



What challenges do we face in drafting and implementing the Latvia's Recovery and Resilience Plan?

Investigation report

Rīga 2022



Latvijas Republikas
Valsts kontrole

Investigation report

What challenges do we face in drafting and implementing Latvia's Recovery and Resilience Plan?

The date is stamped on the document's signature time stamp and the document number is displayed in a text file.

The investigation was performed by State Auditor- Lawyer Tatjana Mētriņa, Senior State Auditor Edgars Sprukts, Senior State Auditor, Head of the Audit Team, and Senior State Auditor Guna Krūmiņa, Acting Head of the Responsible Sector, Senior Auditor Dzintra Tripane, and Department Director Ilze Bādere, based on audit schedule No 2.4.1-26/2021 of 17 August 2021 of the Audit and Methodology Department of the State Audit Office.

The investigation was conducted and the report drafted within the framework of the financial audit "On the consolidated annual financial statement of the Republic of Latvia for 2021 on state budget outturn and municipal budgets" (Audit schedule No 2.4.1-26/2021 of 17 August 2021 of the Audit and Methodology Department of the State Audit Office) based on Sub-paragraph c), Paragraph 3, Section 3 of the State Audit Office Law.

The cover design includes a photo from the website <http://depositphotos.com>, *Tree growing from coins*, author *aeydenphumi*, ID 50689663

Why and how this investigation was conducted

Dear Members of the Saeima committees for Sustainable Development, for the National Economy, Agrarian, Environmental and Regional Policy, on Budget and Finance (Taxation) and for Public Expenditure and Audit,

Dear Representatives of the Government,

When conducting a **financial audit of the Consolidated annual financial statement of the Republic of Latvia for 2021 on the state budget outturn and municipal budgets**, the State Audit Office **assesses** the activities related to the drafting and implementation of the Recovery and Resilience Facility (hereinafter – RRF) plan **as significant in scope and nature**.

As a Member State of the European Union (hereinafter - the EU), Latvia enjoys the rights to which the Member States are entitled to in full by receiving certain amounts of financial resources from the EU budget for the implementation of various investment projects. To help curb the economic and social damage caused by the COVID-19 pandemic and to help make the transition to a modern, sustainable, green and digital¹ Europe, the EU's long-term budget for 2021-2027 stipulates a new temporary instrument for funding - the European Recovery and Resilience Facility - NextGenerationEU (hereinafter - NGEU) with a fund of 750 billion euros². The RRF is a new budget instrument managed centrally by the European Commission (EC), which provides the bulk of the NGEU's funds – 672.5 billion euros³.

Support from the RRF will take the form of grants⁴, and loans⁵ if requested by a Member State. The Member States will be able to spend RRF funding for the implementation of reforms or investment projects from 1 February 2020 (with retroactive effect) to 31 August 2026⁶. The amount of the RRF grant component allocated to Latvia is 1.82 billion euros⁷ while the indicative amount of loans available is around 2 billion euros⁸.

In order to receive funding, each EU Member State had to draft and submit to the EC for approval a reform and investment plan (hereinafter referred to as the RRP), including planned reforms and investments, as well as achievable goals, in accordance with the reform and investment criteria set in the regulation on the RRF⁹ and taking into account recommendations made in the context of the European Semester¹⁰.

As the implementation of the RRP has a positive impact on the development of the economy of Latvia, but decision-makers and those involved in the investment planning and implementation process must also anticipate significant risks and challenges, the State Audit Office has elaborated this investigation report summarizing comprehensive information (facts) on the drafting process of Latvia's RRP, its content, the financing intended for the implementation of the measures included in the plan, including impact on the state budget. This report also summarizes information on the control measures for the implementation of Latvia's RRP and the risks associated with its implementation. This investigation report does not analyse the reforms and investments included in the RRP or the feasibility of the required response and spending contained therein.

The State Audit Office hands over the investigation report to you and expects you to monitor the implementation of Latvia's RRP and to, within your capacity, invite the responsible authorities to

report regularly on progress made in the implementation of the RRP in order to address the risks and challenges identified in the investigation report.

Taking into account the significant financial resources of the RRF, which will flow into Latvia's economy and for the relevant acquisition of which the ministries will be responsible, the State Audit Office plans to start audits on the implementation of the reforms and investments included in Latvia's RRP¹¹ in 2022.

Summary: what challenges do we face in drafting and implementing Latvia's RRP?

A new long-term programming period began in Latvia and the EU in 2021, and Latvia needed a clear, balanced, thorough, and well-founded vision on its national development to achieve the improvement of the quality of life of society, as a substantial amount of EU and state budget funds is to be invested in the implementation of this vision over the next seven years. Therefore, there was a medium-term development planning document adopted on 2 July 2020 in Latvia, that is, the National Development Plan of Latvia for 2021–2027 (hereinafter - NDP2027)¹². NDP2027 was developed with broad public participation by covering all regions of Latvia, and its strategic environmental impact assessment has been performed. During the elaboration of NDP2027, discussions took place among MPs and experts in the Saeima Committee for Sustainable Development, other Saeima Standing Committees and various fora on NDP2027 priorities, sectoral analysis and their development perspectives.

In turn, the development of the current EU long-term budget for 2021–2027 began in 2018 and it was approved on 17 December 2020¹³. Yet, while drafting the budget (May 2020), in response to the COVID-19 pandemic, a proposal was made for a new recovery instrument, the NGEU of 750 billion euros, wherefrom the majority of NGEU funds of 672.5 billion euros, was intended for grants and loans to the Member States under a new, centrally managed EC budget instrument for the RRF to help address the economic and social damage caused by the COVID-19 pandemic and to make the transition to a modern and sustainable Europe. Therefore, when planning NDP2027 activities and resources for their financing, the planned EU funding available to Latvia in 2021–2027 was taken into account whereas RRF funding for NDP2027 activities was not planned.

Latvia drafted its RRP on 27 April 2021 and submitted it to the EC on 30 April 2021. In general, Latvia's RRP includes 85 measures (24 reforms, 61 investments) with a specific required response in each component and a total funding of 1.82 billion euros¹⁴. Although the EC has assessed 10 out of 11 criteria of Latvia's RRP with the highest rating A and only one criteria under the criterion *cost justification* was scored B, several questions arose regarding the drafting and implementation of Latvia's RRP during the investigation, the answers to which are crucial especially for decision-makers and those involved in the investment planning and implementation process.

Are we satisfied that we base our public investment planning on political choices rather than on social and economic benefit analysis?

The development of Latvia's RRP started in August 2020: 1) The Coalition Council adopted decisions at the political level on the six components of Latvia's RRP (climate change and environmental sustainability, reduction of inequality, digital transformation, economic transformation and productivity, health, rule of law) and the percentage distribution of funding among the components; 2) further development of Latvia's RRP was coordinated by the Ministry of Finance and organized at the government level in six thematic working groups, developing a vision for the reforms and investments to be included in Latvia's RRP and stipulating that the line ministries were responsible for selecting reforms and investments for inclusion in Latvia's RRP¹⁵ by 15 January 2021.

The social and co-operation partners, as well as the rest of society, were also involved in the development of Latvia's RRP. However, dissatisfaction and criticism expressed by the social and co-operation partners indicate a delayed, fragmented and insufficient involvement of these partners, as well as the lack of an integrated approach to gain confidence that all available financial resources will contribute to the NDP2027 objectives.

The expert group of the Fiscal Discipline Council and Latvia's Productivity Council generally praised the work of the Ministry of Finance, noting that Latvia's RRP was drafted in difficult circumstances and the procedure for developing the plan was democratic - with broad involvement of social partners. At the same time, experts have pointed to the following shortcomings: 1) Latvia's RRP is fragmented and based strongly on a sectoral approach; 2) a closer link between Latvia's RRP and other national planning documents is required, especially with NDP2027; 3) Latvia's RRP lacks the ambition of a "top goal" that would have a significant impact on the sustainable economic and social development of the country, as well as on each component separately.

In the process of elaborating Latvia's RRP, the initial reform and investment proposals submitted by the ministries amounted to more than 7.5 billion euros¹⁶, which significantly exceeded the amount of RRF funding intended for Latvia. In such circumstances, when the demand for investments significantly exceeds opportunities, transparency and traceability of the investment planning process assures critical preconditions for supporting the most important investment projects (to achieve the objectives of the NDP2027). However, the facts gathered during the investigation show that the process of selecting reform and investment proposals for inclusion in Latvia's RRP was not transparent and traceable because there is no documented justification that any of the submitted reform and investment proposals was more appropriate for inclusion in Latvia's RRP and its impossible to determine whether the funds are allocated to those projects that meet the national development priority needs.

Due to the limited financial resources available for public development expenditure, it is essential that their planning and use be as efficient and transparent as possible and that they serve as a tool for

national development. Therefore, the issue of development expenditure has been relevant in several audits where we have reached similar conclusions regarding the public investment planning process: 1) “the process of evaluating applications for priority measures and selecting eligible measures is not transparent, as 40% of all supported measures (worth 66 million euros) are those which have not been made in the procedure for the submission of proposals for priority measures provided for by law”¹⁷; 2) “There is no management system for large public investment projects in Latvia, including purposeful, systemic planning of public investment expenditures, which would ensure that funds are first allocated to those projects that meet the priority development needs of the country”¹⁸. It is possible that the lack of integrated investment planning, without a vision of how all available financial resources (EU funds and other foreign financial instruments, basic and development state budget expenditures) will contribute to the implementation of the National Development Plan, is one of the reasons for the conclusion in the recent *ex-post* evaluation of the implementation of the National Development Plan 2014-2020 that “only slightly more than a third of the targets set have been fully met, [...] Some of the targets have not been adequately funded”¹⁹.

Are we aware what the impact on the state and municipal budgets will be if the interim indicators and targets of the reforms and investments envisaged in Latvia’s RRP are not achieved 100%?

One intends to implement Latvia’s RRP in the period until 2026. Effective administration, control, and supervision of Latvia’s RRP is essential for its successful implementation. This is even more important because the conditions for disbursement of RRF funds to Member States differ from other EU funds. The disbursements of RRF funds are envisaged when the interim indicators and targets for specific reforms set out in the RRFs that the Member States have committed to meet are actually met, and not disbursed for investments made, as is the case with other EU funds.

Failure to meet interim indicators and targets for reforms and investment in Latvia’s RRP, i.e., if they are not achieved 100%, will have great consequences - the funds spent on the implementation of those reforms and investments will have to be covered from state or municipal budgets, as the RRF shall not finance them²⁰.

Are we aware of the additional impact on the state and municipal budgets that the implementation of the reforms and investments envisaged in Latvia's RRP will have?

The expert group of the Fiscal Discipline Council and Latvia's Productivity Council forecasts that the implementation of Latvia's RRP from 2022 to 2026 could increase budget revenues by more than 500 million euros, reduce the investment gap by at least 25-30% over the next five years and increase productivity by 3.5% per year from 2022 to 2029²¹.

However, the implementation of Latvia's RRP also causes costs to the state budget of at least 32.3 million euros. Although the RRF funds from the EU are received as EU grants and the implementation of the projects included in the RRP does not require state co-financing²², the implementation of Latvia's RRP will result in costs that will not be covered from RRF funds following the scope of Regulation (EU) 2021/241 of the European Parliament and of the Council establishing a Recovery and Resilience Facility (hereinafter - the RRF Regulation) and according to the information provided by the Ministry of Finance.²³ Such costs include costs of administration, control and monitoring of Latvia's RRP (including adjustment and maintenance of the Cohesion Policy Fund Administration Information System), VAT and other expenditures such as translation and publicity expenditures. Although there are cases when VAT is covered from private funds or is recoverable (depending on the project implementer)²⁴, VAT shall be covered from the state budget for some of the measures of Latvia's RRP²⁵. Information on VAT costs and potential impact on the state budget is not known, and ministries and the State Chancellery must reserve these expenses by preparing and submitting relevant legislation to the Cabinet of Ministers for specific reform and investment projects in Latvia's RRP according to the information provided by the Ministry of Finance.

Sanctions for breaches of sound economic governance²⁶, the quality of implementation of measures and project management, overlapping project implementation²⁷, inaccurately planned reform and investment costs²⁸, as well as the current tense international situation, etc. might have an adverse effect on the state budget.

Since 1 May 2004, Latvia as a full-fledged EU Member State enjoys all the rights of the Member States, while undertaking certain responsibilities at the same time. Latvia's net balance amounted to 1 billion euros in 2020; it means that Latvia receives more funds from the EU budget than it pays into it. In 2020, Latvia paid 323.5 million euros to the EU general budget but the country received 1 323.5 million euros²⁹ during the year under various programs.

Expenditure in the EU budget is planned according to a **multiannual financial framework** (MFF), known as the financial framework (formerly the financial perspective). EU long-term budgetary regulation for 2021-2027 was adopted on 17 December 2020³⁰. The EU's long-term budget for 2021-2027 of 2.018 trillion euros³¹ is the largest to date, which includes **the temporary recovery**

instrument (NGEU) in the amount of 750 billion euros introduced in parallel apart from the EU's own resources (see Table 1).

Table 1

The EU 2021-2027 long-term budget by expenditure categories and funding sources (BEUR)

Expenditure categories /source of funding	MFF	NGEU	TOTAL
Single market, innovation and digitalisation	149.5	11.5	161.0
Cohesion, resilience and values	426.7	776.5	1203.2
Natural resources and environment	401.0	18.9	419.9
Migration and border management	25.7		25.7
Security and defence	14.9		14.9
Neighbourhood and the world	110.6		110.6
European public administration	82.5		82.5
TOTAL	1210.9	806.9	2017.8
(expressed at 2018 prices)	1074.3	750.0	1824.3

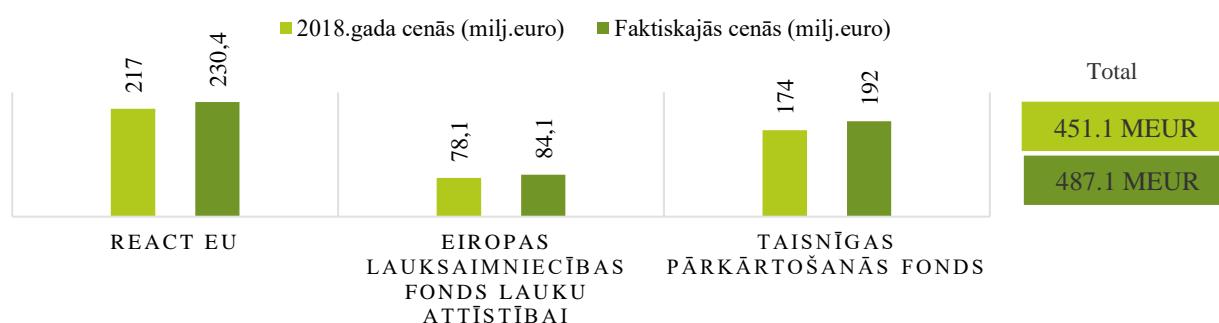
The NGEU funds of the temporary recovery instrument will be^{32,33} invested in several programs (instruments) under the EU 2021-2027 long-term budget and will be earmarked for EU Member States and beneficiaries as grants and loans (see Table 2).

Table 2

Temporary Recovery Facility NGEU resources as per funds and programs (BEUR)

	At 2018 prices	Actual prices as of Nov 2020. ^{34,35}
Recovery and Resilience Facility	672.5	723.8
including grants	312.5	338
incl. loans	360	385.8
REACT EU	47.5	50.6
European Agricultural Fund for Rural Development	7.5	8.1
Just Transition Fund	10	10.9
Programs InvestEU	5.6	6.1
RescEU	1.9	2
Horizon Europe	5.0	5.4
TOTAL	750.0	806.9

The individual price values - actual and at 2018 prices - represent the same amount in nominal and real terms. The difference is due to the annual adjustment of inflation, applied annually to compensate for inflation of 2% per annum (Article 4 (2) of Council Regulation No. 2020/2093 of 17.12.2020 laying down the MFF 2021-2027). The 2018 prices are free of inflation and are useful for comparison. Actual prices show how much the beneficiaries will actually benefit from the budget. The EC makes technical adjustments to the MFF each year before the budgetary procedure, based on a fixed deflator of 2% per annum.



/Prices in 2018 (in MEUR); Actual prices (in MEUR); REACT EU, EAFRD, Just Transition Fund/

Figure 1. Funding available to Latvia from NGEU 2021–2027 (excluding RRF)^{36, 37} by funds and programs.

Latvia has not earmarked funding in InvestEU, RescEU and Horizon Europe programs, as their regulation does not provide for the distribution of funding among countries or regions. Additional funding is available for those programs under the NGEU, but is not earmarked at the national level³⁸.

Most of the NGEU funds, 672.5 billion euros will be spent through **the Recovery and Resilience Facility** program. It should be noted that the Member States could use the funding from the Recovery and Resilience Facility to implement reform or investment projects from 1 February 2020 (with retroactive effect) to 31 August 2026³⁹. Funding is provided for six policy areas (pillars) of European interest⁴⁰ with the aim of promoting economic, social and territorial cohesion in the EU (See Figure 2).

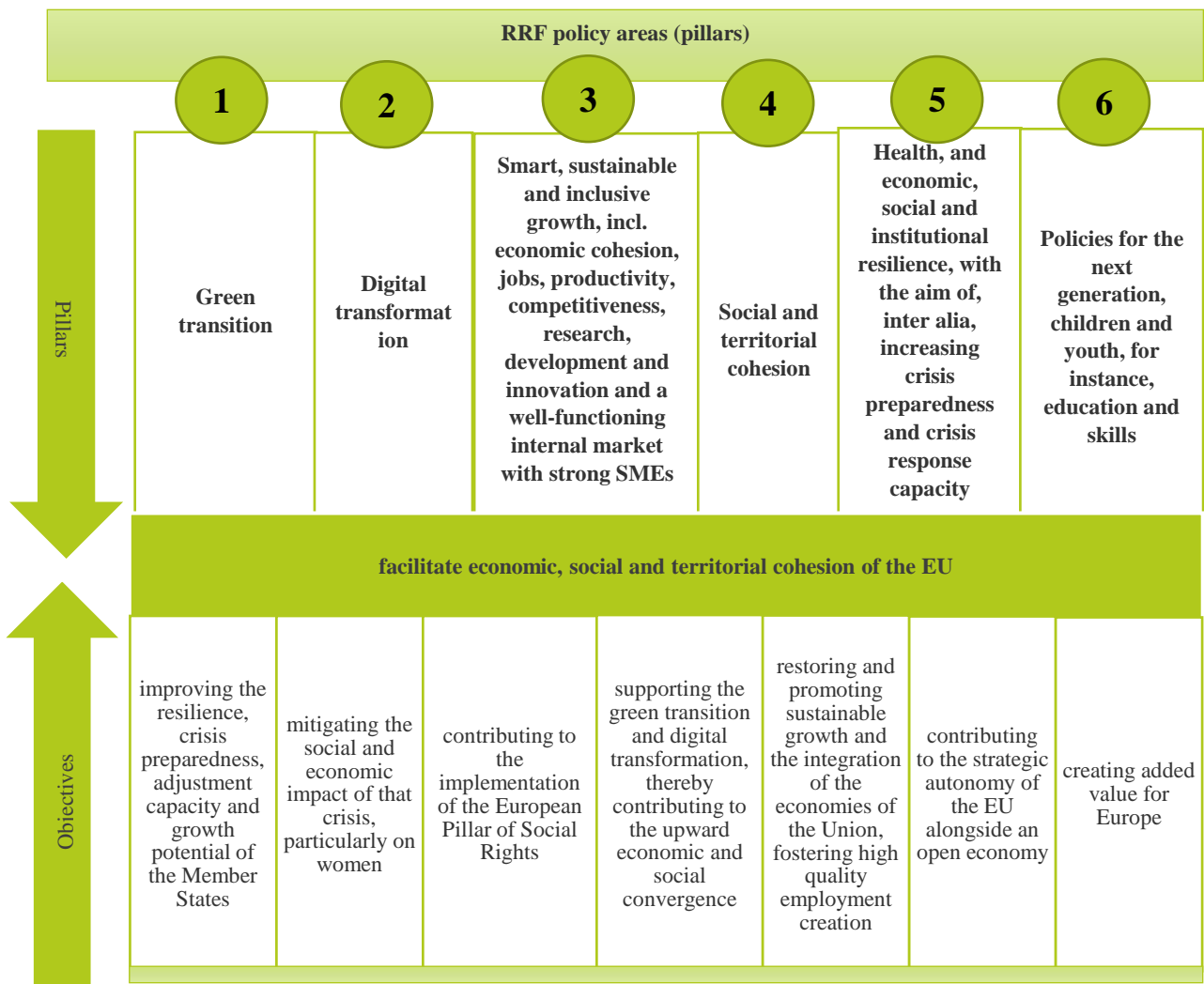


Figure 2. RRF policy areas (pillars) and objectives.

The Recovery and Resilience Facility is a new, centrally managed EC budget instrument in the EU’s long-term budget for 2021-2027⁴¹ where the EC directly monitors its implementation. The amount of RRF funds currently available to Latvia is 1.82 billion euros⁴². The final calculation of the amount of RRF funds available to each EU Member State will be made by the EC by 30 June 2022⁴³.

In order to receive financial support from the RRF, each Member State must draft a reform and investment plan (RRP), which the EC assesses and the European Council (hereinafter - the Council) approves.

See Annex 1 of the Investigation report for a more detailed description of the EU budget for 2021-2027 (MFF and temporary recovery instrument NGEU, Recovery and Resilience Facility and RRP).

References

- ¹ https://ec.europa.eu/info/business-economy-euro/recovery-coronavirus/recovery-and-resilience-facility_en, (Resource viewed on 27 Sep 2021).
- ² At 2018 prices.
- ³ At 2018 prices.
- ⁴ Article 6, first paragraph, point a) of Regulation (EU) 2021/241 of the European Parliament and of the Council establishing a Recovery and Resilience Facility of 12 Feb 2021, 312.5 billion euros at 2018 prices, 338 billion euros at current prices.
- ⁵ Article 6, first paragraph, point b) of Regulation (EU) 2021/241 of the European Parliament and of the Council establishing a Recovery and Resilience Facility of 12 Feb 2021, 360 billion euros at 2018 prices, 385.8 billion euros at current prices.
- ⁶ Article 17, paragraph 2 of Regulation (EU) 2021/241 of the European Parliament and of the Council establishing a Recovery and Resilience Facility of 12 Feb 2021.
- ⁷ Article 2 (1) of the Council Implementing Decision ([pdf \(europa.eu\)](#)) (Resource viewed on 23 Dec 2021).
- ⁸ Letter No 5.1-6 /11/28 “On the draft report “What challenges do we face in drafting and implementing the Latvia’s RRP?” of the Ministry of Finance of 20 April 2022.
- ⁹ Article 18 (4) a), b), c) and d) of Regulation (EU) 2021/241 of the European Parliament and of the Council establishing a Recovery and Resilience Facility of 12 Feb 2021.
- ¹⁰ Article 18, paragraph 4, point b) of Regulation (EU) 2021/241 of the European Parliament and of the Council establishing a Recovery and Resilience Facility of 12 Feb 2021.
- ¹¹ EU Recovery and Resilience Facility. Latvia 2021-2026 (approved by the EC Implementing Decision of 6 July 2021 on the approval of the assessment of the Latvia’s Recovery and Resilience Plan), Article 415. RECOVERY AND RESILIENCE FACILITY PLAN ([esfondi.lv](#))
- ¹² Approved at the sitting of the Saeima on 2 July 2020.
- ¹³ [Multiannual financial framework | European Union Fact Sheets | European Parliament \(europa.eu\)](#), resource viewed on 18 Oct 2021.
- ¹⁴ [PowerPoint presentation \(esfondi.lv\)](#), (resource viewed on 22 Nov 2021)
- ¹⁵ Minutes of the interview “Latvia’s RRP” at the Ministry of Finance on 2 Nov 2021.
- ¹⁶ Information provided by the Ministry of Finance on 18 Feb 2022 on the proposals of the line ministries and the State Chancellery as of 22 Sep 2020.
- ¹⁷ Financial audit “On the Consolidated Annual Financial Statement of the Republic of Latvia for 2018 on the state budget outturn and on municipal budgets”.
- ¹⁸ Performance audit “Efficiency of the budget management system: Part 1 – Assessment of the effectiveness of the budget planning cycle”.
- ¹⁹ Annual report of Prime Minister A.K. Kariņš to the Saeima on the work done and planned by the Cabinet of Ministers (https://tapportal.mk.gov.lv/legal_acts/b8095613-0848-437a-a3ac-fce09d9048ba).
- ²⁰ In cases when an implementer of measures (projects) is an individual, the funds used for the implementation of the projects (measures) will have to be recovered from the individual.
- ²¹ The assessment of the expert group of the Fiscal Discipline Council and Latvia’s Productivity Council coincides with the assessment of the macroeconomic impact of the RRF by the Ministry of Finance.
- ²² Article 2, paragraph 2, Article 11 of Regulation (EU) 2021/241 of the European Parliament and of the Council establishing a Recovery and Resilience Facility of 12 Feb 2021.
- ²³ Minutes of the interview “Latvia’s RRP” at the Ministry of Finance on 2 Nov 2021.
- ²⁴ According to the Cabinet Minutes-Decision of 22 March 2022 (Minutes No 17, § 34, Par. 9) – economic operators shall cover VAT from their private financial resources or other attracted financing, which is not the RRF financing. For such derived public entities and SOEs as state and municipal medical institutions (hospitals), programming regions, universities and scientific institutions, VAT is covered from the state budget only if it cannot be recovered. For NGOs when they perform a function delegated by the state, VAT is covered from the state budget if it cannot be recovered.
- ²⁵ Cabinet Minutes-Decision of 22 March 2022 (Minutes No 17, § 34, Par. 9).
- ²⁶ [Economic governance | European Union Fact Sheets | European Parliament \(europa.eu\)](#) (Resource viewed on 21 Jan 2022)
- ²⁷ Assessment of the EU RRP, approved by the Fiscal Discipline Council at meeting No 3 (49) on 26 Apr 2021, Minutes No 1-04/122, §1.1, [Downloads \(fdp.gov.lv\)](#) (Resource viewed on 9 Jan 2022).

-
- ²⁸ Minutes of the meeting of the Ministry of Finance and line ministries on the issues of implementation of the Recovery and Resilience Facility of 7 Oct 2021 <https://www.esfondi.lv/normativie-akti-1> (Resource viewed on 25 Nov 2021).
- ²⁹ <https://www.fm.gov.lv/lv/media/9450/download> (Resource viewed on 03.12.2021).
- ³⁰ [Multiannual Financial Framework | European Union Fact Sheets | European Parliament \(europa.eu\)](#) (Resource viewed on 18 Oct 2021).
- ³¹ At current prices as of November 2020 - The EU's 2021-2027 long-term Budget and NextGenerationEU Facts and Figures (<https://op.europa.eu/en/publication-detail/-/publication/d3e77637-a963-11eb-9585-01aa75ed71a1/language-en>).
- ³² 407.5 billion euros at current prices, 390 billion euros at 2018 prices.
- ³³ 385.8 billion euros at actual prices, 360 billion euros at 2018 prices.
- ³⁴ NextGenerationEU breakdown - https://ec.europa.eu/info/strategy/recovery-plan-europe_en (Resource viewed on 24 Jan 2022).
- ³⁵ The EU's 2021-2027 long-term Budget and NextGenerationEU Facts and Figures (<https://op.europa.eu/en/publication-detail/-/publication/d3e77637-a963-11eb-9585-01aa75ed71a1/language-en>).
- ³⁶ About *React EU* funding – information provided electronically by the Ministry of Finance on 28 Feb 2022 and 2 March 2022 about the funding from the European Agricultural Fund for Rural Development and the Just Transition Fund - The EU's 2021-2027 long-term Budget and NextGenerationEU Facts and Figures (<https://op.europa.eu/en/publication-detail/-/publication/d3e77637-a963-11eb-9585-01aa75ed71a1/language-en>).
- ³⁷ Funding for the European Agricultural Fund for Rural Development and the Just Transition Fund at actual prices as of November 2020.
- ³⁸ Minutes of the interview “Latvia’s RRP” at the Ministry of Finance on 18 Feb 2022.
- ³⁹ Article 17, paragraph 2, of Regulation (EU) 2021/241 of the European Parliament and of the Council establishing a Recovery and Resilience Facility of 12 Feb 2021.
- ⁴⁰ Article 3 of Regulation (EU) 2021/241 of the European Parliament and of the Council establishing a Recovery and Resilience Facility of 12 Feb 2021.
- ⁴¹ [European Recovery Fund \(esfondi.lv\)](#) (resource viewed on 27 Sep 2021).
- ⁴² [Amount of financing \(esfondi.lv\)](#) (resource viewed on 21 Feb 2022).
- ⁴³ Minutes of the interview “Latvia’s RRP” at the Ministry of Finance on 18 Feb 2022.