COUNCIL DECISION

of 7 July 2009

on the existence of an excessive deficit in Latvia

(2009/591/EC)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(6) thereof,

Having regard to the recommendation from the Commission,

Having regard to the observations made by Latvia,

Whereas:

(1) According to Article 104 of the Treaty, Member States shall avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) The excessive deficit procedure (EDP) under Article 104 of the Treaty, as clarified by Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure [1], which is part of the Stability and Growth Pact, provides for a decision on the existence of an excessive deficit. The Protocol on the excessive deficit procedure annexed to the Treaty sets out further provisions relating to the implementation of the EDP. Council Regulation (EC) No 3605/93 [2] lays down detailed rules and definitions for the application of the provisions of that Protocol.

(4) The 2005 reform of the Stability and Growth Pact in 2005 sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of public finances in the long run. It aimed at ensuring that, in particular, the economic and budgetary background was taken into account fully in all steps in the EDP. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation.

(5) Article 104(5) of the Treaty requires the Commission to address an opinion to the Council if the Commission considers that an excessive deficit in a Member State exists or may occur. Having taken into account its report in accordance with Article 104(3) of the Treaty and having regard to the opinion of the Economic and Financial Committee in accordance with Article 104(4) of the Treaty, the Commission concluded that an excessive deficit exists in Latvia. The Commission therefore addressed such an opinion to the Council in respect of Latvia on 2 July 2009 [3].

(6) Article 104(6) of the Treaty states that the Council should consider any observations which the Member State concerned may wish to make before deciding, after an overall assessment, whether an excessive deficit exists. In the case of Latvia, this overall assessment leads to the conclusion set out in this Decision.

(7) According to the April 2009 EDP notification, the general government deficit in Latvia reached 4 % of GDP in 2008, thus exceeding the 3 % of GDP reference value. Furthermore, the deficit was not close to the 3 % of GDP reference value. The excess over the reference value can, however, be qualified as exceptional within the meaning of the Treaty and of the Stability and Growth Pact. In particular, it results from a severe economic downturn in the sense of the Treaty and of the Stability and Growth Pact. According to the Commission services' spring 2009 forecast, real GDP growth in Latvia is projected to be strongly negative in 2009, with output 13,1 % after falling by 4,6 % in 2008; more recent indicators point to an even larger contraction in 2009, of the order of 18 %.

Consequently, the targets set in December 2008 under the framework of the Community balance of payments assistance programme — namely 5,3 % of GDP in 2009, 4,9 % of GDP in 2010 and below 3 % in 2011 — have become unrealistic. However, the excess over the reference value cannot be considered temporary. According to the Commission services' spring forecast, taking into account budgetary measures for 2009 based only on the amendments adopted in December 2008, the deficit would widen from 4 % of GDP in 2008 to 11,1 % of GDP in 2009 and, on a no-policy change assumption, worsen further to 13,6 % of GDP in 2010. After adoption of the package of new consolidation measures by the Latvian authorities in June 2009, and

[1] OJ L 209, 2.8.1997, p. 6.
[2] OJ L 332, 31.12.1993, p. 7.

[3] All EDP-related documents for Latvia can be found at the following website: http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2

indicated by the authorities for 2010, and assuming their full implementation, the general government deficit may reach around 10 % of GDP in 2009 and 8,5 % in 2010 and 6 % in 2011 [1]. Therefore, although the excess of the 2008 deficit over the reference value appears exceptional, the deficit was not close to the reference value and the excess cannot be considered temporary. Thus the deficit criterion in the Treaty is not fulfilled.

(8) General government gross debt stood at 19,5 % of GDP in 2008, still well below the 60 % of GDP reference value. It is nevertheless projected to be on a rapidly growing trend (in the Commission services' spring forecast, rising to 34,1 % of GDP in 2009 and 50,1 % of GDP in 2010, assuming full take-up of the international financial assistance being extended to Latvia during the period up to 2011). Taking account of the new consolidation measures adopted in June 2009 and further consolidation plans indicated by the authorities for 2010-12, and depending on whether and to what extent the government assumes further debt in respect of financial sector stabilisation needs, the gross debt ratio may exceed the 60 % of GDP reference value in 2012 even with sufficient corrective action.

(9) The budgetary impact of the fully-funded pillar of the systemic pension reform introduced by the Latvian government will be considered, in line with the provisions of the Stability and Growth Pact. While the implementation of these reforms leads to a temporary deterioration of the budgetary position, the long-term sustainability of public finances clearly improves. Based on Commission services' estimates, the total cost of such a reform undertaken in Latvia amounts to 1,6 % of GDP in 2008, and, due to the temporary reduction of contributions from 8 % to 2 % in 2009, − 0,4 % in 2009 and in 2010. The social contribution rate transferred to the fully-funded second pillar is planned to be increased to 4 % in 2011 and to 6 % in 2012, which is projected to increase the total cost of the reform in 2011-2012 respectively to 0,8 and 1,2 percentage points of GDP. According to the Stability and Growth Pact, these can be taken into account on a linear degressive basis for a transitory period and only where the deficit remains close to the reference value. Since in 2008 the deficit was not close to the reference value, and for 2009 and 2010 the deficit forecast by the Commission services remains not close to the reference value, the cost of the pension reform cannot be taken into account.

(10) According to Article 2(4) of Regulation (EC) No 1467/97, 'relevant factors' can only be taken into account in the steps leading to the Council decision on the existence of an excessive deficit in accordance with Article 104(6) of the Treaty if the double condition — that the deficit remains close to the reference value and that its excess over the reference value is temporary — is fully met. In the case of Latvia, this double condition is not met. Therefore, relevant factors are not taken into account in the steps leading to this Decision,

HAS ADOPTED THIS DECISION:

Article 1

From an overall assessment, it follows that an excessive deficit exists in Latvia.

Article 2

This Decision is addressed to the Republic of Latvia.

Done at Brussels, 7 July 2009.

For the Council
The President
A. BORG

[1] The impact of the temporary redirection of the social contribution payments from the second pillar pension system is included in these estimates.