D.61+D.91-D.995)		9 139.1	31.0	30.4	30.5	30.4	30.2
Selected components of expenditure							
17. Compensation of employees and intermediate consumption	D.1+P.2	<b>4 738.8</b>	<b>16.1</b>	<b>15.8</b>	<b>15.1</b>	<b>14.7</b>	<b>14.2</b>
17a. Compensation of employees	D.1	3 003.1	10.2	10.3	9.9	9.6	9.3
17b. Intermediate consumption	P.2	1 735.7	5.9	5.5	5.2	5.1	4.9
18. Social payments (18=18a+18b)		3 387.6	11.5	11.6	11.8	11.7	11.9
of which Unemployment benefits		120.0	0.4	0.4	0.4	0.4	0.4
18a. Social transfers through market producers	D.6311. D.63121. D.63131	375.9	1.3	1.2	1.2	1.2	1.3

18b. Social transfers which are no transfers in kind	D.62	3 011.7	10.2	10.4	10.6	10.5	10.7
19.=9. Interest expenditure	D.41	208.8	0.7	0.7	0.8	0.8	0.8
20. Subsidies	D.3	300.8	1.0	1.6	1.5	1.4	1.4
21. Gross fixed capital formation	P.51	1 596.7	5.4	5.1	4.9	4.7	4.4
22. Capital transfers	D.9	58.1	0.2	0.1	0.1	0.1	0.1
23. Other		1 071.0	3.6	1.8	2.2	2.3	2.4
24.=7. Total expenditure	TE	11 361.8	38.5	36.7	36.4	35.6	35.2
Government consumption	P.3	5 226.8	17.7	17.8	17.2	16.9	16.1

\* Including share of taxes collected by the EU budget

**Table 2b. No-policy change projections**

	2018	2018	2019	2020	2021	2022
	mln euro	% of GDP				
1. Total revenue at unchanged policies	10 066.3	37.5	36.2	35.9	35.4	34.9
2. Total expenditure at unchanged policies	11 361.8	38.5	36.7	36.3	35.8	34.6

**Table 4. General government debt developments**

% of GDP	ESA code	2018	2019	2020	2021	2022
1. Gross debt		35.9	37.4	36.1	33.5	33.1
2. Change in gross debt ratio		-0.7	3.5	0.8	-0.8	1.3
Contributions to changes in gross debt						
3. Primary balance		-0.3	0.2	0.5	0.4	1.0
4. Interest expenditure	EDP D.41	0.7	0.7	0.8	0.8	0.8
5. Stock-flow adjustment		-1.7	3.0	0.4	-1.1	1.6
Implicit interest rate on debt		1.9	2.2	2.3	2.2	2.5
Other relevant variables						
6. Liquid financial assets		8.4				
7. Net financial debt (7=1-6)		27.6				
8. Debt amortization (existing bonds) since the end of the previous year		2.6	1.2	3.8	4.1	0.6
9. Percentage of debt denominated in foreign currency		10.5	10.0	4.4	1.3	1.2
10. Average maturity		7.63 years				

**Table 5. Cyclical development**

% of GDP	ESA code	2018	2019	2020	2021	2022
1. Real GDP growth (%)	B1g	4.8	3.2	3.0	2.9	2.9
2. Net lending of general government	B.9	-1.0	-0.5	-0.4	-0.2	-0.3
3. Interest expenditure	D.41	0.7	0.7	0.8	0.8	0.8
4. One-off and other temporary measures <sup>9</sup>			0.1			
5. Potential GDP growth (%)		3.5	3.5	3.4	3.2	3.2
contributions:						
- labour		0.4	0.2	0.1	-0.1	-0.1
- capital		1.2	1.3	1.3	1.3	1.3
- total factor productivity		1.9	2.0	2.0	2.0	2.0
6. Output gap. % of potential GDP		1.7	1.4	1.0	0.7	0.4
7. Cyclical budgetary component		0.7	0.5	0.4	0.3	0.2
8. Cyclically-adjusted balance (2-7)		-1.7	-1.1	-0.8	-0.5	-0.5
9. Cyclically-adjusted primary balance (8+3)		-1.0	-0.3	0.0	0.3	0.3
10. Structural balance (8-4) <sup>10</sup>		-1.7	-1.1	-0.8	-0.5	-0.5

**Table 6. Divergence from previous update**

	ESA code	2018	2019	2020	2021	2022
<b>Real GDP growth (%)</b>	B1g					
<b>2018</b>		4.0	3.4	3.0	2.9	-
<b>2019</b>		4.8	3.2	3.0	2.9	2.9
<b>Difference</b>		0.8	-0.2	0.0	0.0	-
<b>General government net lending/borrowing (% of GDP)</b>	B.9					
<b>2018</b>		-0.9	-0.9	-0.4	-0.4	-
<b>2019</b>		-1.0	-0.5	-0.4	-0.2	-0.3
<b>Difference</b>		-0.1	0.4	0.0	0.14	-
<b>General government gross debt (% of GDP)</b>						
<b>2018</b>		38.4	37.4	38.0	35.6	-
<b>2019</b>		35.9	37.4	36.1	33.5	33.1
<b>Difference</b>		-2.5	-0.0	-1.9	-2.1	-

**Table 7a. Contingent liabilities**

% of GDP	2018
Public guarantees*	1.4%
Of which: linked to the financial sector	0.8%

\* central government and local government guarantees

<sup>9</sup> The share of revenue of EUR 18.2 million from the EU ETS sale of emission allowances, which took place in November 2018 and is attributable to the increase in volume, is included in the Stability Programme as a one-off measure. On the other hand, the increase in revenue from this transaction, which is attributable to price fluctuations in 2019, is not considered a one-off measure.

<sup>10</sup> In order to facilitate data comparability, the structural balance in 2019 and 2020 is shown together with a reduction in net revenue from the tax reform 0.5% of GDP and 0.3% accordingly, which is temporary and recognised as a one-off measure from the perspective of Latvian fiscal framework, but the EC includes this effect in the structural balance, since revenue-reducing/expenditure-increasing measures by the EC as a rule are not recognised as one-off/short-term measures.