

Abstract

At the invitation of the Ministry of Finance (MoF letter 5.1-25/21/720) dated 08/02/2021), the Fiscal Discipline Council in cooperation with the Latvian Productivity Council LV PEAK established an expert panel to evaluate the Recovery and Resilience Facility (hereinafter - RRF) plan. The aim of the expert panel was to identify the macroeconomic and fiscal impact of the RRF plan and to assess the compliance of the included reforms and projects with the tasks and priorities defined in the RRF plan.

The analysis and modelling of macroeconomic indicators was used to study the macroeconomic impact of the RRF plan (Section 1). The methodology of the Latvian Productivity Report 2020, as well as the macroeconomic forecasts of the Ministry of Finance have been used as the basis for the calculations of medium-term growth scenarios.

The task of the RRF plan fiscal impact assessment (Section 2) was done to examine the impact of the RRF on government budgets, tax revenues and risks to fiscal sustainability. The dynamics of fiscal indicators was analysed using available statistical indicators of Latvia and, for comparison, other countries, Treasury data, as well as forecasts of fiscal indicators of the Ministry of Finance.

The assessment of the compliance of the RRF plan with the objective of the RRF (Section 3) was analysed in general and by components, using expert opinions and the survey method, considering that the RRF plan aims to ensure a sustainable increase in the well-being of the population. The components of the plan form a single framework for reform and investments, with the key objectives of promoting: (1) productivity growth, (2) reducing inequalities, and (3) promoting climate change and (4) digital transformation.

The limitations of the study stem from the fact that the methodology and structure of the RRF plan evaluation were developed within a month, but the evaluations themselves were updated several times, following the process of improving the RRF plan. Uncertainty associated with changes to the RRF plan made the evaluation process very difficult.

The study concluded that:

- ✓ RRF makes up about 10% of all public funds available to Latvia in the next 7-8 years or 6.7% of the 2020 GDP. At the same time, it should be noted that the RRF is only one of the available sources of public funding for the next 7-8 years and should therefore be seen in the context of other investments;
- ✓ The RRF plan is fiscally neutral, as the financial resources of the RRF are budgeted as EU grants. However, the RRF program has an undeniably positive impact on the national budget, which is difficult to quantify. The direct fiscal impact is formed by the replacement of other budget funds by the RRF funds in order to make the necessary expenditures and promote the growth of the Latvian economy, at the same time increasing the tax base and tax revenues. The indirect positive fiscal impact will be felt in the medium term, when investment will result in potential as well as real GDP growth, which in turn increases tax revenues.
- ✓ According to a simplified forecast of FDP experts, from 2022 to 2026, the RRF program could increase budget revenues by more than 500 million euros.

- ✓ The government should develop a fiscal “exit” strategy, as after the end of the active phase of RRF projects, the national budget will have to live. In the case of rapid economic growth, tax revenues will increase, which could compensate for the lack of external financing (grants). But if the economic growth is modest, fiscal consolidation may be needed to prevent public debt growth. The aim of Covid-19's post-crisis fiscal exit strategy is to develop a roadmap for a return to a balanced budget, or even a budget with a surplus.
- ✓ The results of the survey show that most experts expect small improvements as a result of the reforms. Experts expect the RRF to have a positive impact on productivity and improving export capacity. The components "Inequality", "Health" and "Rule of Law" are the most critical. The quality risks of the implementation of measures and project management are often pointed out, as well as the lack of roadmaps for the implementation of measures and quality evaluation criteria. Very often, experts have pointed to the fragmentation of the plan and a highly sectoral approach.
- ✓ It should be noted that the development of the RRF plan took place in the shadow of the general public fatigue of the Covid-19 crisis. The amount of funding requested for the submitted projects significantly exceeded the capacity of the RRF, which put additional pressure on the government and those developing the RRF plan. The work of the Ministry of Finance in difficult circumstances and the procedure of drawing up a democratic plan, with the broad involvement of the social partners, should be commended.
- ✓ A closer link of the RRF plan with other national planning documents is needed, especially the National Development Plan. It is necessary to ensure that the RRF plan complements other national projects to achieve the priority objectives by creating synergies and a multiplier effect.
- ✓ Although the RRF plan includes many good measures that are useful for economic and social development, the program has a rhetorical approach. The plan lacks the ambition of a "big goal" that would have a significant impact on the sustainable economic and social development of the country.