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# Latvia: a Quick Look at the Current Challenges

## Labour Market

Fiscal Discipline Council
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# Contents of Presentation

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- Recent developments in the Latvian labour market
- Possible linkages to fiscal
- Long-term outlook – Sustainability Report (2021-2041)

- Key issues:
  - post-Covid developments,
  - Ukrainian refugees,
  - issues related to ageing.

# Recent developments in the Latvian labour market

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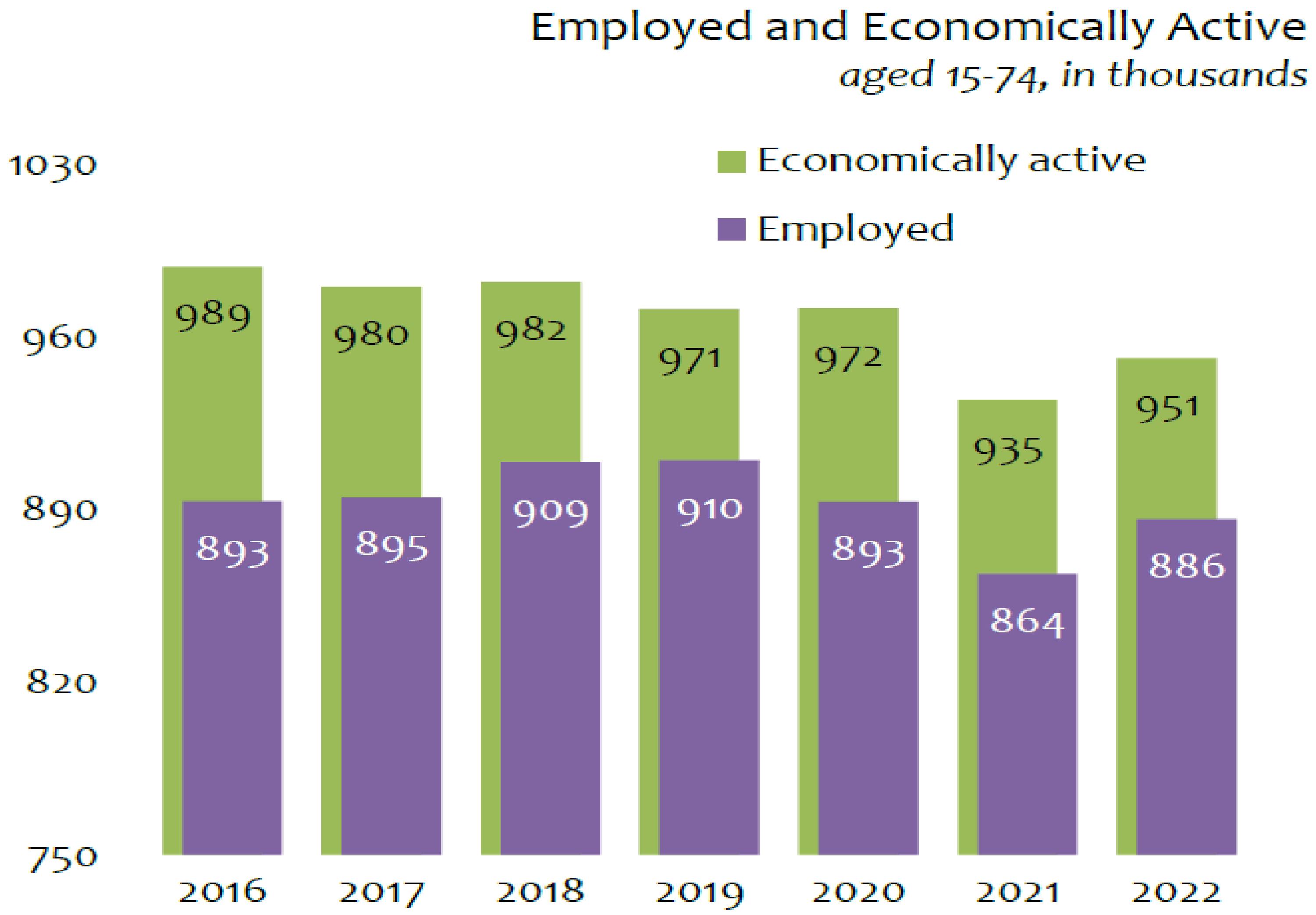
- Increase in Latvian population for the first time in 30 years (due to inflow of Ukrainian refugees)

- Positive impact on the labour market also due to post-COVID developments



# Recent developments in the Latvian labour market

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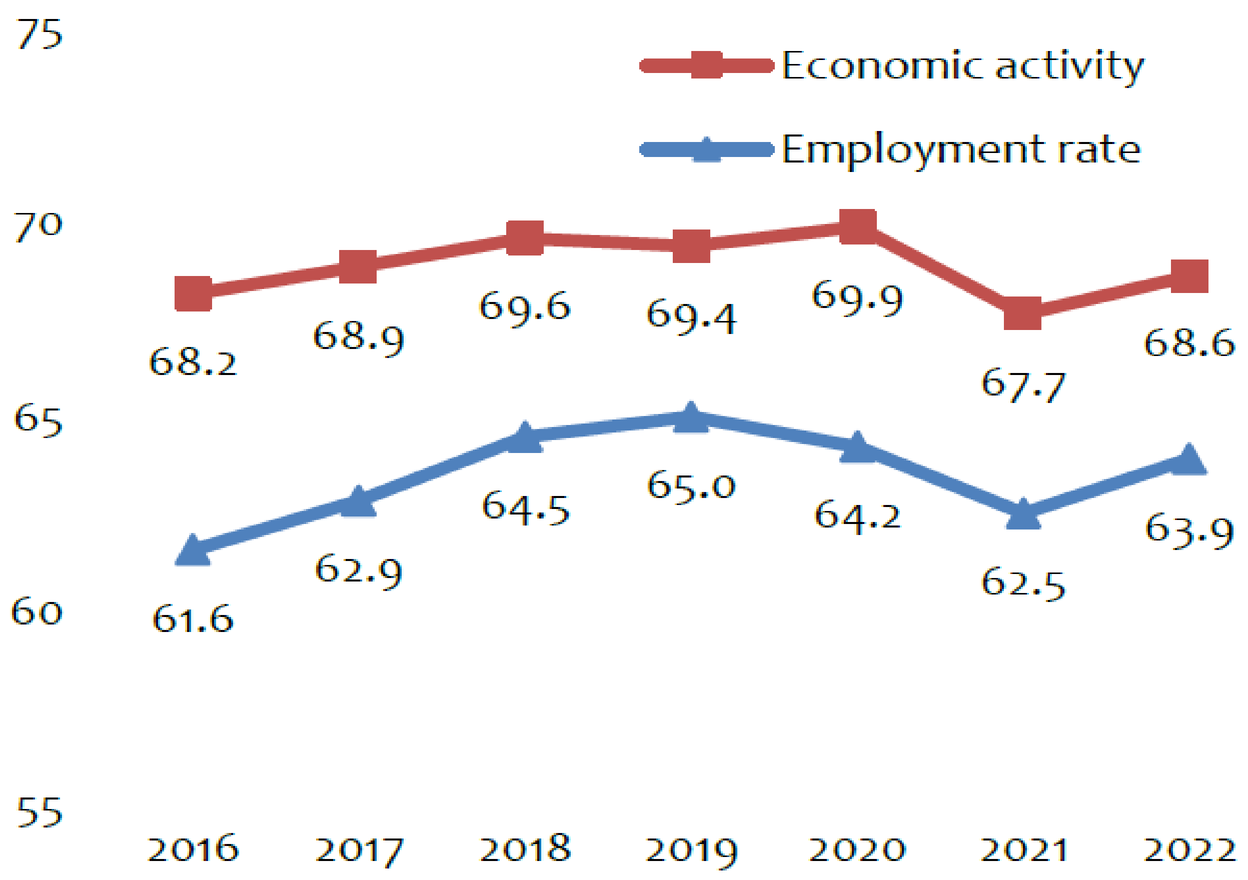
- Recovery of employment rate (but still below pre-COVID)
- Vacancy rates rising – growing economic activity, skills mismatches

Employment and Economic Activity

*aged 15-74, as per cent*



# Recent developments in the Latvian labour market

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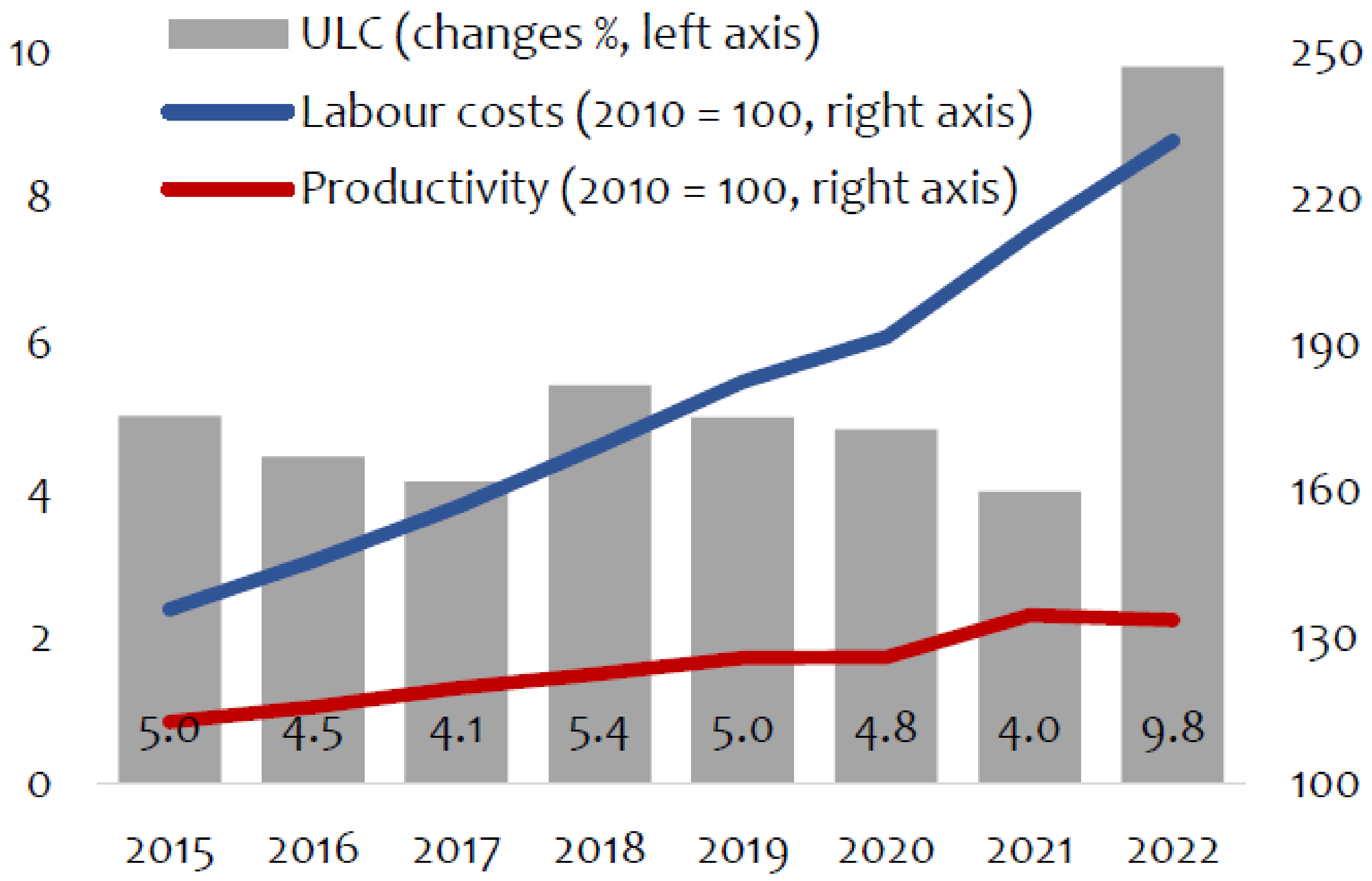
- Productivity not increasing in 2022
- Labour costs – significantly up due to inflation
- Unit labour costs signal some possible competitiveness issues, but sector-level comparisons needed
- Lower producitivity may also arise from filling the low-skills vacancies – Ukrainian refugees

Labour Costs and Productivity



# Possible linkages to fiscal

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World Economic Forum – Global Competitiveness Report

- Which **labour market** indicator of this report usually has Estonia as a winner (with Latvia and Lithuania not far behind)?

# Possible linkages to fiscal

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World Economic Forum – Global Competitiveness Report

- Which **labour market** indicator of this report usually has Estonia as a winner (with Latvia and Lithuania not far behind)?

a. Internal labour mobility
b. Ease of hiring foreign labour
c. Flexibility of wage determination
d. Redundancy costs

# Possible linkages to fiscal

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| | | | | |
|---|---|---|---|---|
| **8th pillar: Labour market** 0–100 | - | **70.2 ↑** | **19** | **Singapore** |
| **Flexibility** 0–100 | - | **70.0 ↑** | **8** | **Singapore** |
| 8.01 Redundancy costs weeks of salary | 12.9 | 81.5 ↑ | 43 | Multiple (8) |
| 8.02 Hiring and firing practices 1–7 (best) | 4.6 | 59.8 ↑ | 19 | Hong Kong SAR |
| 8.03 Cooperation in labour-employer relations 1–7 (best) | 5.3 | 72.3 ↑ | 16 | Singapore |
| 8.04 Flexibility of wage determination 1–7 (best) | 6.2 | 86.7 ↑ | 1 | Estonia |
| 8.05 Active labour market policies 1–7 (best) | 5.0 | 66.2 ↑ | 12 | Switzerland |
| 8.06 Workers' rights 0-100 (best) | 89.0 | 89.0 ↑ | 18 | Multiple (2) |
| 8.07 Ease of hiring foreign labour 1–7 (best) | 3.3 | 38.0 ↓ | 132 | Albania |
| 8.08 Internal labour mobility 1–7 (best) | 5.0 | 66.9 ↓ | 23 | United States |
| **Meritocracy and incentivization** 0–100 | - | **70.4 ↑** | **33** | **Denmark** |
| 8.09 Reliance on professional management 1–7 (best) | 5.3 | 72.2 ↑ | 23 | Finland |
| 8.10 Pay and productivity 1–7 (best) | 4.8 | 63.5 ↑ | 16 | Hong Kong SAR |
| 8.11 Ratio of wage and salaried female workers to male workers % | 0.91 | 88.7 ↑ | 24 | Multiple (4) |
| 8.12 Labour tax rate % | 38.8 | 57.2 = | 136 | Multiple (24) |

# Possible linkages to fiscal

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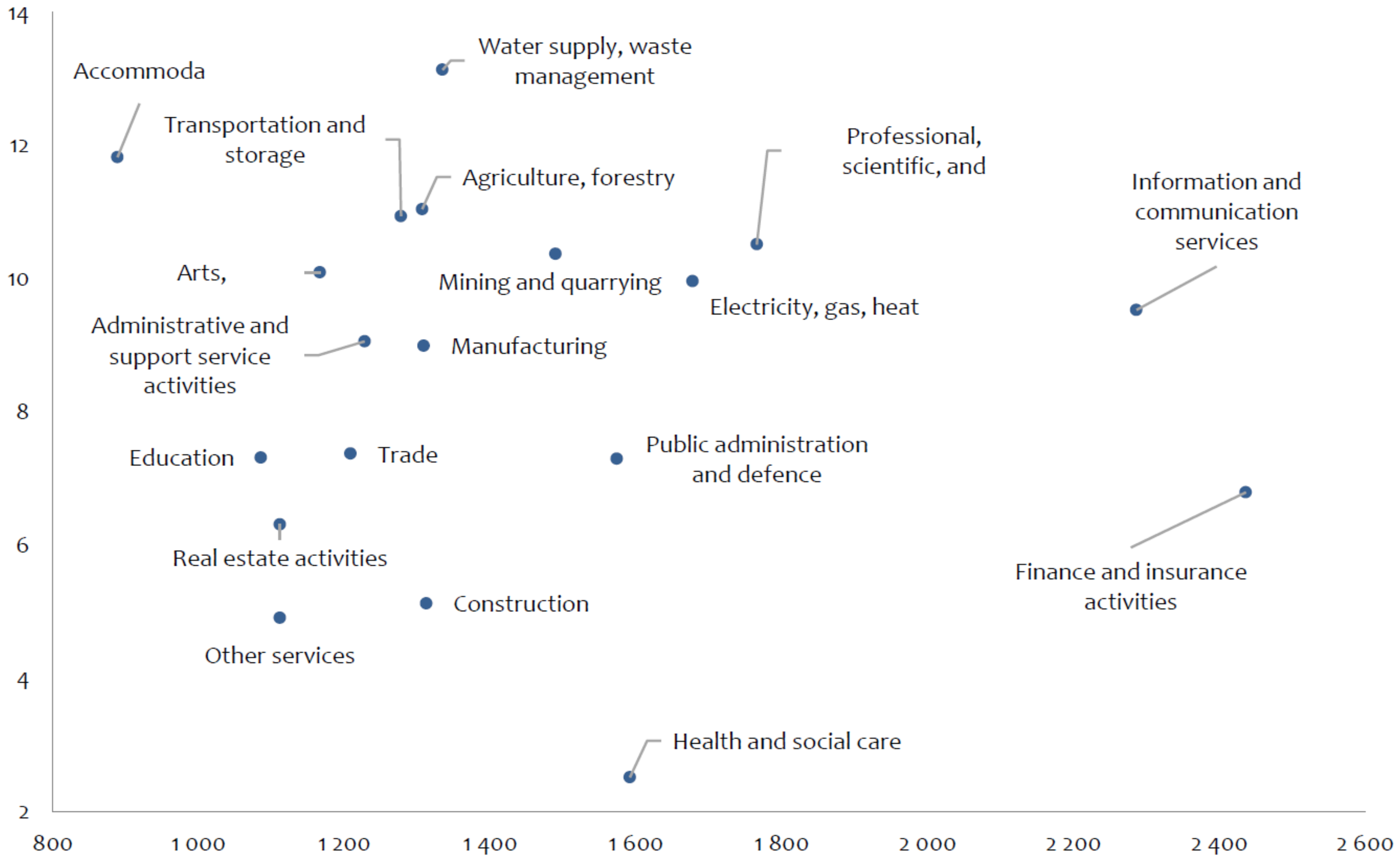
- Some sectors highly dependent on budget financing; trade unions play a more significant role
- Wage pressures arising during high inflation
- Also – some political promises remain unfulfilled creating future pressures on expenditures

**Gross wages in economic sectors**

*in 2022; horizontal axis – average gross wage, euro; vertical axis – average gross wage changes, compared to 2021, as per cent*



# Long-term outlook – Sustainability Report (2021-2041)



- This FDC study uses the EC Ageing Report 2021 and the author's assumptions about employment indicators, potential GDP growth, etc.
- Demographic projections are used from the Ageing Report calculations and have a major impact on the modeling results.
- In the scenarios of fiscal sustainability without the impact of the green transition, goals are set to reach social protection and health care funding of 66% and 75% of the EU average.
- For the modeling of the fiscal impact of the green deal author used data from the Berenshot study. Berenshot had calculated investment needs for reducing carbon losses for each EU member state.

# Long-term outlook – Sustainability Report (2021-2041)

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| **Targets before green deal** | Trend towards social protection and health spending to 66% of the EU average | Trend towards social protection and health spending to 75% of the EU average |
|---|---|---|
| Council macroeconomic framework | Scenario 1 | Scenario 3 |
| EC Ageing Report macroeconomic framework | Scenario 2 | Scenario 4 |

| **Additional target to reduce CO2 emissions by 60%** | **Low UTM** | **Moderate UTM** | **High UTM** |
|---|---|---|---|
| Annual green investments as share of GDP | 0,38% | 0,68% | 0,98% |

## The right side of the picture: Fiscal sustainability scenarios at tax and Social Securities Contribution revenue trends to 33% of GDP.

## The left side of the picture: Fiscal sustainability scenarios for taxes and Social Security Contribution revenue trends towards the EU average of 41.5% of GDP

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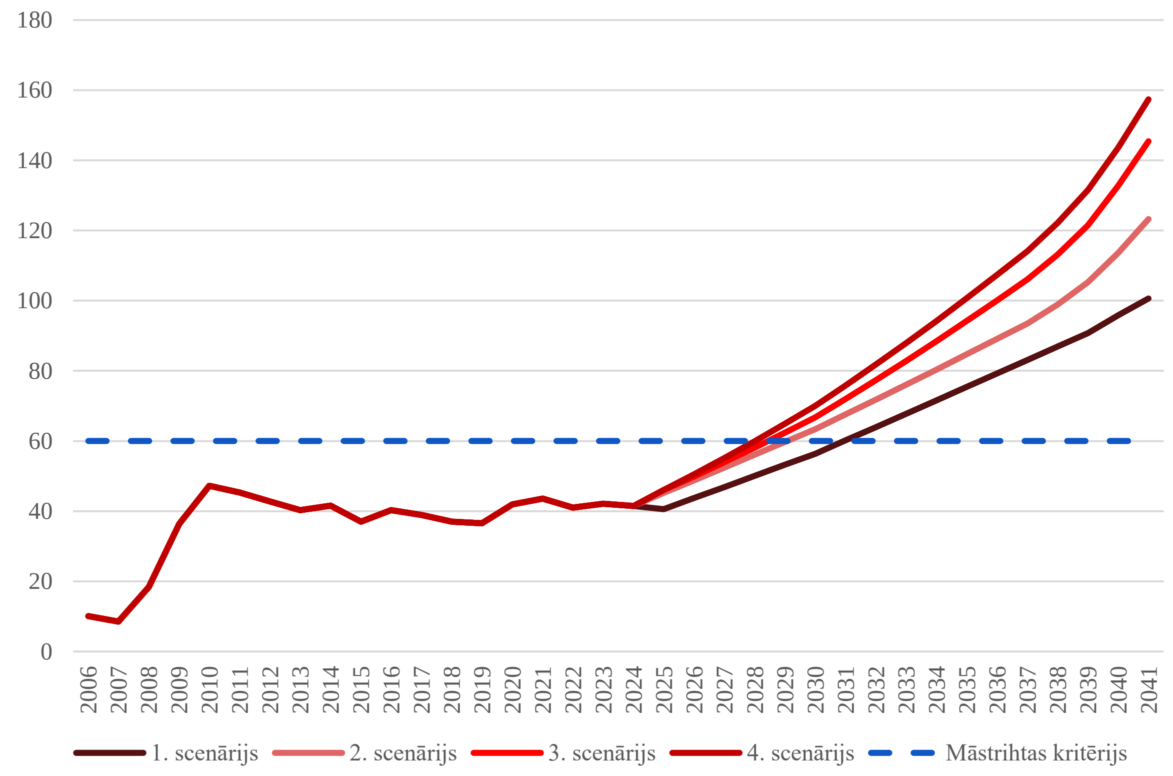


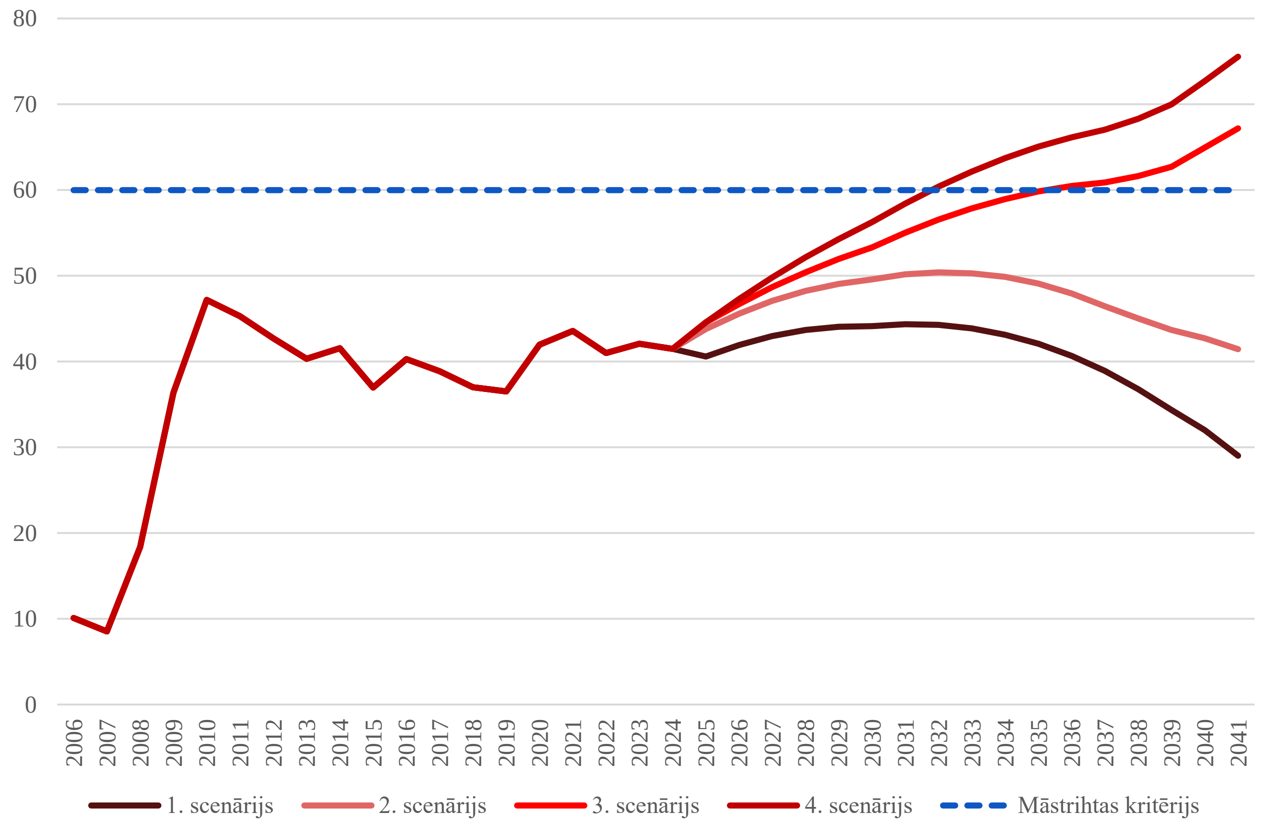


| **Targets before green deal** | Trend towards social protection and health spending to 66% of the EU average | Trend towards social protection and health spending to 75% of the EU average |
|---|---|---|
| Council macroeconomic framework | Scenario 1 | Scenario 3 |
| EC Aeging Report macroeconomic framework | Scenario 2 | Scenario 4 |

# Latvia's expenditure on social protection, when evaluated as a % of GDP, lags behind the Baltic neighboring countries, while all Baltic countries lag behind the EU level in terms of social protection expenditure by almost half.

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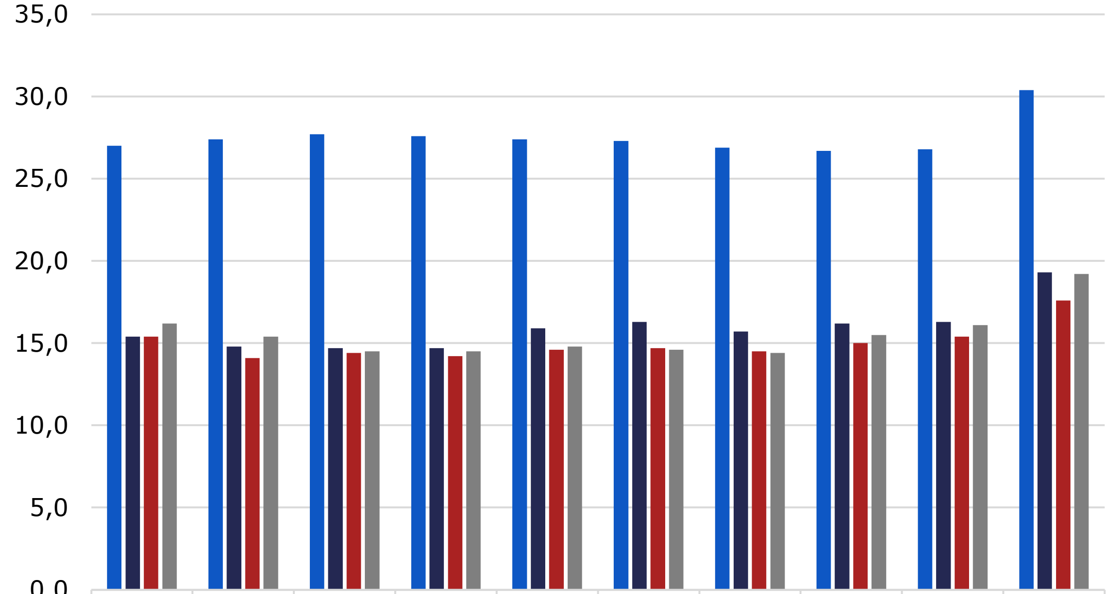
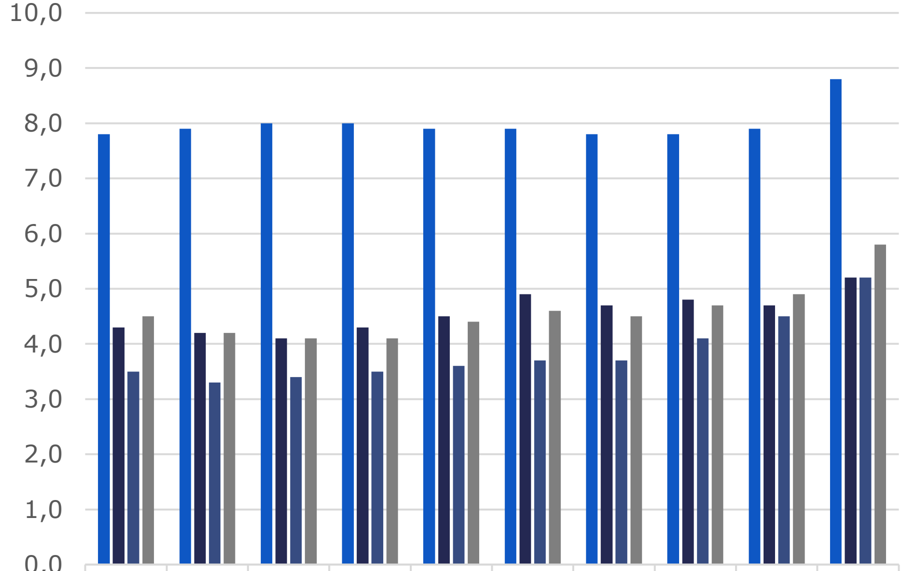
## Social protection benefits expenditures as % of GDP




| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| ES-27 (no2020) | 27,0 | 27,4 | 27,7 | 27,6 | 27,4 | 27,3 | 26,9 | 26,7 | 26,8 | 30,4 |
| Igaunija | 15,4 | 14,8 | 14,7 | 14,7 | 15,9 | 16,3 | 15,7 | 16,2 | 16,3 | 19,3 |
| Latvija | 15,4 | 14,1 | 14,4 | 14,2 | 14,6 | 14,7 | 14,5 | 15,0 | 15,4 | 17,6 |
| Lietuva | 16,2 | 15,4 | 14,5 | 14,5 | 14,8 | 14,6 | 14,4 | 15,5 | 16,1 | 19,2 |

EU 10Y average: 27,5% of GDP
Target: 66% of EU = 18,2% of GDP
Target 75% of EU = 20,6% of GDP

## Sickness/Health care expenditures as % of GDP




| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| European Union - 27 countries (from 2020) | 7,8 | 7,9 | 8,0 | 8,0 | 7,9 | 7,9 | 7,8 | 7,8 | 7,9 | 8,8 |
| Estonia | 4,3 | 4,2 | 4,1 | 4,3 | 4,5 | 4,9 | 4,7 | 4,8 | 4,7 | 5,2 |
| Latvia | 3,5 | 3,3 | 3,4 | 3,5 | 3,6 | 3,7 | 3,7 | 4,1 | 4,5 | 5,2 |
| Lithuania | 4,5 | 4,2 | 4,1 | 4,1 | 4,4 | 4,6 | 4,5 | 4,7 | 4,9 | 5,8 |

EU 10Y average: 8 % of GDP
Target: 66% of EU = 5,3 % of GDP
Target 75% of EU = 6 % of GDP

In the first scenario supplemented with the costs of the Green Deal, the increase in debt to 60% of GDP does not occur, but the maximum amount of debt is reached in 2033 at 50.4%, under the condition that the additional costs of health and social protection move to the level of 66% of the EU and 0.98% of GDP is marked for the Green Deal annually.

In the third scenario supplemented with the costs of the Green Deal, it can be seen that even without the Green costs, the debt trajectory is not fiscally sustainable.

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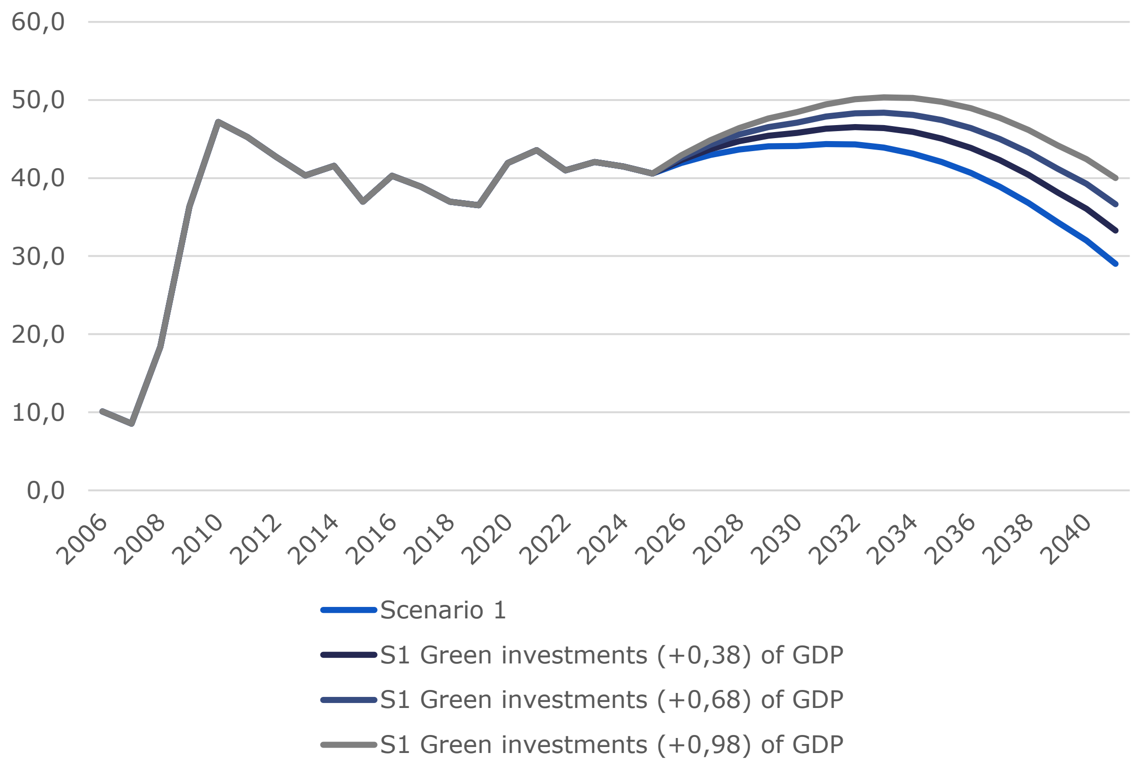


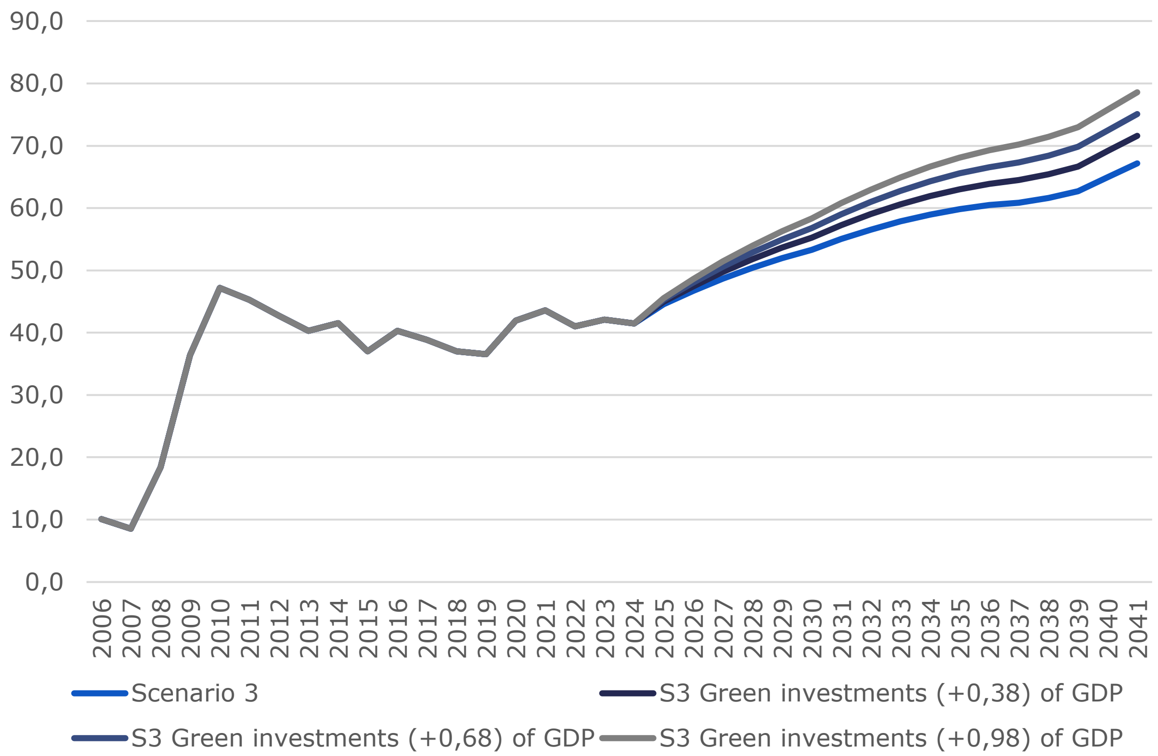


*Scenario 1 – Fiscally sustainable*
*Council macro framework and fiscal target 66% of EU average social and healthcare spendings + green investments 0,38;0,68;0,98 of GDP.*

*Scenario 3- Fiscally unsustainable*
*Council macro framework and fiscal target 75% of EU average social and healthcare spendings+ green investments 0,38;0,68;0,98 of GDP*

In the second scenario supplemented with the costs of the Green deal, the debt does not reach 60% of GDP, but the max level of debt will be reached in 2034 at 57.9%. This happens if the costs of health and social protection will move towards 66% of the EU average level and the highest green financing intensity of 0.98% of GDP will be invested every year.

The fourth scenario shows the highest possible debt volume of 87.6% of GDP in 2041.

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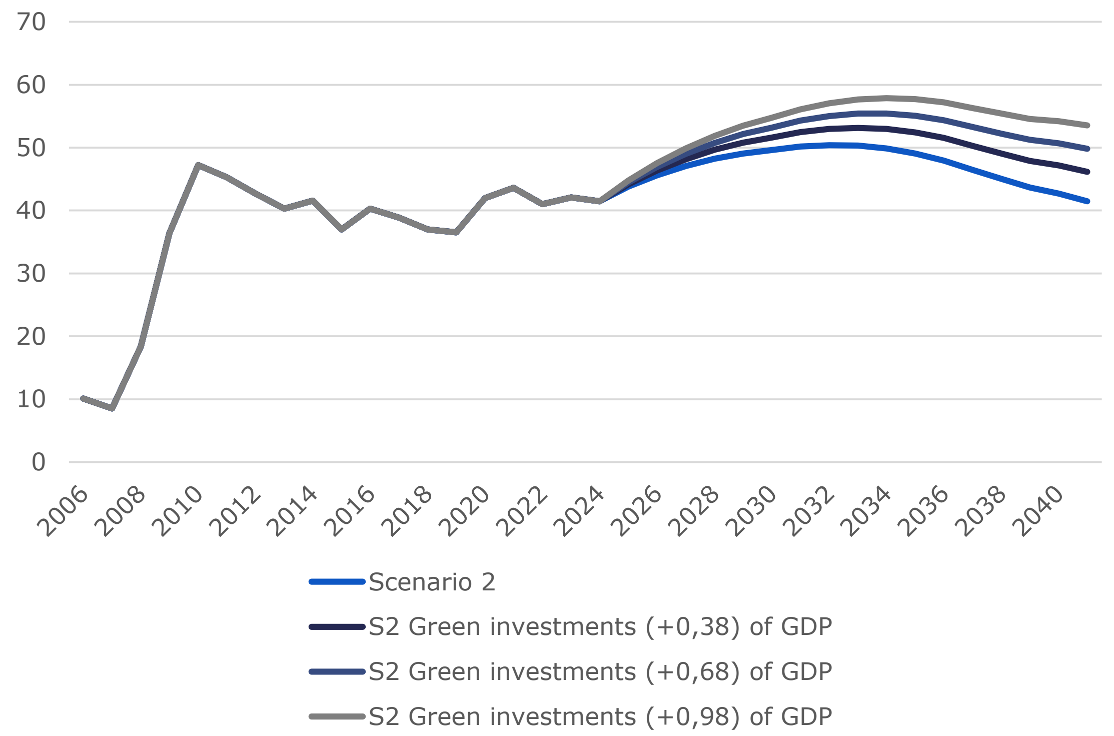


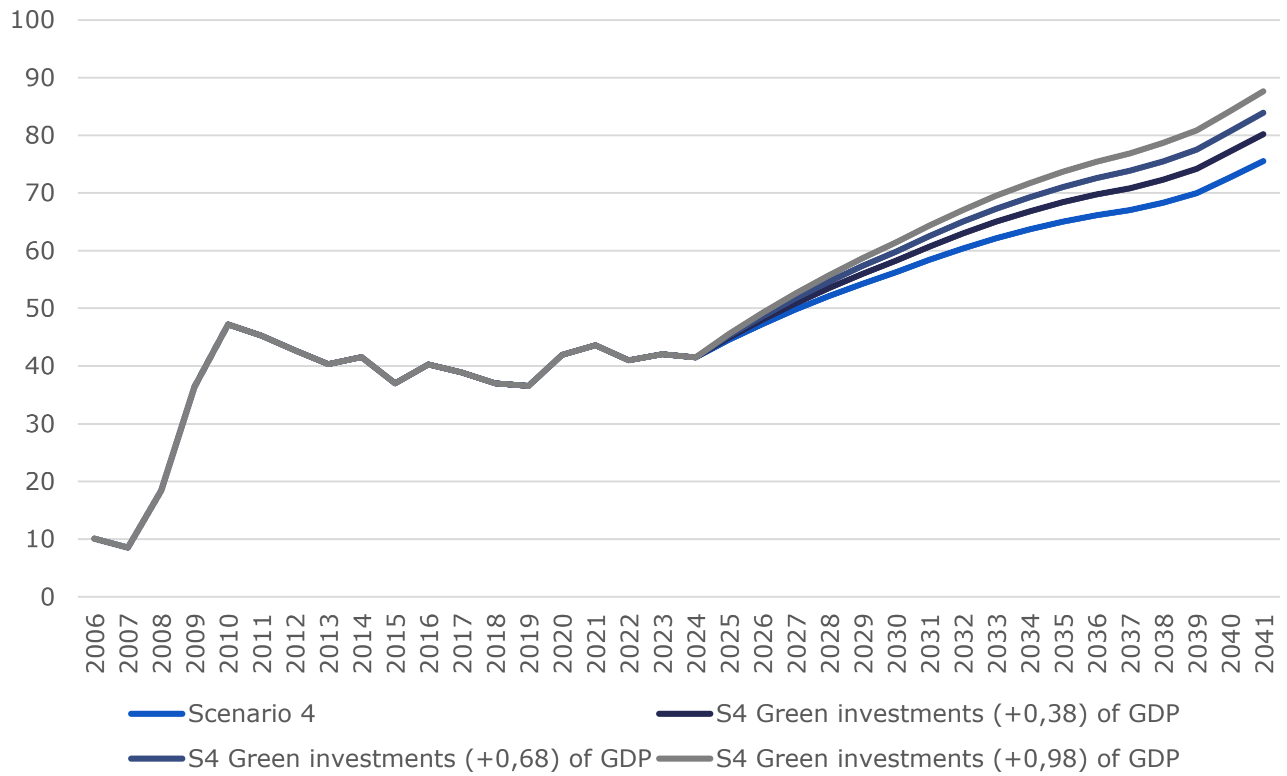


*Scenario 2 Fiscally sustainable*

*EC AR macro framework and fiscal target 66% of EU average social and healthcare spendings + green investments 0,38;0,68;0,98 of GDP*

*Scenario 4- Fiscally unsustainable*

*EC AR macro framework and fiscal target 66% of EU average social and healthcare spendings + green investments 0,38;0,68;0,98 of GDP*

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# Thank You!

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# **Starting point**: the study takes place at a time when the Covid-19 crisis has just ended, but a new wave of geopolitical tension and energy price shock has already begin.

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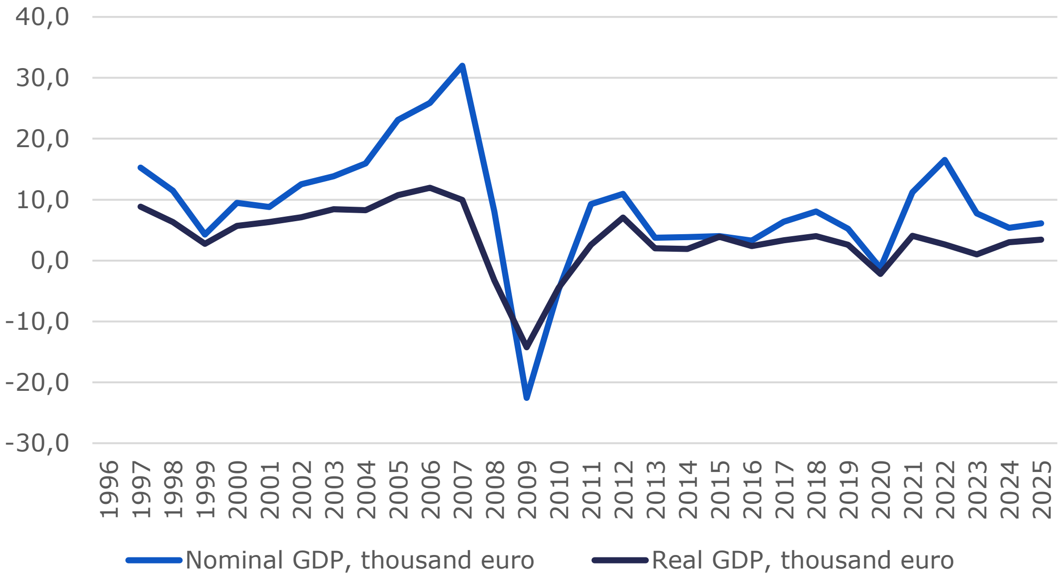


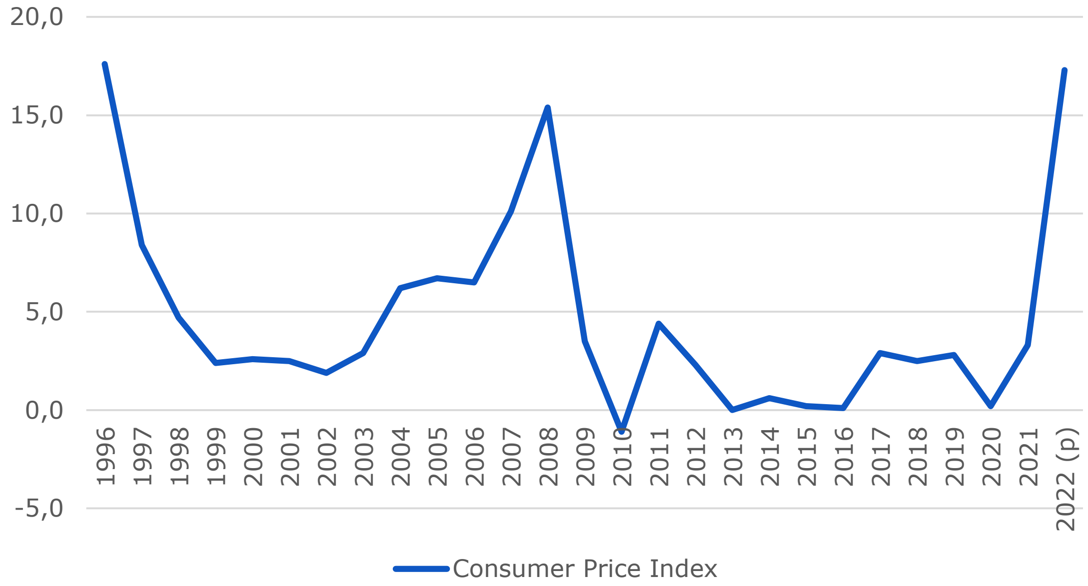


| | | |
|---|---|---|
| **Institution** | 2022 | 2023 |
| **MoF (Aug.2022)** | 2.8 | 1.0 |
| **BoK (Sep. 2022)** | 3.0 | -0.2 |
| **EC (Nov.2022)** | 1.9 | -0.3 |
| **IMF (Okt. 2022)** | 2.5 | 1.6 |
| **Average** | 2.6 | 0.5 |

| | | |
|---|---|---|
| **Institution** | 2022 | 2023 |
| **MoF (Aug.2022)** | 16.5 | 6.5 |
| **BoL (Sep. 2022)** | 16.9 | 9.2 |
| **EC (Nov.2022)** | 16.9 | 8.3 |
| **IMF (Okt. 2022)** | 18.9 | 3.4 |
| **Average** | 17.3 | 6.8 |

# As the population decreases and the age of the population increases, retirement will be an increasing challenge and the labor force participation rate will continue to increase. Potential GDP will decline moderately, mainly due to negative labor market trends.

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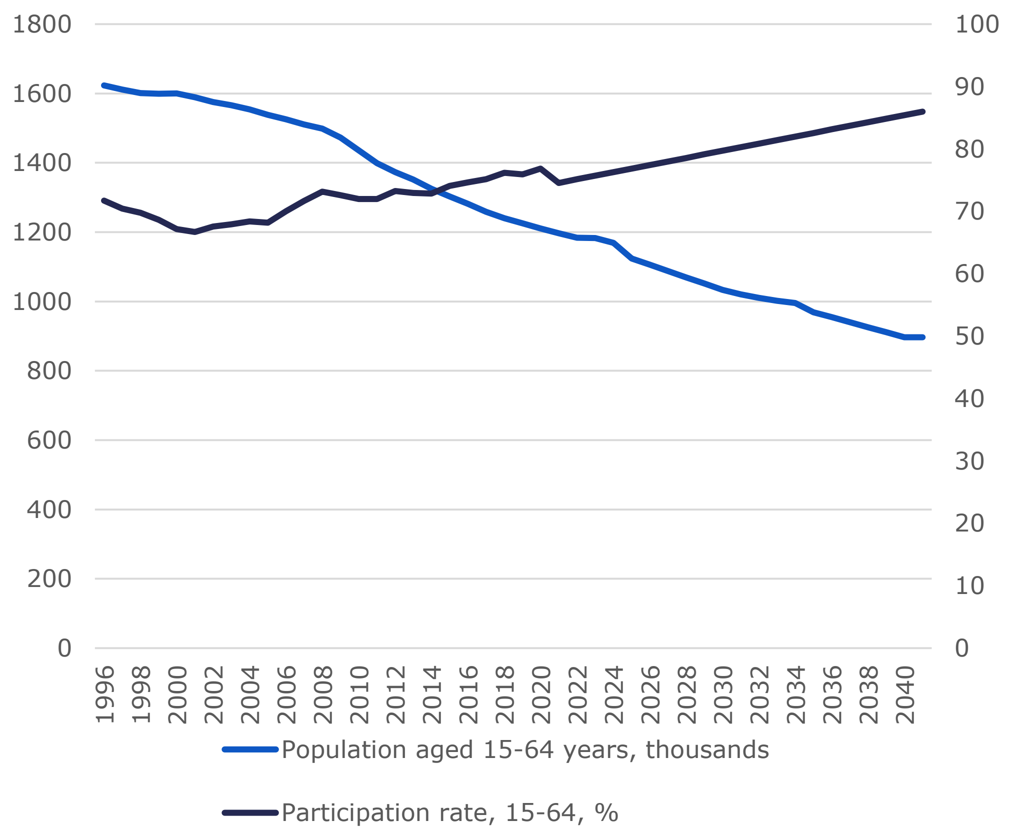
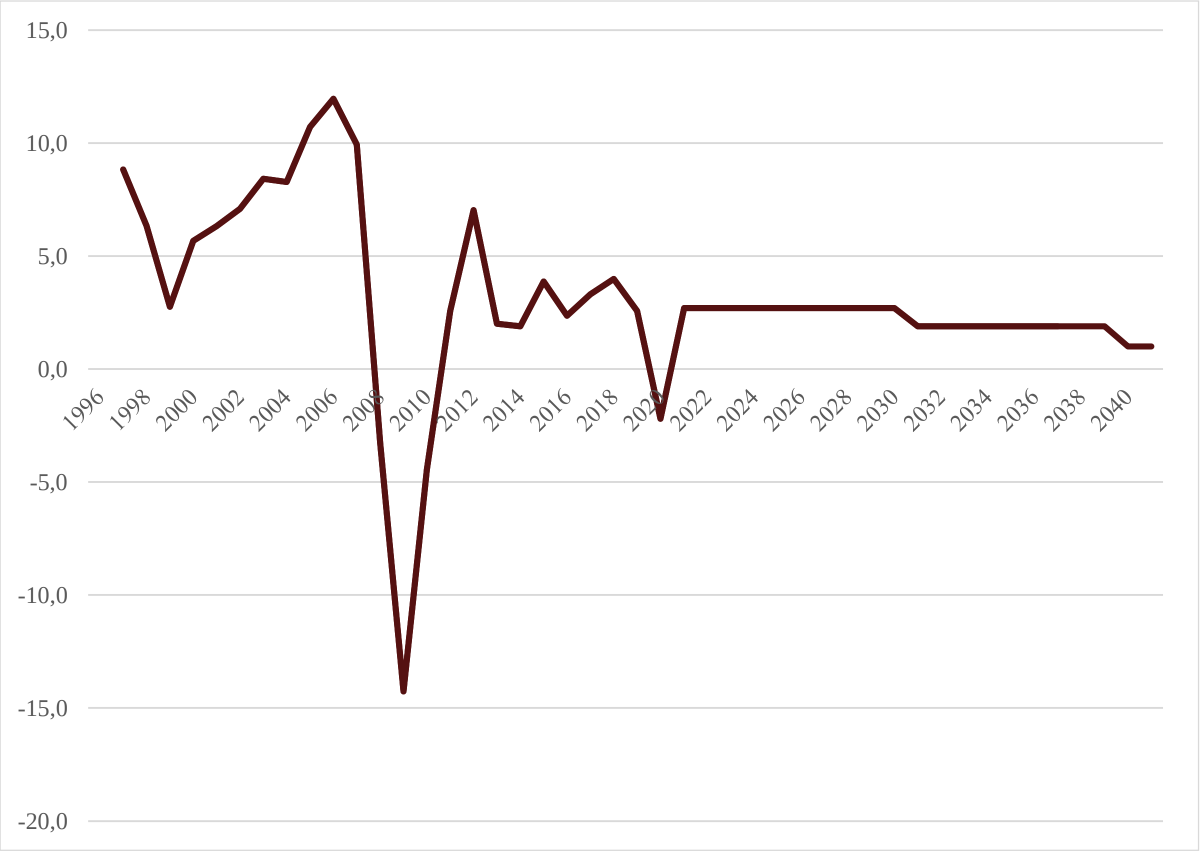



Population and participation rate (15-64)




Real / potential GDP growth, y-t-y, %

# Unemployment will approach the natural rate of unemployment in the long run. The importance of investments will increase in the coming years, which will be related to technological advances and greener living and production.

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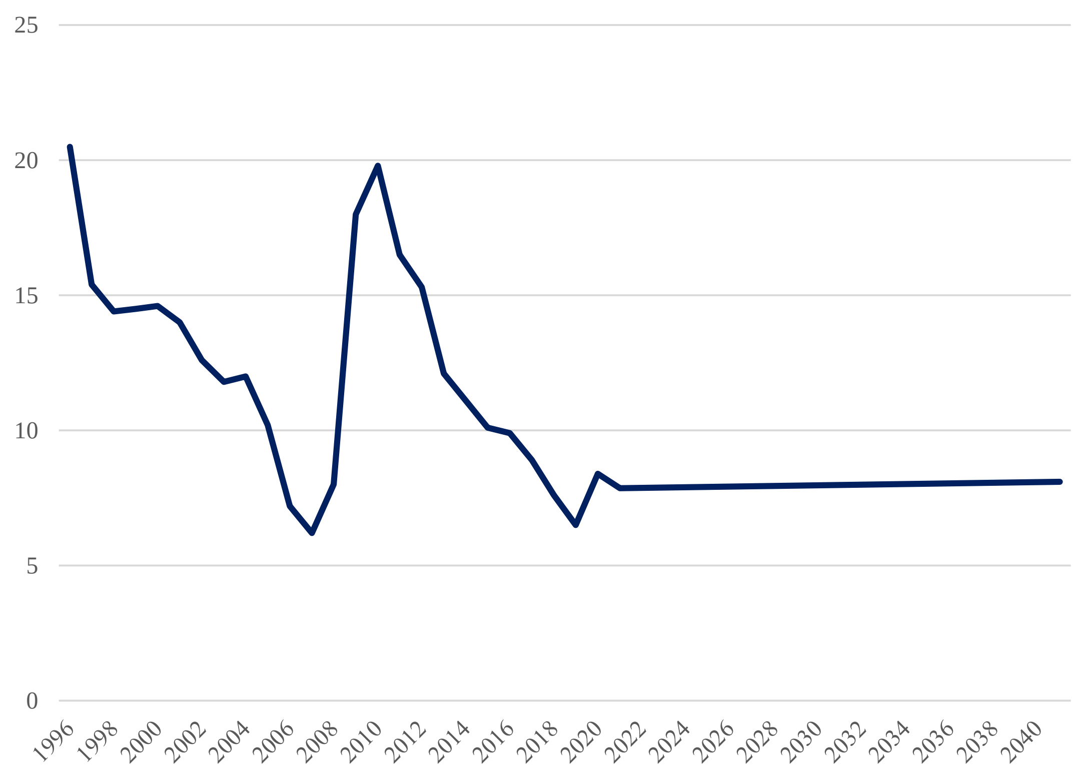
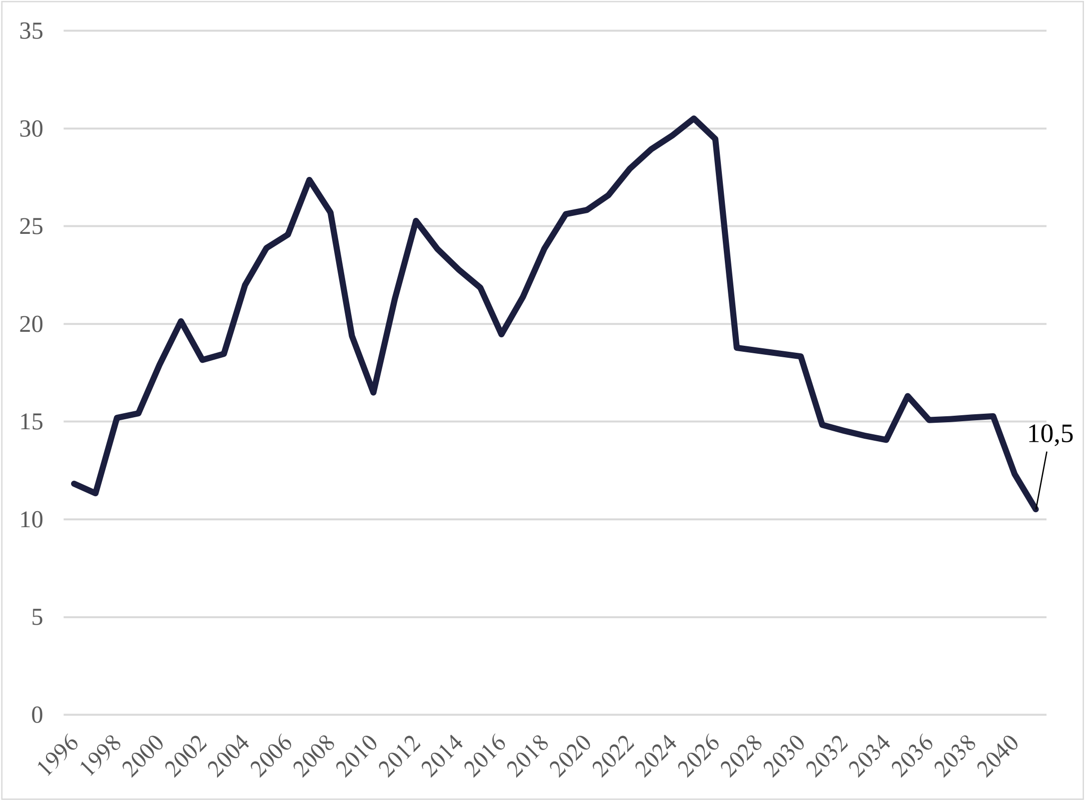



Unemployment rate, 15-64, %




Investment to GDP, %

# Next step: inputs for macro framework

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**Council Macro framework  for fiscal scenarious 1 & 3**

**Participation rate, 15-64** at Y 2041 ( 86%)

**Unemployment rate**, **15-64** at Y 2041 (6%)

**TFP growth, y-t-y,** at Y 2030 (2,85), at Y 2041 (2,1)

**Real / potential growth:**
Period  2020-2030 (4,05%);
Period 2031 -2040 (2,85);
Period 2040-2041 (1,5).

**EC Aeging report Macro for fiscal scenarious 2 & 4**

**Participation rate, 15-64** at Y 2041 (82%)

**Unemployment rate**, **15-64** at Y 2041 (8,1%)

**TFP growth, y-t-y,** at Y 2030 (1,9), at Y 2041 (1,4)

**Real / potential growth:**
Period  2020-2030 (2,7%);
Period 2031 -2040 (1,9);
Period 2040-2041 (1).

| Additional asumptions | |
|---|---|
| Depreciation rate | ***0,05*** |
| Capital elasticity rate | ***0,7*** |
| Initial capital stock | ***19428716*** |