



# Weekly Briefing

## **Latvia political briefing:**

**Latvia's 2021 state budget: main priority of domestic politics in**

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# Latvia's 2021 state budget: main priority of domestic politics in October

## Introduction

On October 14, 2020, the Minister of Finance submitted a budget draft to the Saeima, Parliament of the Republic of Latvia. In total, there are budget-related amendments to 28 laws, which related to both the tax increase block and the welfare enhancement block.

The priorities of the 2021 budget are socially oriented, with the potential to fiscally stimulate aggregate domestic demand, improve the capacity of the health care system and reduce social inequalities, without compromising the country's fiscal sustainability.

Back in 2019, the Council of Europe recommended Latvia to take measures and amendments to regulatory enactments to prevent social exclusion, in particular by improving the adequacy of the minimum income benefit, the minimum old-age pension and income support for people with disabilities.

Amendments to the laws of Welfare enhancement and Social block are related to both the recommendations of the Council of Europe and the judgments of the Constitutional Court of the Republic of Latvia<sup>1 2, 3</sup>, noting that the state has identified that its established social assistance system does not provide social opportunities to meet the basic needs of the population. Amendments in the social field at a minimum level require that the state creates an opportunity for every person who is unable to acquire sufficient resources on his or her own, for them to be able to integrate into the society of a modern democratic state governed by the rule of law.

## Budget division

Next year, consolidated budget revenue is projected at 9.58 billion EUR (31.9% of GDP) and expenditure at 10.76 billion EUR (35.8% of GDP). The basic budget revenue is estimated at 6.68 billion EUR and expenditure at 7.84 billion EUR. In the special budget, revenues are planned at 3.15 billion EUR, and expenditures - 3.17 billion EUR.

Revenue is projected to fall by 328 million EUR next year and expenditure by 744 million EUR, while the budget deficit is projected at 1.2 billion EUR, or 3.9% of GDP.

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<sup>1</sup> <https://www.satv.tiesa.gov.lv/cases/?search%5Bnumber%5D=2019-25-03>

<sup>2</sup> <https://www.satv.tiesa.gov.lv/cases/?search%5Bnumber%5D=2019-24-03>

<sup>3</sup> <https://www.satv.tiesa.gov.lv/cases/?search%5Bnumber%5D=2019-27-03>

In the healthcare sector, an additional 183 million EUR is foreseen next year, which will be allocated to the previously planned increase in the salaries of healthcare workers.

The salary increase is also planned for teachers, and next year it is planned to allocate an additional 33.3 million EUR, but in 2022 and in the following years - 49.1 million EUR.

In the area of welfare, additional funding of 95.7 million EUR is planned for a guaranteed minimum income for the poor and low-income (needy) people. 70.7 million EUR is planned to increase the minimum pension and state social security benefit, 23.8 million EUR in local government budget is planned to finance the guaranteed minimum income and housing benefit, while 1.3 million EUR is planned to increase social guarantees for orphans and children left without parental care.

10.5 million EUR next year is intended for strengthening the activities of the Ombudsman's Office, judicial system institutions, the State Audit Office, the Constitutional Court and other independent institutions. 8.91 million EUR is earmarked for the exit of public service media from the advertising market and the implementation of public procurement in commercial electronic media.

From next year, the minimum wage, which is currently 430 euros, is planned to be raised to 500 euros per month. It is planned to increase the threshold up to which the differentiated personal non-taxable income minimum is applied - to EUR 1,800 instead of the current EUR 1,200. In turn, the maximum non-taxable minimum is planned to be increased from the current 250 euros to 300 euros per month next year. It is planned to increase the non-taxable minimum for the retired from the current 300 to 330 euros.

It is planned to set the highest progressive personal income tax rate at 31% instead of the current amount of 31.4%.

Until the end of 2023, it is planned to maintain the reduced rate of value added tax (VAT) in the amount of 5% for Latvian fruits, berries and vegetables.

Excise duty rate for tobacco products is set to increase by 5% each year over the next three years, and will also be levied on liquids used in electronic cigarettes. A mandatory deposit system has been introduced in accordance with the Packaging Law for reusable and single-use packaging.

The pandemic crisis has highlighted the need to strengthen social protection for workers in alternative tax regimes. Thus, it is planned that from July next year these employees will have to pay mandatory social contributions. It is planned to maintain the current patent fee regime only for pensioners and persons with 1st and 2nd disability groups.

From 2021, it is planned to reduce the rate of mandatory state social insurance contributions by one percentage point - from 35.9% to 34.09%. The social tax will be 10.5% for employees and 23.59% for employers.

From 2021, it is planned to gradually limit the micro-enterprise tax regime, providing that: the micro-enterprise tax may be applied only to one person - the owner of the micro-enterprise; the tax rate for turnover up to 25,000 euros per year is 25 percent, but for turnover part which excess 25,000 euros per year - 40 percent; the VAT tax payer will not be able to become a micro-enterprise taxpayer, while by becoming a VAT payer, the person will lose the right to apply for the micro-enterprise tax payer status next year. From 1 January 2021, limited liability companies (LLCs) will no longer be able to acquire the status of micro-enterprise tax payer, but as of 1 January 2022, LLCs already registered as micro-enterprise tax payers will no longer be able to be micro-enterprise tax payers.

It is also planned to increase the tax on natural resources for certain facilities, including the disposal of municipal solid waste and hazardous waste in landfills.

The exemption from the tax on natural resources for CO<sub>2</sub> emissions is abolished when peat is used in technological installations.

Unfair proportion of the tax payment is for the disposal of municipal waste and for the disposal of hazardous waste between the state budget and the local government budget. At present, it is 60% in the state budget and 40% in the local government budget. The planned changes determine that natural resource tax payments for municipal waste disposal are included in the following proportions: in 2021, 100% - in the state basic budget; In 2022, 90% - in the state basic budget and 10% - in the basic budget of the local government in the territory of which the waste is disposed of; from 2023, 85% - in the state basic budget and 15% - in the basic budget of the local government in the territory of which the waste is disposed. In turn, natural resource tax payments rates for hazardous waste disposal are included: 80% - in the state basic budget; 20% - in the basic budget of the local government in the territory of which the waste is disposed of.

The changes will also affect the transportation sector, and it is planned to increase the toll for heavy trucks, increase the rate for businesses for the use of powerful cars, and balance the tax rates for cars and trucks with a gross vehicle weight of up to 3,500 kg.

It is also planned to change the distribution of personal income tax - in the state budget by 25% (currently 20%), in the local government budget - by 75% (currently 80%), providing that approximately 90 million EUR will be taken from local governments.

## **Reaction of society at 2021 state budget draft**

The Parliament's Budget and Finance (Tax) Commission has received more than 500 proposals from various institutions and individuals for the second reading of the draft state budget for 2021, of the draft law on the medium-term budget framework for 2021, 2022 and 2023 and the accompanying draft laws. Several entities have exercised their right to submit proposals provided in the Parliament Rules of Procedure: the Parliament political party factions, as well as parliament commissions, individual MPs and also field ministries<sup>4</sup>.

The submitted proposals concern such issues as not reducing the share of local governments in the state budget in 2021 from the funds received in the personal income tax, maintaining it at the current level; encouraging a reduction in VAT from 21% to 18%; increase funding for social needs and teacher support; further raising the non-taxable minimum threshold for pensioners; the provision of unemployment benefits for a longer period than before; increase state benefits for families with children; to preserve the amount of funding for the sacred heritage; increase the healthcare budget to ensure the reduction of the queues for medical services and to expand the availability of reimbursable medicines, etc.

The biggest discussions, while already negotiating the submitted proposals will take place on the regulation of royalty payments and the regime of micro-enterprises, as well as on the distribution of personal income tax and natural resources tax between the state budget and local government budgets.

## **Summary**

The fiscal policy of the Latvia's 2021 state budget is conservative, maintaining socially oriented priorities, with the potential to stimulate aggregate domestic demand, to improve the capacity of the health care system and to reduce social inequalities, responding flexibly to the economic conditions created by the pandemic without compromising the country's fiscal sustainability.

In 2021, the revenue of the consolidated budget is planned to be lower than the expenditure (revenue - EUR 9.58 billion (31.9% of GDP)) and the expenditure - EUR 10.76 billion (35.8% of GDP). The increase in expenditure is estimated at EUR 744 million, while the budget deficit is estimated at EUR 1.2 billion, or 3.9% of GDP.

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<sup>4</sup> <https://www.saeima.lv/lv/aktualitates/saeimas-zinas/29278-2021-gada-valsts-budzeta-projektam-sanemti-vairak-neka-500-priekslikumi>

The biggest discussions and public dissatisfaction are about the changes in the regulation of royalties and the regime of micro-enterprises, as well as about the distribution of personal income tax and natural resources tax between the state budget and local government budgets.