

**MINISTRY OF ECONOMICS
REPUBLIC OF LATVIA**

**ECONOMIC
DEVELOPMENT
OF LATVIA
REPORT**

**June
2015**

RIGA

**Ministry of Economics
Republic of Latvia**

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Comments, questions or suggestions are welcome:

Ministry of Economics of the Republic of Latvia
Brīvības iela 55, Rīga, LV-1519, Latvia

Phone: 371-67013293

Fax: 371-67280882

E-mail: macro@em.gov.lv

Website: <http://www.em.gov.lv>

Authors: O.Barānovs (overall compilation, 1., 4.1.1.), I.Skribāne (2., 3.1.3., 4.3., 5.2.), E.Gergelevičs (2., 3.1.4.), J.Salmiņš (2., 3.2.1., 3.2.2., 3.3.), L.Stelmaka-Leja (3.1.1., 3.1.2., 4.1.2., 4.1.3., 5.2.), G.Piņķe (3.3.), I.Šnīdere (4.2.), V.Skuja (4.4.), N.Ozols (5.1., 5.3.), A.Rožkalne, J.Ušpelis (5.4.), Č.Gržibovskis, R.Rimša (6.1.), G.Silovs (6.2.1., 6.8., 6.12.), D.Klinsone, M.Rone, L.Stauvere, D.Šikova (6.2.2.), M.Ivanova, V.Laizāns, A.Upīte (6.2.3.), K.Soms (6.3.), A.Leite, R.Meijers, I.Niedrīte (6.4.), R.Kņūtiņa, S.Soila, I.Strazdiņa, R.Špade (6.5.), M.Lūka, I.Šrava (6.6.), I.Lore (6.7., 6.8.), E.Fernāts (6.8., 6.12.), M.Jansons (6.9.), L.Neiders, (6.10.), I.Kabanova (6.11.), A.Krūze, M.Zondaks (6.12.), M.Ivanova, L.Kauliņa (6.13.), B.Mistre, J.Reinsone (6.14.), M.Drāke (6.15., 6.16.), D.Freimane (6.17.).

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Dear reader,

The specialists of the Ministry of Economics have prepared a regular Report on the development of the national economy of Latvia. The first Report was issued in September 1994, the following Reports since 1995 were published traditionally twice a year – in June and December. Like the previous Reports, this one assesses the economic situation, as well as provides forecasts on the prospects for growth of economy.

The gross domestic product in Latvia has increased by 17.4% from 2010 to 2014, and it has been the most rapid increase among all Member States of the European Union. It gives evidence that the reforms in general have been correct. However, we should not relax even for a while, as the global economic situation is rather fragile. We see that the pace of growth slows down in Latvia mainly due to geopolitical reasons, as well as the increasing competition within the domestic market of the European Union.

In 2015, the economic growth of Latvia will be closely related to global tendencies in our geopolitical region. The economic situation in the export market that is so important for Latvia – in the EU – gradually improves, while the exporters focusing on the Eastern markets are affected by the worsening economic situation in Russia. Unfortunately, the consequences of the geopolitical issues will impede the economic growth in Latvia also this year. Experts of the Ministry of Economics forecast that the GDP growth might be approximately 2% in 2015.

The geopolitical situation in the region and slow growth of the economy in the European Union hinder investments and the increase of the export. Under such conditions, the most important role in promoting the economic growth of Latvia is attributed to the ability to improve competitiveness and ensure the accessibility of financial resources at all stages of business development.

It is crucial to find the most effective ways to support the development of a knowledge-intensive economy, to increase the competitiveness of companies across exporting sectors, to increase productivity and innovation capacity. The economic policy supporting the development of the regions of Latvia, including creation of new, well-paid jobs in the regions, will be just as important.

In order to prepare for and adapt to the significant structural changes, it is necessary to undertake proactive steps in the labour market. The Ministry of Economics holds a view that the reforms started in the education system shall be carried on, focusing on the increase of the quality of acquisition of the physical and natural sciences in the primary and secondary education, as well as on the development of adult education. It is necessary to improve the contents of the subjects of the physical and natural sciences and introduce a mandatory elective

centralised examination in physics or chemistry in secondary education. Likewise, the system for education of adults with clear financing model based on the needs of employers has to be established, and work-based learning shall be introduced in vocational education.

The new programming period of the EU funds gives us an opportunity to invest 4.4 billion euro in the growth and development of Latvia over the next seven years. It should be noted that the planned most crucial aims of financing provided by the EU funds include increasing the financial flow in research and development, promoting the attraction of private investments, and activating co-operation between research institutions and entrepreneurs. Significant investments are planned for the improvements of information and communications technologies and transport infrastructure which directly affect the economic productivity, form the basis for the creation of new and well-paid jobs and increase in the quality of living.

Within the framework of activities implemented by the Ministry of Economics, approximately 800 million euro will be available for targeted investments in the modernisation and industrialisation of the Latvian economy. A significant increase of the EU funding is envisaged for promoting efficient use of energy, investing more than 300 million euro in the increase of energy efficiency in multi-apartment residential houses, public and industrial buildings within the programming period. In 2015, it is planned to launch such EU funding activities as *Introduction of New Products and Technologies into Production* (support for procurement of the equipment), *Access to International Trade Markets* (participation in exhibitions), *Promotion of International Competition* (national stands), *Training of Employees, Competency Centres, Business Incubators* and *Improvement of Heat Insulation of Multi-Apartment Residential Buildings*.

It is essential to maintain the existing and develop new tax stimuli so that businesses would be willing to invest in the development of new and more profitable products. The enterprise income tax exemptions currently are applied to investments in procurement or development of new technological equipment for production, research and development and large investment projects. It shall be noted that on 19 May this year the Cabinet of Ministers upon proposal of the Ministry of Economics restated and approved “The Procedures of Approving and Implementing an Aided Investment Project” that allow to continue the provision of the state support to large investors as far as until 1 October 2020.

To promote economic activities, it is significant that after long discussions we have managed to maintain the micro enterprise tax, at the same time the social insurance of the employees of such companies has been improved.

One of the priorities of the Ministry of Economics is to improve business environment. The latest World Bank research *Doing Business 2015* has ranked Latvia 23rd among 189 countries or 9th among the EU Member States. The World Bank has recognised Latvia as one of the TOP30 countries that have implemented major reforms to improve the business environment.

Latvia has improved its performance in the fields of tax payment and real estate registration. Yet, in order to improve the quality of the Latvian business environment as fast as possible, it is essential to continue reforms in the judiciary, particularly in the area of commercial dispute resolution and simplification of the insolvency procedure. It is also necessary to reduce the bureaucracy burden on tax administration purposefully by reducing the number of procedures and the time required for them. The quality and speed of implementation of the reforms will determine further competitiveness of the Latvian business environment and economy. Our target in the coming years is to be among Top 20 countries in terms of favourable business environment.

The Ministry of Economics continues its work on the regulatory framework for protection of consumers. On the 1st of July this year, the amendments to the *Unfair Commercial Practice Prohibition Law* and *Advertising Law* will come into force; they will extend the powers of the Consumer Rights Protection Centre and other supervising authorities in the events of unfair commercial practice, as well as increase the maximal amount of penalty for unfair commercial practice.

The Ministry of Economics continues introducing regulatory enactments arising from the new *Construction Law* by carrying out the complete adaptation of the *Eurocode Standards* and inclusion of requirements contained in the *Latvian National Annexes* in the regulatory system governing the construction sector. Thus, a modern and strict regulation of the sector is developed which will ensure higher quality of construction at all stages.

At the same time, the supervision of the construction control is improved, and the State Construction Control Office has started its operation. It carries out public supervision of new public buildings and their operations.

In 2015, the Ministry of Economics continues reforms in the area of the management of commercial activities of public persons and capital shares. The *Law on Management of Capital Shares and Capital Companies of Public Persons* has already come into force. It has been developed to ensure professional and transparent management of state capital companies and capital companies of derived public persons, including local governments, as well as to improve the performance of the said capital companies. *The Law on Management of Capital Shares and Capital Companies of Public Persons* is the fundamental law of this reform. Its implementation is vital for the acceptance of Latvia in the Organization of Economic Cooperation Development (OECD).

The representatives of the Ministry of Economics and government institutions under its supervision continue working on accession to the OECD, so that Latvia can become a full member of the OECD. In 2015, an in-depth review on compliance of Latvia to the OECD guidelines regarding management of the state capital, the Report on the Economy of Latvia and the Report on the Consumer Policy in Latvia have been prepared and distributed. The Ministry of Economics actively takes part in development of new instruments, development of positions and policies in the area of its competence pursuant to the OECD guidelines and recommendations.

The integration of the Latvian energy market in Europe continues. The provisions of the *Electricity Market Law* have already come into force, ensuring complete opening of the electricity market. At the same time, we have launched a support provision system for poor and low-income households, as well as for families with many children, compensating for changes in electricity prices. Likewise, the Ministry of Economics has implemented complex measures in order to restrict further increase of the mandatory procurement component in the price of electricity until 2017, maintaining it at the level of 2013.

The Ministry of Economics actively develops the regulatory framework for energy efficiency policy. The Cabinet of Ministers has reviewed the draft *Energy Efficiency Law* aiming at cost-effective energy efficiency at all stages of the energy chain from its production to its final consumption. Energy efficiency shall be considered the largest energy resource, and its implementation is a method that shall be efficiently used to increase the security of supply and reduce greenhouse gas emissions. Increase in energy efficiency definitely is the fastest and the most cost-effective way of mitigation of risks, creating additional jobs and fostering growth at the same time.

Currently, the liberalization of the gas market is in the agenda in order to develop the framework for open operation of the gas market as of April 2017.

In addition to the improvement of the provisions of regulatory enactments regarding energy market, active work is performed in the area of the development of energy and gas infrastructure and attraction of investments for the existing and future infrastructure projects in order to strengthen energy security and diversify energy supply.

The main aim in the energy sector for the period until 2020 is to strengthen the energy independence of Latvia, to increase the energy supply security, to promote energy sustainability, and to ensure competitive energy prices to consumers.

To achieve the set aims, we are actively engaging in a dialogue with entrepreneurs, non-governmental organisations and other representatives of the society. It is particularly significant during the period when Latvia is the presiding country in the Council of the European Union.

The present Report provides information regarding the main economic and social indicators, the development of economic sectors and global economic environment, the economic policy of the government and its key instruments for implementing the policy, including the utilisation of the EU structural funds.

The Cabinet of Ministers has not assessed all issues discussed in the Report, therefore a range of conclusions on the economic growth of the country and recommendations for further activities reflect solely the opinion of the experts of the Ministry of Economics.

I would like to express my gratitude to the authors of the Report.
June 2015



Dana Reizniece-Ozola,
Minister of Economics

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ABBREVIATIONS, MEASUREMENT UNITS AND SYMBOLS

Abbreviations

CC	Competition Council	HGP	Heat-electric generating plant
CF	Cohesion Fund	HPP	Hydroelectric Power Plant
CIF	Price of goods created by the value of goods inclusive of freight and insurance costs till the border of the importing country	ICT	Information and Communication Technologies
CIS	Commonwealth of Independent States	IDAL	Investment and Development Agency of Latvia
CLC	Central Land Commission	IGC	Intergovernmental commission
CoM	Cabinet of Ministers	IMF	International Monetary Fund
CPI	Consumer Price Index	JSC	Joint Stock Company
CRPC	Consumer Rights Protection Centre	LGA	Latvian Guarantee Agency
CSB	Central Statistical Bureau	LLC	Limited Liability Company
EAGGF	European Agricultural Guidance and Guarantee Fund	LNAB	Latvian National Accreditation Bureau
EC	European Commission	LTDA	Latvian Tourism Development Agency
ECC	The European Consumer Centre of Latvia	LVS	Latvian Standard
ERDF	European Regional Development Fund	MSS	Meeting of the State Secretaries
ESF	European Social Fund	NEC	National Economy Council of the Ministry of Economics
EU	European Union	NPP	Nuclear Power Plant
EU-15	European Union Member States before the enlargement on May 1, 2004	OP	Operational Programme
EU-27	European Union Member States after the enlargement on January 1, 2007	PJ	Petajoule
FDI	Foreign Direct Investment	SEA	State Employment Agency
FIFG	Financial Instrument for Fisheries Guidance	SMEs	Small and Medium-Sized Enterprises
FOB	Price of the goods, including value, and transport and insurance costs to the border of the exporting country	SMM	Small and Medium-Sized Merchants
FTA	Free Trade Agreement	SOLVIT	EU Internal Market Problem Solving System
GDP	Gross Domestic Product	SRS	State Revenue Service
		TPI	Trade Protection Instruments
		TWh	Terawatt hour
		USA	The United States of America
		WTO	World Trade Organization

Country Abbreviations

AT	Austria	IE	Ireland
BE	Belgium	IT	Italy
BG	Bulgaria	LT	Lithuania
CZ	Cyprus	LU	Luxembourg
CY	Czech Republic	LV	Latvia
DE	Germany	MT	Malta
DK	Denmark	NL	The Netherlands
EE	Estonia	PL	Poland
EL	Greece	PT	Portugal
ES	Spain	RO	Romania
EU	European Union	SE	Sweden
FI	Finland	SI	Slovenia
FR	France	SK	Slovakia
HR	Croatia	UK	United Kingdom
HU	Hungary		

1. ECONOMIC SITUATION: BRIEF OVERVIEW

A substantial inflow of foreign capital from 2005 to 2007 stimulated significant increase in the private consumption and investments in Latvia. The average growth rate of the GDP exceeded 10%. In 2008 and 2009, the recession set in as the foreign capital inflow stopped due to the global financial crisis. During the crisis, the GDP decreased by ¼, the external debt almost doubled, the number of employed decreased by 16%, the actual wages of the employed – by 12 per cent.

Since the end of 2009, the economic recession in Latvia has been stopped, and the growth has resumed. From 2011 to 2013, the GDP increased on average by 4.7% annually, and it was one of the most rapid economic growths in the EU. In 2014, the GDP

increased by 2.4%. The decrease in the growth rate was determined by external tendencies: growth in the EU was not as rapid as expected, as well as the economy of Russia became weaker. Although the economy in Latvia has been growing in recent years, the GDP is still by 5% lower than it was before the crisis in 2007.

In the 1st quarter of 2015, the GDP was by 0.3% higher than in the previous quarter (according to seasonally adjusted data) and by 1.9% higher than a year ago. It can be assessed as a good indicator, taking into account the unfavourable geopolitical situation in the region. The **specialists of the Ministry of Economics forecast that the increase of the growth of the GDP will be within 2% in 2015.**

Table 1.1

Latvia: Key Indicators of Economic Development									
	2008	2009	2010	2011	2012	2013	2014	2015f	2016f
Gross Domestic Product (current prices, billion EUR)	24.4	18.9	18.2	20.3	22.0	23.2	24.1	24.8	26.1
increase when compared to the previous year, in per cent									
Gross domestic product	-3.2	-14.2	-2.9	5.0	4.8	4.2	2.4	2.0	3.0
Private consumption	-8.0	-16.2	3.1	2.9	3.0	6.2	2.3	2.2	2.7
Public consumption	2.4	-10.7	-8.1	3.1	0.4	2.9	3.4	2.8	0.7
Gross fixed capital formation	-9.2	-33.3	-20.0	24.2	14.5	-5.2	1.3	0.4	2.2
Exports	2.4	-12.9	13.4	12.0	9.8	1.4	2.2	1.6	2.6
Imports	-10.7	-31.7	12.4	22.0	5.4	-0.2	1.6	1.5	0.5
Consumer prices	15.4	3.5	-1.1	4.4	2.3	0.0	0.6	0.9	2.0
% of the gross domestic product, unless indicated otherwise									
General government sector balance	-4.0	-9.0	-8.1	-3.3	-0.8	-0.7	-1.4	-1.5	-1.2
General government debt	18.6	36.4	46.8	42.7	40.9	38.2	40.0	37.0	40.0
Export-import balance	-13.6	-1.5	-1.5	-5.0	-4.4	-2.9	-2.9	-2.3	-1.7
Changes in the number of the employed (aged 15-74 years, compared to the previous year, %)	-0.2	-13.9	-6.4	1.3	1.6	2.1	-1.0*	0.2	0.5
Employment rate	62.0	54.3	52.0	54.0	56.1	58.2	59.1	60.0	61.0
Unemployment rate (share of unemployed persons to the number of economically active population, aged 15-74 years, %)	7.7	17.5	19.5	16.2	15.0	11.9	10.8	9.8	8.7
f – forecast									
* As of 2014, the methodology for Labour Force survey has been modified. For generalization of the quarterly data, the quarterly average number of inhabitants living in private households is used (formerly – number of the inhabitants at the beginning of a year)									

Since 2010, exports of the goods and services from Latvia have increased rapidly, and it has been the main driving force of the national economy. The amount of exports currently exceeds the level of exports before the crisis for more than 25%. However, the low demand in the foreign markets of the recent years has affected the dynamics of the exports, and it has become moderate. In 2013, the amount of exports increased only by 1.4%, but in 2014 – by 2.2%. In 2014, the increase was mainly determined by the increase of exports of goods, but the amount of exports of services decreased.

In the 1st quarter of 2015, the total amount of exports was by 3.5% higher than a year ago. The economic problems in Russia have affected the possibilities of exports of Latvia: in the first quarter of this year, the amount of exports to Russia in actual prices was by 28.5% lower than a year ago. At the same time, while the economic situation in the EU improved, the exports of Latvia to those countries increased by 4%. Exports to third countries increased as well at the beginning of the year, showing that the Latvian manufacturers are able to diversify their markets. In the first quarter of 2015, the volume of exports of services increased as well.

Further development of exports will be affected not only by the changes in the global demand, but also by the competitiveness of the Latvian manufacturers. It has to be taken into account that the improvement of the competitiveness of Latvia so far has occurred due to cuts in labour costs; however, further improvement of competitiveness will depend on the ability to raise productivity.

During the crisis, the amount of imports rapidly dropped due to decrease in the domestic demand. The demand for imports grows along the increase in economic activities in the domestic market. Yet, the dynamics of imports has become rather moderate since the middle of 2012. In 2014, imports increased only by 1.6 percent.

The external deficit on trade of goods and services in 2013 and in 2014 was 2.9% of the GDP. The current account deficit in 2013 was 2.3% of the GDP, but in 2014 – 3.1%. It shall be noted that **current account deficit in Latvia has been low since 2010 that gives evidence of the external balance of the economy in Latvia.**

Domestic demand has contributed much to the growth. The increase in employment and gradual increase of wages fosters the growth of the private consumption. In 2013, the amount of private consumption increased by 6.2%, but in 2014 – by 2.3%. In the 1st quarter of 2015, the total amount of private consumption was by 2.6% higher than a year ago. Like the overall growth of the economy, the dynamics of the growth of private consumption has become moderate.

As the situation in the budget has improved, the public consumption has started to grow. In 2013, the amount of public consumption increased by 2.9%, but in 2014 – by 3.4%. Similar rate of increase was observed also during the 1st quarter of 2015.

In recent years, the dynamics of investments in Latvia have been rather unstable. During the crisis in 2008-2009, the investments decreased considerably, while in 2011-2012 they increased significantly. In 2013, the amount of the investments in the national economy of Latvia decreased again – by 5.2%. In 2014, the dynamics of the investments were moderate, and the amount of investments was by 1.3% higher than a year ago. The level of investments still is significantly lower than during the years before the crisis. The increase rate of the investments is comparatively low due to the cautious attitude of entrepreneurs regarding the increasing uncertainty of the external factors. Low crediting level is still one of the factors limiting the investments. It shall be noted that the role of the state is important for the investment process – in the circumstances of poor crediting options the state ensures significant support to private investments using co-financing of the EU structural funds.

In recent years, the poor demand of export markets has been slowing down the growth of the manufacturing industry. After the crisis, the manufacturing industry was the main driving force of the development of the national economy. From 2009 until the end of 2012, the volume of production in the manufacturing industry increased by 24%. In 2013, the production volume in the manufacturing industry remained at the level of 2012. The termination of the operation of “Liepājas Metalurģs” in 2013 had a significant impact on the output of the industry, and, as a result, the volume of production of metal decreased considerably. In addition, the amount of the goods produced in 2014 was close to the one of the previous year. In the 4 months of 2015, the output volume of the manufacturing industry increased rapidly and was by 6.3% higher than a year ago.

Individual sub-sectors continue to grow steadily, but the production volume of other sectors decreases due to several factors. Production volume keeps growing in the largest industry sector – wood processing. Production volumes increased by 6.9% in 2014. In the 4 months of 2015, the production volumes were by 8.2% higher than a year ago. The metalworking sector has significantly contributed to the growth of the manufacturing industry at the beginning of 2015; it was because one of the largest industrial companies “KVV Liepājas Metalurģs” resumed its operation. The production volumes in the food sector in 2014 remained at the level of the previous year, but the output volume in January-April 2015 was by 5.1% lower than a year ago. The economic relationship between the EU and Russia has a significant impact on the development of the sector. The production of computers, electrical and optical equipment experienced the most rapid increase in the production volume in 2014

and at the beginning of 2015. The production volumes in light industry, manufacture of non-metallic mineral products, manufacture of paper, printing and publishing industry and chemical industry decreased.

The largest contribution to the increase of the GDP over the past years was ensured by the sectors focusing on the domestic demand. After significant recession during the crisis, the construction sector has resumed its growth that is fostered largely by public procurements and the EU funded projects. In 2013, the volumes of construction increased by 7.5%, mainly due to the increase in the engineering construction volume. In 2014, the building volume kept growing; it increased by 8.1%. The growth largely was fostered by a rapid increase of the construction of buildings in the first half of the year. However, the latest statistical data show that the growth of the construction sector in 2015 is expected to be moderate.

In 2013, the volume of the commercial services sectors increased by 6%, and taking into account the significant share of the sectors, it accounted for almost a half of the overall growth of the national economy. However, in 2014, the volume of services in the commercial services sector grew more slowly – by 1.3%. The increase in the volume in 2014 mainly was affected by the growth of the financial and insurance activities, as well as in art, entertainment and recreational services sectors. A moderate growth was observed in the information and communication services sector.

As the expenditure of the government increased, a steady increase was observed in public services sectors in 2013 – by 3.8%, but in 2014 – by 3.3 per cent.

In other industry, the production volume decreased both in 2013 and 2014, by 3.3% and 2.5% respectively. It is mainly related to the weather, as less electric power and heat energy was produced in comparison to the previous periods.

In the trade sector (including accommodation and catering services) the amount of services provided in 2013 increased by 4.8%. They kept growing also in 2014, however, the pace of growth was slower – 2.3%. The trading sector is fostered by the increase in the private consumption and retail turnover, while weak foreign trade activities slow down the growth of the wholesale.

In the transport sector, the growth reached 1.6% in 2013, and it was fostered by the increase in the freight turnover in road transport. In 2014, the volume of services provided in the sector was by 3.3% higher than a year ago. The increase of this sector in 2014 was fostered largely by successful operation of the ports and increase in the freights carried by road transport. At the beginning of 2015, the volume of services provided in the transport sector decreased – by 1.6% in the 1st quarter. The decrease was largely determined by the drop in the freight turnover in railway and ports.

In recent years, a moderate inflation has been observed in Latvia. In December 2014, the prices increased by 0.2% (12-months inflation) if compared to December 2013. The increase in consumption prices during the year was mainly influenced by the rise in prices for the services; they grew by 3.3% and increased the overall level of the prices by 0.9 percentage points. The major decreasing factor during the year was the drop in fuel prices (by 12.3%), it decreased the overall level of consumer prices by 0.8 percentage points. At the end of December, the global oil prices reached the lowest level during the last five and a half years; the global oil price decreased by 50% over the year. A more rapid drop of the fuel prices was delayed by the increase in the exchange rate of the US dollar against the euro. In addition, the drop in food prices (by 0.8%) had a large impact. It decreased the overall level of consumer prices by 0.2 percentage points. The global food prices decreased by 8.5% over the year and it was due to a rapid drop of dairy product prices. The drop in food prices in Latvia was further influenced by the embargo imposed by Russia on specific products as of August 2014. In 2014, average annual inflation increased by 0.6 per cent, if compared to the inflation in 2013.

In 2015, the inflation is mainly related to the dynamics of oil and food prices in the world. In May, consumer prices were by 1.2% higher than a year ago. **In 2015, average annual inflation may grow a little more rapidly than in the last year.**

After facing the financial market crash at the end of 2008 and at the beginning of 2009, the monetary indicators of Latvia have been gradually stabilising: the quality of credit portfolio has been improving and the amount of deposits attracted by banks has been growing. The amount of loans with overdue payments in the total loan portfolio was 13.1% in the 1st quarter of 2015, which is the lowest indicator since the end of 2008. The improvement of the credit portfolio of the banks is largely related to writing-off of the bad debts.

The volume of the deposits of the residents attracted by the banks keeps growing. Due to the planned introduction of the euro, the deposits increased very rapidly at the end of 2013. At the end of March of 2015, the volume of the deposits increased by 17.2%, if compared to the volume of the deposits of the same period in 2014.

However, the balance of credits keeps decreasing, though the negative trends become slower. This is mainly due to repayment of the previously granted credits and writing-off of bad credits. At the end of March of 2015, they have decreased by 3.5% if compared to the same period in 2014. The balance of mortgage and industrial loans shrank more rapidly. Meanwhile, the balance of commercial loans increased a little. In terms of volumes, more loans were granted for operations with real estate and in the manufacturing industry.

The fiscal situation in the country is stable. In 2014, the general government budget deficit was 1.4% of the GDP or 347 million euro that is by 0.4 percentage points more than planned in the *Stability Programme for Latvia* of the previous cycle. The reason for such deviations is a single transfer of capital for fulfilment of the obligations of the general government towards the European Reconstruction and Development Bank.

Pursuant to the Stability Programme for 2015-2018 submitted to the European Commission, expected general government budget deficit in 2015 is 362.1 million euro or 1.5% of the GDP. In the state budget of 2015, the following measures are determined as priority: strengthening of state social and national security, sustainable development of the economy in Latvia that would improve well-being of the society, as well as the measures to facilitate competitiveness of commercial activity.

Ensuring the stability of the tax policy and taking into account the commitment to decrease the labour force tax burden, the personal income tax rate has been decreased from 24% to 23% as of 1 January 2015. The contributions into the second level pension plan have been increased from 4% to 5%. As of 1 January 2015, the minimum wage is also increased from 320 to 360 euro. It is one of the ways of implementing the strategic objective of the national development: to decrease social inequality of the inhabitants. As of 2016, it is planned to introduce the differentiated non-taxable minimum.

Following the approval of the *Fiscal Discipline Law* (FDL) at the beginning of 2013, the national fiscal policy framework is based on the concept that envisages ensuring of balanced budget within an economic cycle, meaning that the volume of the structural budget balance of the general government does not exceed -0.5% of the GDP as it is envisaged by the FDL. Latvia reached the structural deficit of 0.5% of the GDP in 2012. Thus, the task for the following years is to maintain the structural deficit at the level of the middle-term targets.

Increase in the economic activities has a positive impact on the situation in the labour market: the unemployment rate caused by the crisis falls, while the employment rate rises. At the same time, certain population groups, especially people having a low level of education and qualification, elderly people, as well as young people, may have only a slight improvement. The pace of improvements also becomes slower due to the gradual decrease of the base effect in the labour market, as well as drop of the pace of growth related to the external tendencies.

In 2014, the situation in the labour market kept improving, though more slowly than in the previous periods. The unemployment rate decreased to 10.8%, which was by 1.1 percentage points less than in 2013, but the employment rate increased by 0.9 percentage points – up to 59.1%. In total, 884.6 thousand people were employed in 2014, but 107.6 thousand people were looking for a job; the latter is less by 12.7 thousand than in 2013.

In the 1st quarter of 2015, the number of employed people increased by 0.3%, and the employment rate increased by 1.1 percentage point, if compared to the corresponding period of the previous year. The unemployment rate, however, dropped by 1.7 percentage points – to 10.2% in the 1st quarter of 2015, if compared to the corresponding period in 2014.

In addition, the registered rate unemployment keeps decreasing – it was 8.6% at the end of May of 2015. 81 thousand unemployed people were registered, which is by 7 thousand less than in May 2014. The highest registered unemployment rate remained in Latgale region (18.9%), but the lowest – in Riga (5%). Almost one third of the total number of registered unemployed was long-term unemployed (jobless for more than a year).

Comparatively high unemployment rate is related to cyclic factors; however, the structural unemployment rate remains high. Some of the unemployed people may experience long-term problems in finding a job, as new jobs are not the same that were lost during the crisis.

The specialists of the Ministry of Economics forecast that, in total, **the number of employed people in 2015 may increase by 0.2%, but the unemployment rate may be close to 10 per cent.**

The correction of wages during the crisis was comparatively moderate; the most part of the drop of the economy volume was compensated by the decrease of the number of employed people. As the economic situation has stabilized, **wages have resumed growing since the end of 2010.**

Average gross wage in 2013 increased by 4.5%, but in 2014 – by 6.8%, and it reached 765 euro. A rapid increase in wages was observed in the 1st quarter of 2015: the average gross wage increased by 6.1% if assessed over the year.

Since 2010, the wages have increased in both the private and public sectors. It should be noted that the annual gross wage in the public sector in 2014 was only by 0.8% higher than in 2008, but it exceeded the level of 2008 by almost 19% in the private sector.

Thus, along the increase of nominal wages, the actual wage increases gradually as well. Since 2013, the increase of the actual wage has become more rapid. In 2013, the actual wage increased by 5.6%, but in 2014 – by 8%. In the 1st quarter of 2015, the actual wage increased by 6.8%. Since 2013, the increase of the actual wage was determined by the rapid increase in the nominal wage, as well as slow increase in consumer prices.

Further development of the national economy in Latvia still will be closely related to export possibilities; **therefore, the major risk of the development of Latvia is related to the development of the global economy.**

The growth of the national economy in the middle-term will depend on several factors. As Latvia is a small open economy with a relatively high level of market liberalization, its growth significantly depends on the development of the global economy and the maintenance

of a stable competition. The dynamics of the development of the economy of the EU and improvement of the geopolitical situation created by the crisis in Ukraine is especially important. The economic strengths of Latvia in the middle term will mainly be based on the macroeconomic stability achieved, as a result of which the credit rating of Latvia has improved, as well as on the basis of the efficiency of the planned support programmes of structural funds and improvements in business environment.

The rapid growth scenario envisages that the most important export markets of Latvia will resume their growth, and the advantages of the competitiveness of the economy in Latvia are mainly based on technological factors, improvement of production efficiency and innovations, to a less extent – to cheap labour force and low prices of resources. **In the middle term, the pace of growth of Latvia may reach the annual increase of 4-5%.** The scenario of weaker growth, however, envisages that the pace of growth of Latvia could be much slower if the growth of Europe remains slow and the geopolitical situation created by the crisis in Ukraine does not improve.

2. GLOBAL ECONOMIC ENVIRONMENT¹

Global economic growth was moderate in 2014, as it increased in the developed countries and slightly slowed down in the developing countries. Despite the slower growth, the contribution of the developing countries to global growth was still very significant. Global growth was facilitated by gradual recovery of demand, decrease in oil prices, measures of monetary expansion etc. Still, geopolitical tensions in some regions, as well as such fundamental factors as the slowing down of growth potential and ageing society are still significant hurdles for growth.

The European Commission forecasts that in 2015 the global economy will grow by 3.5%, whereas in 2016 the growth rate will increase to 3.9 per cent.

In 2014, stable growth was observed in the economy of the **USA**, although it slowed down in late 2014. This growth slowdown was related to increased imports and a higher USD value. The GDP in 2014 in total was by 2.4% higher than in 2013.

At the beginning of 2015, the U.S. economy growth was also slightly slower than expected, as well. The growth is still positively influenced by the low price of oil, development on the labour market and improvement in

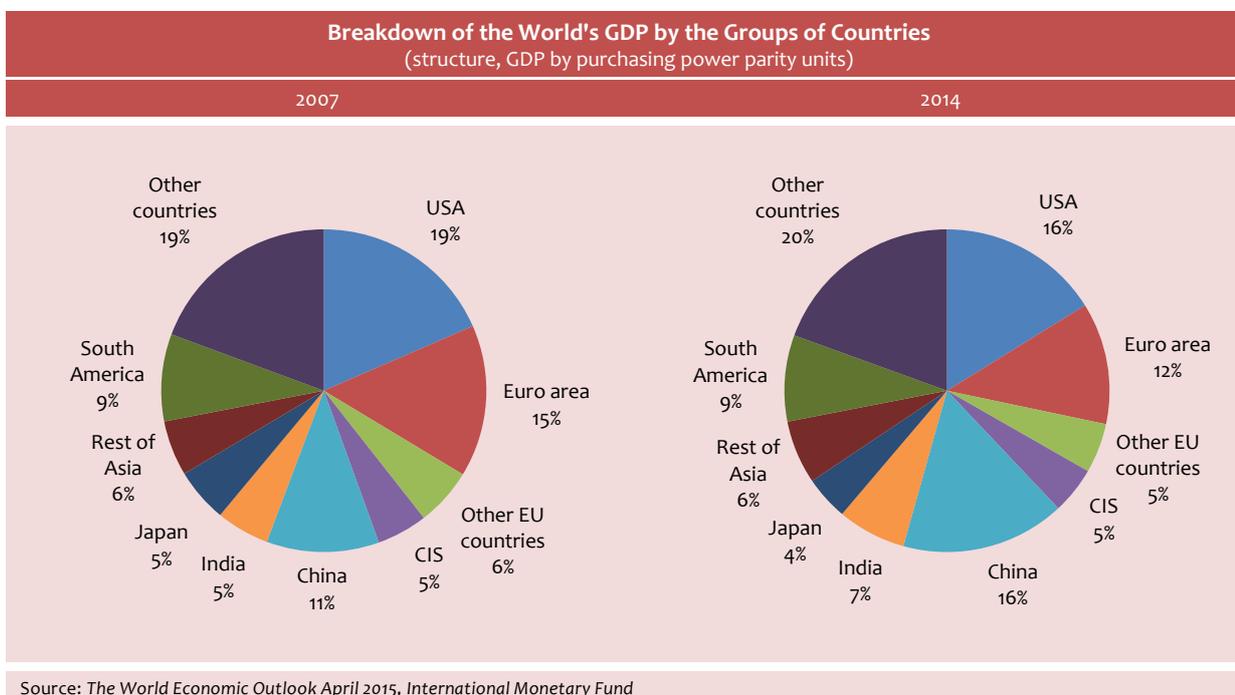
confidence among businesses and consumers. It should be noted that up until now the U.S. economy has been resilient to the unfavourable external environment and strengthening of the USD exchange rate.

Table 2.1

GDP Growth (% compared to the previous year)				
	2013	2014	2015f	2016f
World including:	3.3	3.4	3.5	3.9
USA	2.2	2.4	3.1	3.0
Japan	1.6	0.0	1.1	1.4
EU including:	0.0	1.4	1.8	2.1
Euro area	-0.4	0.9	1.5	1.9
Russia	1.3	0.6	-3.5	0.2
China	7.6	7.4	7.0	6.8

Source: European Commission- European Economic Forecast, Spring 2015
f – forecast

Figure 2.1



¹ The following publications have been used in preparation of this section: *European Commission- European Economic Forecast, Spring 2015*; *International Monetary Fund- World Economic Outlook, April 2015*

Further growth in the USA will remain slightly above the potential level. The situation on the labour market will continue to improve, and energy prices will stay low. Growth will be also stimulated by a favourable monetary and fiscal policy. However, it should be noted that, in the short term, the growth will be slightly weaker than expected.

Asian countries remain leaders in global growth. Although growth accelerated in many states within the region, in its largest economies – China, Indonesia and

Japan – it slowed down: overall growth rate in the region in 2014 was slightly slower than in the previous years. Decrease of demand in China, Japan and countries in the euro area negatively influenced the growth of export from the Asian region, which was partially compensated by growth of demand in the USA. Growth of investment was also slower, especially in China, mainly due to adjustments on real estate markets. Private consumption being the main driving force of growth in majority of countries in the region (excluding Japan) remained stable.

Table 2.2

Main Macroeconomic Indicators of EU Member States (per cent)									
	GDP growth			Consumer prices			Unemployment		
	2014	2015f	2016f	2014	2015f	2016f	2014	2015f	2016f
EU	1.4	1.8	2.1	0.6	0.1	1.5	10.2	9.6	9.2
Austria	0.3	0.8	1.5	1.5	0.8	1.9	5.6	5.8	5.7
Belgium	1.0	1.1	1.5	0.5	0.3	1.3	8.5	8.4	8.1
Denmark	1.1	1.8	2.1	0.3	0.6	1.7	6.6	6.2	5.9
France	0.4	1.1	1.7	0.6	0.0	1.0	10.3	10.3	10.0
Greece	0.8	0.5	2.9	-1.4	-1.5	0.8	26.5	25.6	23.2
Italy	-0.4	0.6	1.4	0.2	0.2	1.8	12.7	12.4	12.4
Ireland	4.8	3.6	3.5	0.3	0.4	1.5	11.3	9.6	9.2
United Kingdom	2.8	2.6	2.4	1.5	0.4	1.6	6.1	5.4	5.3
Luxembourg	3.1	3.4	3.5	0.7	0.8	2.1	5.9	5.7	5.4
The Netherlands	0.9	1.6	1.7	0.3	0.2	1.3	7.4	7.1	6.9
Portugal	0.9	1.6	1.8	-0.2	0.2	1.3	14.1	13.4	12.6
Finland	-0.1	0.3	1.0	1.2	0.2	1.3	8.7	9.1	9.0
Spain	1.4	2.8	2.6	-0.2	-0.6	1.1	24.5	22.4	20.5
Germany	1.6	1.9	2.0	0.8	0.3	1.8	5.0	4.6	4.4
Sweden	2.1	2.5	2.8	0.2	0.7	1.6	7.9	7.7	7.6
Bulgaria	1.7	1.0	1.3	-1.6	-0.5	1.0	11.4	10.4	9.8
Czech Republic	2.0	2.5	2.6	0.4	0.2	1.4	6.1	5.6	5.5
Croatia	-0.4	0.3	1.2	0.2	0.1	1.3	17.3	17.0	16.6
Estonia	2.1	2.3	2.9	0.5	0.2	1.9	7.4	6.2	5.8
Cyprus	-2.3	-0.5	1.4	-0.3	-0.8	0.9	16.1	16.2	15.2
Latvia	2.4	2.3	3.2	0.7	0.7	2.2	10.8	10.4	9.4
Lithuania	2.9	2.8	3.3	0.2	-0.4	1.7	10.7	9.9	9.1
Malta	3.5	3.6	3.2	0.8	1.3	1.9	5.9	5.9	5.9
Poland	3.4	3.3	3.4	0.1	-0.4	1.1	9.0	8.4	7.9
Romania	2.8	2.8	3.3	1.4	0.2	0.9	6.8	6.6	6.4
Slovakia	2.4	3.0	3.4	-0.1	-0.2	1.4	13.2	12.1	10.8
Slovenia	2.6	2.3	2.1	0.4	0.1	1.7	9.7	9.4	9.2
Hungary	3.6	2.8	2.2	0.0	0.0	2.5	7.7	6.8	6.0

Source: European Commission- European Economic Forecast, Spring 2015
f – forecast

In 2015, stable growth is expected in Asian countries, and the region will maintain its leading position in terms of growth. Despite the indicators of China's growth approaching a more sustainable rate, growth will accelerate in other countries of the region. The growth will be based on a decrease in prices of consumer goods and oil, as well as the increasing external demand and continued favourable financial conditions.

Due to a moderate increase of wages, favourable monetary policy and beneficial external demand, economic growth in Japan will be slightly above 1% in 2015.

Although growth in China in early 2015 was slightly slower than it was expected, the overall growth in 2015 will reach 7%. This will mainly be the result of low oil prices, strengthening growth in the region and increasing domestic demand.

In turn, thanks to political reforms, an increase of investment and low oil prices, growth in India in 2015 is expected to be slightly faster than before, i.e. 7.6 per cent.

Growth in **CIS countries** slowed down in the second half of 2014. It was caused by a decrease in private consumption, fall in oil prices, international sanctions imposed on Russia, as well as structural shortcomings of the Russian economy, which led to a sharp decline of the Russian ruble and rapidly increasing inflation. In response to this situation, interest rates were increased significantly and various other measures were implemented by the Russian Central Bank to stabilise the economic situation in the state. These events in Russia significantly slowed the growth of other national economies in the entire CIS region.

The GDP in CIS countries will shrink in 2015; a slight increase is expected only in 2016, with exceptions only in a few Central Asian states — Tajikistan, Uzbekistan and Turkmenistan, where relatively rapid growth will continue in 2015, as well. The main factor

restricting growth is linked to geopolitical tensions in this region.

With reduction of investment, further growth in **Russia** is evaluated as weak. The major banks of Russia still have a limited access to capital markets of Western countries, which makes borrowing costs significantly higher. The outflow of capital will continue, economic uncertainty will remain and the business environment will deteriorate in 2015. Positive growth in Russia is expected only in the second half of 2016, facilitated by a worldwide increase in oil prices.

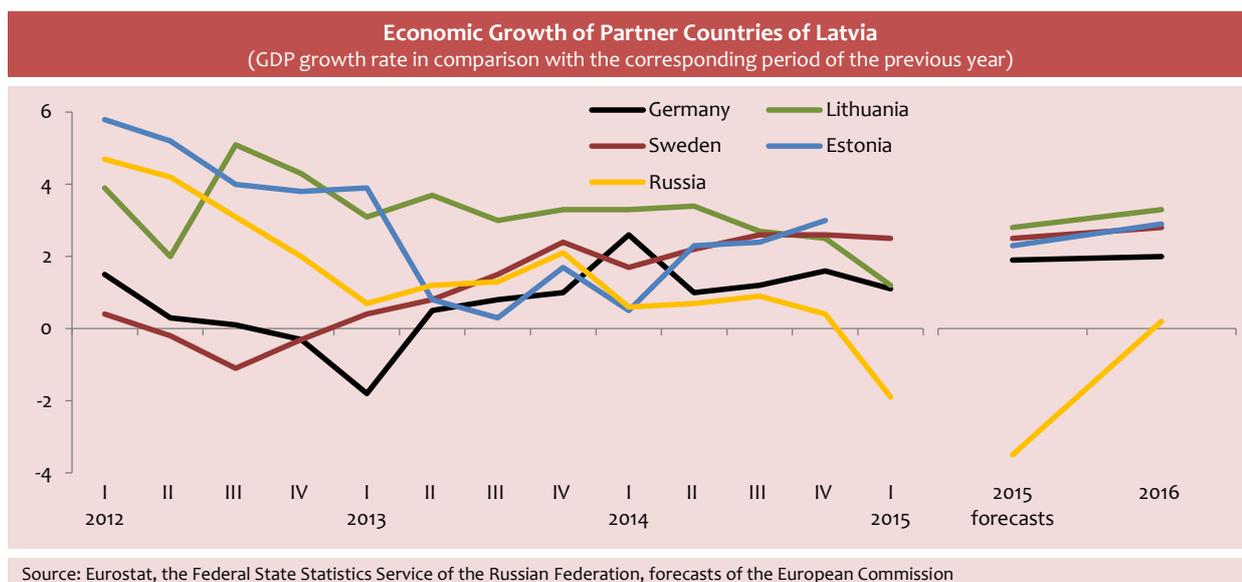
Economic recovery continued in the **European Union** and euro area in 2014, whereas the GDP growth was slower than previously expected, due to the low demand as well as high levels of debt and unemployment rate. Manufacturing and investment levels also remained below the pre-crisis indicators.

Economic activities in the EU are still moderate. Low prices of oil and supportive financial conditions still remain, although growth is weakened by the continuously low inflation.

In early 2015, EU development prospects improved significantly. The main factors of growth in 2015 are low oil prices, decrease of the euro's exchange rate against the U.S. dollar, as well as monetary policy measures (quantitative easing) implemented by the ECB and their downward pressure on interest rates. Risks affecting growth still exist; however, their impact is expected to be lower than previously.

Stronger growth will improve indicators of the labour market in the future, which will positively influence private consumption. Increasing demand and lower necessity for balance corrections will promote investment. Structural reforms implemented so far in some countries within the region have given positive results, however, these reforms are still not sufficient to improve growth prospects in the medium term.

Figure 2.2



The growth rate in **the Baltic countries** remains higher than the EU average, even though it has decelerated due to a slowdown in export growth.

The growth rate in **Lithuania** in 2014 was slightly slower than the year before. The Russian crisis negatively influenced exports and the amount of investment in the second half of the year. Private consumption continued growing rapidly, unemployment rate fell, and wages increased. Due to low oil prices, the inflation rate decreased, thereby accelerating an increase of disposable income for households.

The growth in Lithuania will remain stable in 2015. Domestic demand, especially private consumption, as well as increasing employment and wages, coupled with low inflation, remain the driving forces of growth. Investment will slow down due to the geopolitical uncertainty.

Growth in **Estonia** in 2014 was slightly faster than the year before, despite the GDP falling in its main trading partner country Finland, as well as in Russia. The largest contribution to growth was made by domestic trade and manufacturing sectors, whereas turnover in the transport and construction sectors decreased. Private consumption was promoted by a significant increase of wages, higher retirement pensions and low inflation. Volumes of investment decreased in the second half of the year. Despite the weak external environment and the import embargo imposed by Russia, exports increased.

As the external environment improves, the growth rate in Estonia will slightly increase in 2015. The main driving force of growth will be private consumption, facilitated by low inflation, increase of wages, lower income tax rate and higher family allowances.

Following weak economic growth in 2012–2013, the economic situation in **Germany** improved in 2014. It was mainly determined by private consumption and investment. Export growth was moderate. Following good growth indicators in late 2014, growth was slightly slower in the beginning of 2015, as the influence of low oil prices decreased. Growth in this period was facilitated by development of the manufacturing and service sectors.

Given a stable labour market, a favourable external environment, low euro exchange rate and favourable financial conditions, growth in Germany in 2015 is generally expected to be slightly above the potential level.

The economic growth of **Sweden** in 2014 was the fastest in the last four years. The main driving force of such growth was consumption, as well as a positive increase in investment.

In 2015, stable domestic demand will continue, and a positive increase in exports is expected due to economic growth in states within the euro area and the weaker Swedish krona. In turn, low oil and energy prices will have a limited positive effect, taking into consideration the low energy intensity of the Swedish economy and the high taxes on energy products. The growth rate in Sweden will continue to increase in 2016.

3. GROWTH

3.1 Gross Domestic Product and Aggregate Demand

3.1.1 Development Trends

Figure 3.1

Since 2011, the growth of economy in Latvia has been one of the most rapid in the EU. From 2011 until 2013, the annual growth of economy reached an average of 4.7%. In the first years after the crisis, the growth of economy in Latvia was largely fostered by the increase of exports volume. Since 2013, the unfavourable external situation has been limiting export possibilities. Private consumption grows faster, as it is fostered by a gradual increase in employment and wages.

In 2014, the pace of the growth of economy decreased due to external tendencies – the growth of the EU being slower than expected, as well as the economic situation in Russia becoming weaker. In total, GDP increased by 2.4% in 2014, and the growth was still more rapid than on average in the EU. However, despite the rapid growth, GDP is by 5% smaller than it was before the crisis – in 2007.

In the first quarter of 2015, GDP increased by 1.9%, if compared to the first quarter of 2014; it should be treated as a good indicator, taking into account the unfavourable geopolitical situation in the region.

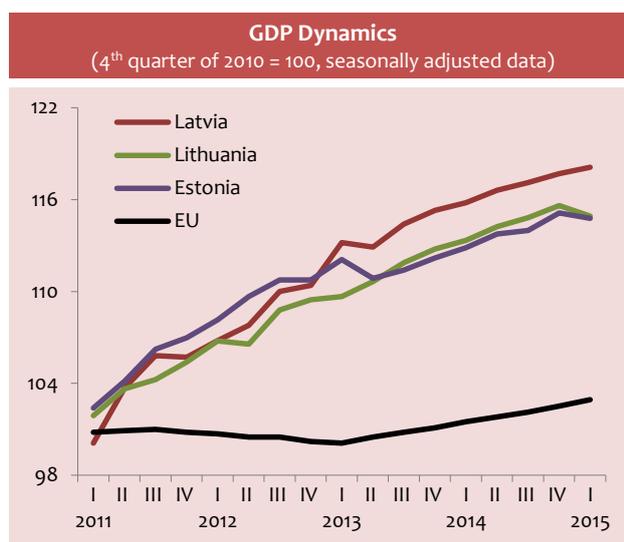


Table 3.1

	2008	2009	2010	2011	2012	2013	2014
Gross domestic product	-3.2	-14.2	-2.9	5.0	4.8	4.2	2.4
Private consumption	-8.0	-16.2	3.1	2.9	3.0	6.2	2.3
Public consumption	2.4	-10.7	-8.1	3.1	0.4	2.9	3.4
Gross fixed capital formation	-9.2	-33.3	-20.0	24.2	14.5	-5.2	1.3
Exports	2.4	-12.9	13.4	12.0	9.8	1.4	2.2
Imports	-10.7	-31.7	12.4	22.0	5.4	-0.2	1.6

Since 2010, exports of the goods and services from Latvia have increased rapidly, and it has been the main driving force of the national economy. The amount of exports in 2012 exceeded the level of exports before the crisis for almost 25%. Since 2013, the dynamics of the exports have become moderate due to the low demand in foreign markets.

In 2014, the volume of exports of the goods and services increased only by 2.2% – the exports of goods increased by 4.6%, while the exports of services dropped by 3.4 per cent.

In addition, in 2015, the dynamics of the exports of the goods and services has been moderate, and in the 1st quarter, the volume of the exports increased by 3.5%, if compared to the 1st quarter of 2014.

In 2014, the domestic demand increased by 2.3%. Although the domestic demand in 2014 was by 18.2% higher than at its lowest point during the crisis in 2010, it still was behind the pre-crisis level in 2007 by 15.5%.

In 2015, the domestic demand kept growing – it increased by 2%, if compared to the 1st quarter of 2014.

After the crisis, economic activities gradually increased in the domestic market, therefore the demand for the imports of the goods and services increased rapidly. However, the dynamics of imports have become very moderate since the middle of 2012.

In 2014, the imports of goods and services increased by 1.6%. The increase was fostered by a drop in volumes of some groups of goods, like mineral products, agricultural and food products, and transport vehicles.

In the 1st quarter of 2015, the imports dropped by 1.2 per cent, if compared to the 1st quarter of 2014.

Table 3.2

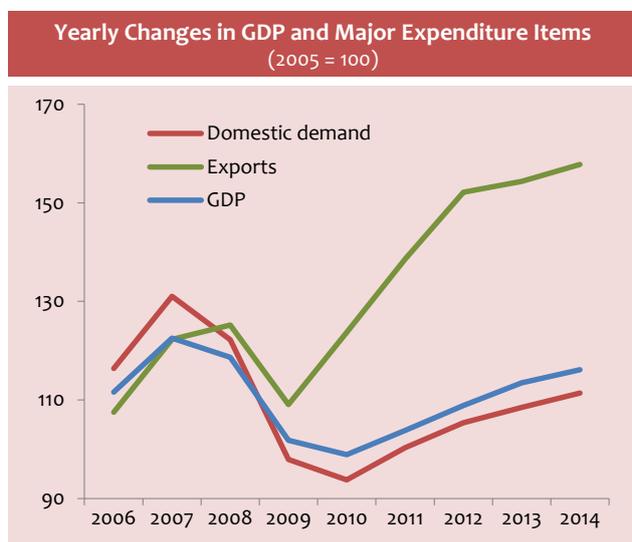
GDP by Expenditure Items by Quarters (changes compared to the corresponding period of the previous year, per cent)													
	2012				2013				2014				2015
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Gross domestic product	8.8	4.3	3.7	3.4	3.1	4.6	4.6	4.5	2.8	2.3	2.4	2.1	1.9
Private consumption	3.0	4.6	2.7	1.8	5.9	8.2	8.4	2.3	2.7	2.3	2.1	2.2	2.6
Public consumption	-8.8	5.5	0.2	3.7	6.2	1.2	3.7	1.5	3.7	4.2	1.7	3.8	3.4
Gross fixed capital formation	30.6	22.0	3.2	12.4	-15.6	-2.5	-2.9	-2.8	9.3	1.8	-1.7	-0.6	-0.9
Exports	12.4	5.9	10.6	10.3	3.4	2.1	-0.4	1.0	3.5	1.8	0.4	3.3	3.5
Imports	11.7	7.0	0.9	3.4	1.9	-1.8	0.2	-0.9	1.2	3.0	-0.7	2.8	-1.2

During the crisis, the Latvian imports-exports balance improved significantly. Yet in 2007, the exports-imports balance exceeded -20% of GDP. Since 2009, the exports-imports balance has been improving.

In 2013 and 2014, the exports-imports balance was -2.9% of GDP.

In 2015, the exports-imports balance still improves, and in the first quarter it was -2.1% of GDP.

Figure 3.2



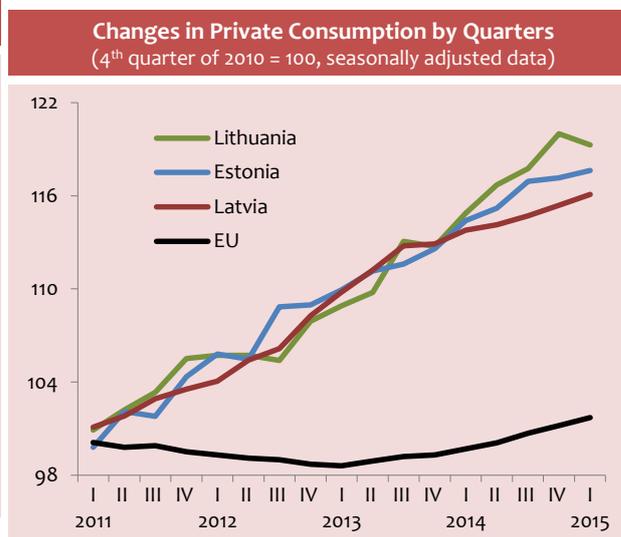
3.1.2 Private and Public Consumption

In recent years, the growth of private and public consumption has been fostered by a gradual increase in employment rate and increase in wages. In 2012, the private consumption grew by 3%, in 2013 – by 6.2 per cent.

Private consumption kept growing in 2014, though the growth rate was more moderate than in 2013 like the overall growth of economy. Over the year, private consumption increased by 2.3%, and the growth was fostered by the increase in average wages; however, at the same time, the rate of employment growth was slow.

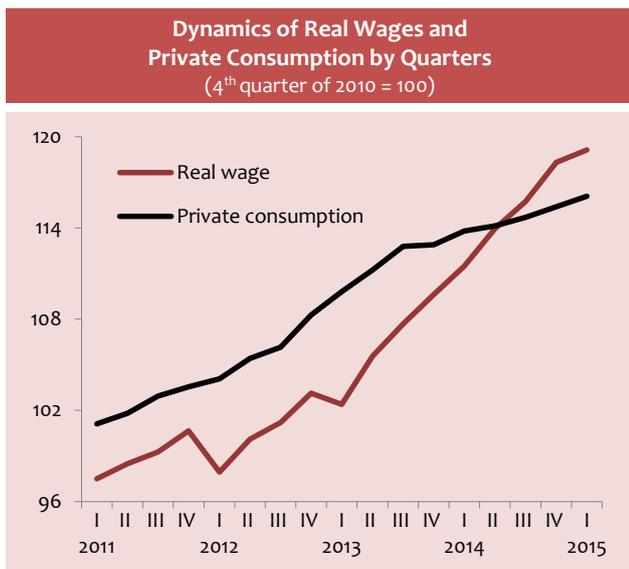
In the 1st quarter of 2015, private consumption increased by 2.6 per cent, if compared to the 1st quarter of 2014.

Figure 3.3



In 2014, the expenditure of households increased in general, if compared to 2013. Expenditure for food increased by 4%, for transport – by 2% and for recreation and culture – by 5%. The expenditure for maintenance of residential houses, in its turn, decreased by 1 per cent.

Figure 3.4



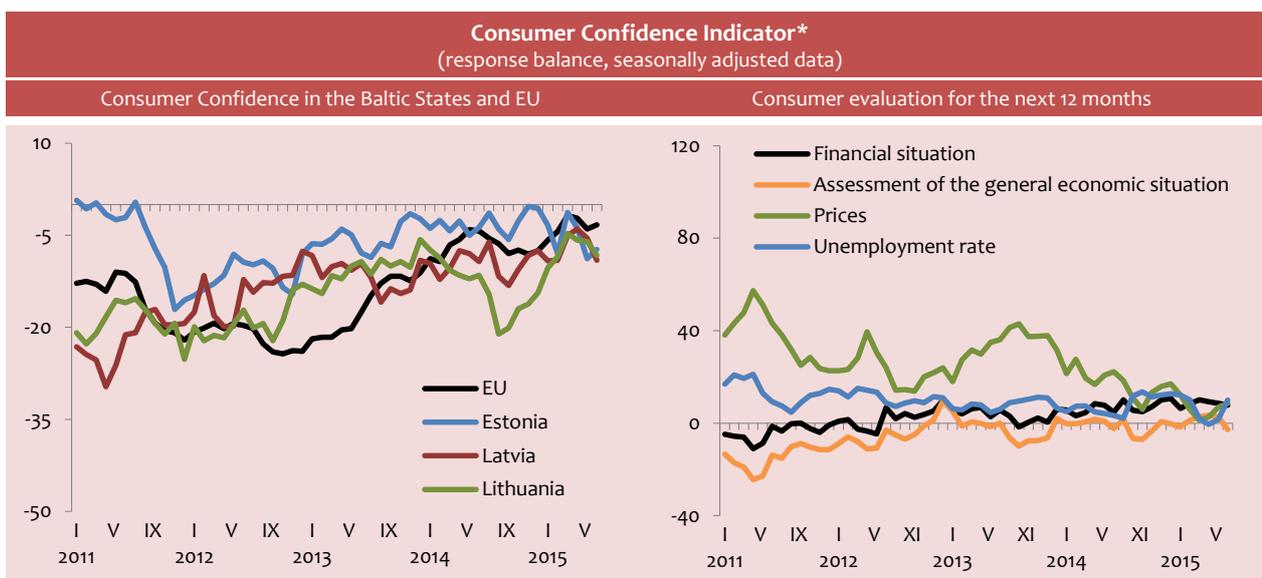
From 2011 to 2012, consumer confidence increased rapidly. However, despite the continuous improvement of the confidence, significant changes in consumers' mood are not observed, and it still is negative.

Since the middle of 2012, the optimism of consumers regarding the financial situation in their families has largely become stable, and it has a tendency to improve.

Consumer reviews of the overall situation in the country essentially have not changed from 2013.

Unemployment and inflation expectations in general diminish. The consumer unemployment expectations have been decreasing since the end of 2011, except for a small increase at the end of 2014; but the inflation expectations have been highly recurring since 2011; consumers react towards different changes in the country this way, for instance, to the introduction of the euro or opening of the energy market.

Figure 3.5



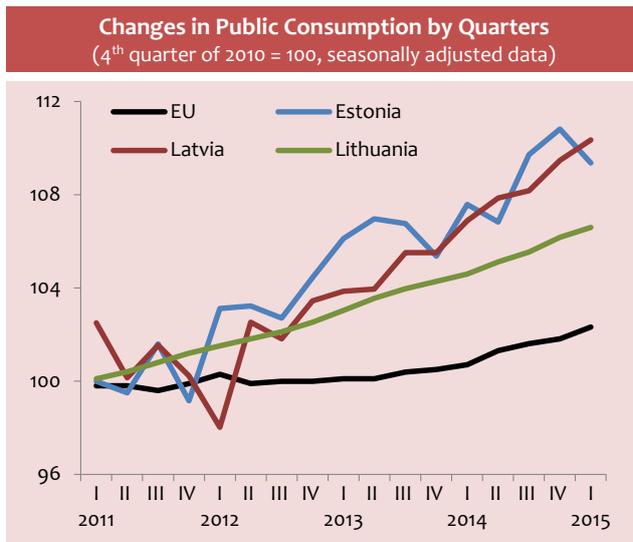
* The consumer confidence indicator is calculated as the average balance amount of responses to 4 questions regarding the financial situation, general economic situation, evaluation of unemployment and savings in the following 12 months.

The volumes of **public consumption** or public services decreased fast during the crisis. In 2011, public consumption was by 13.3% lower than in 2007. The drop was due to the implementation of state budget consolidation measures. It resulted in a reduced share of public consumption in GDP. In 2008, public consumption accounted for 20% of GDP. In 2012, the volume of public consumption constituted only 17% of GDP. Although the economic situation was improving, the government commitment to keep on reducing the budget deficit limited rapid increase in expenditures also in 2012. In 2013, the volumes of public services increased by 2.9 per cent compared to 2012.

In 2014, public consumption increased by 3.4%; however, despite a gradual increase, the public consumption still fell behind the level of the pre-crisis period.

In 2015, public consumption kept growing – in the first quarter it increased by 3.4%, if compared to the first quarter of 2014.

Figure 3.6



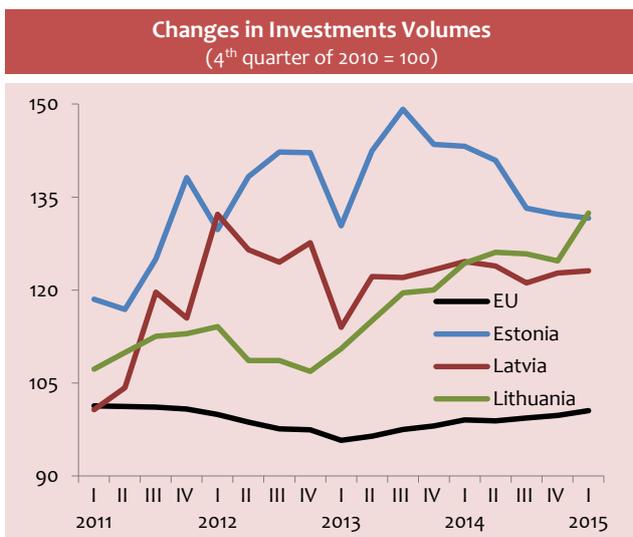
3.1.3 Investments

Investment activities in Latvia, like in other EU Member States in general, have been rather moderate in recent years, and the volumes of investments still have not reached the level of the pre-crisis period.

Low investment rate and weak dynamics slow down renewal and modernization of fixed assets that may decrease the competitiveness of the state and its growth potential, thus affecting the productivity and the ability to create jobs.

In 2014, the volume of investments in the EU Member States in total has decreased by almost 12.5%, if compared to 2007, and it was 19.3% of GDP, i.e., almost by 2.5 percentage points lower than on average in 2004-2007.

Figure 3.7

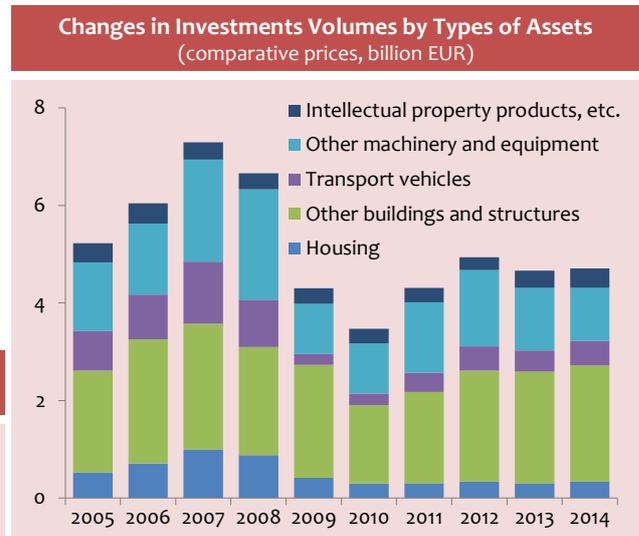


In some EU Member States, the decrease of investments is even more dramatic, for instance in Greece – by 65%, Cyprus – by 57%, Romania – by 45%, Ireland, Portugal, Spain – by almost 35%. At the same time, it should be noted that the volumes of investments in Germany, Poland and Belgium in 2014 exceeded the level of 2007 by 4.9%, 26% and 2% respectively.

The decrease of investments in the Baltic States during the crisis was almost four times larger than on average in the EU, and in 2010, the investments were by 63% lower than before the crisis. Investment activities grew along with the stabilizing economic situation, however, the volume of the investments in the Baltic States in total fell behind the pre-crisis level by 30% in 2014.

The investments in Latvia have been rather unstable since 2008. During the years of rapid recession, they decreased almost twice. Since late 2010, positive dynamics of the investments resumed, and in 2011, the volume of investments exceeded the level of 2010 by 24.2%. The rapid increase in investments was largely related to the low base effect. Thus, in 2012, the pace of growth of investments was almost twice as slow (increased by 14.5%), but in 2013, the investments in the national economy of Latvia decreased by 5.2 per cent, if compared to 2012.

Figure 3.8



In the first half of 2014, the dynamics of investments were positive. In the first quarter, the investments in the national economy of Latvia grew by 9.3%, while in the second quarter – by 2.1%. In the third and fourth quarter, the volume of investments was by 1.7% and 0.6% lower respectively than a year before. In total, the investments increased by 1.3% in 2014, and they constituted 23% of GDP. The investment process has been very moderate also in early 2015. In the first quarter of this year, the volumes of investments in the national economy of Latvia were by almost 1% lower than a year before. It was mainly due to a decrease in the investments

in residential houses and transport vehicles that was partly compensated by an increase in investments in other machinery and equipment, as well as intellectual property products. It is expected that investments in the national economy of Latvia will maintain a moderate growth. The low level of investments and weak dynamics are largely influenced by weak crediting, a relatively low demand, a comparatively high level of debt obligations of the private and public sector, as well as uncertainty of foreign economic and political situation.

The structure of the invested assets has changed since 2007. It was mainly determined by a significant drop in the investments in residential houses, as well as machinery and equipment during the recession years. In 2010, the investments in residential houses decreased by 70.3%, but in transport vehicles and equipment – by 62.4%, including transport vehicles – by 81.3%, if compared to 2007. During the following two years, the investments in machinery and equipment increased a little; however, since 2013, less and less investment has been made in those assets, and their volumes in 2014 were half of the volumes in 2007. The investments in residential houses, in their turn, basically did not increase, and in 2014 they constituted only 35% of the pre-crisis level.

The investments in other buildings and constructions were relatively consistent. In 2010, they decreased by 37.5%, if compared to 2007. In the following three years, the investments in those assets increased rather rapidly – by 42.3%, mainly owing to significant state investments in infrastructure projects. In 2013, the volumes of the

investments in buildings and constructions were almost at the level of the pre-crisis period, and they constituted 48.5% of the total investments in the national economy of Latvia.

In 2014, the most rapid growth was experienced by investments in residential houses and transport vehicles, respectively by 13.3% and 16.7%, whereas the investments in manufacturing equipment decreased by 15.2% if compared to the previous year. In the first quarter of 2015, the investments in construction of residential houses, as well as other buildings and constructions in total were by 6% lower than a year before, but the investments in manufacturing equipment increased by 4.4 per cent.

The role of the state in the investment process has become more important over the past few years. The state provides a significant support to private investments through the EU structural funds co-financing under weak crediting conditions.

Although during the recession the volume of the state investments decreased, its share in the total investments in the national economy of Latvia increased, and it reached 24% in 2010, i.e. it was by 8 percentage points higher than in 2007. In 2011, the state investments increased by 16%, constituting 4 percentage points of the total growth of the investments. However, the state investments in 2012 and 2013 were by 3.4% and 7.3% lower respectively than a year before. The volume of the state investments in 2014 was by 8.8% lower than a year before, whereas the private investments increased by 2 per cent.

Table 3.3

Gross Capital Formation						
	2008-2010 average annual	2011	2012	2013	2014	2015 I-III
growth rate, per cent						
Gross domestic product	-6.9	5.0	4.8	4.2	2.4	1.9
Gross capital formation	-25.1	42.1	2.6	-4.0	-0.1	-14.1
– gross fixed capital formation	-21.5	24.2	14.5	-5.2	1.3	-0.9
% of GDP						
Gross capital formation	25.8	24.3	26.0	23.8	24.2	20.4
– gross fixed capital formation	25.2	22.1	25.2	23.3	23.0	18.9
– changes in inventories	0.6	2.1	0.8	0.6	1.1	1.4

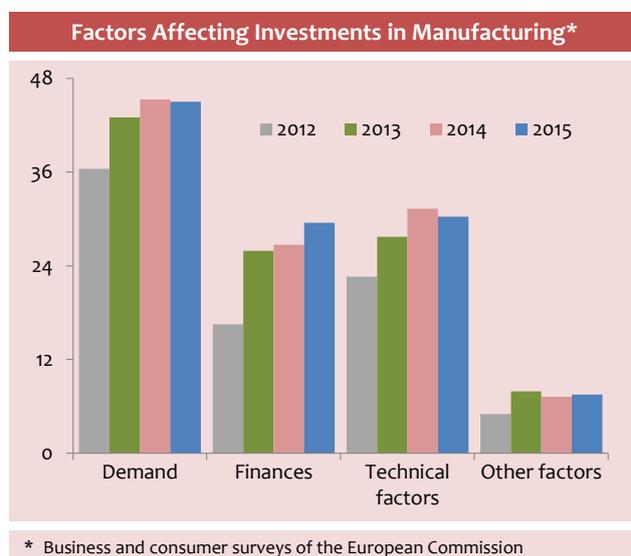
Results of enterprise manager surveys show that the increase in demand is the main factor promoting investments. Since 2013, the role of “access to finance” factors in promoting investments has significantly increased. In 2015, the access to finance is estimated to be a significant factor promoting investments of equal importance to the factors of technical character, such as development of technologies, availability of qualified workforce, etc. It should be noted that technical factors have been mentioned as the main drivers for investments

followed by demand factors in the EU Member States over the past few years.

The capacity load level in the manufacturing has been gradually increasing since the beginning of 2010. At the end of the second quarter of 2015, it reached 71.3%, which is only by 1 percentage point lower than at the end of 2007. Low investment activities at comparatively high capacity load level give evidence of reserved mood of investors. An increase in demand, as well as entrepreneurs’ positive future expectations may foster not only an increase in the capacity load, but also an

increase in investments. Positive trends in the investing process are expected to largely depend on the access to credit resources and other external financing sources and on the wish to strengthen the positions in foreign and domestic markets, including by technologically renewing the existing production capacity.

Figure 3.9



Structure of investments by sectors.¹ Due to the financial crisis, the investments dropped in all sectors. Particularly large decrease in the volume of investments was observed in the field of construction. In 2010, investments in the construction sector were by 78% lower than in 2008. Almost as large decrease in the volume of investments was in trade and accommodation and catering service sectors. Investments in such sectors

as information and communications services, health and social care, mining and energy decreased rather moderately.

Positive investment dynamics have renewed in some sectors since the end of 2010, and in 2011, the said dynamics were very rapid. Investments in goods manufacturing sectors in 2011 were by 49.4% higher than a year before; it was largely determined by significant investments in the energy sector and manufacturing. Investments in the services sector, in their turn, increased by 12% and constituted almost 60% of the total investments in the national economy of Latvia.

Investments dynamics in services sector in 2012 increased slightly more rapidly than a year before – by 19.2%. It was mainly determined by large investments in the transportation and storage sector, as well as in activities related to immovable property. Investment dynamics in goods production sectors were moderate (by 6.6%); it was largely influenced by a decrease in investments in the construction sector.

According to provisional data, the volumes of investments in services sectors in 2013 remained at the level of 2012, whereas the investments in goods production sectors in total were by 14.7% lower than a year before. Slowdown of investments in the services sectors was largely influenced by a decrease in the investments in the trade and transportation and storage sectors. The decrease of the volume of investments in goods production sectors was determined by the drop of investments in the manufacturing (by 31.2%) and energy sector (by 21%). It was compensated in part by an increase in investments in construction, as well as wastewater, waste management and treatment.

Table 3.4

Dynamics and Structure of Investments by Sectors*								
	growth rate				structure			
	2012	2013	2014	2015 I-III	2012	2013	2014	2015 I-III
	Agriculture and forestry	7.0	2.5	-17.9	-27.8	7.0	7.5	4.4
Manufacturing	7.6	-30.6	21.9	6.9	13.4	9.7	12.8	14.8
Construction	-29.1	6.1	-10.8	3.0	3.0	3.3	2.2	2.7
Trade and accommodation	19.9	-4.6	25.2	11.2	8.5	8.5	7.1	8.9
Transport and storage	31.1	-5.5	12.7	50.0	15.7	15.6	18.4	21.8
Other commercial services	34.1	7.1	4.2	-10.5	20.7	23.3	14.5	15.9
Public services	-3.9	4.3	-2.7	-5.6	16.3	17.9	26.6	19.1
Other industry	16.6	-12.0	-17.6	3.9	15.4	14.2	14.0	11.8
Total	14.5	-5.2	1.4	4.9	100	100	100	100

* 2013 – provisional data; 2014 – evaluated according to quarterly data

¹ Investments by sectors are presented according to the non-financial investment statistics.

In 2014, the investments in the sectors of the Latvian national economy in total remained at the level of the previous year. However, the dynamics was rather different from sector to sector. Investment volumes in services sectors increased by 5.3%, whereas the investments in goods production sectors were by 5.4% lower than in 2013. The growth of the investments in services sectors was largely determined by a significant investment volume increase in information and telecommunications services – by 36.4%, and trade – by 30.4%. The decrease in investment volume in goods production sectors was mainly related to decreased investments in the energy sector and agriculture that was compensated only partly by the growth of investments in the manufacturing. In 2014, the volumes of investments in the energy sector were by 19% lower than a year before. It can be explained by the completion of large investment projects in the previous year. Similar tendencies are present at the beginning of 2015. In the first quarter of this year, the total investments in services sectors were by 8.5% higher than a year before, mainly owing to significant investments in the transportation and storage sector. In goods production sectors, the negative dynamics was maintained, and in the first quarter of 2015, the investments were by 1.3% lower than in the first quarter of the previous year.

Investing processes in the manufacturing are uneven with considerable fluctuations in the recent years. During the rapid recession of economy, the volumes of

investments in the sector decreased almost three times, reaching the lowest point in 2009. It was largely determined by a decrease in investments in the production of consumption goods (including the food industry – by 44%), as well as in intermediate consumption goods sectors (including wood processing – by 88% and production of chemical substances and products – by 77%).

Since 2010, the sector resumed positive dynamics. In 2010, the investments in the manufacturing exceeded the level of the previous year by 5.5%. Investments in the sectors of production of non-durable consumer goods and investment goods were increasing most rapidly. The wood processing sector, paper industry and publishing, as well as production of pharmaceuticals had the largest contribution to the increase in investments in the manufacturing.

In 2011, investment activities in the manufacturing increased rapidly. Compared to 2010, investment volumes in the sector increased by 37.5%. More than a half of the investments in the manufacturing were made in wood processing and production of metals. The investments in the manufacturing kept growing in 2012, though slower than a year before. It was largely determined by lower volumes of investments in wood processing and production of metals. In total, the investments in the manufacturing in 2012 constituted 13.4% of the total volume of investments in the national economy of Latvia, which is by 7.6% more than in 2011.

Table 3.5

Dynamics and Structure of Investments in Manufacturing*								
(per cent)								
	Growth rate				Structure			
	2012	2013	2014	2015 I-III	2012	2013	2014	2015 I-III
Food industry	46.7	-39.6	2.5	50.0	27.9	25.1	21.1	25.3
Light industry	-19.2	-7.6	41.2	20.3	1.4	1.9	2.2	2.3
Wood processing	-28.2	-26.9	56.9	-19.1	23.9	26.0	33.4	23.6
Paper industry and publishing	0.3	16.4	-10.3	177.2	3.2	5.5	4.1	6.8
Chemical industry and related industries	-33.6	-19.1	3.5	-10.5	7.5	9.0	7.6	8.1
Production of other non-metallic mineral products**	43.2	-18.6	20.1	-38.7	7.5	9.0	8.9	7.6
Production of metals and metal articles**	-33.4	-68.7	6.7	34.7	14.2	6.6	5.8	8.1
Production of machinery and equipment	5.1	-35.8	45.3	4.6	1.5	1.5	1.8	1.5
Production of electrical and optical equipment	66.6	-30.8	54.3	14.6	3.3	3.3	4.2	4.1
Production of transport vehicles	22.1	-40.7	33.9	53.1	5.7	5.0	5.5	8.0
Other sectors of manufacturing	-6.6	18.8	-6.6	-15.0	4.0	7.1	5.4	4.7

* 2013 – provisional data; 2014 – evaluated according to quarterly data
** Evaluation of the Ministry of Economics

According to the provisional data, investments in the manufacturing in 2013 were by 31.2% lower than a year before. The decrease in the investment volumes, if compared to the previous year, is mainly related to weaker investment activities in the food industry and

wood processing sector in the first half of 2013, as well as a significant decrease in investments in the metal manufacturing sector. The investment activities in other manufacturing sectors were also slightly weaker at the beginning of 2013 than a year before. In the second half

of 2013, the overall positive dynamics of investments in the sector resumed and remained in 2014. According to the provisional data, investments in the manufacturing sector in 2014 were by 21.9% higher than a year before and constituted almost 15% of the total volume of investments in the national economy of Latvia. The increase in investments was mainly determined by significant investments in wood processing and production of non-metallic mineral products. The investments in the above sectors constituted 42% of the total investments in the manufacturing. The investments in the manufacturing kept growing at the beginning of 2015 – in the first quarter of this year they were by almost 7% higher in the sector in general than in the corresponding period of the previous year. Investments in the publishing and record reproduction sector increased most rapidly – almost seven times, almost twice as much as investments in the production of metal, as well as production of transport vehicles, trailers and half-trailers, almost one and a half times more than investments in the food industry a year before. It should be noted that the dynamics of investments in all sectors were positive.

Investor survey results show that the investment structure in the manufacturing mostly remains unchanged. In 2015, investments in the manufacturing were mainly related to the replacement of worn-out equipment and machinery and expansion of their production capacities – respectively 38.5% and 25.8% of the total investments in manufacturing. In recent years, investments for rationalising the production process are growing as well. At the beginning of 2015, they constituted 21% of the total investments in the manufacturing.

In the nearest future, investment volumes in the national economy of Latvia are likely to increase gradually. However, the dynamics of the investing process will largely depend on the growth of demand, access to financial resources, as well as improvement of the external situation.

3.1.4 Exports and Imports

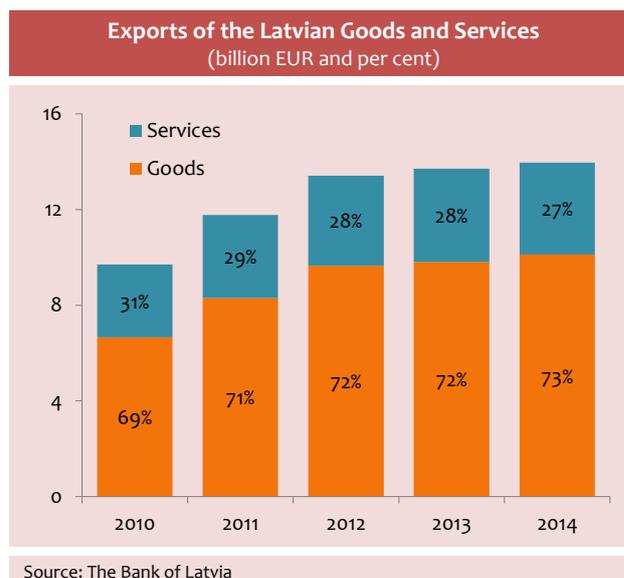
Exports and Imports of Goods

The Latvian exports grew fast in 2010-2012, when the annual growth rate in actual prices was on average above 20%. Due to decrease in the foreign demand, the growth rate of exports of goods was considerably slower in 2013, yet, it maintained positive dynamics.

Exports in actual prices grew moderately in 2014 – by 2.3%, but in comparable prices – by 3.8 per cent.

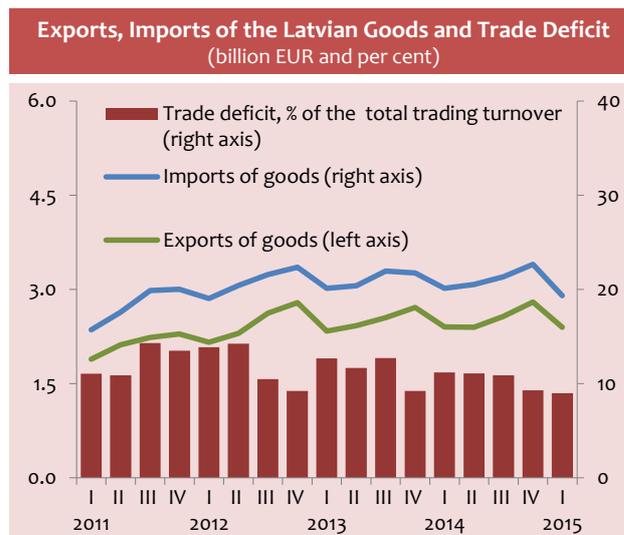
Like exports, also the imports of the Latvian goods grew very fast from 2010 to 2012, but in 2013 the growth rate became slower – up to 1% in actual prices.

Figure 3.11



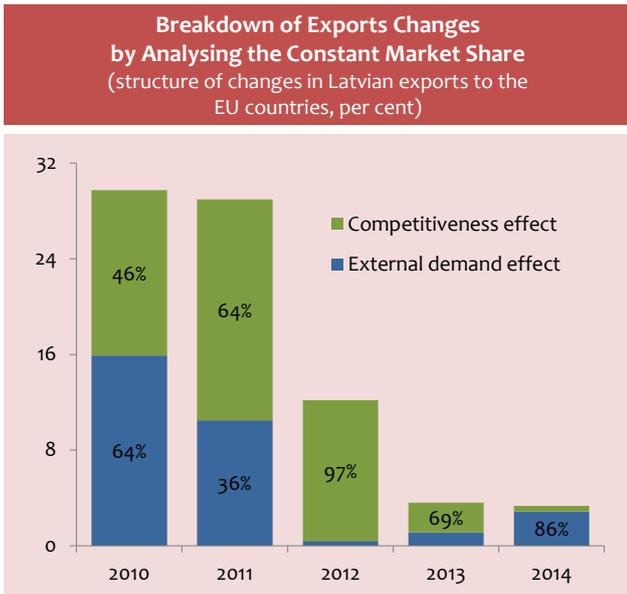
In 2014, the imports of the Latvian goods in actual prices increased by 0.4%, but in comparable prices – by 0.8 per cent.

Figure 3.12



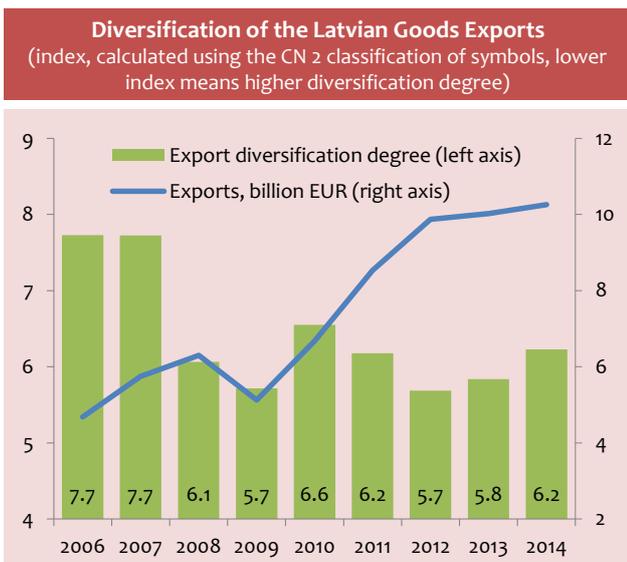
In 2012-2013, when exports grew slightly faster than imports, the trade deficit decreased as well. In 2013, it constituted 11.5% of the foreign trade, but in 2014 – 11%. At the beginning of 2015, the trade deficit remained under 10%. It should be noted that in the years of rapid growth (2007-2008), the deficit constituted even more than one fourth of all foreign trade.

Figure 3.12



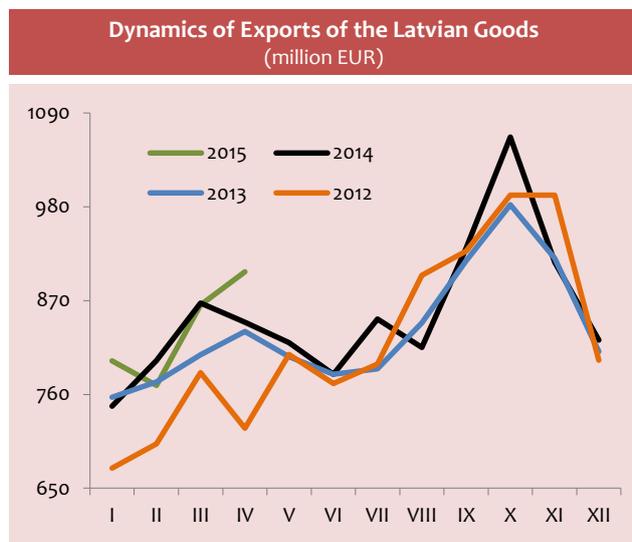
In the post-crisis period, from 2010 to 2011, the growth of the Latvian exports to the EU Member States was influenced equally by improving competitiveness of the Latvian enterprises and the steady foreign demand. Yet, in 2012-2013, the deteriorating growth in the EU led to a significant drop in foreign demand, and thus the growth of exports was mainly determined by the improving competitiveness. The improving competitiveness of the Latvian enterprises in the post-crisis period was mainly determined by a drop in workforce costs. In 2014, the growth of exports was mainly influenced by the external demand, and the role of competitiveness in the growth of exports became less important.

Figure 3.13



Over the past few years, the level of diversification of the Latvian goods exports has been improving. During the years of rapid growth, several largest export product groups, like timber and timber products, and metals, dominated in the growth of exports. During the crisis, the volumes of exports dropped in all product groups; however, the largest export groups experienced the most rapid decrease in volumes, which led to an improvement of the diversification index. Yet, as the growth resumed in the post-crisis period, the volumes of exports by groups of goods grew at a similar pace, which is a sign of a higher level of diversification. It should be noted that recently this index in Latvia has become equal to the average level of the EU-15 countries.

Figure 3.14



As export prices decreased faster than import prices (respectively by 1.4% and 0.5%), the trade conditions became slightly worse in 2014. Similar tendency remained at the beginning of 2015.

In 2014, the growth of exports was still negatively influenced by the decrease of exports of metal and its products. Exports of agricultural and food products, mineral products, as well as light industry goods slightly decreased. The growth of exports was influenced positively by the increase of exports of machine manufacturing, timber and its articles. Exports of transport vehicles and chemical and light industry goods grew more moderately.

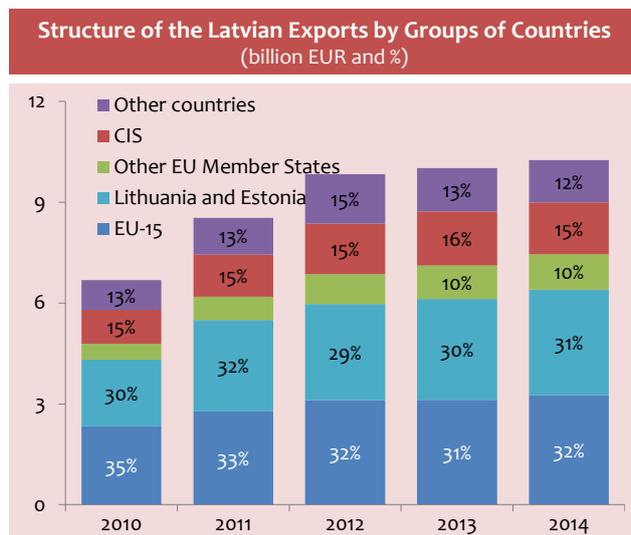
In January-April 2015, export was positively influenced by the growth of exports of mechanisms and machinery, wood and wood products, as well as chemical industry goods. As the prices dropped considerably, the export value of agricultural and food products decreased. Exports of transport vehicles and metals and their products decreased as well.

Table 3.6

Exports of the Latvian Goods by the Main Commodity Groups (%, in current FOB prices)				
	2014		2015 I-IV	
	structure	changes compared to the previous year	changes compared to the corresponding period of the previous year	contribution to the changes in volumes
Total including:	100	2.4	2.5	2.5
Agriculture and food products	19.3	-3.1	-18.0	-3.5
Mineral products	8.3	-2.7	0.2	0.0
Products of chemical and allied industries, plastics	10.0	4.5	10.8	1.0
Light industry products	4.7	-2.5	10.5	0.5
Wood and articles of wood	16.6	6.7	6.4	1.1
Metal and articles of metal	9.0	-11.9	-2.9	-0.3
Machinery and mechanical appliances	16.9	10.8	22.7	3.6
Transport vehicles	5.2	16.9	-15.7	-0.9
Other goods	10.0	6.8	8.4	0.9

Exports of goods to the EU Member States increased by 4.7% in 2014. The growth of export groups of machinery and transport vehicles constituted a significant part of it. Also in January-April 2015, exports to the EU Member States increased similarly – by 4.9%. During this period, exports of machinery, wood and its products, light and chemical industry goods increased considerably.

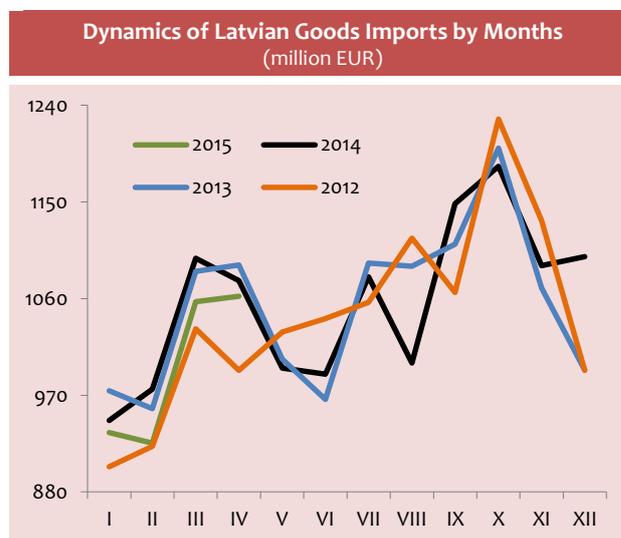
Figure 3.15



Exports of goods to the CIS countries in 2014 decreased by 5%, but in January-April 2015 – considerably faster – by 19.4%. It was determined by a significant decrease of exports to Russia (by 23.9%). The decrease was mainly determined by a considerable fall in the value of the Russian currency, as well as the sanctions

on imports of some food products introduced in Russia. The growth of machinery exports had a small positive impact on the decrease of exports.

Figure 3.16



The slight growth of imports of goods in 2014 was positively influenced by the increase in imports of machinery, wood and its products, as well as chemical products, while it was also influenced negatively – mainly by the decrease of imports of mineral products. In the four months of 2015, the imports of goods were positively influenced by the same groups of goods as in 2014. Imports of mineral products, agricultural and food products, in their turn, decreased significantly in the said

period. Mainly, it was due to a significant decrease in prices of petroleum and food products.

Imports from the EU Member States in 2014 increased just as the overall imports, but in January-April they decreased by 3.7%.

In 2014, due to a significant decrease in imports of mineral products, imports from the CIS countries dropped (by 3.2%). A similar tendency remained also in the four months of 2015, when imports of the goods from the CIS countries shrank by 10.6%.

Table 3.7

Imports of the Latvian Goods by the Main Commodity Groups (%, in current CIF prices)				
	2014		2015 I-IV	
	structure	changes compared to the previous year	changes compared to the corresponding period of the previous year	contribution to the changes in volumes
Total	100	0.4	-2.8	-2.8
including:				
Agriculture and food products	15.7	-0.3	-10.6	-1.7
Mineral products	14.5	-15.1	-21.3	-3.1
Products of chemical and allied industries, plastics	15.3	2.6	6.0	0.9
Light industry products	6.0	-1.4	-3.8	-0.2
Wood and articles of wood	2.6	33.7	15.4	0.4
Metal and articles of metal	8.3	-4.3	-5.0	-0.4
Machinery and mechanical appliances	20.1	9.6	10.9	2.1
Transport vehicles	7.7	1.0	-9.0	-0.7
Other goods	9.9	6.2	-0.1	0.0

Until 2009, the share of import of capital goods shrank along with the decrease in investments, but from 2009 to 2012, the imports of consumption goods dropped. In recent years, the structure of imports by targets of use has not changed significantly.

Figure 3.17

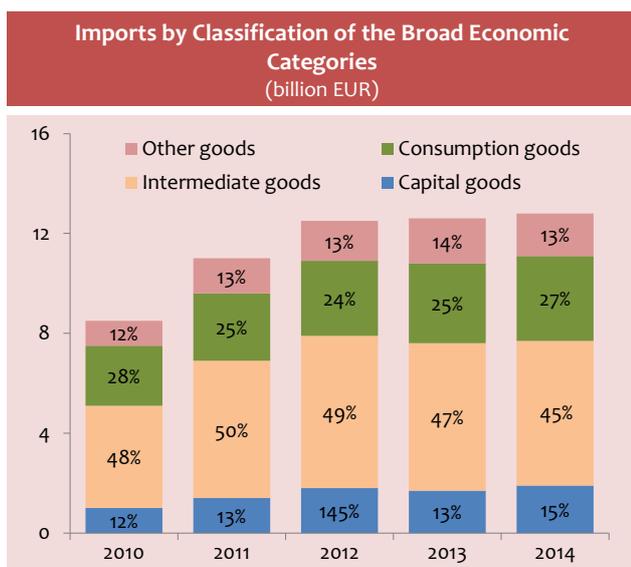
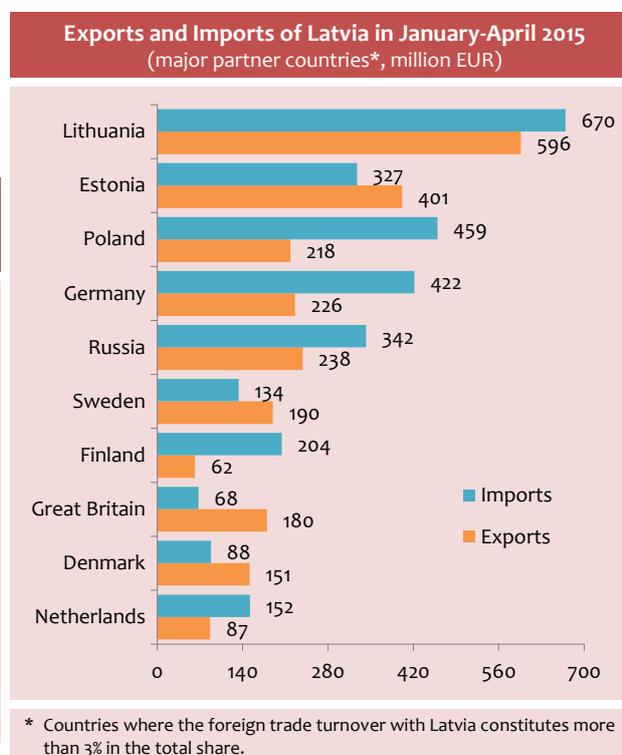


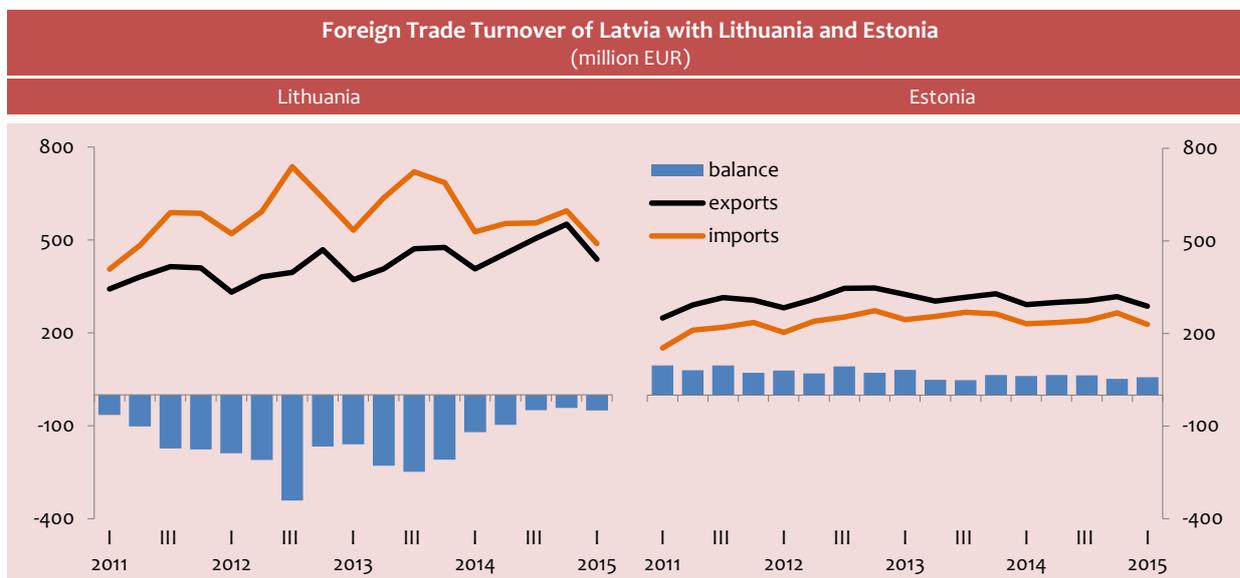
Figure 3.18



The largest **trade partners** of Latvia in January-April 2015 were Lithuania – 17% of the total foreign trade turnover, Estonia – 10%, Poland and Germany – 9% each, Russia – 8%, Sweden and Finland – 4% each and the United Kingdom, Denmark and the Netherlands – 3 per cent each.

Latvian neighbours **Lithuania and Estonia** traditionally are the largest trade partners of Latvia. As imports considerably increased during the rapid growth period, an explicit deterioration of the Latvian trade balance with both countries was observed. Yet, in the second half of 2008, the balance with Lithuania and Estonia started improving gradually.

Figure 3.19



Recently, the trade balance with Estonia has remained steadily above 10% of the total trade turnover, while the balance with Lithuania slightly decreased mainly due to faster imports of mineral products and agricultural and food products in 2012-2013. But in 2014, due to a decrease in prices of petroleum and food products, the value of imports of the said groups rapidly dropped, and the negative trade balance with Lithuania decreased considerably also at the beginning of 2015.

The main groups of products exported to both Baltic States in 2015 still are agricultural and food products, mechanical engineering products, chemical industry products and mineral products.

Exports and Imports of Services

The decrease in exports of services during the crisis was considerably lower than that of exports of goods. In 2011-2012, exports of services grew similarly to the exports of goods at a stable pace. The positive balance of services in 2012 covered approximately 64% of the negative trade balance of goods. In 2013-2014, taking into account the improvement of the trade balance of goods, the positive balance of services covered 70% of the negative trade balance of goods, but in the first quarter of 2015 – 80%.

The revenues from transit transport still constituted slightly less than a half of the exports of services. Year 2014 was not particularly successful for transit – the

volumes of this group of exports dropped by 5.1%. Exports of road and sea transport services dropped, but it was slightly compensated by an increase in the exports of railway transport and other transport services. The volume of transport export decreased a little also in the first quarter of 2015.

The revenues from foreign tourists grew at a stable pace both in 2014 and in January-March 2015.

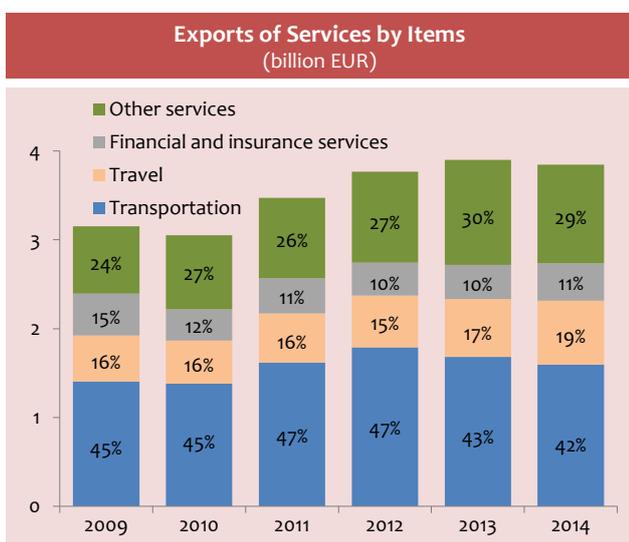
Exports of services to the EU Member States constitute a half of the total exports of services of Latvia. In 2014, export volumes of services to the EU Member States increased by 1.7%, but in the first quarter of 2015 – by 7.3%. Road and sea transport and trips constitute the largest share in exports of services to the EU Member States.

Volumes of export of services to the CIS countries were a little above 10% of the total export of services. In 2013, exports of services to the CIS countries increased rapidly. However, in 2014, the total export of services decreased (by 4.6%) along with the drop in volume of transit export services. It was partly compensated by an increase in the revenue from tourists from the CIS countries. In the first quarter of 2015, like in 2014, the total volume of exports of services to the CIS countries has slightly dropped (by 1.9%) due to the decrease in the volume of transit export services.

Table 3.8

Exports and Imports of Services (per cent)								
	2014				2015 I-III			
	structure		changes compared to the previous year		structure		changes compared to the corresponding period of the previous year	
	exports	imports	exports	imports	exports	imports	exports	imports
Services – total, including:	100	100	-1.4	-1.4	100	100	5.0	6.9
Transport services	41.5	32.5	-5.1	4.2	43.6	33.2	-2.0	8.2
– sea transport	10.4	7.0	-6.4	-1.0	12.2	6.9	1.6	-1.1
– air transport	6.3	11.1	-9.2	5.0	5.2	12.0	1.6	17.9
– rail transport	10.9	4.2	0.7	8.2	13.7	5.0	-0.3	19.2
– road transport	12.5	9.6	-8.5	5.6	11.0	8.8	-8.6	-0.6
– other transport	1.4	0.5	19.1	6.0	1.5	0.6	-5.0	3.7
Travel	18.7	25.6	10.5	-0.3	16.6	21.9	11.8	-1.9
Other services	39.8	41.9	-2.5	-6.0	39.8	44.8	10.9	10.9
– construction services	3.3	2.4	5.0	-24.9	2.3	2.2	10.6	-24.5
– insurance and financial services	10.9	8.1	8.6	-18.3	12.6	11.0	28.5	41.1
– communication services	2.4	3.4	-2.2	-2.8	2.4	4.3	3.1	33.9
– information and computer services	5.1	4.5	6.5	-7.9	6.3	4.7	20.9	12.2
– other commercial services	16.7	22.1	-12.0	2.3	14.9	20.9	-2.4	0.9
– other services	1.3	1.4	0.6	-6.8	1.2	1.6	8.9	10.0

Figure 3.20



In 2014, exports of services to Estonia slightly decreased (by 3.6%), but to Lithuania – increased (by 19.2%). In the first quarter of 2014, exports of services to both Estonia and Lithuania increased considerably (by 9.7% and 21.46% respectively). The most important exported services to both neighbour countries were related to tourism, transit and trade intermediation.

3.2 Contribution of Sectors

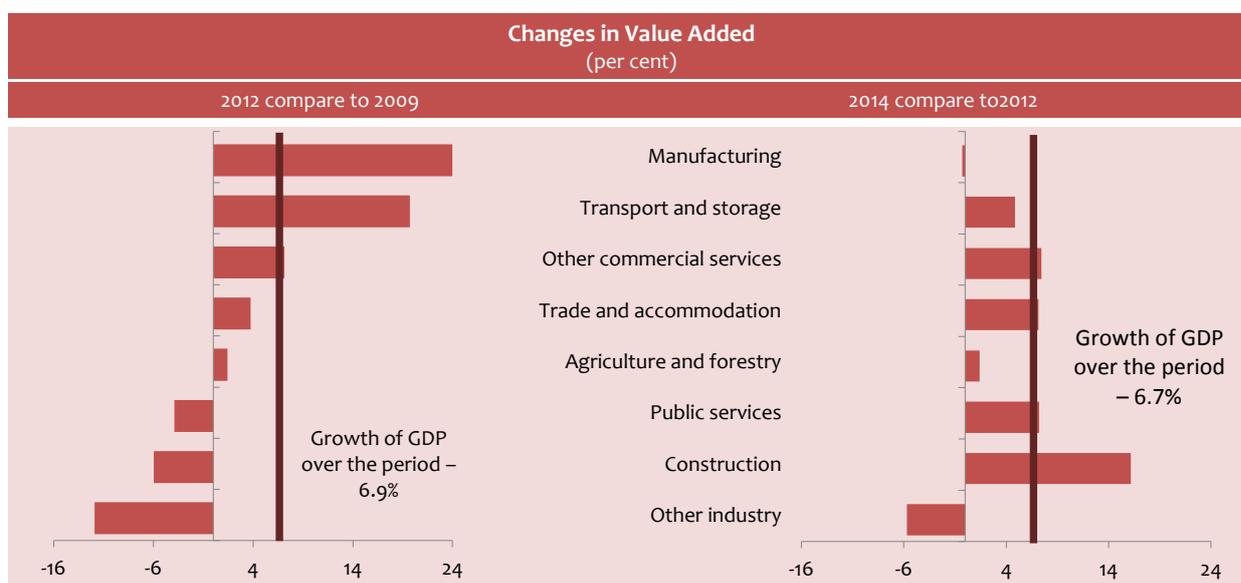
3.2.1 Development Trends of Sectors

After a significant drop of volumes during the crisis, owing to the improvement of the competitiveness and export opportunities, the tradable sectors were the first to resume their growth. In the key export sector – manufacturing – the production volume in 2013 exceeded the level of 2009 by 24%. The growth of the tradable sectors and increase of the income from exports

fostered the growth of the domestic market oriented sectors.

From 2010 to 2012, the rate of growth in the key export sector – manufacturing – was much higher than the overall growth of the national economy, and the sector became the main driver of the growth of the national economy. In addition, the growth of other tradable sectors, for instance, agriculture, forestry, transportation and storage, resumed faster than in other sectors of the national economy in the post-crisis period.

Figure 3.21



In recent years, the contribution of the domestic market oriented sectors – trade, construction and commercial services – has become larger.

In comparison to 2008, the share of manufacturing and commercial services has increased significantly, but the share of the construction sector and public services in the overall added value has decreased.

Table 3.9

Dynamics of GDP						
(in %, compared to the previous year)						
	2009	2010	2011	2012	2013	2014
Agriculture and forestry	12.7	-3.9	-1.8	7.5	-0.1	1.5
Manufacturing	-22.4	14.0	4.0	4.6	0.0	-0.3
Other industry	6.8	-1.7	-5.2	-5.5	-3.3	-2.5
Construction	-38.0	-35.4	27.1	14.5	7.5	8.1
Trade and accommodation	-16.5	-1.9	4.1	1.7	4.8	2.3
Transport and storage	-23.3	-5.5	18.5	6.9	1.6	3.2
Other commercial services	-6.8	-4.1	6.2	5.2	6.0	1.3
Public services	-9.9	-6.9	3.1	0.1	3.8	3.3
Gross domestic product	-14.2	-2.9	5.0	4.8	4.2	2.4

Improvement of the situation in the labour market – increase in the employment rate and increase in wages – fosters the increase in private consumption that, in its turn, has a positive impact on the growth of the service sectors oriented towards the domestic market. The

turnover of retail trade increases, and a stable growth is observed in the sectors of commercial services. Narrowing of export possibilities since 2013 has had a negative impact on the growth of tradable sectors.

Table 3.10

Structure of the Economy (by value added, per cent)							
	2000	2005	2009	2011	2012	2013	2014
Agriculture and forestry	5.2	4.3	3.7	3.9	3.7	3.6	3.4
Manufacturing	15.7	13.2	10.9	13.1	12.9	12.6	12.2
Other industry	4.3	3.2	5.2	5.0	4.7	4.4	4.2
Construction	6.4	6.4	7.4	5.4	6.1	6.4	6.7
Trade and accommodation	15.2	17.8	16.4	16.3	15.7	15.8	15.7
Transport and storage	11.8	12.3	10.3	10.2	10.3	9.7	9.6
Other commercial services	24.0	27.5	29.0	30.4	31.3	32.7	33.2
Public services	17.4	15.2	17.2	15.6	15.2	14.8	15.1
Total	100						

The economic crisis, the growth of the tradable sectors in post-crisis period, as well as the growth of the domestic market oriented sectors in recent years had an impact on the structure of the national economy. In 2012, the share of the manufacturing in the national economy increased rapidly, if compared to 2009. In 2014, the share of the domestic market-oriented sectors

(construction, trade and services sectors) became larger, if compared to 2012. In 2014, the share of those sectors exceeded 70%. It should be noted that, since 2000, the share of the commercial sectors in the national economy has gradually increased. Its growth within 15 years is almost 10 percentage points.

Table 3.11

GDP by Quarters (changes compared to the corresponding period of the previous year, %)									
	2013				2014				2015
	I	II	III	IV	I	II	III	IV	I
Agriculture and forestry	1.2	-1.7	-2.0	4.3	9.1	4.3	-5.6	2.4	-8.6
Manufacturing	-4.8	-0.6	2.5	2.6	1.2	0.1	-0.6	-1.7	4.4
Other industry	-1.4	1.4	-4.1	-8.3	-7.4	-5.4	0.5	3.4	-4.1
Construction	9.8	5.3	11.6	3.9	24.6	15.8	0.6	4.4	-0.1
Trade and accommodation	6.2	5.8	5.2	2.2	2.6	2.2	2.4	2.1	1.1
Transport and storage	2.0	0.5	0.8	3.3	5.1	2.2	2.3	3.2	-1.6
Other commercial services	4.1	6.1	7.2	6.5	1.9	-0.1	2.9	0.7	2.1
Public services	1.3	5.0	2.7	5.1	3.3	3.4	3.2	3.4	3.5
GDP	3.1	4.6	4.6	4.5	2.8	2.3	2.4	2.1	1.9

In the **agriculture and forestry** sector, following an insignificant drop in the production volume in 2013, a moderate growth (by 1.5%) was observed in 2014. The volume of plant-growing produce increased by 0.4%, the volume of cattle breeding – by 4.8%. In 2014, the volume of wood cut increased a little.

In the agriculture and forestry sector, year 2014 started positively – in the first six months of the year, the production volume in the sector in total was by almost

6% higher than a year before. However, in the second half of 2014, the agriculture sector was significantly influenced by the ban of imports of food products imposed by Russia. In the 2nd half of 2014, the production volume in the sector was by 2.6% lower than a year before.

In the 1st quarter of 2015, the production volume in the agriculture and forestry sector was by 8.9% lower than a year before. The drop in the production volumes

was mainly due the situation in the forestry sector. Comparatively warm weather at the beginning of the year limited the possibilities to take out timber from felling areas. Low timber prices in Russia at the same time fostered significant increase in imports – in the 1st quarter of 2015, the imports of timber from Russia increased by more than 40 per cent.

Like in 2013, low demand in the export markets continued to slow down the **growth of the manufacturing** also in 2014. In 2014, the production volume was by 0.3% lower than a year before.

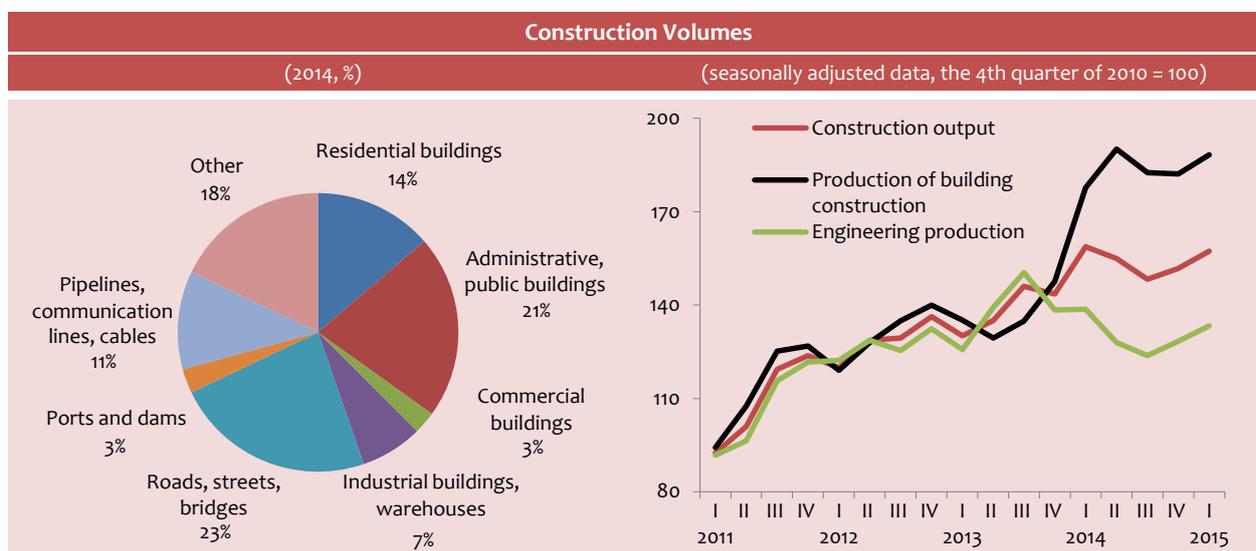
In the 1st quarter of 2015, the production volume in the sector was by 4.4% higher than a year before. The manufacturing was positively influenced by the resumed activity of KVV Liepājas metalurģs, as well as the stable growth in one of the largest sub-sectors of the manufacturing – wood processing. The previously observed trends continued in other sub-sectors of the

manufacturing – some of the sectors still demonstrated a steady growth, while others experienced a drop in the production volumes due to different factors.

Production volumes in **other industry sectors** (mining and quarries, electricity, gas supply, heat supply, water supply, wastewater and waste management and treatment) decreased in 2014 by 2.5%. It was largely related to the weather; therefore lower volumes of electricity and heat energy were produced. The production volumes in the sector decreased also at the beginning of 2015 – in the 1st quarter they were by 4.1% lower than a year before.

The development of the **construction** sector is largely related to public contracts and the EU funds projects. After a rapid growth of the construction volumes in the first half of 2014, the growth of the sector slowed down at the end of the year. In total, the growth of the construction sector reached 8.1% in 2014.

Figure 3.22



The growth rate of the construction sector in 2014 was similar to 2013, when the production volume of the sector increased by 6.9%. At the same time, the growth of the sector in 2013 was mainly fostered by the increase in construction volumes of engineering structures, but in 2014, the construction volumes of non-residential buildings contributed most to the growth of the sector (increase by 34.6%).

In 2014, the construction volumes of residential and non-residential buildings had an equally rapid growth (by 31.1% and 34.6% respectively). In the category of non-residential buildings, construction of hotels and similar buildings had the most rapid growth of the construction volumes. In 2014, a moderate growth of construction volumes was observed in construction of industrial buildings and warehouses. In the category of residential houses, the construction volume of double-apartment houses increased most rapidly.

The construction volume of engineering constructions dropped by 10% in 2014. The most rapid

decrease was observed in the construction of ports and dams, as well as bridges and tunnels, while the construction volumes of complex industrial buildings increased.

In the 1st quarter of 2015, the construction volumes were at the level of the 1st quarter of 2014 (decrease by 0.1%, in comparable prices, unadjusted data). It was largely influenced by the base effect – the growth of the construction sector in the 1st quarter of the previous year was almost 25 per cent.

At the beginning of 2015, the volume of the construction of buildings increased more rapidly (by 6%). Even more rapid increase was observed in the construction of residential houses. It was mainly determined by the growth of construction of three- and more apartment buildings. The most rapid drop was experienced by the construction volume of double-apartment houses. The construction of residential houses ensured the largest contribution to the growth of the construction volumes, while there was a slight drop in the

construction of non-residential houses. In this category, the most rapid increase was experienced by the construction of sports buildings. A rapid increase was also observed in the construction volumes of industrial and warehouse buildings that experienced a rapid drop in 2014.

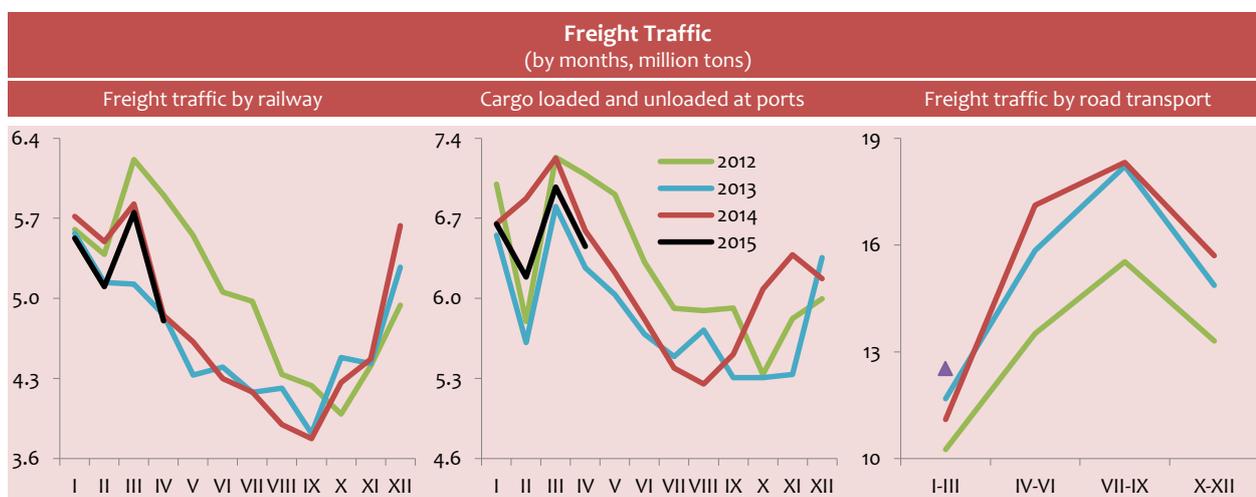
A significant decrease of the construction volumes at the beginning of 2015 was observed in the category of engineering structures that mainly determined the total decrease of the growth of the construction volumes at the beginning of the year. The most rapid decrease in this sector was experienced by the construction volume of ports and dams, but the construction of roads increased most rapidly.

In 2014, the production volumes of the services provided in the **transport and storage** sector increased

by 3.2%. The growth of the transport and storage is largely fostered by the successful operation of ports. In 2014, the volumes of cargo loaded and unloaded at ports were by 5.2% higher than a year before. During the same period of time, the volumes of the freights transported by railway increased by 2.2%. In 2014, the volumes of freight transported by road increased as well.

Year 2015 did not start so successfully for the transport sector. The services provided in the transport sector in the 1st quarter of 2015 dropped by 1.6%, if compared to the corresponding period of the previous year. The decrease was largely due to the drop in the freight turnover in railway transport and cargos at ports. In the four months of 2015, the volumes of cargo turnover at ports and freight in railway were lower by 3.9% and 32% respectively than a year before.

Figure 3.23



The volumes of services provided in the **trade** sector are still increasing. The growth of the trade sector (including accommodation and catering services) reached 2.3% in 2014. At the beginning of 2015, the increase of the volumes of the provided services was more moderate – they increased by 1.1% in the 1st quarter. The trade sector is positively influenced by the increase of private consumption and retail turnover. Weak foreign trade activities, in their turn, slow down the growth of the wholesale sector.

In 2014, the retail turnover increased by 3.6%. The turnover of non-food retail trade increased by 2.8% during the said period of time. The increase in retail trade of clothing and footwear, household electrical goods, as well as retail trade via mail and online contributed the most to the growth.

Trade of food products constitutes more than one third of the total retail trade turnover, and it increased by 3.4% in 2014. Fuel retail trade, in its turn, increased in 2014 after a drop in 2013, especially at the end of the year

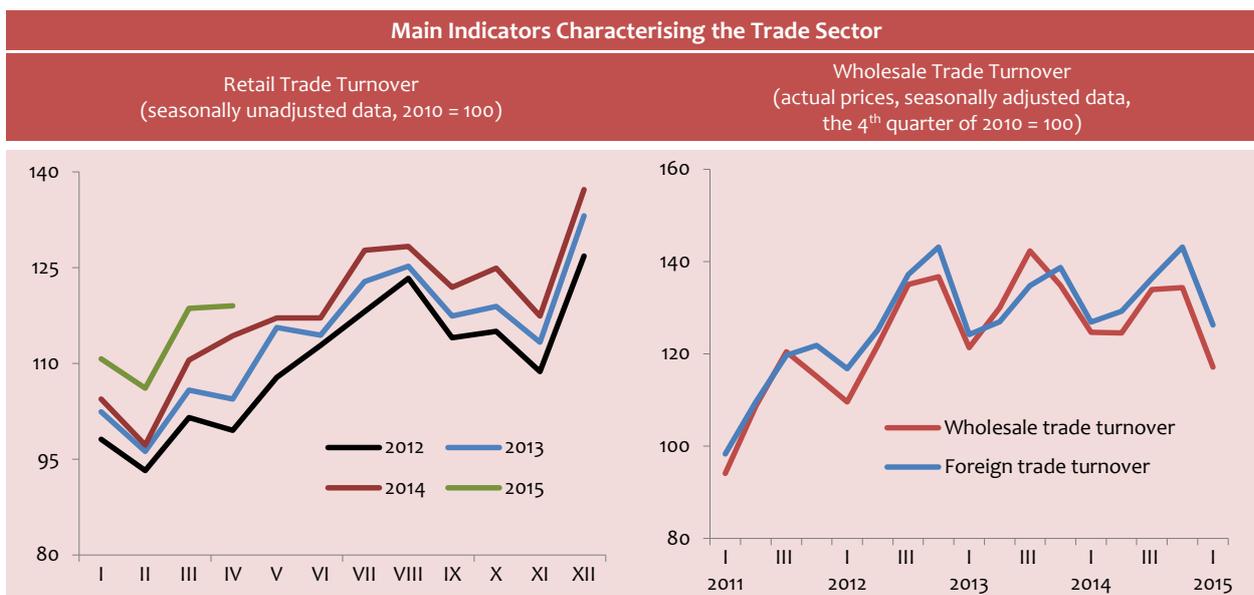
when fuel retail prices decreased due to the drop in global oil prices. In total, the fuel retail trade volumes increased by 5.8 per cent in 2014.

A rapid growth in retail trade was also observed in the first months of 2015. In January-April, total retail turnover was by 6.6% higher than a year before. During the said period of time, the retail trade volumes in the non-food products group increased by 6.8%. Retail trade of household electric equipment increased more rapidly. Retail trade via mail or online also contributed a lot to the growth.

The growth of car fuel retail trade is still being fostered by comparatively low fuel prices. In the 4 months of 2015, the volume of car fuel retail trade was by 14.1% higher than a year before. It ensured almost one third of the total growth of the retail trade turnover.

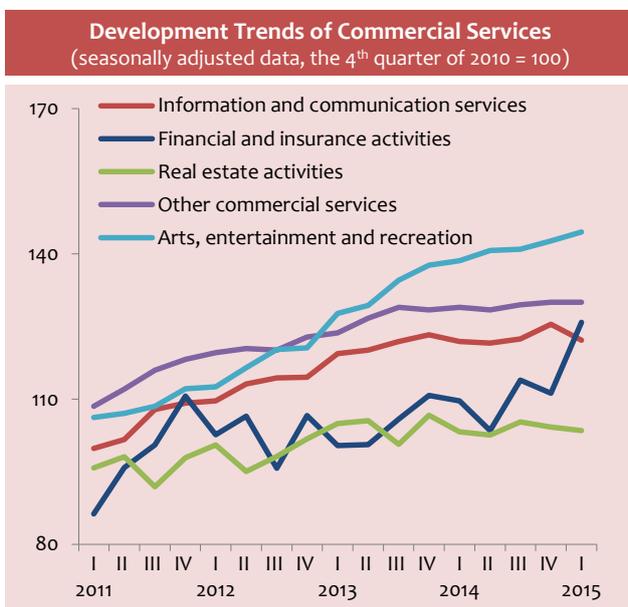
Turnover of food retail trade in the four months of 2015 grew more moderately – by 3.3%, if compared to the corresponding period of the previous year.

Figure 3.24



Development trends of wholesale are largely influenced by the activities of foreign trade. As the growth rate of exports and imports slowed down, the dynamics of the turnover of wholesale companies were moderate. In 2014, the turnover of wholesale trade in actual prices was by 2.1% lower than in 2013. In the 1st quarter of 2015, the wholesale trade turnover in actual prices was by 6% higher than a year before.

Figure 3.25



The growth of the **commercial services** sectors in 2014 was more moderate than a year before. In 2014, the volumes of commercial services sectors increased by 1.3%. The increase was mainly fostered by the growth in the field of art, entertainment and recreation where the volume of services provided rose by 6.2% in 2014. The

growth in financial and insurance activities reached 4.7% in 2014. A moderate growth was observed in the information and communication services sector.

At the beginning of 2015, the volume of the provided services in the sector grew more rapidly – by 2.1% in the first quarter, if compared to the first quarter of 2014. The increase was mainly determined by a more rapid growth in financial and insurance activities. However, the volumes of the services provided in the information and communication sector decreased a little over the year.

As the expenditure of the government grew, the volumes of the services provided in the **public services** sectors increased – by 3.3% in 2014. In 2015, the volume of the services provided within the sector keeps growing, and they were by 3.5% higher in the first quarter, if compared to the corresponding period in 2014.

3.2.2 Manufacturing

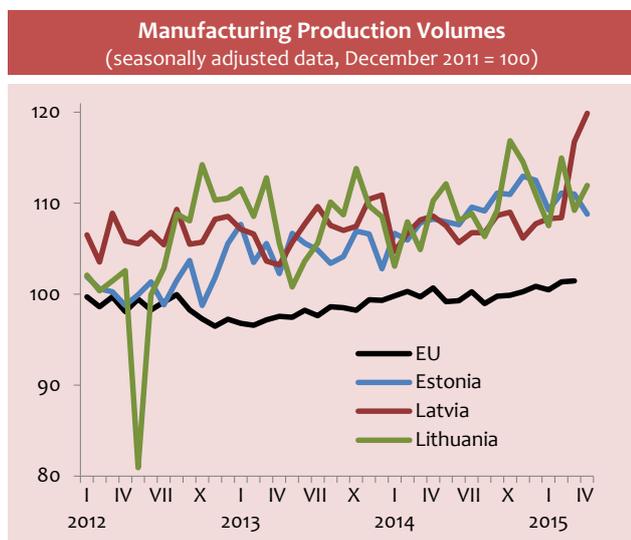
During the crisis, when the costs dropped, the competitiveness of the Latvian producers improved. It facilitated the development of manufacturing. From 2010 until the end of 2012, production volumes of manufacturing increased rapidly.

The low demand in export markets in 2013 slowed down the growth of manufacturing. In 2013, the production volume of manufacturing was only by 0.1% higher than a year before. Apart from the low demand in foreign markets, the output of manufacturing was significantly affected also by the termination of JSC “Liepājas metalurģs” activities.

In 2014, the production volume of the manufacturing was by 0.3% lower than a year before. The growth of the sector was still affected by the trends in foreign markets – the economic growth in the EU was slower than expected, also the economic situation in Russia was weak.

Still, the development trends in the sub-sectors of the manufacturing differed a lot.

Figure 3.26



The production volumes of one of the largest manufacturing sectors – wood processing – grew at a stable pace in 2014, and the output of the sector was by 6.9% higher than a year before. The volumes of exports and domestic demand for the production of the sector increased at a stable pace.

The production of electrical and optical devices experienced the most rapid increase in the production volume in 2014. Moderate growth in 2014 was observed in the production of non-metallic mineral products, as well as the production of machinery and equipment.

In 2014, the volume of produced goods in food and beverages sector was by 0.1% higher than a year before. Following a successful beginning of the year, the food imports embargo imposed by Russia affected the food industry during the last months of the year. The decrease in production volumes in 2014 was observed in the light industry sector, metalworking sector (due to the outage of JSC “Liepājas metalurģis”), chemical industry and production of transport vehicles.

Table 3.12

Structure of Manufacturing in 2014 (per cent)			
	by output	by the number of posts occupied	share of exports in the sales of the sector
Manufacturing- total	100	100	61.6
Food and beverage industry	25.5	21.7	35.5
Light industry	4.1	10.6	86.0
Wood processing	25.7	20.3	72.8
Paper industry and publishing	4.5	4.0	59.8
Chemical industry and related industries	7.6	6.7	76.5
Production of other non-metallic mineral products	6.6	4.5	46.7
Production of metals and metal articles	9.1	10.0	59.3
Production of electrical and optical equipment	6.0	3.9	90.3
Production of machinery and equipment	2.2	3.0	81.1
Production of transport vehicles	3.4	3.3	86.7
Other sectors of the manufacturing	5.3	11.9	56.9

In 2014, the total turnover of manufacturing sector shrank by 1.4%. The turnover of production sold in the domestic market decreased by 1.2%, but the turnover of the exported production – by 1.5%. The total turnover of the manufacturing was positively affected by the rapid growth of turnover in wood processing (by 9.7%). In 2014, a slight general increase of the turnover was observed in the food and beverage industry, as well as the production of non-metallic minerals. The decrease of turnover in metal processing related to the termination of activity of JSC “Liepājas Metalurģis”, in its turn, contributed most to the total drop of turnover.

In the 4 months of 2015, the output volume of the manufacturing increased rapidly, and it was by 6.3% higher than a year before. Individual sub-sectors are still growing steadily, but the production volume of other sectors decreases due to several factors.

The production volumes in the wood processing keeps growing also in 2015. In the 4 months of 2015, the volume of goods produced was by 8.2% higher than a year before.

The metalworking sector contributed significantly to the growth of the manufacturing in general at the beginning of 2015, as one of the largest industrial companies “KVV Liepājas Metalurģs” resumed its operation.

In the food sector, the output in 2015 was by 5.1% lower than a year before. The relationship between the

EU and Russia also has a significant impact on the development of the sector.

Like in 2014, the fastest growth of production volumes at the beginning of 2015 was in the production of computers, electrical and optical equipment.

The production volume in light industry, production of non-metallic mineral products, paper industry and publishing, as well as chemical industry decreased.

Table 3.13

Changes of the Production Volume in Manufacturing (%, compared to the corresponding period of the previous year)						
	2010	2011	2012	2013	2014	2015 I-IV
Manufacturing- total	16.5	11.7	9.3	0.1	-0.3	6.3
Food and beverage industry	-0.1	-0.2	2.5	6.0	0.1	-5.1
Light industry	19.4	19.4	3.0	1.4	-13.6	-18.7
Wood processing	33.0	12.6	5.4	2.7	6.9	8.2
Paper industry and publishing	19.8	-0.5	10.1	5.6	-0.6	-2.5
Chemical industry and related industries	5.2	4.4	8.3	-8.7	-3.6	-0.2
Production of other non-metallic minerals	17.6	24.2	8.6	4.6	1.2	-7.1
Production of metals and metal articles	24.2	28.3	16.3	-17.6	-10.5	*
Production of electrical and optical equipment	33.2	29.6	19.9	18.4	32.3	23.4
Production of machinery and equipment	17.8	37.1	8.7	1.4	2.4	3.4
Production of transport vehicles	59.0	37.0	15.8	3.0	-15.2	2.4
Other sectors of the manufacturing	-4.9	9.5	26.1	-7.6	-12.0	0.7
* – confidential data						

In the 4 months of 2015, the turnover of manufacturing was by 0.4% higher than a year before. During the said period, the turnover of production sold in the domestic market decreased by 6.8%, but the turnover of the exported production – increased by 4.7%.

Like in 2014, in the first months of 2015, the wood processing sector contributed most to the total turnover of the manufacturing. The turnover in this sector from January to April was by 10.4% higher than a year before. Likewise, the turnover in the said period increased in the production of electrical and optical equipment (by 24.2%) and production of machinery and equipment (by 5.7%). The largest negative impact was experienced by the food industry, where the turnover in the four months of 2015 was by 7.5% lower than a year before. In the said period, the turnover decreased also in light industry, chemical industry, paper industry and publishing, production of non-metallic minerals, as well as production of transport vehicles.

In the four months of 2015, 65.3% of all production of the manufacturing was exported. Like in 2014, more than a third of all exported production was sold in the markets of EU-15. Almost 30% of all exported production was sold in Lithuania and Estonia. In comparison to 2014, the share of third countries in the export structure of the production of manufacturing has increased. Exports to the CIS in the four months of 2015

constituted 11% of the total exports of manufacturing production that was by 6 percentage points lower than in 2014.

During the post-crisis years, the manufacturing significantly contributed to creation of new jobs in the national economy – in 2011 and 2012, the sector ensured almost one fifth of all new jobs. The growth of employment rate in the manufacturing was considerably slower than the increase in the output, which shows an increase in productivity.

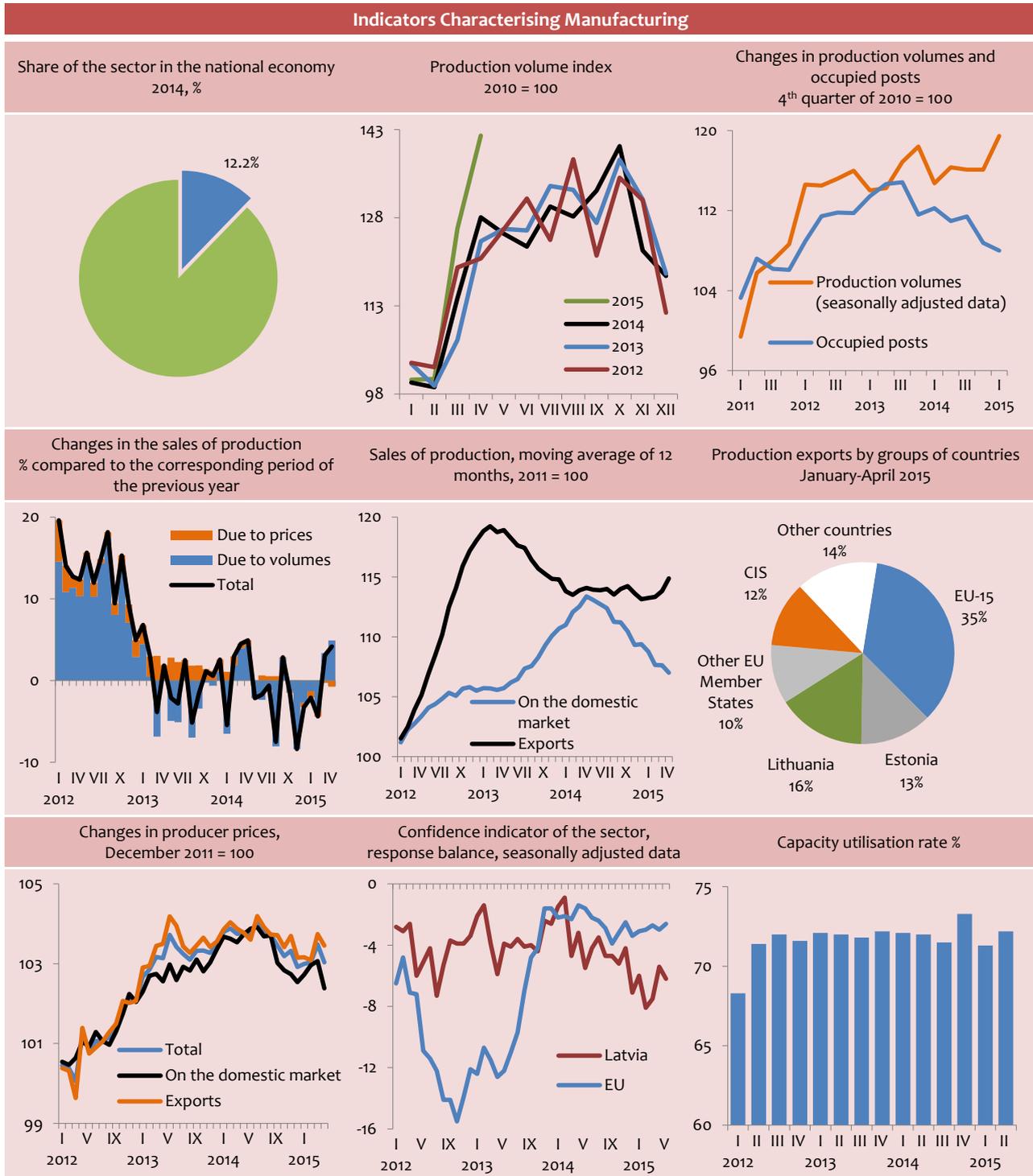
After the growth of the sector slowed down in 2013 and 2014, the demand for workforce dropped. In 2014, the number of occupied posts in the manufacturing was by 2.5% lower than a year before. Decrease of the number of jobs in metalworking, light industry and production of food and beverages contributed most to it. At the same time, the increase in the number of occupied posts in 2014 was observed in wood processing, chemical industry, production of electrical and optical equipment, as well as in production of non-metallic minerals.

Since the middle of 2012, the load of production capacity in the manufacturing remained at the level of 71-72%. In the 2nd quarter of 2015, the load of production capacity was 72.2% that was very close to the historically highest level in 2005.

The indicator of the Latvian producer confidence after certain stability in 2011-2013 has been worsening since March 2014. It is largely related to the events in Ukraine and the economic situation in Russia becoming

worse. At the end of May 2015, the confidence indicator of manufacturing companies in relation to their future prospects was slightly worse than a year before.

Figure 3.27



The **food and beverage industry** constitutes more than one fourth of the total output of the manufacturing sector, and it is the largest sector in terms of the number of jobs in the sector.

The sector sells more than one third of its production in the export markets – mainly in the CIS, as well as in Lithuania and Estonia. Thus, the economic problems in the CIS, as well as the ban of food imports imposed by Russia have affected the growth of the sector.

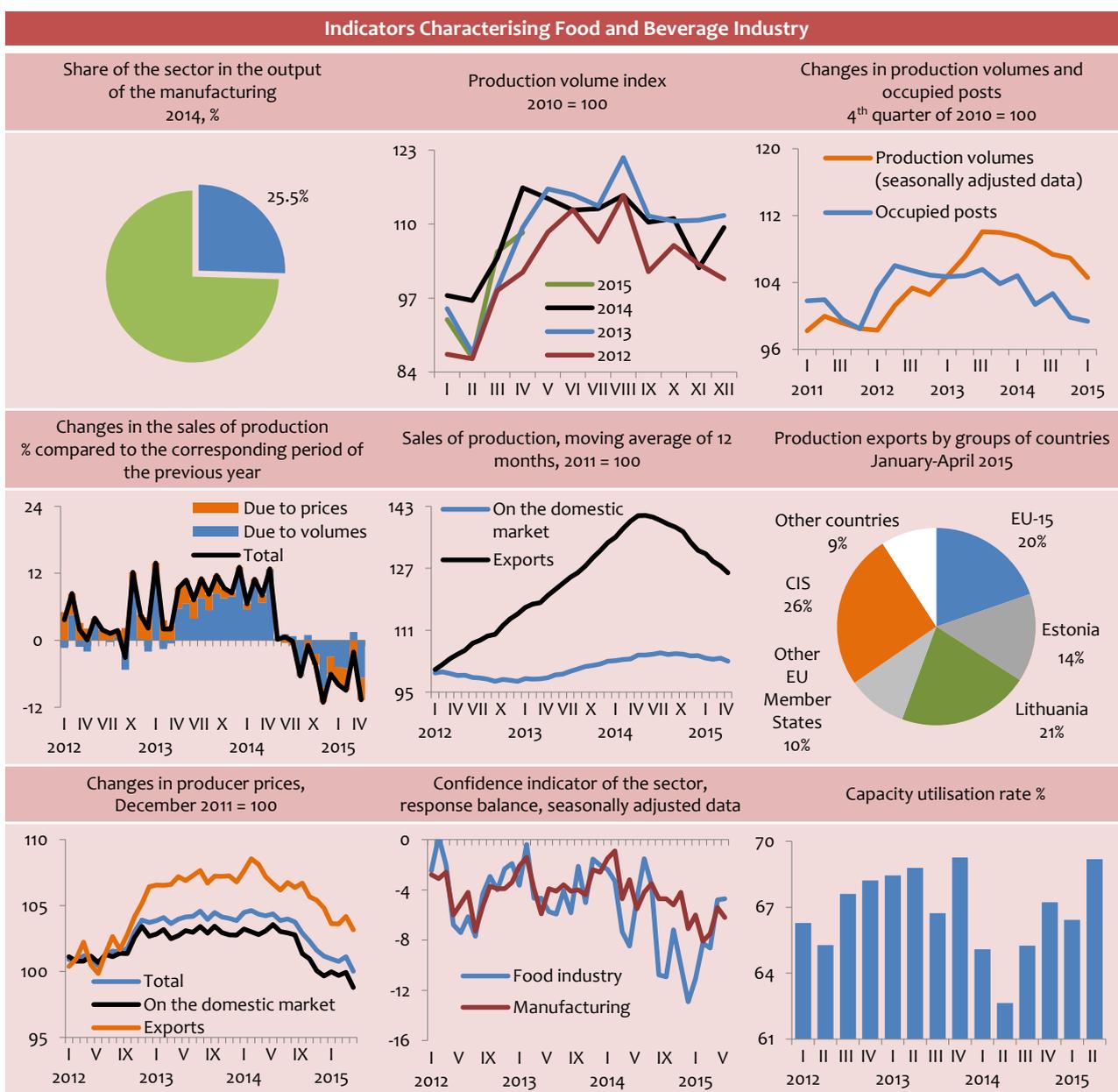
Yet, at the beginning of 2014, the sector demonstrated a stable growth; however, since August it had been affected by events in foreign markets. In general, in 2014, the food and beverage sector's output was only by 0.1% higher than a year before. In the four months of 2015, the production volume was by 5.1% lower than a year before.

The decrease of producer prices along with weaker production volumes have affected the turnover of the sector. In 2014, the turnover was by 0.3% higher than a year before. At the same time, the sales of the exported goods decreased by 1.5%. In January-April 2015, the turnover was by 7.5% lower than a year before, while the turnover of exported production fell by almost 13%.

The decrease of the production volumes influenced the employment rate – in 2014, the number of occupied posts dropped by 2.4%, but in the first quarter of 2015, it was by 5.2% lower than a year before.

In recent months, some positive trends have been observed as well – the evaluation of the prospects of sector's companies has slightly improved, as well as the load of the production capacity has increased in the second quarter of 2015.

Figure 3.28



The **light industry** sector basically is oriented towards foreign markets. About 90% of all production is exported – mainly to the EU Member States, therefore the growth of the sector is closely linked to changes in demand and competitiveness in the foreign markets.

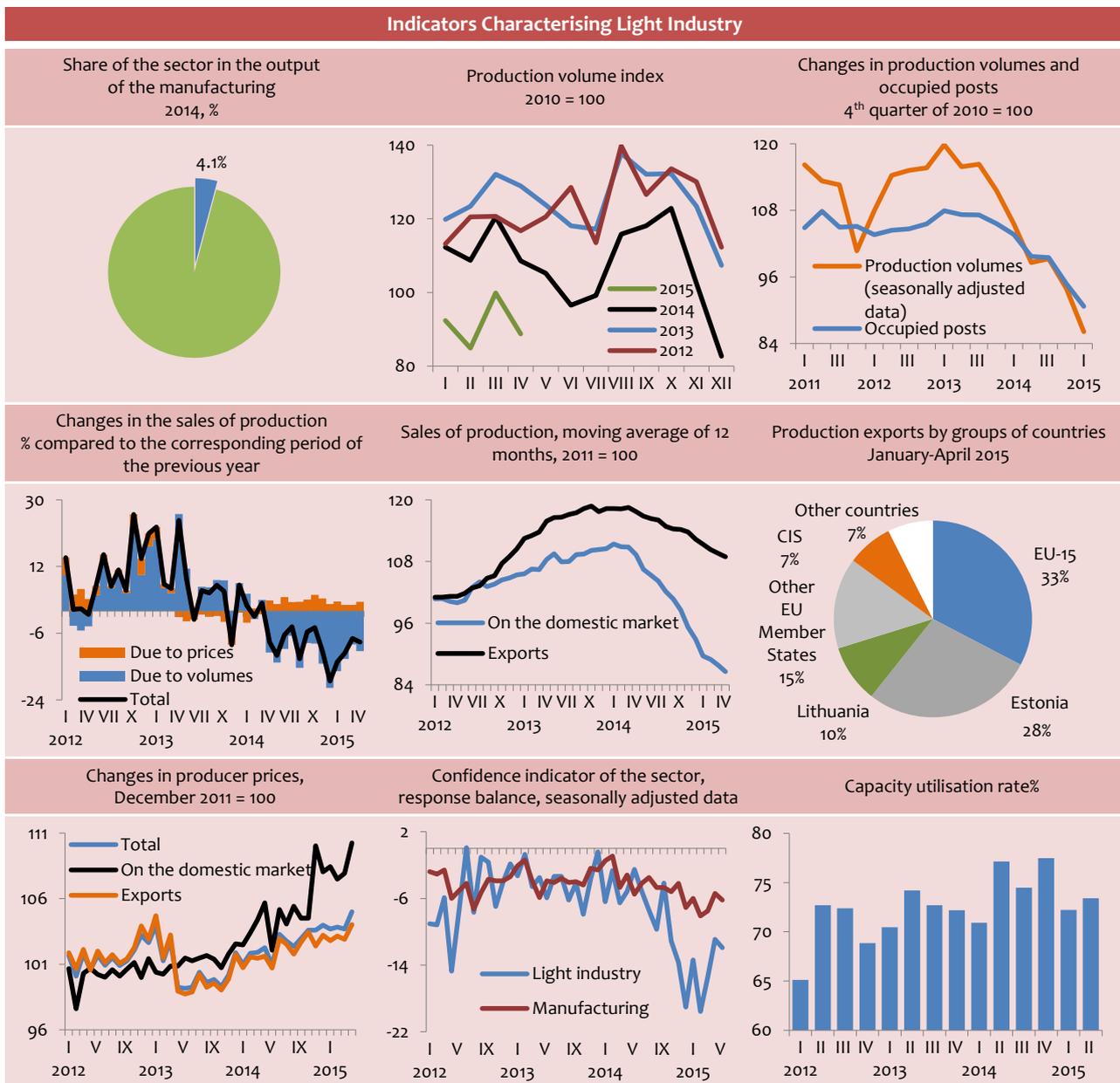
The weak economic situation in the largest market – the EU – has affected the growth of the sector in recent years. In 2014, the production volumes in light industry decreased by 13.6%. At the beginning of 2015, despite the gradual growth of the demand in the EU market, the production volumes in light industry kept decreasing. In January-April 2015, they were by 18.7% lower than a year before. The production volumes decreased both in clothing and textile production.

In 2014, the dynamics of the turnover of the industry were influenced by the increase in the producer prices.

The turnover of the industry dropped by 6.7%. The sales volume of the exported production decreased by 5%, whereas the revenue from the production sold in the domestic market - by almost 16%. The turnover of the industry decreased further in 2015 – in January-April it was by 10.2% lower than a year before. In this period of time, the volume of the exported production decreased by 8.7%, while the volume of the production sold in the domestic market - by 19%.

In the post-crisis years, the growth of the sector has been mainly ensured by the increase of production, but in recent years, when the production volumes are decreasing, the number of jobs also decreases. In 2014, the number of occupied posts in the sector decreased by 7.1%, but in the first quarter of 2015, the number of jobs decreased by 12.5% over the year.

Figure 3.29



Wood processing is one of the largest manufacturing sectors. The sector exports $\frac{3}{4}$ of all produced goods, and the largest export market is EU-15 Member States.

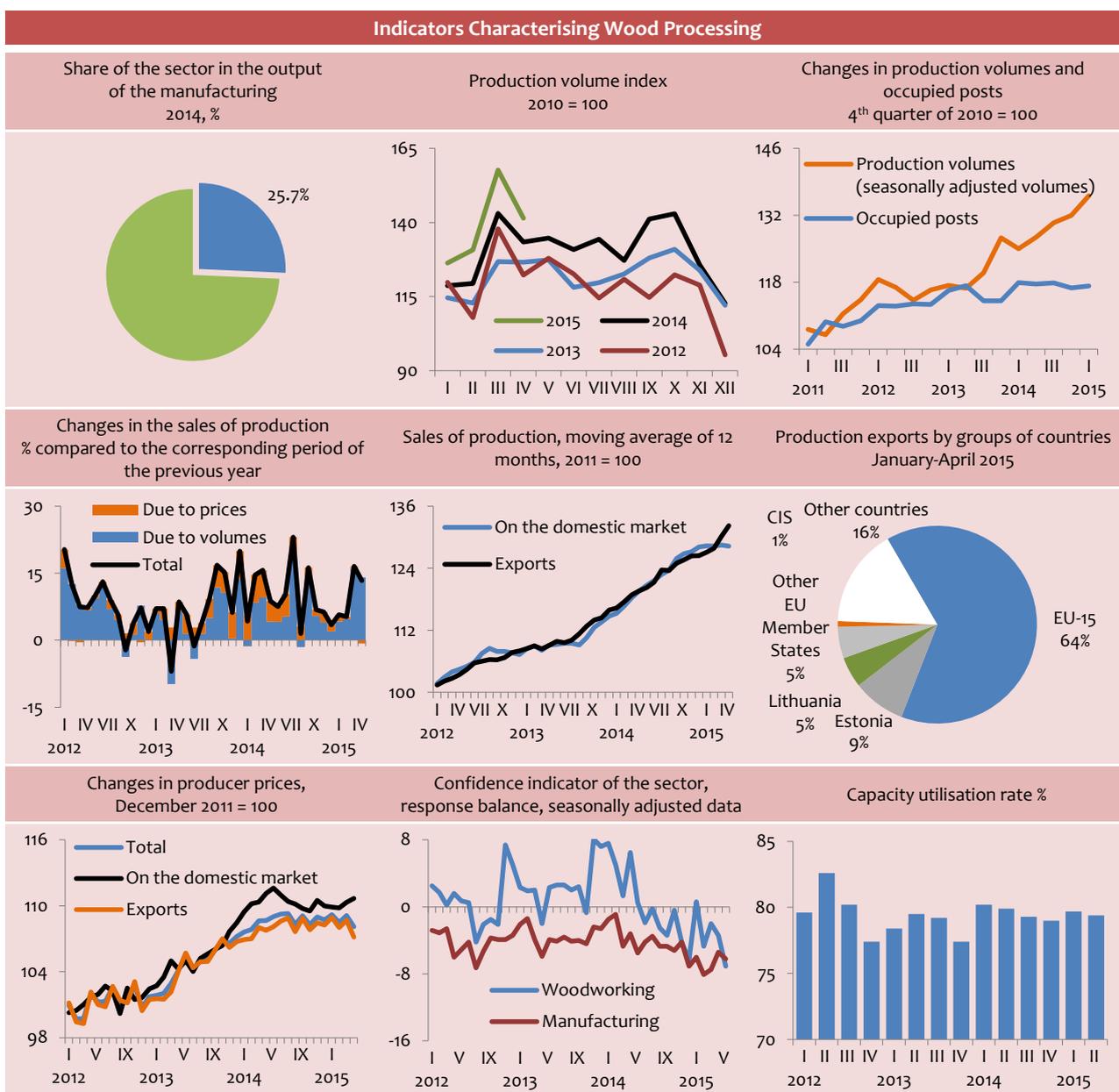
Wood processing was one of the first sectors that resumed growth after the crisis. In 2012, the production volumes in the sector exceeded the level of 2007 by more than 40% already. At the end of 2012 and in the first half of 2013, the weak demand in the largest trade partner states slowed down the growth of the sector.

Since the end of 2013, a steady growth has been observed in the sector. In 2014, the production volumes were by 6.9% higher than a year before, but in the four months of 2015, the production volume was by 8.2% higher than a year before.

In 2014, the turnover in the wood processing sector increased by 9.7%. Sales volumes both in the domestic market and export increased at a similar pace. In January-April 2015, the turnover was by 10.4% higher than a year before. The turnover of the export production increased by 14.2% in the said period. In the four months of 2015, the sales volumes in the domestic market essentially remained at the level of the corresponding period of the previous year.

In comparison to the increase in the production volumes, the number of jobs in the sector increased more moderately. It gives evidence of the increase in productivity. In 2014, the number of occupied posts increased by 1.8%. In the 1st quarter of 2015, the number of jobs was even a bit smaller than a year before.

Figure 3.30



The improved competitiveness and weak domestic demand during the crisis was the reason for **paper production and publishing industry** sector to reorientate their market focus to foreign markets. In recent years, the export possibilities were the basis for the growth of the sector. Currently, more than 60% of the production is sold in exports.

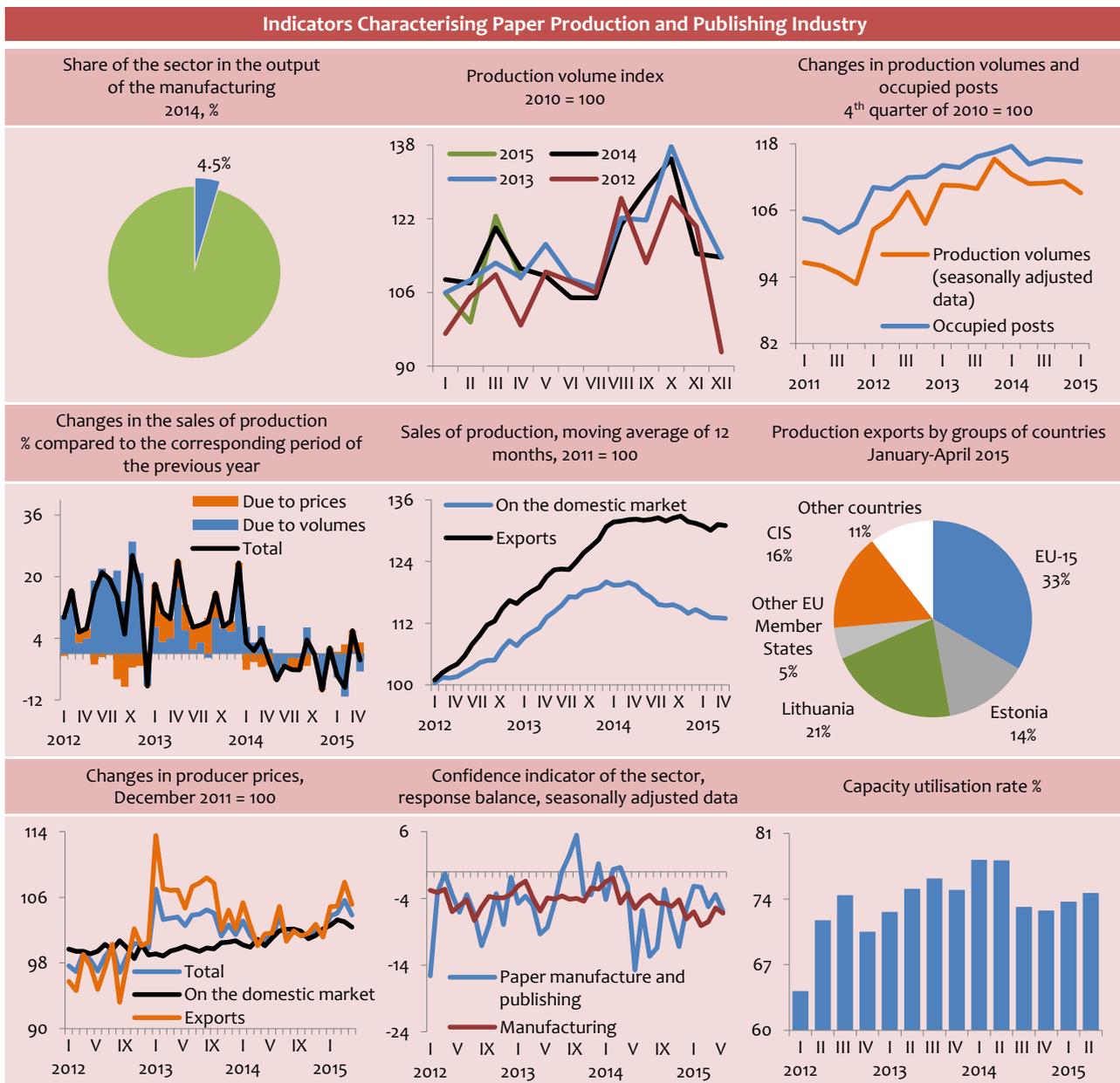
In 2012, the production volumes in the sector reached the pre-crisis level, and a steady growth continued in 2013. In 2014, production volumes dropped by 0.6%. The decrease was mainly influenced by a drop in production volumes in paper production sector (by 4.7%), while in publishing sector the production volumes increased by 2.1%. In the four months of 2015, the production volume in paper industry and publishing was by 2.5% lower than a year before.

From 2010 to 2013, the turnover of the sector grew steadily, but since 2014, the turnover of the sector has been decreasing. The decrease is mainly influenced by a drop in the turnover of production sold in the domestic market.

In 2014, the turnover of the sector dropped by 1.5%, but in January-April 2015 it was by 2.5% lower than in the corresponding period of the previous year. In the four months of 2015, the turnover of the exported production shrank by 1.1%, while the turnover of the production sold in the domestic market – by 4.5%.

In 2014, the number of occupied posts in the sector increased at a moderate pace – by 0.5%, but in the first quarter of 2015, the number of occupied posts was by 2.4% lower than a year before.

Figure 3.31



The **chemical industry** and related sectors constitute about 8% of the total output of the manufacturing and ensures more than 6% of jobs. Approximately ¾ of the production of the chemical industry is being exported, thus the growth of the sector is closely related to the tendencies in foreign markets.

Since 2014, the sector has been negatively influenced by the deterioration of the economic situation in Russia that is one of the significant markets for the sector. The demand in the EU markets is also still weak. In 2014, production volumes in the sector dropped by 3.6%. The decrease in production volumes was mainly influenced by the drop in the pharmaceuticals sector. A moderate growth remains in the production of chemicals and chemical products and production of rubber products. In the four months of 2015, the production volumes in

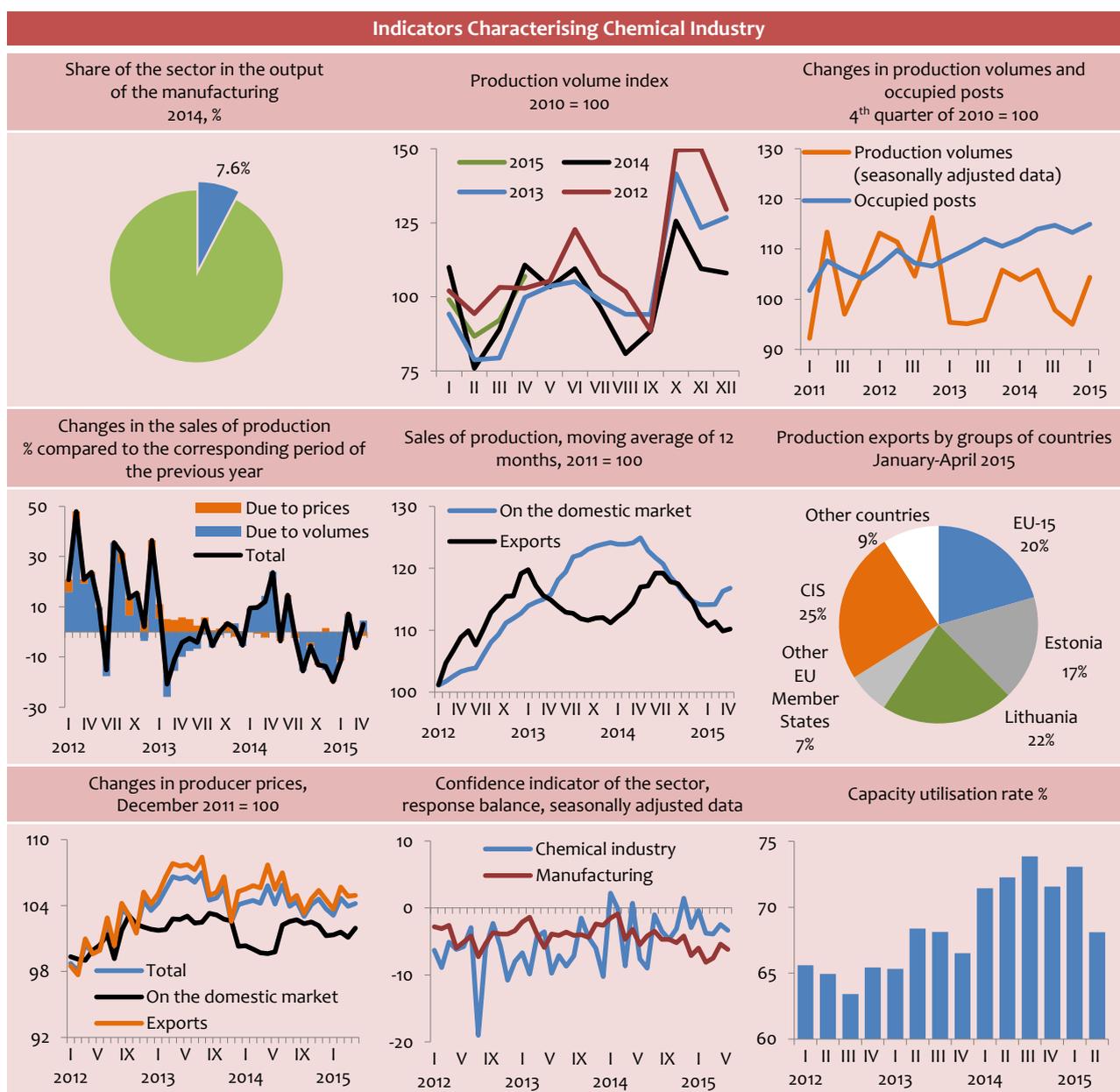
chemical industry in general remained at the level of the corresponding period of the previous year.

A smaller output influences the turnover in the sector. In 2014, the turnover in the sector decreased by 1.5%. Owing to the increase in producer prices in exports, the turnover of the production sold in 2014 remained at the level of the previous year.

In the 4 months of 2015, the turnover of the sector was by 2% lower than a year ago. During the period, the revenue from the production sold in the domestic market increased by 8.1%, while the turnover of the exported production was by 4.6% lower than a year before.

Despite the difficulties, the number of occupied posts in the sector continued growing – in 2014, it increased by 2.9%, but in the first quarter of 2014 – by 2.6%, if compared to the first quarter of the previous year.

Figure 3.32



The **production of other non-metallic minerals** is closely related to the growth of construction. Recovery of the sector from the crisis is facilitated also by the ability to focus on foreign markets – mainly the old Member States of the EU. Currently, the sector exports on average half of all production. For comparison, in 2007, the share of the exported production was only 18 per cent.

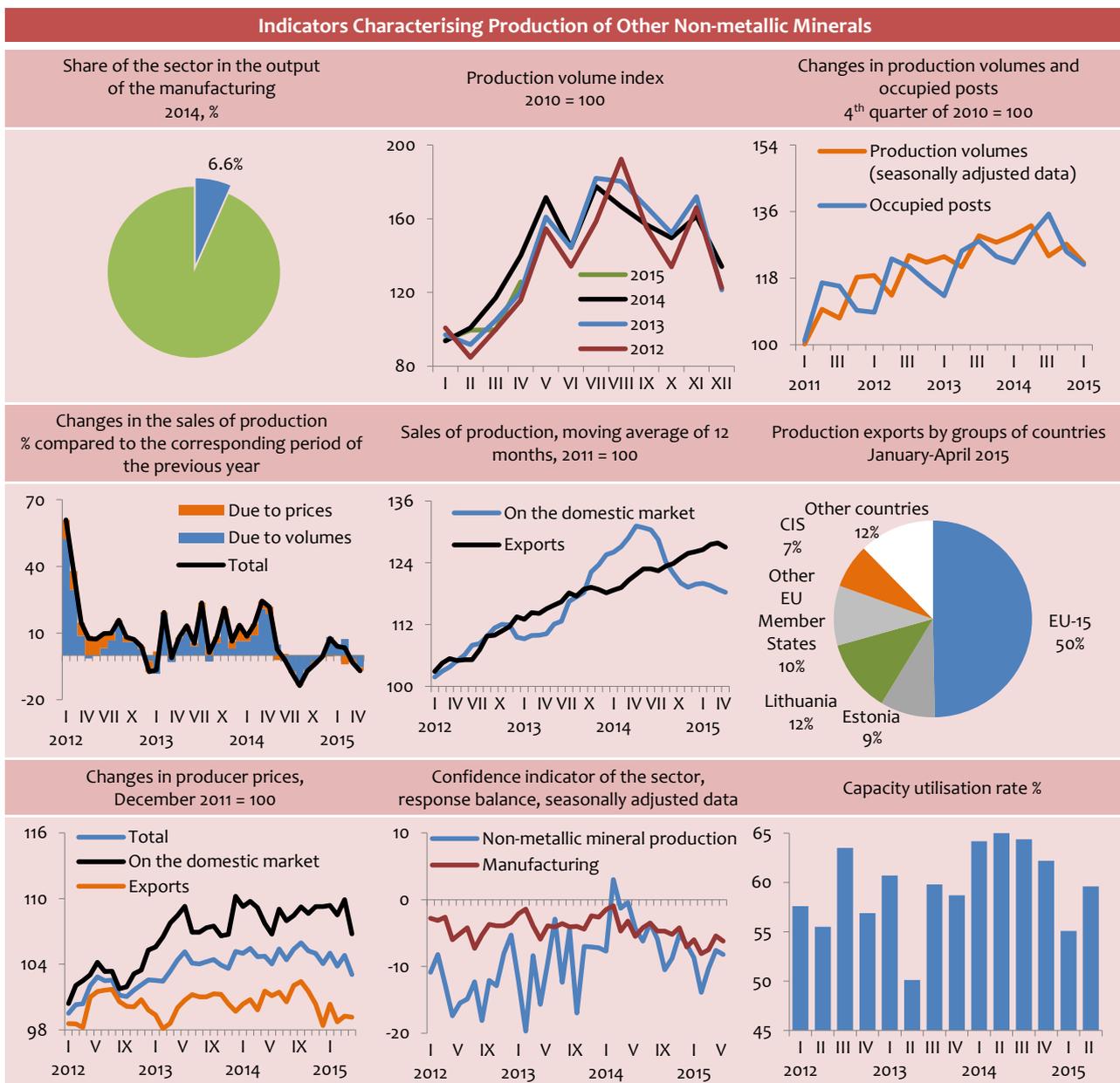
In 2014, the production volumes of the sector increased by 1.2%. In the four months of 2015, they were by 7.1% lower than a year before. The development of the sector is influenced by the deceleration of the growth of construction in the domestic market.

As moderate dynamics of producer prices remained, the turnover in 2014 essentially was maintained at the

level of the previous year. At the same time, the turnover of the exported production increased by 6.8%, whereas it shrank by 4.6% in the domestic market. Similar tendencies can be observed also in 2015. In January-April, the total turnover was by 1.5% lower than a year before. It was due to a drop in the turnover of the production sold in the domestic market by more than 6 per cent.

In 2014, the number of occupied posts in the sector increased by 4.5%, but in the first quarter of 2015, the number of jobs remained at the level of the corresponding period of the previous year.

Figure 3.33



Production of metal and metal articles had a significant contribution to the growth of the manufacturing in general in the post-crisis years. In 2012, the output was by almost 40% higher than before the crisis, and most of the production was being exported.

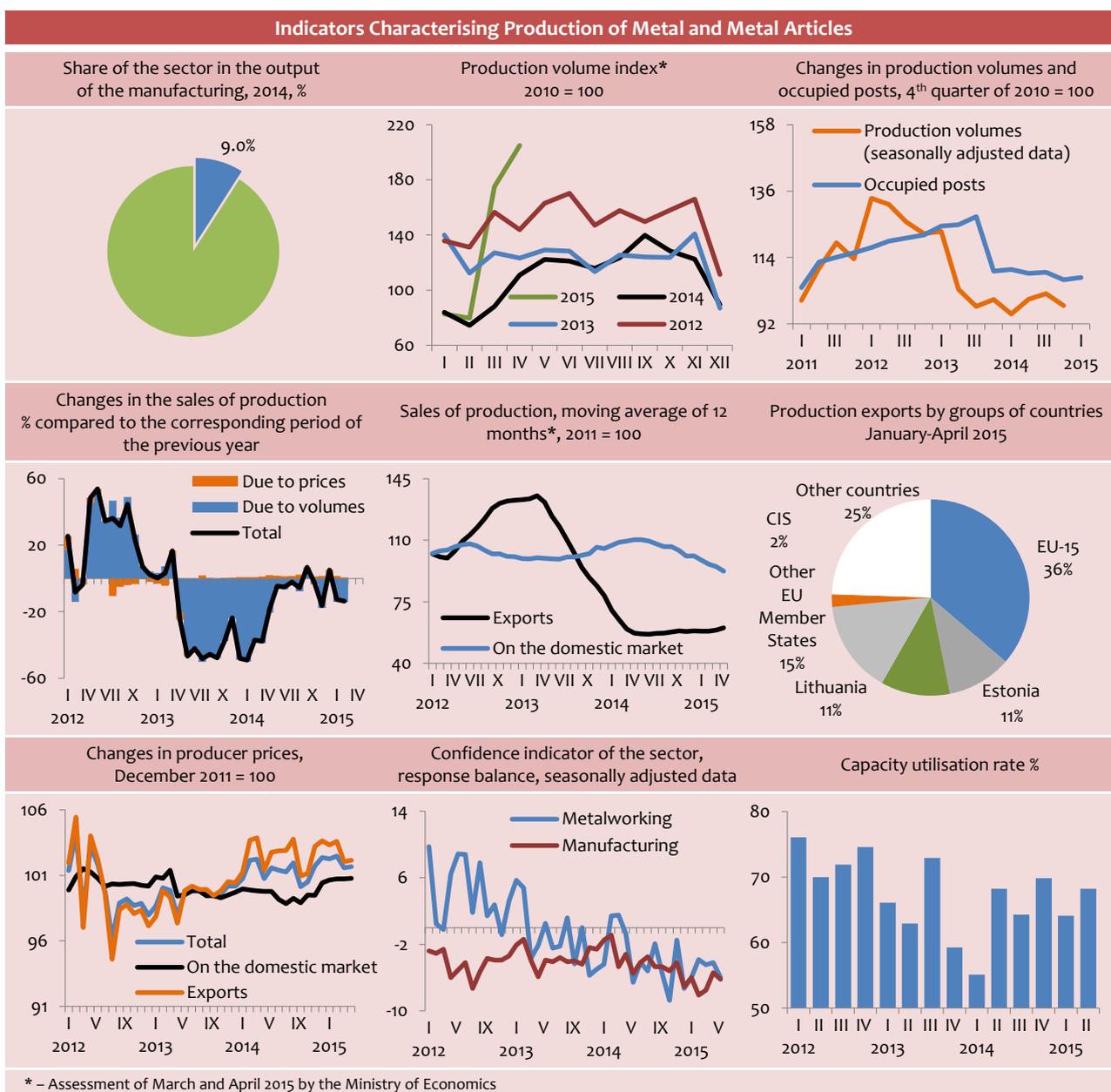
In 2013, the sector was significantly influenced by the termination of the activity of one of the largest manufacturing enterprises – JSC “Liepājas Metalurģs”. Metal production volumes shrank twice in 2013. The outage of JSC “Liepājas Metalurģs” significantly influenced the total growth indicators of the manufacturing also in 2014. In metalworking sector, the production volumes in 2014 were by 17.6% lower than a year before. “KVV Liepājas Metalurģs” overtook the assets of the insolvent company and has resumed activity

as of March 2015. It influences positively not only the growth indicators of metalworking, but also the manufacturing as a whole.

Along with the drop in output in 2014, the turnover of the sector decreased (by 18%). In the four months of 2015, the total turnover of the sector fell behind the level of the previous year. It was largely due to weak indicators in January-February.

At the end of 2013, when the activity of JSC “Liepājas Metalurģs” was terminated, about 1/10 of the employees working in the sector were fired. In 2014, the number of occupied posts in the sector was by 10.7% lower than a year before. In 2015, resuming of the operation of “KVV Liepājas Metalurģs” will have a positive impact on the number of jobs in the sector.

Figure 3.35



Production of electrical and optical equipment has been the fastest growing sector of manufacturing since 2010. The share of this sector in the total output of the manufacturing has increased from 3.7% in 2009 to 6% in 2014. More than 90% of all production of the sector is exported.

In 2015, the output of the sector increased by 32.3%. Production of computers, electrical and optical equipment contributed most to the growth of the sector. Similar tendencies were observed in the sector in 2015 – in January-April, the production volumes were by 23.4% higher than a year before.

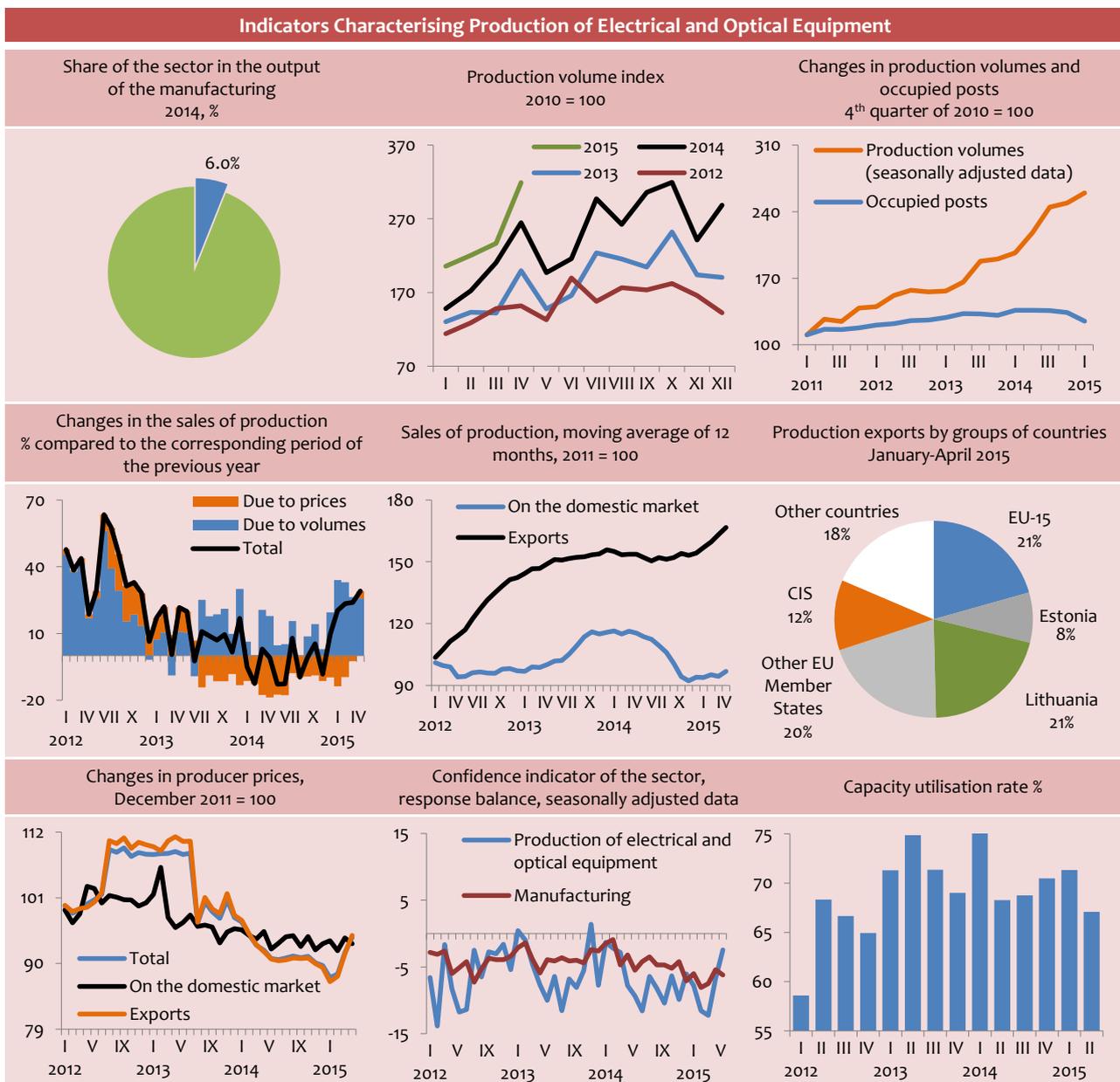
In 2014, despite the increase in the output of the sector, the turnover was by 3.1% lower than a year before. The turnover of the exported production decreased by 1%, whereas it shrank by 18.8% in the

domestic market. The decrease in the turnover was influenced by a significant drop in producer prices - in December 2014, they were by 10.5% lower than a year before.

In the 4 months of 2015, the turnover of the sector was by 24.2% higher than a year before. In this period, the turnover of the exported production increased by 25.8%, and in the domestic market – by 9.4%.

The increase in productivity contributed most to the growth of the sector, whereas the number of jobs has increased at a moderate pace. In 2014, the number of jobs in production of electrical and optical equipment increased by 3.2%, but in the first quarter of 2015 the number of occupied posts was even smaller than it was a year before.

Figure 3.35



Machinery and equipment production is a sector that provides means for production and technologies to other sectors, therefore its development is closely related to the growth of other manufacturing sectors. On average, 80% of the production is exported. The largest export markets are EU-15 states, as well as Lithuania and Estonia.

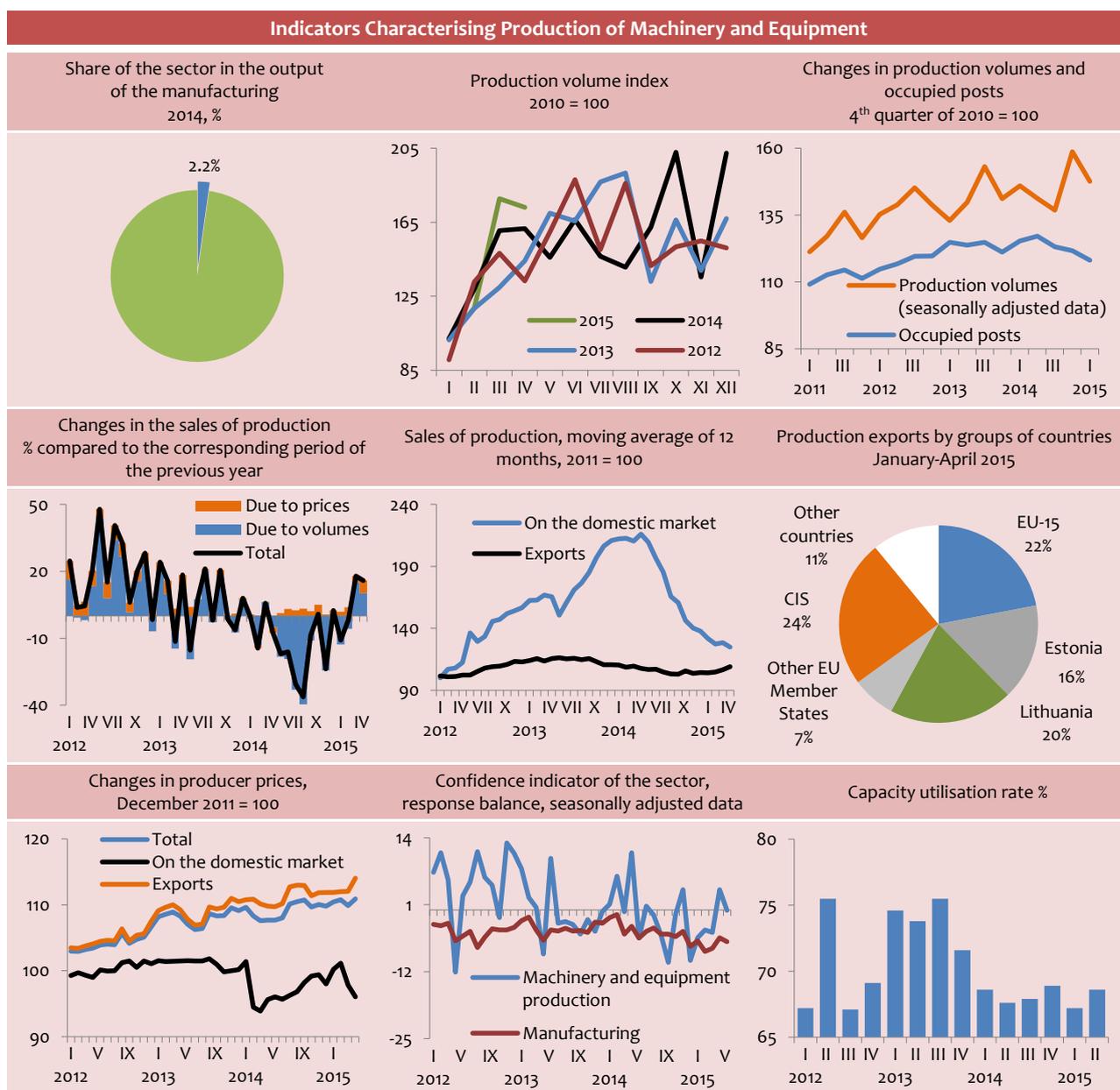
Since 2013, the growth of the sector has been affected by the weak demand in the largest trade partner countries, and the pace of growth of the sector is moderate. In 2014, the production volumes in machinery and equipment production increased by 2.4%, but in the four months of 2015 they were by 3.4% higher than in the corresponding period of the previous year.

In 2014, the turnover in the sector decreased by 13%. In this period, the turnover of the exported production decreased by 5.7%, but in the domestic market – almost by one third.

In 2015, the turnover indicators of the sector improved owing to a gradual increase in the demand in the export markets. In the four months, the turnover of the sector was by almost 6% higher than a year before. During the said period of time, the turnover of the exported production increased by 13.5%.

As the growth of the sector has been moderate in recent years, the pace of growth of the number of jobs has also slowed down. In 2014, the number of occupied posts in the sector increased only by 0.5 per cent.

Figure 3.36



The volumes of new orders in the domestic and foreign markets and production volumes increased rapidly in the **production of transport vehicles** in the post-crisis period. In 2012, the production volumes in the sector were by one third higher than in 2007.

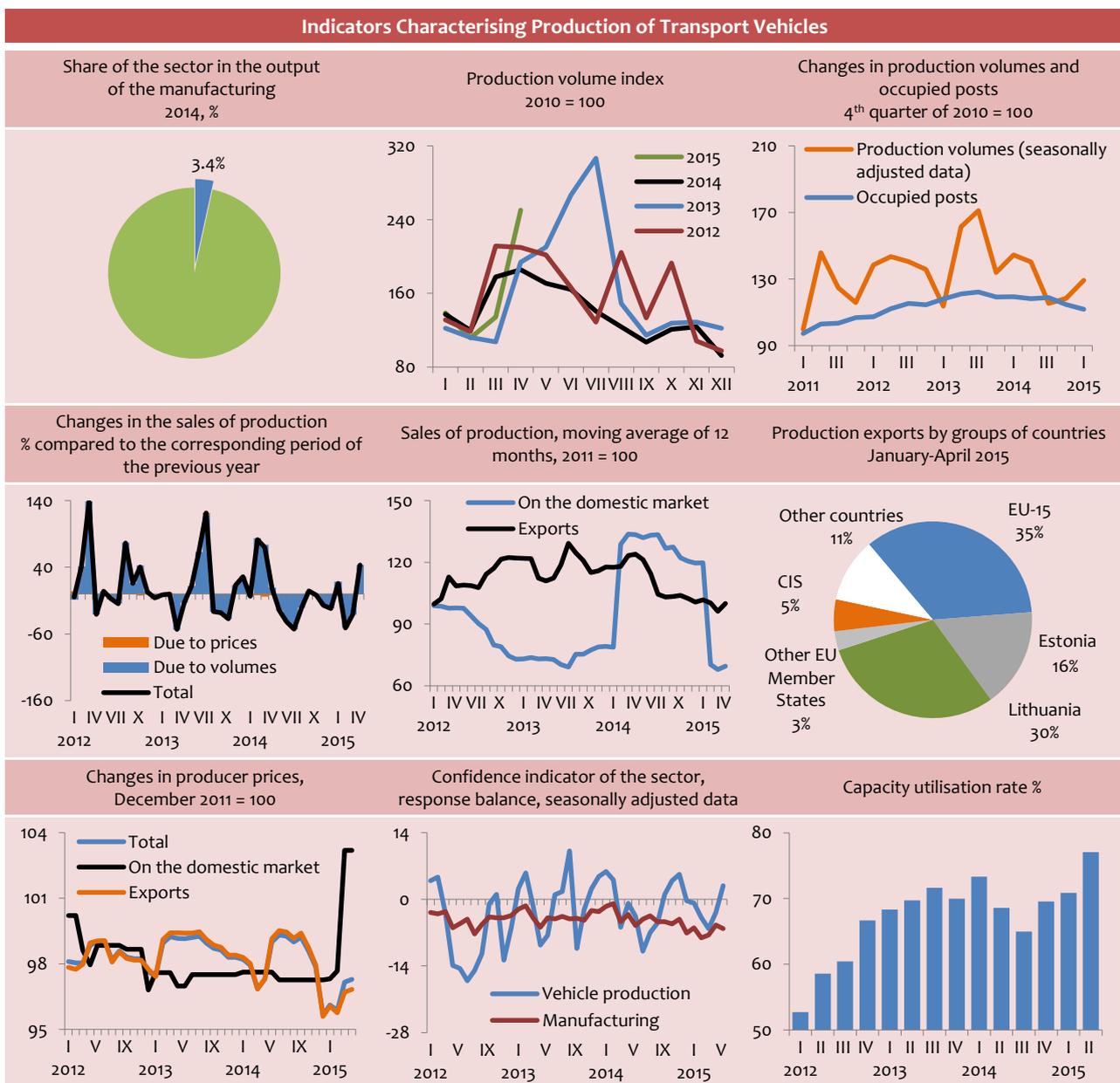
The industry is characterised by explicit fluctuations of production volumes. In recent years, on average 90% of the production is exported.

The orders finished in the previous years and the weak demand in foreign markets have affected the growth of the sector. In 2014, the output volumes decreased by 15.2% due to the weak demand. In early 2015, the situation in the sector slightly improved – in January-April, the volume of production was by 2.4% higher than a year before.

In 2014, the turnover of the sector decreased by 9.3%. A significant increase was observed in sales income from the production sold in the domestic market that increased by more than 50% in this period of time. The turnover of exported production in 2014 was by 14.5% lower than a year before. In the four months of 2015, the turnover of the sector was by 15.4% lower than a year before, mainly due to a decrease in the amount of production sold in the domestic market.

The explicit fluctuations of the production volumes in the sector affect the number of employees of the sector. In 2014, the number of occupied posts in the sector decreased by 1.9%, but in the first quarter of 2015 the number of occupied posts was by 6.2% lower than a year before.

Figure 3.37



3.3 Forecasts

The latest EU's and IMF's forecasts were used in the development of national economy development forecasts of the Ministry of Economics for the analysis of external markets and the evaluation of global economic development trends (see section 2).

National economy development in 2015

In the 1st quarter of 2015, the economic growth rates of Latvia reached 1.9 per cent.

In 2015, the development of Latvia's economy will be still closely linked to export possibilities. Therefore the highest risk for the growth of Latvia is linked with the global economic development. The export in 2015 will be close to the level of the previous year. The Latvian export dynamics might be positively affected by the improvement of the economic situation in the wider sales market – the EU, as well as the capabilities of entrepreneurs to find sales markets in third countries. Export will also be affected by the food import restrictions set by Russia. The factors related to Russia's economic situation will have even more significant impact on Latvia's export capabilities.

The latest forecasts of international institutions suggest that a decline is expected in the Russian economy in 2015. This will in turn have a negative effect on the growth rates of the EU countries. More than 70% of all the Latvian export goes to the EU countries, therefore, a weaker demand in these markets will most probably slow down the growth of the Latvian export.

Private consumption will continue to grow in 2015. Its dynamics will be mainly determined by the increase in wages which will be slower than in 2014. Improvements in the labour market will be more moderate than in the previous years. Whereas investments will be influenced by the awaiting behaviour of entrepreneurs regarding future perspectives, as well as a cautious crediting policy of commercial banks.

Sub-sectors of the manufacturing will retain different development trends, and sectoral growth will be closely linked to the changes in demand in the main export markets. It is projected that production volumes in the manufacturing in general might exceed the level of 2014 this year. Growth will continue in sub-sectors of the manufacturing, where production volumes have been steadily growing, for example, in wood processing and production of electrical and optical equipment.

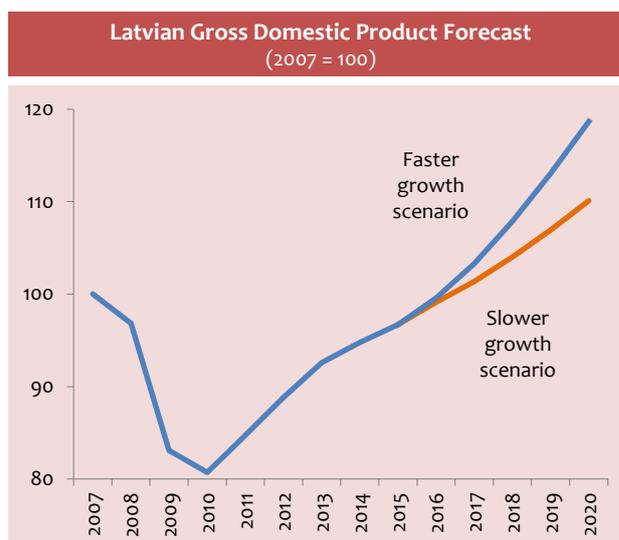
The growth in private consumption will promote growth of retail and other domestic market oriented sectors. Whereas, as evidenced by the latest statistical data, a very moderate growth is expected in the construction sector in 2015.

The Ministry of Economics forecasts that in total GDP growth rates will be within 2% in 2015.

Development prospects in 2016-2020

Faster and slower development scenarios have been developed for the medium-term until 2020. The main assumptions of the scenarios are based on various global economic development trends in the medium term.

Figure 3.38



Latvia as a small open economy with a relatively high degree of market liberalisation is significantly affected by global economic development and maintenance of stable competitiveness. The development dynamics of the EU's total economic space, as well as the improvement of the geopolitical situation, which was caused by the Ukrainian crisis, are especially important.

In the medium term, economic advantages of Latvia are mainly linked with the achieved macroeconomic stability, as a result of which Latvia's credit ratings, as well as efficiency of planned aid programmes of structural funds and the business environment improved.

Labour costs in Latvia are significantly lower than in the old EU Member States. Cheap labour force and comparatively high cost-effectiveness is a weak stimulus to change the business model and to create other advantages of competitiveness. At the same time, an increase in labour costs is inevitable because of the growth and the open labour market. Thus, without appropriate structural policy measures Latvia may lose its competitiveness in low cost segments faster than gain advantages in manufacturing of products with higher added value.

The weaker growth scenario is based on the assumption that global economic development is inhomogeneous, the EU's recovery from the crisis is slow, the geopolitical situation caused by the Ukrainian crisis does not improve. In the weaker growth scenario, annual export growth rates in this period will not reach

4%. Private consumption and investments are growing slowly. In its turn, the average GDP growth rates from 2016 to 2020 might be within 3 per cent.

Table 3.14

Forecast of the Latvian GDP by Expenditure Items						
	2012	2013	2014	2015	2016	2017-2020 (annual average)*
	Fact		Forecasts			
growth rates, % over the previous year						
Gross domestic product	4.8	4.2	2.4	2.0	3.0	3.0 .. 4.6
Private consumption	3.0	6.2	2.3	2.6	3.2	3.1 .. 4.8
Public consumption	0.4	2.9	3.4	2.4	0.2	1.7 .. 3.1
Gross fixed capital formation	14.5	-5.2	1.3	-1.1	3.0	4.1 .. 5.5
Exports	9.8	1.4	2.2	2.4	2.8	3.4 .. 4.8
Imports	5.4	-0.2	1.6	0.7	2.1	3.2 .. 4.5
structure, %						
Gross domestic product	100	100	100	100	100	100
Private consumption	61.2	61.9	61.5	61.9	61.9	61.6 .. 61.8
Public consumption	17.2	17.2	17.2	17.8	17.2	16.9 .. 16.7
Gross fixed capital formation	25.2	23.3	23.0	22.4	22.5	22.9 .. 22.6
Changes in inventories	0.8	0.6	1.1	1.0	1.0	1.0 .. 1.0
Exports	60.9	59.4	58.0	57.1	56.7	57.0 .. 56.4
Imports	65.3	62.3	60.9	60.2	59.2	59.3 .. 58.5
Export-import balance	-4.4	-2.9	-2.9	-3.1	-2.5	-2.3 .. -2.2

* structure at the end of the period

The rapid growth scenario envisages that growth in Latvia's main exports markets will restore and the advantages of the Latvian economy in competitiveness are mainly associated with technology factors, the improvement of production efficiency and innovation, and, to a lesser extent, with cheap labour force and low

cost of resources. In the rapid growth scenario, in the medium term, export and the manufacturing keep comparatively faster growth rates, which are based on competitiveness of the Latvian producers and growing external demand. In this scenario, GDP growth rates in the medium term can reach 5% per year.

Table 3.15

Forecast of the Latvian GDP by Sectors (real growth, % in comparison with the previous year)						
	2012	2013	2014	2015	2016	2017-2020 (annual average)
	Fact		Forecasts			
Gross domestic product	4.8	4.2	2.4	2.0	3.0	3.0 .. 4.6
Agriculture and forestry	7.5	-0.1	1.5	-6.1	2.8	3.0 .. 3.4
Manufacturing	4.6	0.0	-0.3	4.4	5.2	4.8 .. 5.6
Other industry	-5.5	-3.3	-2.5	-3.9	2.9	2.5 .. 3.4
Construction	14.5	7.5	8.1	2.9	5.7	3.4 .. 6.4
Trade and accommodation	1.7	4.8	2.3	2.3	3.4	3.1 .. 5.2
Transport and storage	6.9	1.6	3.2	-0.7	-0.2	1.4 .. 2.9
Other commercial services	5.2	6.0	1.3	2.4	2.7	3.3 .. 5.0
Public services	0.1	3.8	3.3	2.6	2.4	1.8 .. 3.1

4. MACROECONOMIC STABILITY

4.1 Public Finances

4.1.1 Fiscal Policy and Public Debt

Deterioration of the economic situation in Latvia in 2008 and 2009, which was influenced by the global financial crisis, significantly worsened the fiscal position of the state. In order to keep the situation in the financial sector under control, extensive budget consolidation was implemented in Latvia. In the period from 2008 until 2012, fiscal consolidation measures were implemented

with a total fiscal effect of 16.9% of GDP: 6.7% on the income side and about 10.2% of GDP on the expense side. During the period from 2008 until 2012, Latvia implemented measures for fiscal consolidation on average to the extent of 3.4% of GDP per year. The budget consolidation activities implemented by the government, resulted in a gradual reduction of the budget deficit and in 2013 it constituted only 0.7% of GDP.

Table 4.1

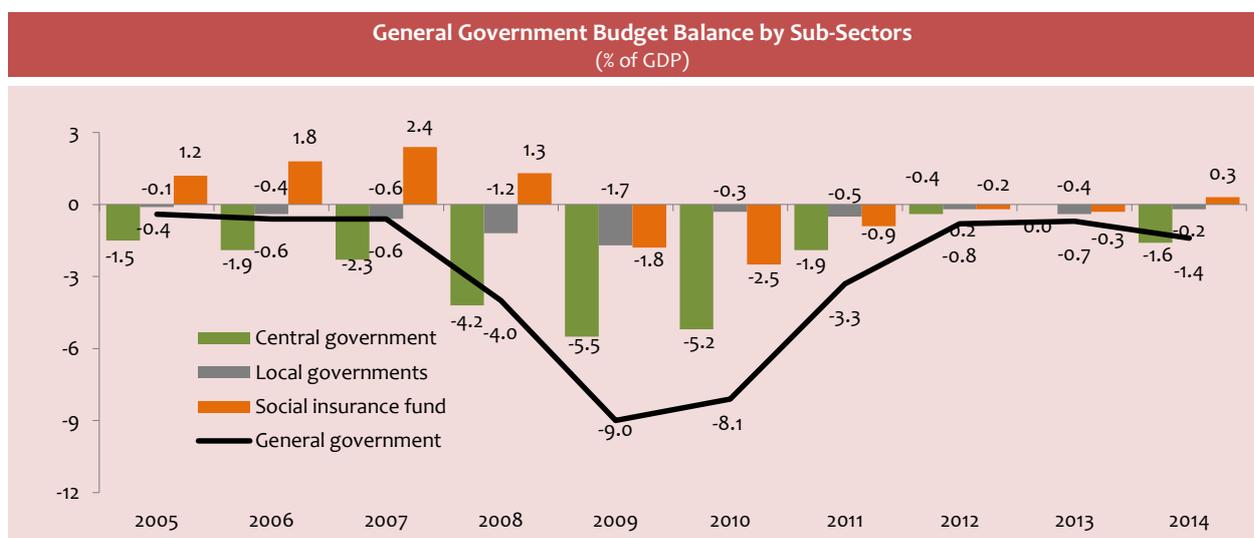
General Government Budget					
	2010	2011	2012	2013	2014
Revenues (million EUR)	6528.3	7203.1	7880.2	8197.3	8535.0
(% of GDP)	35.9	35.5	35.7	35.3	35.5
Expenditures (million EUR)	7993.2	7881.5	8055.3	8369.4	8882.1
(% of GDP)	44.0	38.8	36.5	36.0	36.9
Balance (million EUR)	-1464.8	-678.3	-175.1	-172.1	-347.0
(% of GDP)	-8.1	-3.3	-0.8	-0.7	-1.4

In 2014, the general government budget deficit was 1.4% of GDP or 347 million euros, which was by 0.4 percentage points more than had been planned in the *Stability Programme of Latvia* from the previous cycle. The discrepancy was mainly caused by a one-time capital transfer for discharging liabilities of the central

government towards the European Bank for Reconstruction and Development (EBRD).

In the recent years, the general government budget deficit has consisted of the deficit in the central government budget, in the budgets of local governments, and the Social Insurance Fund (see: Figure 4.1).

Figure 4.1



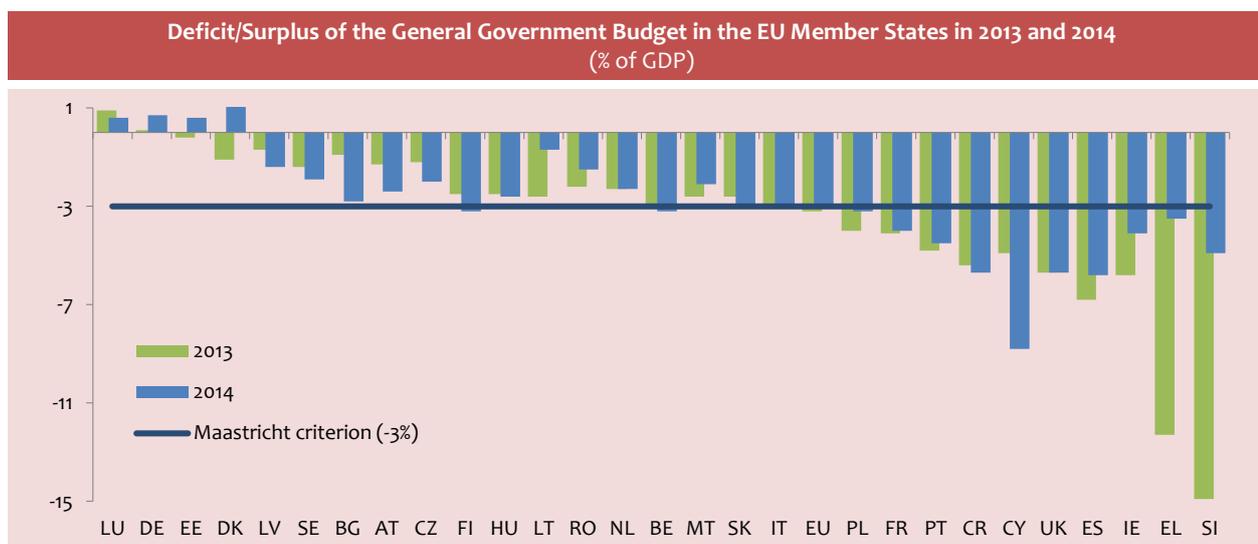
In 2014, the budget deficit of the central government increased significantly, which was related to the above mentioned one-time capital transfer for discharging liabilities of the central government towards the EBRD, as well as for increased expenditures on compensation and social benefits. A decrease of the budget deficit was observed in the other two sub-sectors of the national government, especially in the social insurance fund, where a small surplus was observed.

As shown in Figure 4.2, the overall budget situation of the EU is improving. The average level of the budget deficit of EU in 2014 was 2.9% of GDP (in 2013, 3.2% of GDP, in 2012, 4.2% of GDP). For 12 EU Member

States (10 in 2013, 17 in 2012), the public budget in 2014 exceeded the Maastricht criterion, which is 3% of GDP. The highest ratio of general government budget deficit to GDP in 2014 was identified in Cyprus, Spain, Croatia and the United Kingdom. The budget deficit in these countries exceeded 5% of GDP. There was a budget surplus in Denmark, Germany, Estonia and Luxembourg.

According to forecasts of the EC announced in the spring of 2015, the budget situation in EU will continue to improve. The average level of the budget deficit in EU in 2015 is expected to reach 2.5% of GDP. The highest budget deficit in 2015, which might exceed 4% of GDP, is expected in Croatia, Spain and the United Kingdom.

Figure 4.2



According to the Stability Programme of Latvia 2015–2018 submitted to the EC, the projected general government budget deficit in 2015 is 362.1 million euro or 1.5% of GDP. Measures for strengthening the social and national security, development of sustainable economy of Latvia, which would improve the public welfare, as well as facilitation of business competitiveness are set as a priority in the national budget for 2015.

For the purpose of ensuring stability of the tax policy and keeping the earlier commitment to reducing the tax burden on the labour force, the personal income tax rate was reduced from 24% to 23% as of 1 January 2015. Contributions to the second pension level were increased from 4% to 5%. Since 1 January 2015, the minimum wage was also increased, from 320 euros to 360 euros. This is one of the approaches to implementing the strategic development goal of the state, namely, reduction of income inequality within the population. Starting from 2016, plans include the introduction of a differentiated untaxed minimum.

Since the adoption of the *Fiscal Discipline Law* (FDL) at the beginning of 2013, the state fiscal policy has been based on the concept of balancing the budget within the economic cycle, i.e. the amount of structural balance of

the general government budget should not exceed -0.5% of GDP, as stipulated in the FDL. Latvia had a structural deficit of 0.5% of GDP in 2012. Consequently, the task in subsequent years is no longer the reduction of structural deficit, but rather its maintenance at the medium-term goal.

While developing goals for a medium-term structural balance, a multi-stage approach is applied, which allows to ensure that the respective goals of structural balance are in compliance not only with the national approach, but with the conditions of the *Stability and Growth Pact* as well; also recalculating the difference of outputs according to the EC standardised methodology. The following targets for the structural balance of the general government budget are defined in the intermediate term: -1% of GDP in 2016, -0.9% of GDP in 2017, and -1.2% of GDP in 2018.

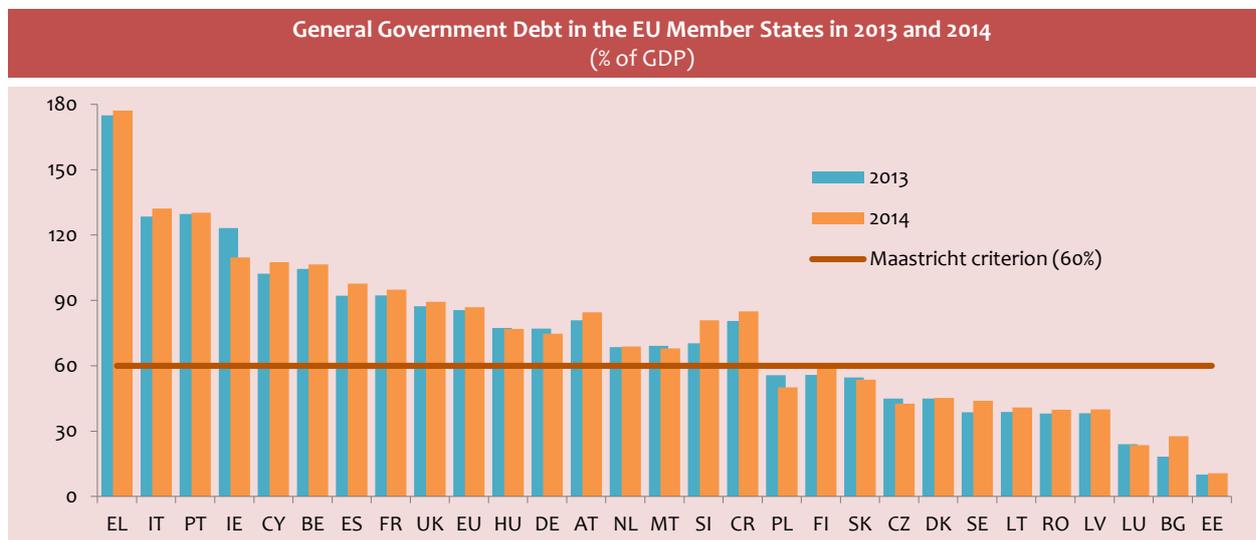
A significant aspect is not only the development and approval of the fiscal discipline framework, but also operation of instruments that actually implement the framework of fiscal discipline in the process of budget formation and monitoring. The authority in charge of compliance with fiscal discipline requirements both during the budget planning process and at the stage of implementation is the Fiscal Discipline Council, which

was established in 2014. During development of the *Law on the State Budget for 2015* and the *Law on the Medium-term Budget Framework for 2015, 2016 and 2017*, the Council prepared a report on monitoring of fiscal discipline, in

which it indicated that the principles and conditions of the FDL are generally complied with.

The level of the **national government debt** in Latvia is still one of the lowest in the EU (see: Figure 4.3).

Figure 4.3



The average level of public debt in EU states in 2014 was 86.8% of GDP (in 2013, 85.5% of GDP, in 2012, 83.7% of GDP). In 16 EU member states (in 2013, 16 member states, in 2012, 14), public debt in 2014 exceeded the Maastricht criterion, which specifies 60% of GDP. The highest public debt to GDP ratio in 2014 was observed in Greece, Italy, Portugal, Ireland, Cyprus and Belgium, whereas the lowest public debt to GDP was registered in Estonia, Luxembourg and Bulgaria. As indicated by forecasts of the EC for the autumn of 2015, the average ratio of public debt in the EU will slightly decrease in 2015.

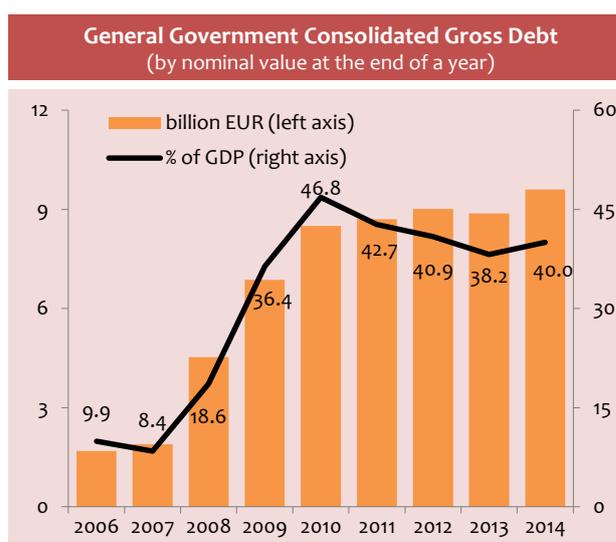
General government debt in Latvia increased gradually until 2007. In order to provide funding for performance of financial liabilities, the general government debt started to grow rapidly in 2008, and by the end of 2010 it had reached 8496 million euros, or 46.8% of GDP. In late 2011 the general government debt constituted 8659 million euros or 42.7% of GDP, and at the end of 2012, 9013 million euros or 40.9% of GDP. The debt slightly decreased at the end of 2013 and constituted 8876 million euros or 38.2% of GDP. In 2014, the debt constituted 9633 million euros or 40% of GDP. The level of general government debt is mainly influenced by the central government's debt, which constituted 9012 million euros at the end of 2014.

It should be noted that a three-year international loan program was successfully concluded at the end of 2011. The amount loaned to Latvia had been planned at 7.5 billion euros. Taking into consideration that the economic and financial situation had improved, it was not necessary for Latvia to take the available loan in full. Latvia only used 4.4 billion euros.

After successful completion of the international loan program, Latvia has repeatedly proved its ability to attract financing on international financial markets on favourable conditions, through organising public issuance of sovereign debt securities.

In 2015, the plan is to repay 1.2 billion euros of the principal loan granted by the EC, and 60.05 million euros of the first principal loan granted by the World Bank. Thus, the amount of public debt is expected to decrease by 5.1% in 2015.

Figure 4.4



By implementing timely borrowing measures according to the medium-term strategy, and by continuing the implementation of a sustainable fiscal policy, it is possible to refinance the current debt liabilities of the central government on favourable conditions in terms of interest rates and maturity, and in a long-term time frame achieve decrease and stabilisation of the level of the general government debt at a sustainable level, convincingly complying with the public debt criteria specified in the Maastricht Treaty.

4.1.2 Budget Revenues¹

A budgetary consolidation was carried out in Latvia from 2008 to 2012 to stabilise country's fiscal position during the economic crisis. Budget deficit dropped from 9% of GDP in 2009 to 0.7% of GDP in 2013. In 2014, the general government budget deficit was 1.4% of GDP. The goal of the government is to keep budget deficit low.

In 2014, as the economy kept growing, **revenue of the general consolidated budget** grew as well and was 8535.9 million euro in 2014 or by 1.9% higher than in

2013. The growing revenue was largely due to the growth in tax revenue.

In the four months of 2015, revenue of the consolidated general government budget was 3074.4 million euro, thus it grew by 12.4% compared to the same period of 2014. The growth in general budget revenue was mainly determined by higher foreign financial aid revenue and the growth in tax revenue.

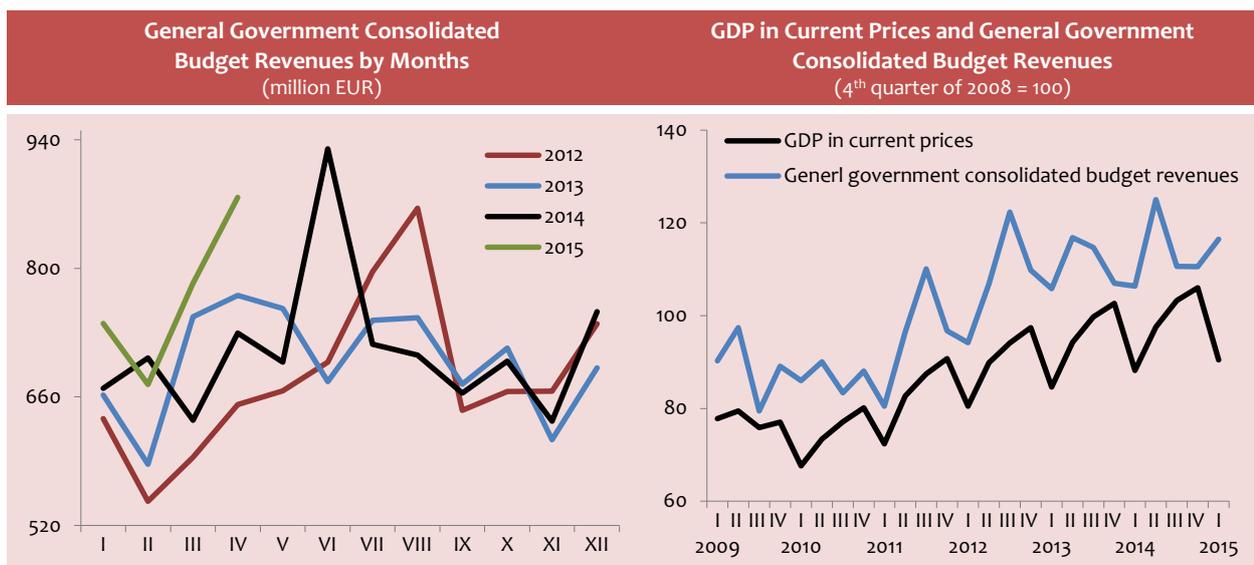
Tax revenue constitutes about 3/4 of the entire budget revenue. Other budget revenue is formed by non-tax revenue and revenue from foreign financial aid.

In 2014, tax revenue was 6675.9 million euro – by 249.6 million euro or by 3.9% larger than in 2013. In 2014, the most significant contribution came from the growth in employment tax revenue which was promoted by the growth in wages; and as retail turnover grew, revenue from value added tax grew as well.

In the four months of 2015, tax revenue grew by 4.9% compared to the same period of 2014 and was 2252.4 million euro.

The tax revenue plan in the general government budget in the four months of 2015 was fulfilled for 99.5 per cent.

Figure 4.5



In 2014, as the average wage and the number of jobs kept growing, **employment tax** revenue grew by 1.4% compared to 2013.

In the four months of 2015, employment tax revenue grew by 4.7 per cent.

Employment taxes constitute almost half of all the tax revenue.

In 2014, personal income tax revenue was 1385.2 million euro and grew by 3.9% compared to 2013.

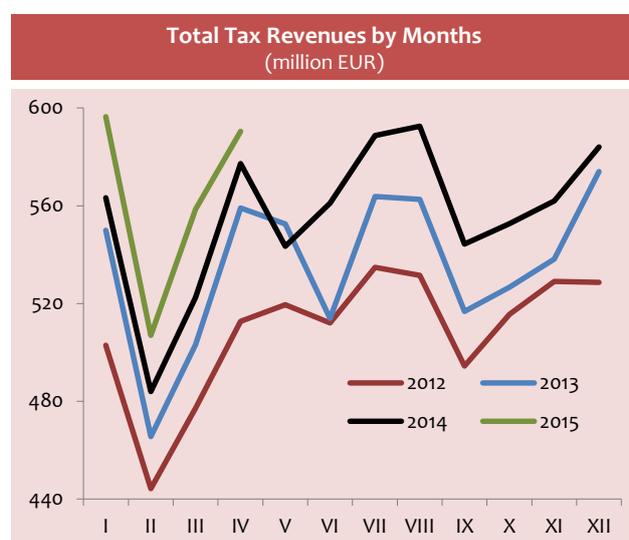
¹ The section uses official data from monthly reports of the Treasury

Table 4.2

Budget Revenues (% of GDP)								
	2008	2009	2010	2011	2012	2013	2014	2015 I
General government consolidated budget revenue	33.4	35.6	36.1	35.7	37.1	36.1	35.5	39.9
I Tax revenue-	27.6	26.5	26.7	27.2	27.7	27.7	27.7	30.2
1. Indirect taxes	9.8	9.9	10.2	10.2	10.5	10.4	10.8	11.4
– value added tax	6.5	6.0	6.5	6.7	7.2	7.2	7.5	7.9
– excise tax	3.2	3.8	3.6	3.4	3.2	3.1	3.1	3.3
– customs duty	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2
2. Income taxes and property taxes	9.3	7.5	7.8	7.7	8.0	8.0	8.0	9.1
– corporate income tax	2.9	1.5	0.9	1.4	1.6	1.6	1.5	1.6
– personal income tax	6.0	5.5	6.2	5.6	5.6	5.7	5.8	5.9
– real estate tax	0.4	0.6	0.7	0.8	0.8	0.7	0.8	1.5
3. Social insurance contributions	8.2	8.8	8.6	8.6	8.5	8.5	8.2	8.8
4. Other taxes	0.3	0.2	0.2	0.6	0.6	0.7	0.8	0.9
II Other revenue	5.8	9.1	9.3	8.5	9.4	8.4	7.7	9.7

In January-April 2015, personal income tax revenue was 445 million euro which grew by 3.8% compared to the same period of 2014.

Figure 4.6



Starting from 1 January 2014, the personal income tax rate was reduced to 24%. The non-taxable minimum was also raised from 64 euro to 75 euro, the exemption for dependants grew from 100 euro to 165 euro and the minimum wage was increased to 320 euro.

Starting from 1 January 2015, the personal income tax rate was reduced to 23%, tax inequality was eliminated in relation to the persons receiving a pension, with regard to the general non-taxable minimum, as well as an attempt was made to reduce the administrative burden on families with children by motivating school-age children to work during their summer holidays, etc. The minimum wage was also increased from 320 euro to 360 euro.

The purpose of the labour tax reform is to ensure labour taxes equal to those in Estonia and Lithuania in terms of costs in the competition of the Baltic States for investment and workplaces. When the total burden of labour taxes is reduced, the risks of poverty and structural unemployment, as well as grey economy and the motivation to evade payment of taxes will reduce as well.

Figure 4.7

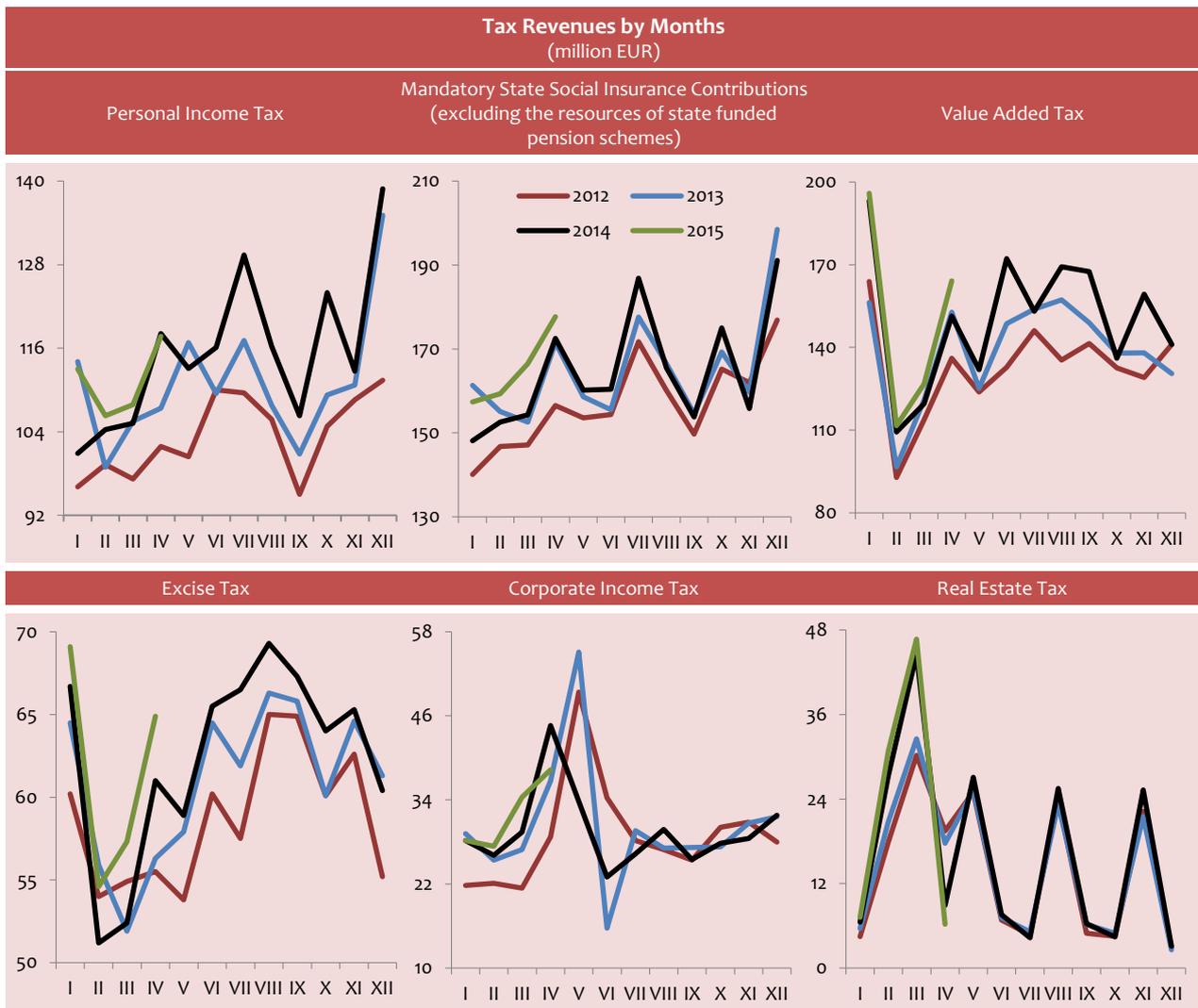


Figure 4.8

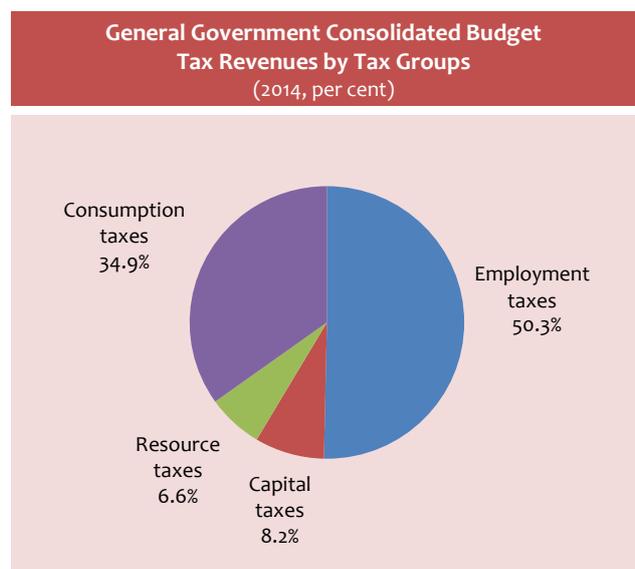
In 2014, revenue from mandatory state social insurance contributions was 1976.1 million euro or by 0.2% lower than in 2013.

Starting from 1 January 2014, the state social insurance rate was reduced by 1 percentage point and is 34.09%, 23.59% of which are paid by the employer and 10.5% – by the employee. Mandatory state social insurance contributions reduced in 2014 because of changes in taxes.

In the four months of 2015, revenue from mandatory state social insurance contributions grew and was 660.9 million euro which was by 5.3% more compared to the same period of 2014.

Revenue from **consumption taxes** constitutes one third of all the tax revenue. As a result of the increase in private consumption and therefore also the increase in retail turnover, consumption tax revenue into the public budget in 2014 was by 8.6% higher than in 2013.

In the four months of 2015, revenue from consumption taxes was by 5.7% higher than in the same period of 2014.



Starting from 1 January 2014, in the VAT sector several VAT input tax deduction restrictions were cancelled, changes were introduced into the application of VAT in real estate deals, VAT securities were introduced into petroleum product deals, etc.

In 2014, value added tax revenue was 1803.7 million euro and grew by 8.2% compared to 2013.

Starting from 1 January 2015, changes were introduced into the sector of value added tax, for example, special value added tax calculation payment schemes were introduced for electronic communication, broadcasting and electronic services, changes were made to the procedure of application of the Law on Value Added Tax.

In the four months of 2015, revenue from value added tax was 598.4 million euro which is by 4.4% higher than in the same period of 2014.

Starting from 1 January 2014, changes were introduced into the consumption part of excise tax (alcoholic beverages, tobacco and other excise products). Changes for tobacco products were made by increasing excise tax for cigarettes, cigars and smoking tobacco. It was decreed that excise tax for this product group would increase every year until 2018.

In 2014, revenue from the consumption part of excise tax increased as well. In 2014, tax revenue was 330 million euro which was by 3.8% more than in 2013.

Starting from 1 January 2015, it is decreed that excise tax for tobacco leaves has the same rate as smoking tobacco.

In the four months of 2015, revenue from the consumption part of excise tax grew by 5.4% compared to the same period of 2014.

The ratio of **capital duties** in the total tax revenue in 2014 was 8.2%. In 2014, revenue from capital duties grew by 2% compared to the year 2013.

In the four months of 2015, revenue from capital duties grew by 1.7% compared to the same period of 2014.

Starting from 1 January 2014, changes were made to the corporate income tax sector the purpose of which was to promote investments and contributions to research and development. For example, some of the changes were an extended possibility to apply a tax relief to new production process equipment, extended application deadlines for tax deductions for investments made into supported projects, etc. Changes in the micro-enterprise tax sector were made.

In 2014, revenue from corporate income tax dropped by 2.1%. It was mainly related to the drop in contributions and the increase in repaid amounts. Repaid amounts grew by 3 million euro or 4.2% compared to 2013. Whereas contributions of corporate income tax dropped by 4.7 million euro or 1.1 per cent.

Starting from 1 January 2015, changes were made to the micro-enterprise tax sector, defining that those micro-enterprises which turnover does not exceed 7000 euro will be subject to the micro-enterprise tax rate

of 11%. It is also planned that the micro-enterprise tax rate will be 13% in 2016 and 15% in 2017. These changes were introduced to increase the social guarantees of the employees of micro-enterprise tax payers. At the same time, amendments to the *Micro-enterprise Tax Law* entered into force on 13 May 2015 providing for maintaining the micro-enterprise tax rate of 9% in 2015 and later on during the first three years of operation with the status of a payer of micro-enterprise tax, but from the fourth year of operation the micro-enterprise tax rate will increase to 12% for micro-enterprise tax payers with a turnover exceeding 7000 euro (see Section 6.8).

In the four months of 2015, revenue from corporate income tax, in fact, remained at the level of the same period of 2014.

Starting from 1 January 2014, changes were introduced into the real estate tax sector, for example, tax exemptions were cancelled for cultural monuments protected by the state, the procedure of determination of the taxpayer for the immovable property belonging to the state or local or regional government was changed, etc.

Revenue from real estate tax in 2014 grew by 10.5% and were 190.9 million euro.

Starting from 1 January 2015, it is decreed in the real estate tax sector that no more 12 months exemption from real estate tax after commissioning of a building is applicable to the buildings which were built or reconstructed for economic operations.

In the four months of 2015, revenue from real estate tax grew by 4.1% compared to the four months of 2013 and was 90.9 million euro.

The group of **resource taxes** is the smallest tax group and it made 6.6% of all the tax revenue in 2014. In 2014, resource tax revenue grew by 1.5% compared to 2013.

In the four months of 2015, revenue from the resource tax group grew by 7.2 per cent.

Starting from 1 January 2014, several changes were introduced into the resource tax sector, for example, rates for new objects subject to natural resource tax and increased natural resource tax rates were introduced (on extraction of natural resources, on waste disposal, on contamination of air and water, on products harmful to the environment, etc.).

In 2014, natural resource tax revenue grew by 5% compared to 2013.

Whereas in the four months of 2015, natural resource tax revenue grew by 8.7%.

Starting from 1 January 2014, the excise tax rate for natural gas used in manufacturing was reduced, but excise tax for petroleum gases and other gaseous hydrocarbons was increased.

In 2014, revenue from excise tax for petroleum products and natural gas was 418.6 million euro – by 1.3% more than in 2013.

Starting from 1 January 2015, several changes were introduced into the excise tax sector that abolished reduced excise tax rates for fuel, updated regulations on

the application of excise tax exemption on natural gas used for heat supply in greenhouses. Changes regarding the application of an excise tax relief for diesel fuel for agricultural needs were also determined.

In the four months of 2015, revenue from excise tax for petroleum products and natural gas grew by 7.1% compared to the level of the same period of 2014.

4.1.3. Budget Expenditures

After an extensive reduction of expenditure during the economic crisis, the **expenditure of the general government consolidated budget** has been gradually growing since 2011.

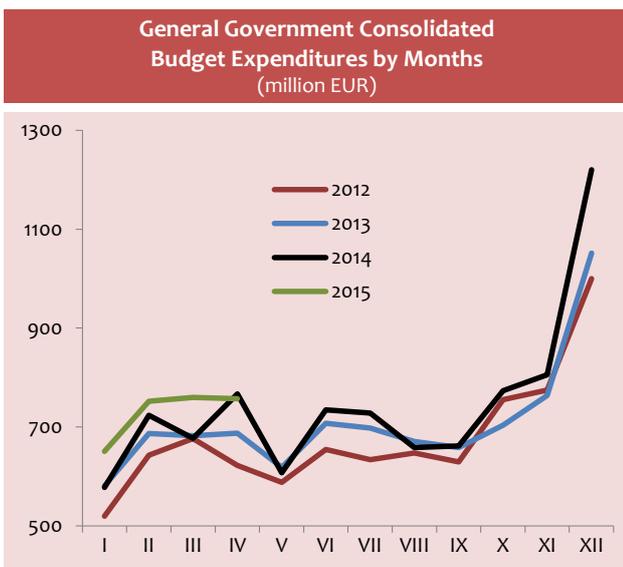
In 2014, total expenditure of the general government consolidated budget was 8934.9 million euro which was by 5% more than in 2013.

In the four months of 2015, general government consolidated budget expenditure continued to grow and increased by 6.3% compared to the same period of 2014 and was 2919.4 million euro.

In 2014, the **expenditure on subsidies and grants** grew by 7.4%. This drastic increase is mainly related to a higher expenditure for the absorption of projects of the EU funds in transport, entrepreneurship and innovations, as well as direct payments to farmers. Grants for healthcare, as well as aid to milk producers, whose activities were negatively affected by sanctions of the Russian Federation, also contributed to this increase.

It should be noted that the expenditure on subsidies and grants also grew during the economic crisis. This is largely related to the growing number of unemployed and unemployment benefits paid, costs of dismissal benefits for employees dismissed in the public sector, as well as social benefits.

Figure 4.9

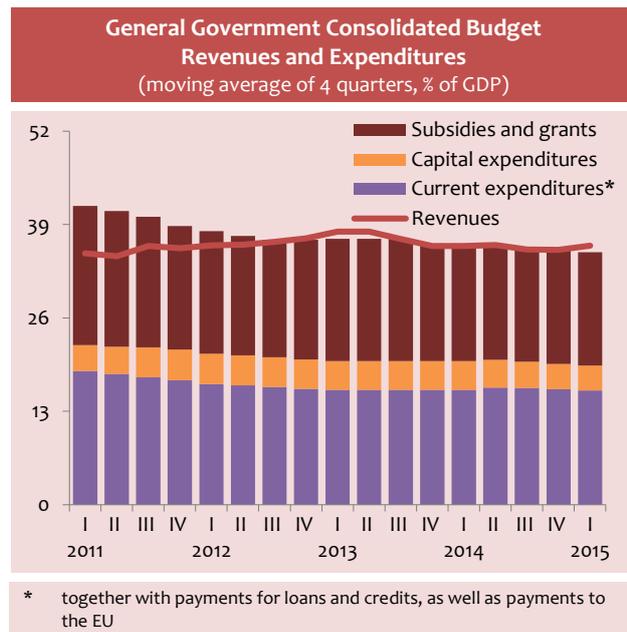


In general, in 2014, the expenditure on subsidies and grants made 44.7% of all the budget expenditure.

In the four months of 2015, the expenditure on subsidies and grants grew by 5.9% compared to the same period of 2014.

During the crisis, when the budget expenditure was reduced, **capital expenditure** was the first to be limited. Already in 2008, capital expenditure was smaller than the year before and it significantly dropped in the years 2009 and 2010. From 2011 to 2013, capital expenditure increased because of active absorption of the EU funds.

Figure 4.10



In 2014, capital expenditure decreased by 4% compared to 2013.

In fact, the ratio of capital expenditure in the total expenditure did not change – it made almost 10% of all the general budget expenditure in 2014.

In the four months of 2015, capital expenditure dropped by 6.1% compared to the same period of 2014.

During the crisis, the **current expenditure** experienced significant reductions. To reduce the expenditure of the general government consolidated budget, individual areas of public administration were optimised: the number of employees in ministries and public bodies, as well as their wages were reduced, and the number of public agencies and hospitals was reduced. During the crisis, this expenditure was reduced the most. In 2008, the current expenditure made up more than half of all the budget expenditure, while in 2014 its ratio was only 45.4 per cent.

In fact, the current expenditure did not grow in 2011 and 2012, yet it has been growing since 2013.

Table 4.3

Expenditures of the General Government Consolidated Budget by Functions (per cent)										
	structure					against GDP				
	2011	2012	2013	2014	2015 I	2011	2012	2013	2014	2015 I
Expenditure – total	100	100	100	100	100	38.8	36.9	36.6	37.1	39.2
General government services	12.1	13.3	12.8	13.2	16.7	4.7	4.9	4.7	4.9	6.5
Defence	2.3	2.1	2.2	2.1	1.8	0.9	0.8	0.8	0.8	0.7
Public order and safety	4.4	4.5	4.8	4.9	4.7	1.7	1.7	1.8	1.8	1.9
Economic activity	19.0	18.6	18.7	18.1	15.0	7.4	6.9	6.9	6.7	5.9
Environmental protection	2.5	2.3	2.4	2.4	1.9	1.0	0.9	0.9	0.9	0.8
Management of municipal territories and housing	3.0	3.0	3.0	2.6	1.9	1.2	1.1	1.1	1.0	0.8
Health	7.8	7.8	7.6	7.4	7.2	3.0	2.9	2.8	2.8	2.8
Recreation, culture and religion	3.2	3.5	3.6	3.4	2.9	1.3	1.3	1.3	1.3	1.1
Education	17.1	16.6	16.4	16.7	15.9	6.6	6.1	6.0	6.2	6.2
Social security	28.5	28.2	28.4	29.1	31.9	11.0	10.4	10.4	10.8	12.5

In 2014, the current expenditure grew by 8.7%. Such a drastic growth was mainly caused by the increase of the minimum wage and the equalisation of wages of those employed in the public sector.

In the four months of 2015, the regular expenditure increased by 6.1% compared to the same period of the previous year.

According to the budget expenditure by functional categories, social protection, education, general government services and economic activity were the

largest contributors to the growth of expenditure. In contrast, the expenditure on management of local and regional government territories shrank.

Similar trends in the dynamics of expenditure are observed in 2015 as well.

Public demand is formed by public consumption or public services the value of which is defined by the scope of provided public services, as well as public investments that are capital contributions for budgetary funds.

Table 4.4

Public Demand (per cent)										
	against GDP					changes				
	2010	2011	2012	2013	2014	2010	2011	2012	2013	2014
Public demand	22.8	23.2	22.0	20.2	21.5	-8.4	5.6	-0.4	-7.0	3.2
<i>Public consumption</i>	18.1	18.2	17.2	16.3	17.2	-8.1	3.1	0.4	-4.7	3.4
– central government*	10.4	10.2	9.2	8.6	9.3	-1.6	0.4	-3.1	-6.1	5.7
– local governments	7.8	8.1	8.0	7.7	7.9	-15.6	6.7	4.9	-3.1	0.9
<i>Gross fixed capital formation</i>	4.6	5.0	4.8	4.0	4.3	-9.6	15.5	-3.4	-15.4	2.1
– central government*	1.8	2.2	2.3	1.7	2.3	-15.8	34.9	2.6	-23.5	13.9
– local governments	2.9	2.8	2.5	2.3	2.0	-5.3	3.5	-8.2	-8.1	-8.8

* together with the social insurance fund

During the crisis, public demand drastically reduced. In 2011, public demand grew by 5.6% because there was a drastic increase in public budget expenditure on investments and an increase in loan and regional government expenditure.

Whereas public demand reduced by 0.4% and 7% in 2012 and 2013 respectively. This drop was largely caused by the decrease of budget expenditure of the central government, as well as the drop in budget expenditure on investments.

In 2014, public demand started to grow again – by 3.2%. This was caused by a faster increase in budget expenditure of the central government – by 5.7%, as well as an increase in budget expenditure of the central

government on investments – by 13.9%. At the same time, the expenditure of local governments shrank because the budget expenditure of local governments on investments reduced by 8.8 per cent.

4.2 Prices

4.2.1 Consumer Prices

After the deflation caused by the crisis when the 12-month consumer price inflation decreased to -4.2% in February 2010, prices started increasing again. In 2011, the 12-month consumer price inflation was 4%, in 2012 – 1.6%, while in 2013 consumer prices decreased by 0.4%. In 2014, a moderate rise in prices was observed, and it was more rapid than a year before, though, the price changes were below the traditional level of seasonal fluctuations. The price changes in 2014 were mainly determined by the rise in prices of services and tobacco, as well as the drop in costs for transport (fuel) and food products. Global price dynamics of food products and oil had a major impact.

In December 2014, consumer prices grew by 0.2% (12-month inflation), but the average annual price level in 2014 was 6 per cent.

At the beginning of 2015, the most rapid rise in prices of the particular period in the last four years has been observed. In the five months of 2015, the consumer prices increased by 2.3%. In May 2015, consumer prices grew by 1.2% (12-month inflation), but the average annual inflation was 0.6 per cent.

Figure 4.11

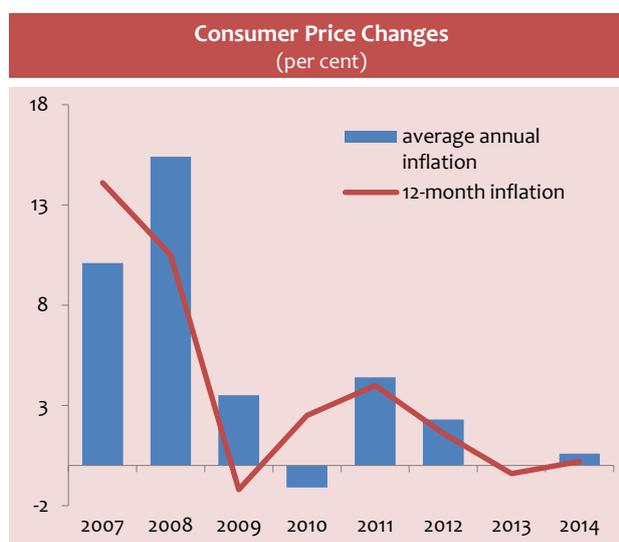


Table 4.5

Consumer Price Changes by Months (per cent)				
		compared to the previous month	compared to the corresponding month of the previous year	average during the year
2014	January	0.6	0.4	0.0
	February	0.0	0.5	0.0
	March	0.3	0.3	0.0
	April	0.5	0.7	0.1
	May	-0.1	0.6	0.1
	June	0.3	0.7	0.2
	July	-0.4	0.6	0.2
	August	-0.6	0.8	0.3
	September	0.5	1.0	0.4
	October	0.0	0.7	0.5
	November	-0.3	0.9	0.6
	December	-0.6	0.2	0.6
2015	January	0.1	-0.4	0.6
	February	0.3	-0.1	0.5
	March	0.8	0.4	0.5
	April	0.6	0.5	0.5
	May	0.6	1.2	0.6

The main factors influencing prices in the five months of 2015 were:

- the rise in electricity prices due to opening of the electricity market as of 1 January 2015 had the biggest impact on price increase. The electricity prices on average increased by 27.5%, raising the overall consumer price level by 0.9 percentage points. It was compensated a little by the drop in heat energy prices of 4.8% that reduced the overall consumer price level by 0.2 percentage points;
- prices of food products increased by 2.5% in the five months of 2015, and they increased the overall price level by 0.6 percentage points. It should be noted that a rise in prices of food products at the beginning of a year is typical. The increase of the prices for vegetables and fruit had the largest impact among the seasonal factors. The rise in prices for the said products in January-May this year was one of the sharpest in recent years. The drop in prices of dairy products, in its turn, was the most rapid since 1997 (except for 2009), it was still under the influence of embargo

imposed by Russia as of August 2014. Prices of food products are largely determined by the global price fluctuations. The prices of food products kept decreasing in the five months of this year reaching the lowest point since September 2009. In May 2015, compared to December, they decreased by 10.2%, influenced by the drop in prices in all major groups of food products. Most rapidly, the prices dropped for sugar and cereal owing to better crops than expected in export countries. Decrease in global prices of food products is related to slow trade activity and expectations of deflation, as consumers expect even lower prices in the following months. Dairy product prices in the world increased in February and March, but in April and May, a sharp decrease was observed; it was related to the embargo imposed by Russia, the abolition of milk quota in the EU, as well as the uncertainty about the procurement of dairy products by China in 2015;

- the increase in prices of clothing and footwear characteristic of the season in March-May was the highest since 1997. In the five months of 2015, the prices of clothing and footwear increased by 6.5% that raised the overall price level by 0.4 percentage points. The growth in prices was influenced by a rise in prices of footwear (by 19.2%) that can be largely explained both by an increasing private consumption and rise in prices of raw materials. Global prices of leather increased on average by 6% in January-April this year (in 2014 in total – by 14%);
- the rise in the prices in transport group by 2.2% that raised the overall consumer price level by 0.3 percentage points. The rise in prices was influenced by an increase in the tariffs of public

transport for road and rail transport services (the prices for transport services increased by 8.2%). Fuel prices increased by 1.2% in the five months of this year, and they raised the overall price level by 0.1 percentage points. In addition, the global oil prices in January-May increased on average by 3 per cent and in the second half of May became stable at the level of USD 65 for a barrel.

According to the forecasts of the Ministry of Economics, the overall average annual inflation in 2015 could be a little higher than in the previous year. The inflation will be related to the external factors: the dynamics of the prices for oil and food products.

Figure 4.12

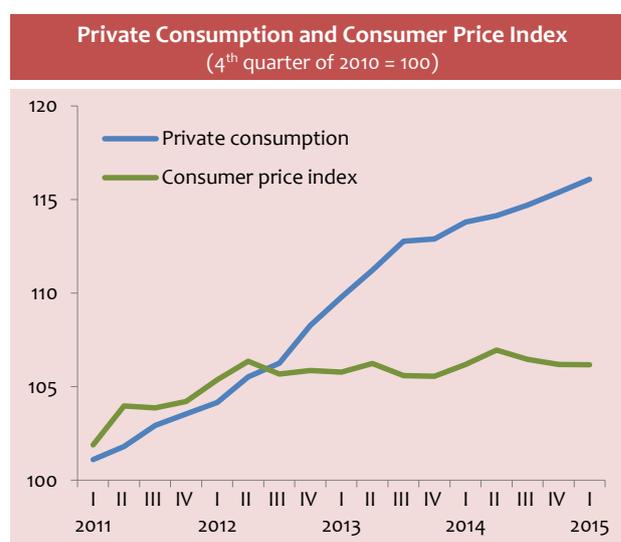


Figure 4.13

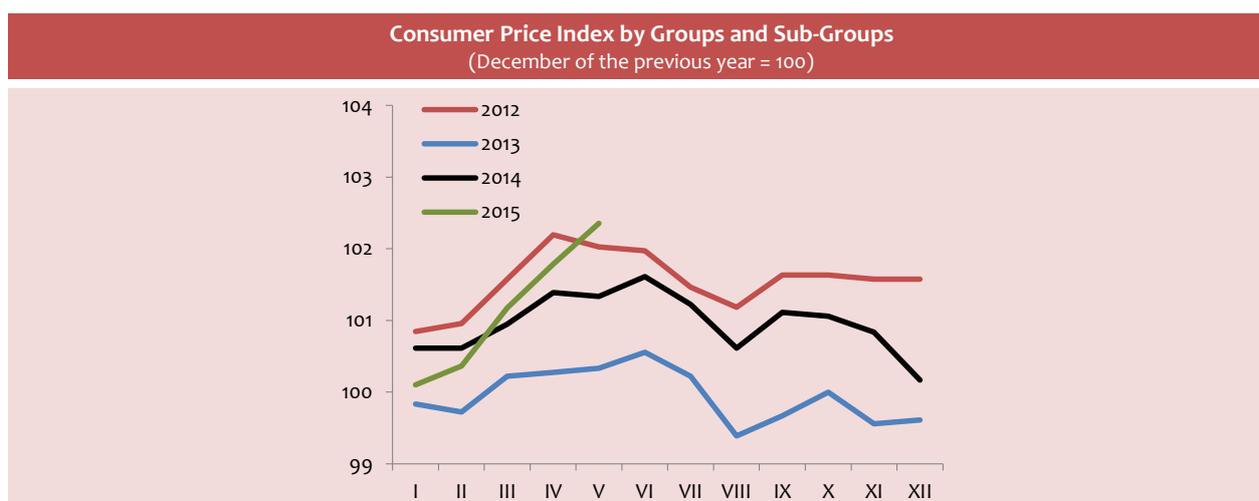
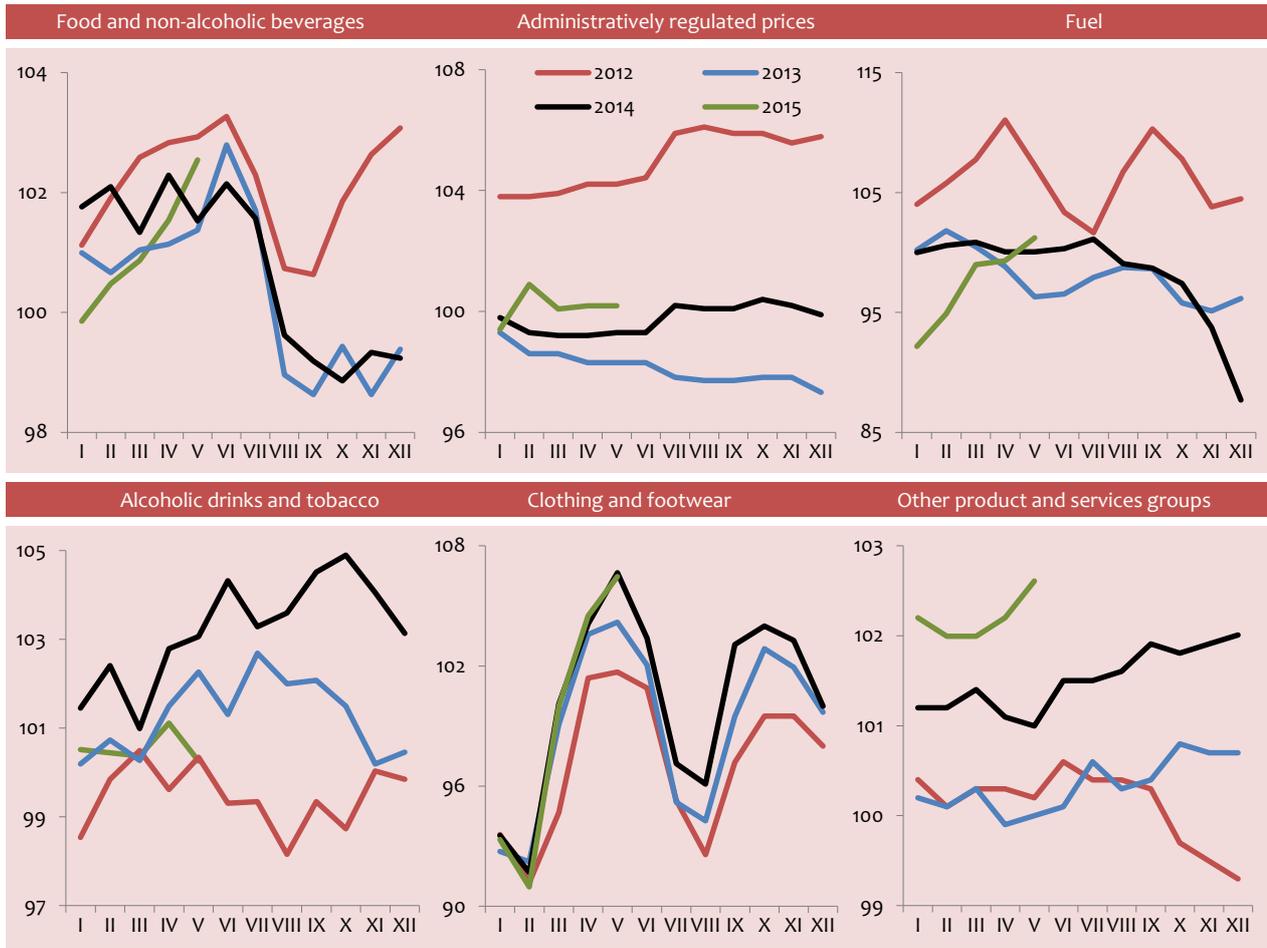
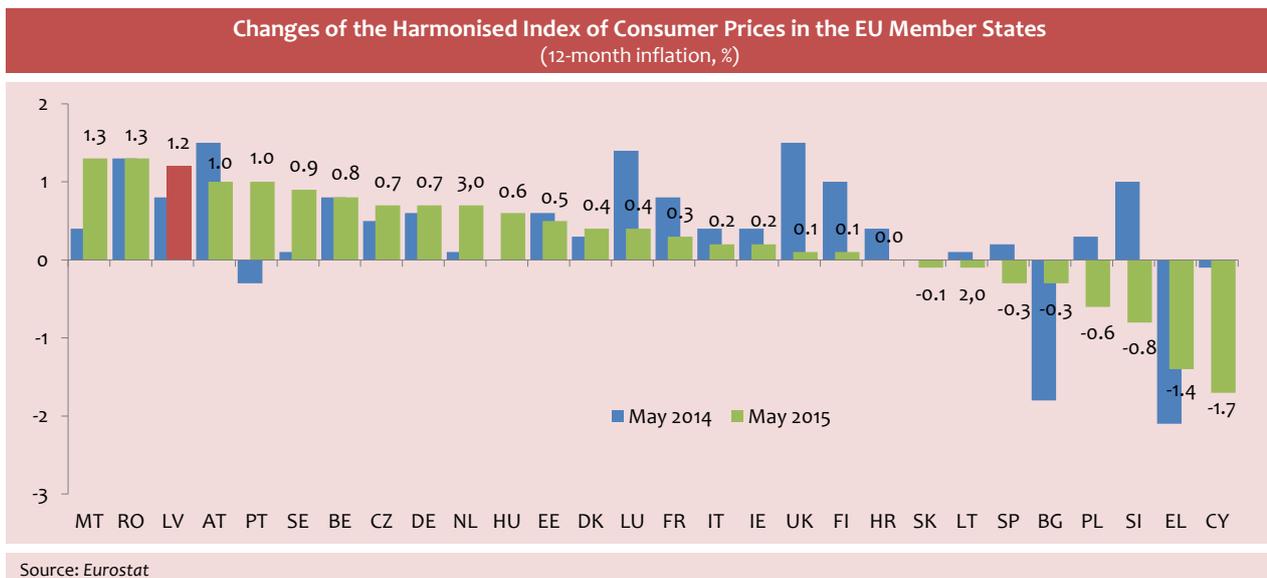


Figure 4.13 continued



In 2014, as compared to 2013, the average price level in the EU rose by 0.6%. It was due to a rise in service prices.

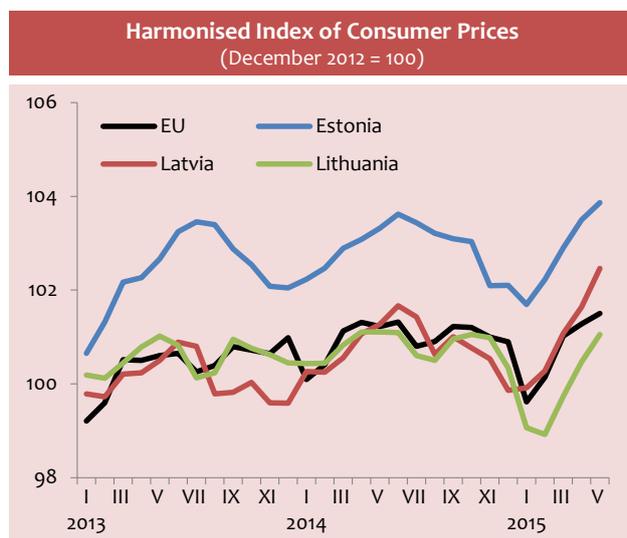
Figure 4.14



Source: Eurostat

In May 2015, compared to May 2014, the overall price level both in the EU Member States and the euro area rose by 0.3%. 12-month inflation grew most rapidly in Bulgaria and Portugal, but the prices decreased more rapidly in Slovenia, Cyprus and the United Kingdom. The highest inflation in May 2015 was in Malta, Romania and Latvia, but the highest deflation – in Cyprus and Greece.

Figure 4.15

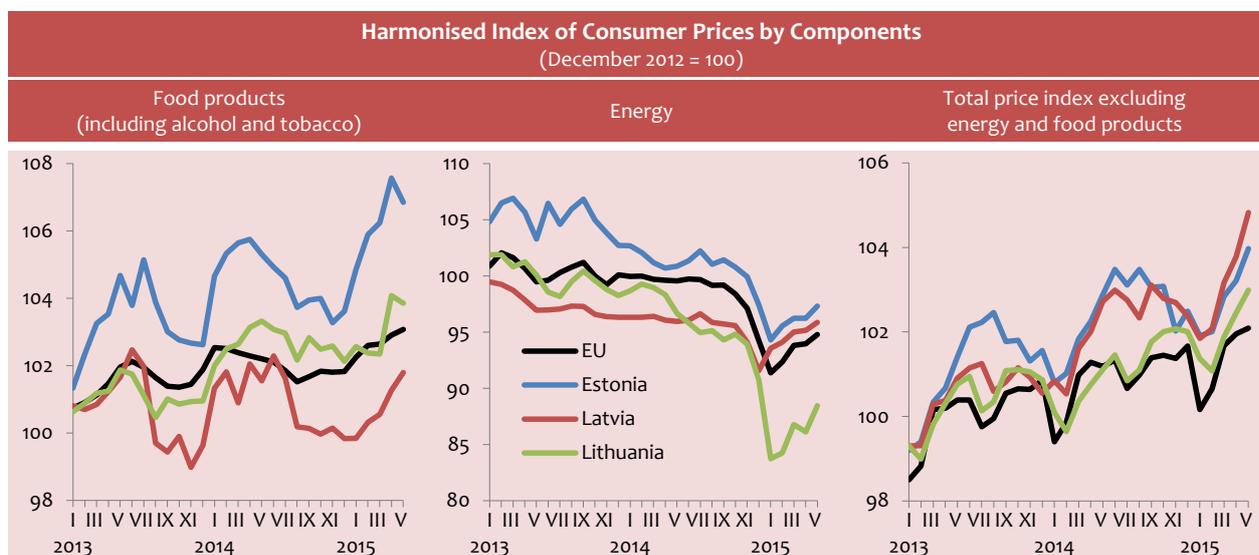


Among the Baltic States, the sharpest increase in the harmonised index of consumer prices in May 2015, as compared to May 2014, was in Latvia (by 1.2%). In Estonia the consumer prices increased by 0.5%. In Lithuania, meanwhile, the prices decreased by 0.1%. In May 2015, as compared to May 2014, the consumer prices of food, alcohol and tobacco slightly increased in all the Baltic States, mainly the prices for alcohol, tobacco and non-alcoholic drinks grew, but the prices in the energy group decreased in all countries.

Among the Baltic States, the prices in the group of non-alcoholic drinks, alcohol and tobacco rose by 1.5% in Estonia, by 0.5% in Lithuania, and by 0.2% in Latvia. The energy prices decreased more sharply in Lithuania – by 8.5%, in Estonia – by 3.5%, whereas the lowest drop in energy prices was observed in Latvia – by 0.1%. Administratively regulated prices dropped in Lithuania and Estonia – by 2% and 1% respectively, while in Latvia they increased by 1.5 per cent.

It should be noted that in May 2015, as compared to May a year before, the prices for the service group in Lithuania increased faster than in Latvia and Estonia – by 3.4% (in Latvia and Estonia – by 2.9% and 1.8% respectively). In May 2014, prices in Latvia were mostly affected by the increase in prices of the group of services, since apart from this group, a slight drop in prices was observed in the rest of the groups.

Figure 4.16



4.2.2 Producer Prices

After a rapid increase in 2010 and 2011, **producer prices** showed a slight, though steady growth in 2012. In 2013, producer prices increased very moderately – by 0.3%. In 2014, as compared to 2013, producer prices increased by 0.4%. Prices of the products sold on the domestic market increased by 0.2% within a year, and prices of exported products – by 0.6%.

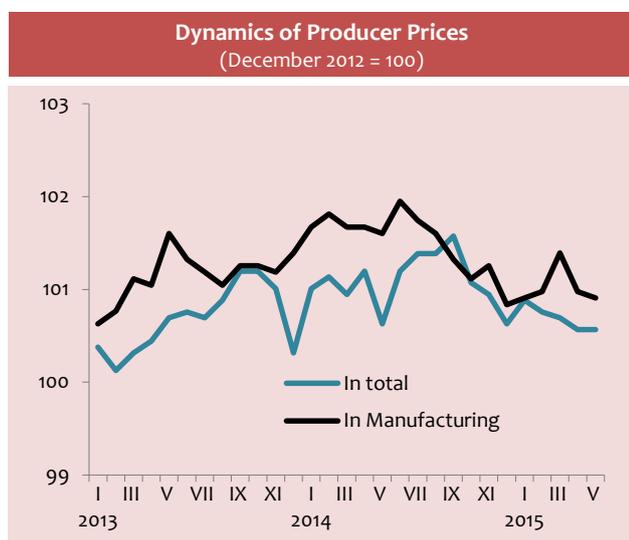
In May 2015, as compared to May 2014, the overall producer price level in manufacturing increased by 0.1%. Within a year, producer prices of the products sold on the domestic market and exported products decreased by 0.1%. Producer prices increased in all industrial sectors, except for manufacturing.

Slightly over 60% of the manufacturing products are being exported, therefore the overall dynamics of producer prices are largely affected by the fluctuations of producer prices of exported products. Prices of exported

products are mainly determined by the dynamics of prices of the main export goods of Latvia, including wood, metal articles and food products, on the world markets. The rise in prices of the products sold on the domestic market was affected by the stabilising domestic demand.

The overall level of producer prices in the manufacturing of Latvia in May 2015 decreased by 0.7%. In the manufacturing, producer prices of products sold on the domestic market decreased by 1.5%, while the prices of exported products – by 0.2%. In the manufacturing, producer prices were affected by the Russian embargo on food products, as well as the economic situation in the EU and Russia, as well as the drop in the global prices of raw materials. It should be noted that in May 2015, as compared to May in the year before, a drop was observed in the prices of energy, industrial and agricultural raw materials.

Figure 4.17

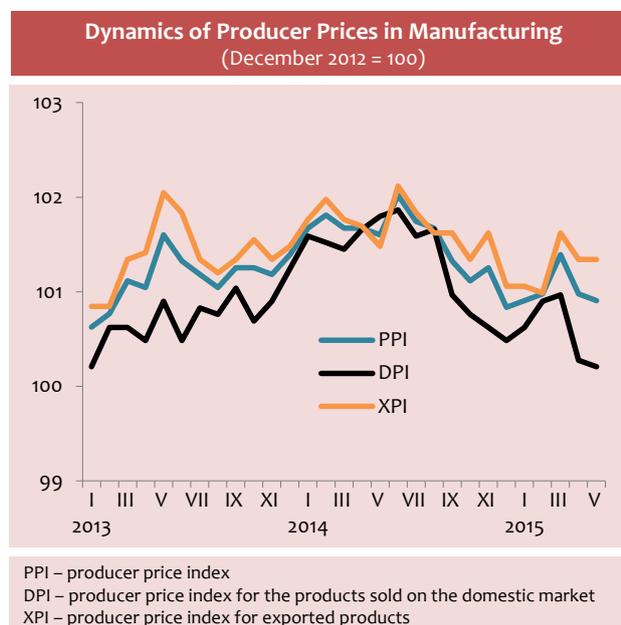


The fastest rise in producer prices in the manufacturing by sectors within the year was observed for the production of computers, electronic and optical equipment (by 8.9%), production of clothing (by 4.7%) and production of electrical equipment (by 2.5%). The rise in producer prices in the said sectors was determined by an increase in the prices of exported production.

In the manufacturing, however, producer prices decreased for food production by 4.3% and production of timber products – by 1.7%. The decrease in producer prices in food production was due to a more rapid decrease in prices of the products sold on the domestic market, whereas in timber products group the prices

decreased more rapidly for exported products. It should be noted that in the course of the year, the prices of food products have significantly decreased throughout the world (by 20%).

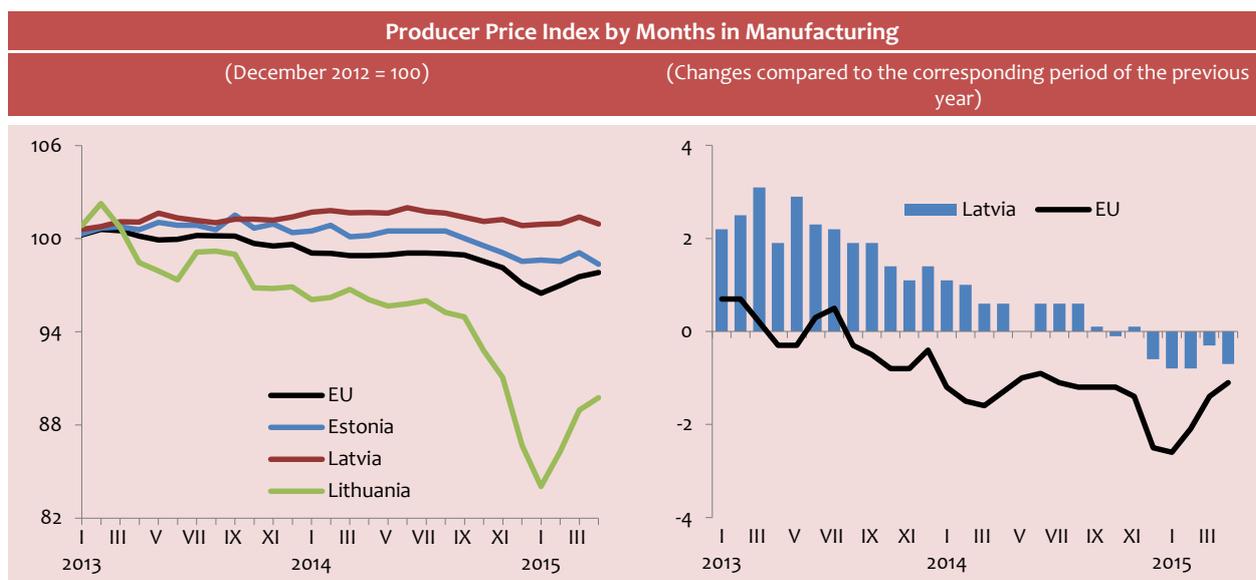
Figure 4.18



The growth rate of producer prices in the EU has been decreasing since the middle of 2011. It is mainly caused by the drop in food prices and in prices of agricultural and industrial raw materials, which, to a certain extent, has derived from a decreasing demand worldwide in response to the escalating debt crisis in the euro area, deteriorating economic situation in other developed countries, as well as a slowdown of the world trade growth rates and uncertainty about the expected fiscal consolidation in the majority of developed countries. In 2014, the rise in the EU producer prices continued to decrease due to the economic situation between the EU and Russia, caused by the Ukrainian crisis, and the drop in the global prices of raw materials.

In January-April 2015, the situation in the EU improved and a slight increase in producer prices has been observed. When comparing the Baltic States, producer prices in the manufacturing decreased in all the Baltic States in April 2015, as compared to April 2014. The sharpest drop was experienced in Lithuania due to a decrease in the oil refining industry – by 6.6%, whereas in Estonia and Latvia, producer prices decreased by 1.9% and 0.7% respectively.

Figure 4.19



4.2.3 Foreign Trade Unit Value Indices

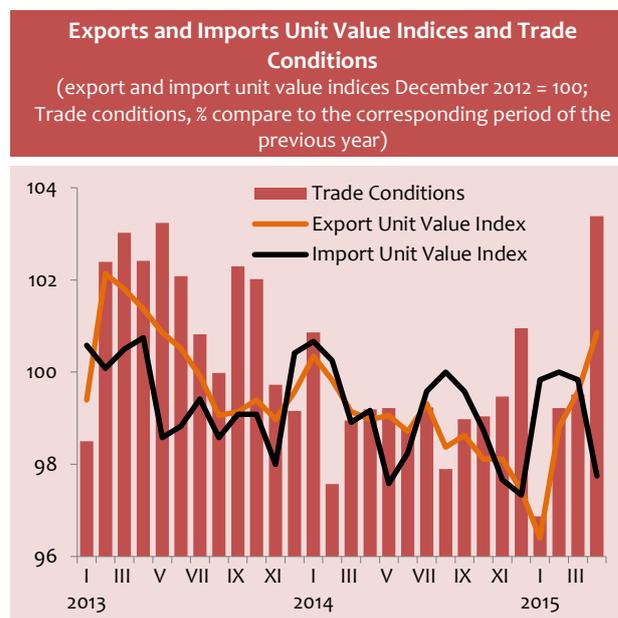
Taking into account a faster increase in the export unit value, the trade conditions improved at the beginning of 2013; however, they worsened at the end of the year, and in December 2013, the unit value decreased by 0.4% for exported goods and increased by 0.4% for imported goods.

In 2014, the trade conditions slightly worsened. In December 2014, the unit value decreased by 2.2% for exported goods, but increased by 3.1% for imported goods. The average level of export and import unit values in 2014 was mostly affected by the decrease of the unit value for coke and petroleum refining products.

In April 2015, the trade conditions improved significantly, with the unit value of exported goods exceeding the unit value of imported goods by more than 3 percentage points. The unit value of exported goods increased by 1.9% in April 2015, as compared to the corresponding period of the previous year, but the unit value of imported goods decreased by 1.4%. The average export unit value in April 2015, as compared to April 2014, was mostly affected by the increase of the unit value for agricultural products, computers, electronic and optical equipment and base metals, as well as the decrease for coke and petroleum refining products, food products and pharmaceuticals. The average unit value of imported goods was mostly influenced by the drop in the unit value of coke and petroleum refining products and agricultural

products, but the most significant upward impact was made by the increase of the unit value of clothing and leather products, food products and chemicals and chemical products.

Figure 4.20



4.3 Balance of Payments

4.1.3 Current Account

Since the crisis, the external stability of Latvia has significantly improved. The current account deficit of the balance of payments has decreased from 20.8% in 2008 to 2.3% in 2013. The current account deficit in 2014 was slightly higher than a year ago; this was largely influenced by a decrease of financial flows from the EU funds in the first half of the year. In the fourth quarter of 2014 and in the first quarter of 2015, the current account deficit decreased and constituted respectively 1.4% and 0.4% of the GDP. The average negative balance of the current account in the last three years was 2.9% of the GDP, which does not exceed the indicative threshold determined in the early warning mechanism, and is considered sustainable.

In our neighbouring countries, the indicator of the current account balance is also close to the level of balance, and the annual fluctuations are fairly insignificant. The current account balance in Estonia in 2014 was at the level of moderate deficit, whereas in Lithuania there was a slight surplus.

The condition of the Latvian current account balance is mainly determined by changes in the balance of external trade. The external trade deficit is characteristic to Latvia, and it increased in the years of rapid growth and decreased in the years of recession. Cyclic corrections of the current account were largely determined by a significant decrease of import. When the economy stabilized, the amount of export also went up. However, the amount of export of goods increased faster than the import and the balance of external trade improved. In recent years, the dynamics of export and import have become slower due to deterioration of the situation in the external environment.

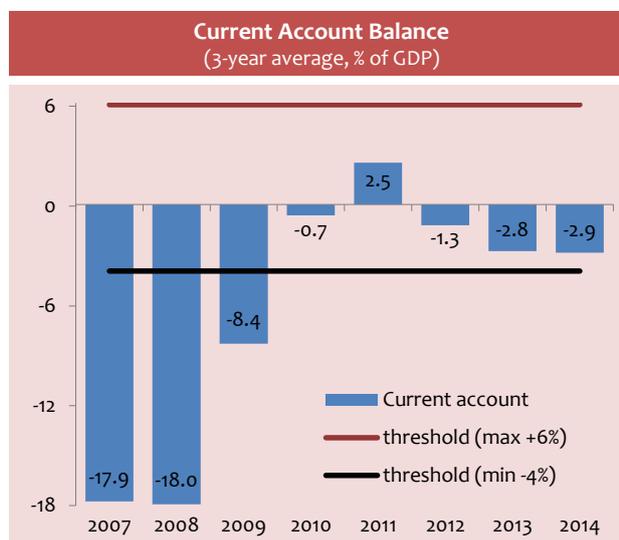
In the last three years, the average annual deficit of external trade remains at the level of 11.5% of the GDP. Though slowly, since 2011, the deficit of external trade has been decreasing each year, and this is mainly facilitated by a faster growth of export than import. In actual prices, the amount of export increased by 3.1% in 2014, which was mainly facilitated by an increase in the export of timber and its by-products, and mechanical engineering products. However, the export of metals and metal products decreased significantly due to termination of operations of the metallurgical plant JSC “Liepājas metalurģs”. The export of agricultural and food products also decreased.

The amount of import of goods increased by 0.4% in 2014 in current prices, which is much slower than export, and the deficit of external trade was 11% of the GDP,

which was by almost 1 percentage point lower than a year ago and significantly lower than before the crisis (in 2007).

In the first quarter of 2015, the amount of export of goods was by 0.9% higher than a year ago, whereas import decreased by 3.4%, and the balance of external trade reached 9.5% of the GDP. At the beginning of 2015, export was positively influenced by the increase of export of mechanisms and mechanical engineering, timber, as well as products of the chemical industry. The export value of agricultural and food products reduced due to a significant decrease in prices. The export of transport vehicles and metal products also decreased.

Figure 4.21



The balance of services is positive in Latvia. In the last three years, the annual surplus of the balance of services is on average 7.4% of the GDP. In 2014, the amount of export and import of services in actual prices was by 1.4% lower than a year ago. The decrease in export of services was mainly determined by the decrease of transport services due to the political instability in the Eastern neighbouring countries and related sanctions. In 2014, the surplus of balance of services decreased to 7.4% of the GDP (in 2013, 7.6% of the GDP). In the first quarter of 2015, the level of export of services was by 5% and the level of import by 6.9% higher than a year ago, and the balance of services reached 7.6% of the GDP. The positive balance of services covers the deficit of external trade almost by 80 per cent.

Table 4.6

Balance of Payments of Latvia (% of GDP)						
	2011	2012	2013	2014	2014 I–III	2015 I–III
A. Current account	-2.8	-3.3	-2.3	-3.1	-3.5	-0.4
Trade balance	-12.0	-11.6	-10.9	-10.1	-10.8	-9.5
Export	40.9	43.8	42.2	42.0	44.6	43.7
Import	-52.9	-55.4	-53.2	-52.2	-55.4	-53.2
Balance of services	7.3	7.4	7.6	7.3	7.6	7.6
Net revenues	0.0	-0.6	-0.3	-0.8	0.5	1.9
Current transfers, net	1.9	1.6	1.3	0.5	-0.8	-0.4
B. Capital account	2.1	3.0	2.5	3.0	2.4	3.3
C. Financial account*	-4.0	2.9	0.7	-4.5	-5.1	2.0
Direct investment	4.9	3.2	1.6	1.0	-1.0	3.2
Abroad	-0.2	-0.7	-1.3	-0.4	-1.2	-0.7
In Latvia	0.1	0.0	0.0	0.0	0.0	0.0
Portfolio investment**	-1.8	4.7	0.1	-0.5	10.8	-24.3
Assets	-1.0	-1.8	0.0	-6.0	-6.8	-19.0
Liabilities	-0.8	6.5	0.1	5.5	17.6	-5.3
Other investment	-7.2	-5.1	-1.0	-5.0	-14.9	23.0
Assets	-1.5	-1.2	0.0	-6.1	1.2	20.2
Liabilities	-5.7	-3.8	-1.0	1.1	-16.1	2.8
D. Net errors and omissions	0.3	1.0	0.8	4.1	6.1	-3.4
E. Reserve assets	4.5	-3.6	-1.7	0.5	0.1	-1.5

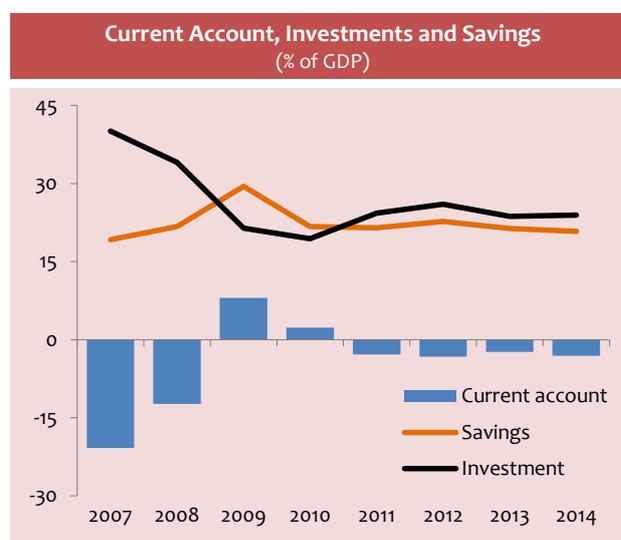
* without reserve assets
** portfolio investments and financial derivatives

The balance of the initial income has been negative in the last three years – the annual average constitutes 0.7% of the GDP with relatively small fluctuations. These fluctuations of the balance of net revenues are mainly determined by changes in the income of non-resident investments, as well as the inflow of finances of the EU funds. The deficit of net revenues in 2014 was 0.8% of the GDP, i.e. slightly higher than a year ago. This was largely influenced by the decrease of credit flows, including subsidies of the EU funds received by Latvia. In the first quarter of 2015, the balance of net revenues was positive (1.9% of GDP), which was facilitated by the inflow of subsidies of the EU funds.

Changes in the current transfers and capital account are mainly determined by flows of finances of the EU funds and contributions made by Latvia into the EU budget. In 2014, the balance of current transfers account had a surplus of 0.5% of GDP. Whereas, the balance of current transfers account in the first quarter of 2015 was negative, i.e. 0.4% of GDP, due to a decrease of flows of the EU funds and incoming personal transfers. The surplus of capital account in 2014 constituted 3% of GDP, whereas, in the first quarter of 2015, it increased to 3.3% of GDP. The increase of surplus of capital account

is related to the increase in the activities of absorption of finances provided by the EU funds, including attraction of finances from the European Regional Development Fund and the Cohesion Fund.

Figure 4.22



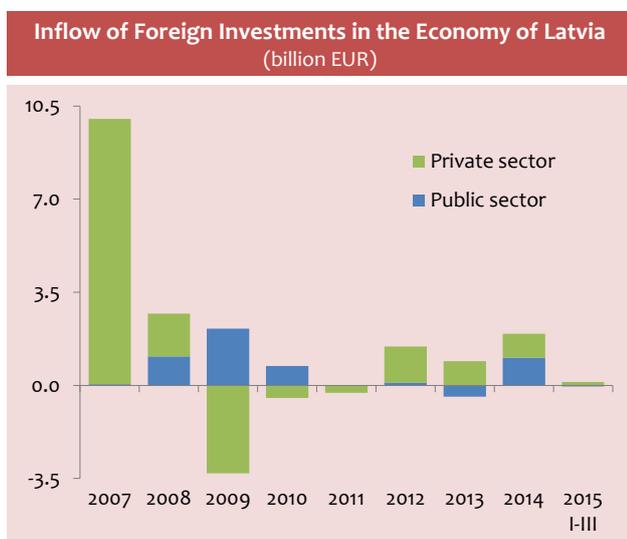
The large current account deficit in the pre-crisis years represented a significant imbalance between the domestic investments and accruals. Since 2007, the level of national accruals showed a gradual growth, while the level of investments in the economy of Latvia decreased from 40% of GDP in 2007 to 23.9% of GDP in 2014. The moderate deficit of the current account balance indicates a balance between the accruals and the domestic investment.

4.3.2 Financial Flows

The global financial crisis significantly influenced cross-border financial and capital flows, causing major corrections in the financial account of the balance of payments. Since the end of the year 2007, the surplus of the financial account (without reserve assets) decreased rapidly, and in 2009 the balance of the financial account was already negative, i.e. almost 6% of GDP. Since 2010, the deficit of the financial account has been decreasing. At the same time, instability of financial flows is also decreasing.

The condition of the financial account balance in the recent years has been mainly determined by stabilization activities in the financial sector, as well as by the public sector debt restructuring and reduction policy.

Figure 4.23



Generally, in the period from 2009 to 2011, there was a deficit in the financial account, respectively, 6.1%, 2.1% and 4% of GDP. Whereas, in 2012 and 2013, the balance of the financial account was positive, respectively, 2.9% and 0.7% of GDP.

In 2014, the balance of the financial account of the balance of payments (without reserve assets) was negative, reaching 4.5% of GDP. The increase of the financial account deficit was mainly determined by the increase of assets of credit institutions in a form of debt securities and deposits in the first half of 2014. At the

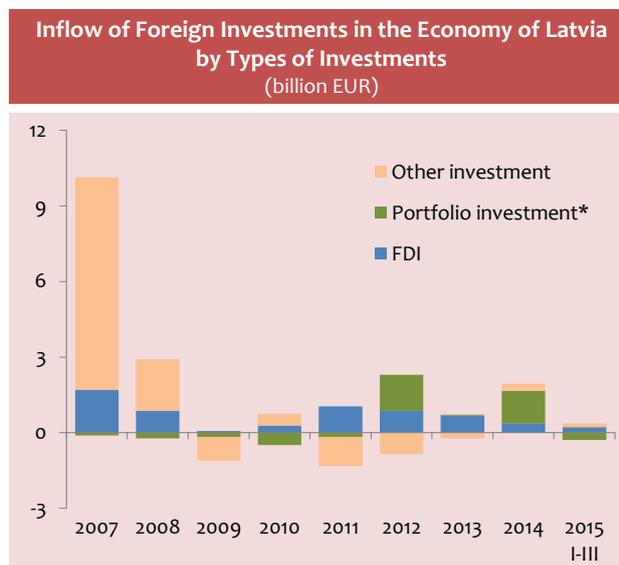
end of the year, the financial account deficit decreased and in the first quarter of 2015 there was already a surplus of 2% of GDP.

In the pre-crisis years, foreign investments were mainly attracted in the private sector. The unfavourable conditions in global financial markets weakened the intensity of foreign investment flows, and the amount of private capital inflow has rapidly decreased since 2008. The structure of attracted foreign capital flows has also changed since 2007.

The balance of direct investments has been positive for several years. Flows of foreign direct investments (FDI) have been moderate in the recent years reflecting the precaution of foreign investors. The amount of FDI, attracted in 2011, constituted 5.1% of GDP. Whereas, in 2012 and 2013, this indicator decreased from 3.9% to 2.6% of GDP. In 2014, the net inflow of FDI in Latvia was fairly moderate and constituted 1.5% of GDP. This situation was mainly determined by reduced investments in the equity capital of companies, which was partially compensated by the increase of reinvested profit.

The amount of FDI, attracted in the first quarter of 2015, was almost 20 times larger than a year ago and constituted 3.9% of GDP. A faster increase of FDI flows is prevented by weak economic activities in the EU Member States, as well as by the existing uncertainty concerning geopolitical turmoil.

Figure 4.24



Over the last three years, the share of portfolio investments has been constantly changing. Fluctuations of portfolio investment flows are significantly influenced by stabilization transactions of bank sector balances, as well as restructuring of the external state debt. In 2013, the portfolio investment balance had a small deficit (0.8% of GDP), however, in 2014, the account of portfolio investments was positive at 0.4% of GDP. Due to the increase in assets of credit institutions, the balance of

portfolio investments in the first quarter of this year was negative – almost 20% of GDP.

Significant fluctuations are observed among other types of investment, which constituted a major part of total foreign investments until 2008. These are trade credits, loans and borrowings, money and deposits etc.

The account of other types of investments of the balance of payments has been negative since 2009 with pronounced fluctuations within quarters, which are mainly influenced by the decrease of deposits in the bank sector.

The deficit of the account of other types of investments in 2014 constituted 5% of GDP. In the first quarter of 2015, the account of other types of investments had a surplus equal to 23% of GDP. Similarly to the portfolio investments, the balance fluctuations of other types of investments are also mainly related to the stabilization activities of the financial sector and the debt restructuring policy of the public sector.

In general, it should be noted that incoming flows of foreign investments are gradually stabilizing, however, they are much smaller than before the crisis.

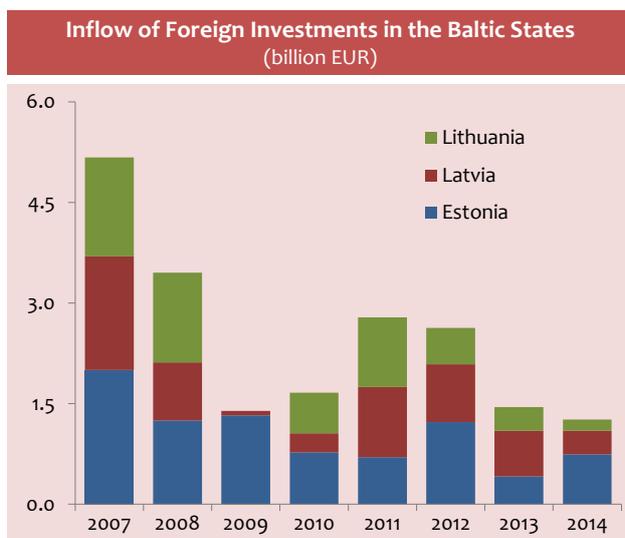
Latvia's gross external debt remained at a relatively high level. As shown by the data of the Latvian international investment balance, the gross external debt constituted 145.7% of GDP at the end of March 2015. Whereas the gross external debt of the government reached 7129.8 million euros (29.5% of GDP).

4.3.3 Foreign Direct Investments

The intensity of FDI flows continues to be fairly moderate. A similar tendency is observed also in our neighbouring countries.

During the period from 2011 until 2014, the average annual inflow of FDI in the Baltic States was almost three times lower than in the pre-crisis years.

Figure 4.25

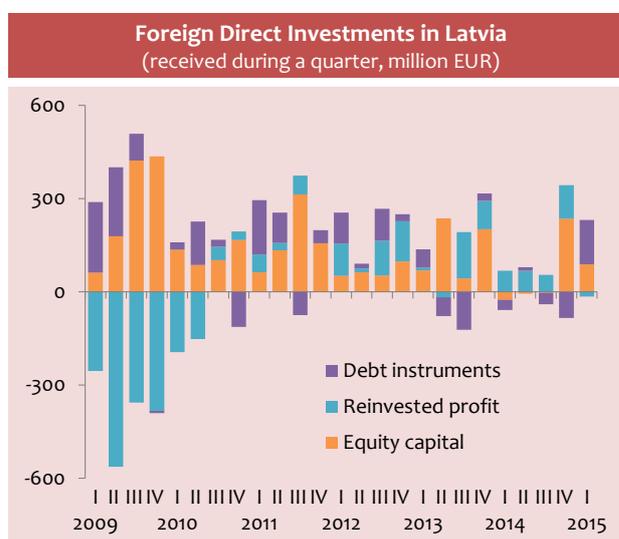


In total, the amount of attracted FDI in the Baltic States in 2014 was 1259.6 million euros, which is by 13% less than a year ago. Latvia attracted approximately 28% of all FDI in the Baltic States, Estonia – 59% and Lithuania – 13 per cent.

The external investments made by Latvian entrepreneurs have also become more moderate. The investments of Latvian entrepreneurs in the form of direct investments in 2014 was almost by half lower than in the previous year and constituted 0.4% of GDP.

The structure of incoming FDI, divided into types of investments, shows that the majority of investments are made in the equity capital. However, it should be noted that the share of reinvested profit is also significant. Since 2011, the annual share of reinvested profit on average was approximately 40% of attracted FDI.

Figure 4.26



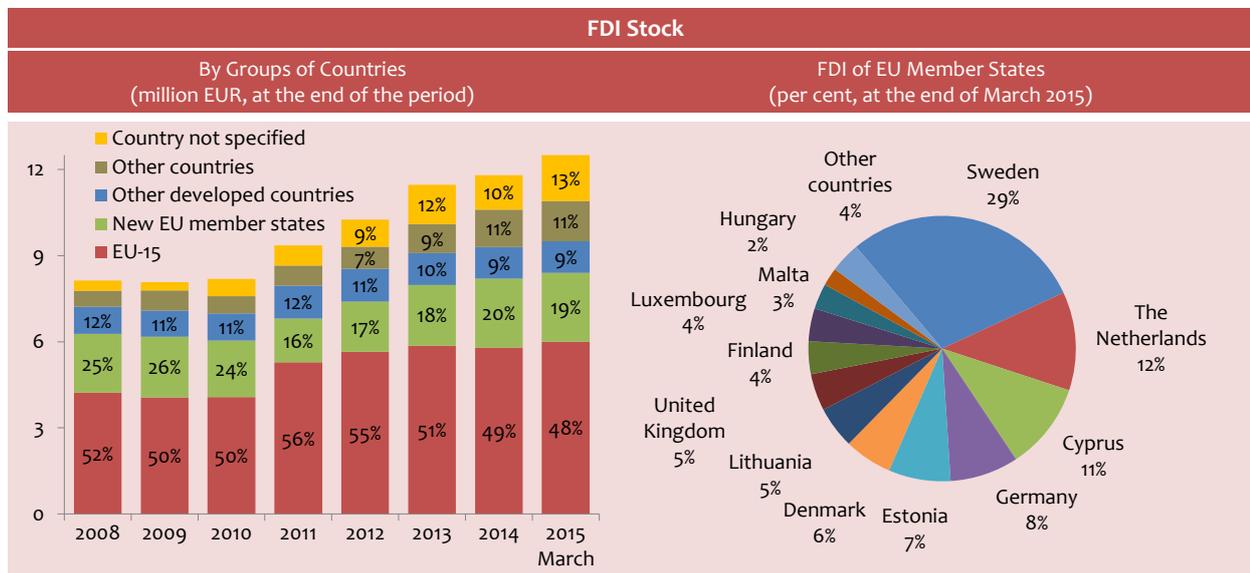
The inflow dynamics of FDI became increasingly moderate in the recent years, which reflects the existing precaution of foreign investors. In 2011, the amount of attracted FDI constituted 5.1% of GDP, whereas in 2012 and 2013 this indicator went down from 3.9% to 2.6% of GDP. In 2014, the net inflow of FDI in Latvia was fairly moderate and constituted 1.5% of GDP. This situation was mainly determined by the reduction of investments in the equity capital of companies, which was partially compensated by the increase of reinvested profit. In the first quarter of 2015, net flows of attracted FDI were more than 20 times higher than in the corresponding period of the previous year, mainly due to the increase of obligations towards direct investors, and the investments made by foreign investors in the equity capital of companies.

According to the balance of Latvian international investments, the amount of FDI, accrued in the economy of Latvia at the end of March 2015, reached 12,447.9 million euros, whereas the share of this FDI constituted almost 28% in the structure of the accrued foreign capital. In comparison with the same period in the

previous year, the level of accrued FDI increased by 8%, which was influenced by an increase of direct investments accrued by entrepreneurs from Norway, Luxembourg, Finland, the United Kingdom, Estonia and

Russia. A larger proportion of accrued FDI in the structure of sectors is observed in the investments in bank intermediation, transactions with real estate and the manufacturing.

Figure 4.27



In general, the geopolitical structure of FDI accrued in Latvia has not significantly changed. It is mainly constituted of EU investments. At the end of September 2014, FDI of the EU states constituted 70% of all accrued FDI and almost a half of this amount was constituted by the investments of the euro area countries.

Sweden is a major investing country in the economy of Latvia. At the end of March 2015, the investments of Swedish entrepreneurs constituted almost 20% of the total accrued FDI. These were mainly investments in the

financial intermediation. Since the end of 2008, the direct investments of Sweden doubled, which was mainly related to mutual transactions in the banking sector between Estonia and Sweden. Due to these activities the accrued direct investments of Estonian entrepreneurs in Latvia decreased almost by half and, at the end of March 2015, constituted 5% of the total accrued FDI (at the end of 2008, 16.1%). It must be noted that in the first quarter of this year the investments of Estonian entrepreneurs in the economy of Latvia increased by 11.4 per cent.

Table 4.7

FDI by Sectors (at the end of the period)						
	Balance (million EUR)			Structure (percentage)		
	2005	2007	2015 III	2005	2007	2015 III
Agriculture and forestry	64.6	130.3	442.5	1.6	1.7	3.6
Manufacturing	490.4	695.5	1474.2	11.8	9.3	11.8
Other industry	544.7	439.0	625.0	13.1	5.9	5.0
Construction	175.2	513.6	490.1	4.2	6.9	3.9
Trade and accommodation	577.4	1003.0	1407.2	13.9	13.4	11.3
Transport and storage	257.2	282.3	391.5	6.2	3.8	3.1
Financial intermediation	1062.9	2492.3	3310.5	25.6	33.4	26.6
Operations with real estate	283.9	662.3	1556.3	6.8	8.9	12.5
Other services	506.1	785.0	725.7	12.2	10.5	5.8
Unclassified activity	196.59	463.09	2024.9	4.7	6.2	16.3
Total	4159.1	7466.4	12447.9	100	100	100

A high level of investments is reached also by entrepreneurs from the Netherlands, Cyprus, Germany, Norway, Russia, Estonia, Lithuania, Denmark and the United Kingdom. At the end of September 2014, the amount of investments provided by these countries constituted 70% of the total accrued FDI in the economy of Latvia. It must be emphasized that in the recent years the activities of Asian investors in Latvia have increased. At the end of March 2015, the accrued FDI of Asian countries constituted 2.5% of the total FDI in the economy of Latvia, which was almost three times higher compared to the end of 2008. The investments of Finnish and Irish entrepreneurs in the economy of Latvia were significantly lower.

The major share of FDI was attracted in the service sectors.

During the years of rapid growth, the structure of incoming FDI flows was clearly dominated by the investments in the sector of financial intermediation. The annual amount of FDI in the service sector on average was almost four times higher than in the manufacturing sector.

Since 2010, the structure of incoming FDI flows in Latvia has become more even, without a clear predominance of the financial sector. However, it must be emphasized that, during the last three years, the investments in service sectors have been almost five times higher than in manufacturing sectors.

At the end of March 2015, the amount of the accrued FDI in the service sector constituted 75.6% of the accrued FDI in the economy of Latvia. It was by 58% higher than at the end of 2007. Almost a half of the accrued FDI in the service sector was constituted by sectors of financial intermediation and real estate.

At the end of March 2015, the amount of accrued FDI in manufacturing sectors constituted 24.4% of the total amount of accrued FDI in the economy of Latvia. It was by 70.5% higher than at the end of 2007.

The amount of investments in the manufacturing has increased significantly. In the period from the end of 2007 until the end of March 2015, the amount of accrued FDI in the sector of manufacturing increased more than twice, which was significantly influenced by the large investments in the manufacturing of construction materials, timber processing and food industry.

In general, upon assessing the changes in the structure of the accrued FDI in the manufacturing from the perspective of quality, it has to be concluded that the share of sectors of low technologies becomes smaller in favour of sectors of medium low and medium high technologies.

Although FDI flows in the Latvian manufacturing have been fairly sustainable even in the years of the rapid decline, it has to be noted that Latvia is lagging behind Lithuania and Estonia in terms of the amount of accrued FDI in this sector.

The **Investment and Development Agency of Latvia (IDAL)** played a major role in the attraction of foreign investments in Latvia. The investment attraction

strategy of the IDAL is oriented to qualitative handling of incoming investment projects and active operation in attracting investment projects through addressing potential investors.

Handling of incoming investment projects in 2014 was quite extensive – 449 requests for investment information were processed, and 109 investment offers were prepared by the agency. In representations of the IDAL, meetings with 167 potential investors, as well as visits to Latvia for 114 potential investors have been organised. In total, the agency has worked with 225 projects of potential investments (in 2013 this number was 176 projects), continuing the work with investment projects initiated in the previous years, working with projects started in 2014, and also with projects for which post-servicing activities were executed.

15% of all projects notified by foreign investors in 2014 represent metal processing and mechanical engineering sectors, however, taking into consideration projects in the sector of electronics, these projects constitute one fifth of all projects. Among the projects, service centres is the next most popular sector (13%), followed by life sciences (10%) and information technologies (7%). It must be noted that the number of projects notified in the sector of information technologies has doubled, compared to the year 2013. The number of projects reported in other sectors of services and manufacturing is increasing, for example, in education, engineering, mineral exploration, peat processing, manufacturing of polymer pipes, light industry etc. is also increasing.

In total, 58% of potential investors the IDAL worked with in 2014 come from European countries. The largest number of potential investment projects the IDAL worked with in 2014 come from countries having the IDAL representations (with the exceptions of USA, Finland and Italy), with the leading countries being Russia, Sweden, USA, Norway and Germany.

In 2014, 18 investors had made a positive decision on implementation of new investment projects, and 15 investors – on extending the existing projects. In case of full implementation of these projects investments in the amount of 139 million euros are expected, creating 1120 new jobs.

As regards the interest shown by investors in the first quarter of 2015, the agency has already worked with 127 potential investment projects. Almost one fifth of these projects represent sectors of metal processing, mechanical engineering and electronics. Most of potential investment projects the agency worked with in the first quarter of 2015 come from the Netherlands, Ukraine, Sweden and Germany.

In the first quarter of 2015, decisions on their implementation in Latvia are already made for 10 projects, for the total amount of 6.535 million euros, and in case of full implementation of these projects 170 new jobs will be created. 3 of these projects are expansion projects. As few of the companies, which have made positive decisions in 2014 and the first quarter of 2015

the following companies can be mentioned: the Belgium-based chemistry company Allnex, which has opened a joint service centre of finances in Latvia, the Finnish company Kaskipuu — the second largest producer of outer doors in Northern Europe, which has already acquired a manufacturing complex in Milzkalne, and initially plans to create 13 jobs and invest 3 million euros in the next year in launching the manufacturing process, as well as the Russian producer of hygiene products Cotton Club, which has already started the manufacturing of its products in Liepāja, in co-operation with its cooperation partner, the Italian company Sanitars S.P.A. and is currently employing already 77 employees.

For improving attraction of significant investments for Latvia, the IDAL continues successful implementation of the methodology for attraction of investments – the POLARIS process, whose aim is to attract export-targeted investments with a high added value. The POLARIS process is based on the coordinated cooperation among the public, private and academic sectors. The main attention is paid to eight priority sectors of investment attraction.

Within the framework of the POLARIS process, the IDAL performs regular post-service visits to the existing investors, in order to gather information about their needs and obstacles at work, to summarize this information and to prepare recommendations for competent ministries, directly or through mediation of the Coordination Council for Large and Strategically Important Investment Projects.

One of the priorities of the IDAL operation within the POLARIS process is working with local governments. The IDAL is aware of and emphasizes the role of local governments in the improvement of business environment and in the process of attracting investments. In order to ensure closer co-operation, 4 new co-operation agreements have been concluded with local governments (Ropazi, Carnikava, Aluksne and Preiļi regions) on a more active co-operation in the field of investment attraction. Agreements on co-operation within the framework of the POLARIS process have been concluded with 26 local governments.

One of the main obstacles in the attraction of investments mentioned both by existing and potential investors is ensuring accessibility of qualified workforce at the moment and in the near future. This factor significantly limits the potential expansion of operations within the investment projects already existing in Latvia. Taking the initiative for solving this issue, the IDAL addresses the responsible authorities on a regular basis, emphasizes this problem in sectoral discussions and participates in implementation of the Plan of Re-emigration Activities for 2013–2016, developed by the Ministry of Economy, through organizing activities, as well as addressing the emigrated Latvian people in various events, urging them to return to Latvia in order to use the knowledge and experience obtained abroad for launching entrepreneurship and building their welfare in Latvia.

Regular work is continued in overcoming the detected investment obstacles within the framework of the Coordination Council for Large and Strategically Important Investment Projects, as well as outside the Council, within the framework of daily work of the POLARIS process. In April 2015, the 14th meeting of the Coordination Council for Large and Strategically Important Investment Projects took place. At the beginning of 2015, the support for solving five problem issues, submitted to the IDAL by foreign investors, has also been provided, outside the framework of the Coordination Council for Large and Strategically Important Investment Projects. Primarily, these issues were related to communication problems with state administration authorities or state capital companies, or addressed restrictions of the legal framework or policy progress, which were considered as unjustified obstacles for entrepreneurship by the investors. The IDAL continues actively working on all of these issues.

Assessing global trends in the attraction of investment, in 2015, it is planned to continue mainly emphasising the role of the post-service activities in making decisions concerning a new investment. This approach promotes a raise in the satisfaction levels of foreign investors, which have already invested in Latvia, and thereby stimulates new investment decisions.

4.4 Financial and Capital Markets

4.4.1 Monetary Policy

The main goal of the Bank of Latvia is stability of price, which promotes long-term economic growth. Its main tasks are:

- to cooperate in the formation and implementation of the monetary policy of the euro area;
- to manage financial investments;
- to ensure movement of cash in Latvia and to participate in ensuring the movement of cash in the euro area;

- to cooperate in the promotion of fast operation of payment systems in the *Eurosystem*;
- to prepare and publish statistical information, according to the requirements of laws and regulations of the European Union.

Since Latvia's accession to the EU, the Bank of Latvia has been a member of the European Central Bank (ECB). Until the introduction of euro monetary policy, instruments and procedures of performance of monetary operations were agreed upon, and the system of management of foreign reserves of the central bank was

adapted to ECB's requirements. The Bank of Latvia uses the same indirect monetary policy instruments based on the free market principles as the ECB. The participation of Latvia in the *European Monetary System* means:

- single currency with other member states of the *European Monetary Policy* – euro;
- single monetary policy across the euro area implemented by the ECB together with the central banks of the euro area;
- coordination of economic and fiscal policies between member states.

The Bank of Latvia has been a member of the *Eurosystem* since 1 January 2014 when euro was introduced.

The following monetary policy operations are offered by the Bank of Latvia to financial market operators for the implementation of monetary policies of the *Eurosystem* and the ensuring of liquidity of credit institutions:

- open market operations;
- marginal lending facility;
- marginal deposit facility;
- appropriate marketable assets in monetary policy operations of the Eurosystem.

Box 4.1

Eurosystem

Being a member of the *Eurosystem*, the Bank of Latvia implements the ECB's monetary policy in relations with its counterparties (the credit institutions registered in Latvia or the branches registered in Latvia of the credit institutions registered in other countries). Decisions on the monetary policy in the *Eurosystem* are taken by the ECB's Governing Council. Members of the ECB's Governing Council are governors of the central banks of all the countries in the euro area and six members of the Executive Board of the ECB. The President of the Bank of Latvia represents Latvia in this Governing Council. Members of the ECB's Governing Council are independent in their opinions and voting. The purpose of the ECB's Governing Council is to act in favour of the euro area. ECB's duties are:

- to approve guidelines and to take decisions necessary to ensure the implementation of the tasks entrusted to the *Eurosystem*;
- to formulate the monetary policy of the euro area. This includes decisions referring to monetary objectives, the most important interest rates, supply of reserves of the *Eurosystem* and the development of guidelines necessary for the implementation of these decisions.

Decisions on interest rates are taken once a month; however, the ECB's Governing Council can take decisions on interest rates at any time – also outside its regular meetings.

The primary objective of the *Eurosystem* is to maintain the stability of prices. It should support EU's general economic policy. The *Eurosystem* should act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources. The independence of the central banks of countries from government bodies and their decisions is a crucial prerequisite for successful implementation of the set objectives of the monetary policy. Institutional independence is required, because the monetary policy should be implemented based on medium and long-term prospects, and the implementers of the monetary policy are not allowed to succumb to short-term interests. Institutional independence means also the prohibition of the country's central bank to finance any tasks of the government or its bodies.

4.4.2 Market Structure and Development

At the end of the 1st quarter of 2015, 17 **banks** were operating and 9 branches of the banks of the Member States were registered in Latvia. 6 branches of the Latvian banks operated in foreign countries. Banking services in Latvia can also be provided by credit institutions registered in countries of the European Economic Area or their branches which submitted applications to the Financial and Capital Market Commission (FCMC).

Several significant changes took place in the banking sector in 2014 and at the beginning of 2015:

- commercial activities of VAS "Latvijas Hipotēku un zemes banka" (Mortgage and Land Bank of Latvia) were stopped and, starting from 1 January 2014, it was transformed into a development financial institution with a new name VAS "Latvijas Attīstības finanšu institūcija Altum" (Latvian Development Financial Institution Altum);
- on 5 November 2014, an agreement was signed on the sale of 75% of shares of Citadele bank for 74 million euro, to a group of twelve international investors and "Ripplewood". The new investors

are planning to develop Citadele bank into one of the leaders of the banking sector in Latvia. The ERDB plans to keep its current 25% of the shares of the bank in its property;

- despite the sale of the credit portfolio of AS "Latvijas Krājbanka", the bank's bankruptcy proceedings continue. Judicial proceedings are ongoing in Latvia and abroad fighting for the recovery of different assets and monetary funds to be able to settle accounts with bank's creditors.

The single supervisory mechanism of the European banks entered into effect on 4 November 2014 to implement a single supervision approach and to prevent problems in any of the countries. Its purpose is to make progress towards integrated financial supervision in order to restore trust to banks and to minimise costs of banks' bankruptcy. The banks' single supervisory mechanism is formed by the ECB and national competent authorities. In case of Latvia, the ECB has overtaken supervision of the three largest banks (in terms of assets) – Swedbank, SEB banka and ABLV Bank. As to other banks, these tasks are still entrusted to the FCMC. The FCMC also cooperates with the ECB providing information on

crucial supervision decisions with regard to other Latvian credit institutions.¹

In the 1st quarter of 2015, operational indicators of all the Latvian banks met regulatory requirements. The liquidity ratio of the banking sector was high – 63.7%, which exceeds the set minimum requirement more than twice (the minimum regulatory requirement is 30%). In 2013, the FCMC introduced individual high liquidity requirements depending on amount of non-resident deposits in total assets of banks.

The level of capitalisation of the banking sector continues to grow. In the 4th quarter of 2014, the average capital adequacy indicator in the banking sector reached 20.85% (the minimum regulatory requirement is 8%), which is the highest indicator in the last years. The return on assets (ROA)² grew to 1.35% and the return on equity (ROE)³ grew to 12.9%, which are the highest indicators since the end of 2008.

The profitability of banks is still positive and in the three months of 2015 they operated with a profit of 104.6 million euro. 15 Latvian banks and six branches of foreign banks (their market share in the total assets of the banking sector is 96.6%) operated with profit in this period.

The **insurance market** continues its stable development. The number of insurance companies has remained unchanged since 2013: 7 insurance companies operated in Latvia in the 1st quarter of 2015, 2 of which deal with life insurance and 5 – with non-life insurance. There are also 14 branches of foreign insurance companies.

In the 1st quarter of 2015, compared to the same period of 2014, gross written premiums of insurance companies grew by 9.1% and reached 112.4 million euro. Life insurance written premiums grew most drastically in the 1st quarter of 2015. The amount of gross paid premiums grew by 8.9% reaching 55.1 million euro. In the 1st quarter of 2015, insurance companies worked with 2 million euro profit: non-life insurance companies – with 163 thousand euro profit, life insurance companies – with 1.8 million euro profit. In total, in the 1st quarter of 2015, the insurance companies earned by 44.7% less than in the same period of the previous year.

From the end of 2011 to 2013, the situation in the **Latvian securities market** significantly improved. In 2014, the situation slightly worsened, and the OMX Baltic Benchmark index value slightly dropped. The index value of NASDAQ OMX Riga and NASDAQ OMX Tallinn shrank; however, if we look at a longer period (3 years), indexes of the Baltic market have significantly grown. At the beginning of 2015, the value of all the indexes continued to grow as well. Since the beginning of the year, the NASDAQ OMX Tallinn index value

showed the fastest growth, while the OMX Riga index showed the lowest growth.

The drop in crediting volumes promoted the growth in banks' contributions into securities. In the 1st quarter of 2015, the amount of central governments' debt securities in banks' assets significantly grew (by 77.3%) compared to the 1st quarter of 2014, which was caused by the growth in the amount of foreign central government securities. The amount of other securities also significantly grew (by 76.2%). As to other securities, bonds of other issuers and other debt securities with fixed income showed the fastest growth (by 86.5%).

4.4.3 Assets, Deposits and Loans

An increase in the Latvian **bank assets** was observed at the end of 2013 in connection with the expected introduction of euro – cash savings of the population were transferred to bank accounts. Therefore, the amount of cash in circulation shrank significantly and the use of non-cash in settlements significantly increased. However, when lats changed to euro, cash in circulation grew significantly from 667.8 million euro at the end of 2013 to 3593.6 million euro at the end of the 1st quarter of 2015. Since the introduction of euro, the increase in cash in circulation has been moderate and no significant fluctuations were observed.

Although a significant drop in banks' assets was observed at the end of the 1st quarter of 2014, banks' assets grew again in later quarters and in the 1st quarter of 2015 they made 31.2 billion euro, which is by 12% more than the year before. In total assets, the ratio of credits issued to non-banks shrank to 47.4% (compared to the 1st quarter of 2011 when bank credits made 65.5% of bank assets), but the ratio of securities has significantly grown.

Since 2014, the amount of **deposits** continues to grow. In the 1st quarter of 2015, they made 22.3 billion euro, which is an increase of 17.2%, compared to the same period of the previous year. This has been the fastest growth since the end of 2007. The amount of non-resident deposits grew faster – by 31% and exceeded the amount of local deposits making 55% of the total amount of deposits. 9.1% in the structure of non-resident deposit holders are deposits of the CIS countries, 18.5% are deposits of other EEA countries and 27.1% are deposits of other countries. However, it should be taken into account that banks working with non-resident deposits are subject to higher requirements to liquidity and capital adequacy. Most of resident deposits are in euro (89.6%), but, as before, most of non-resident deposits are in US dollars (68.3%).

¹ Of all 6000 banks in the euro area, 123 largest banks of the euro area (according to approved criteria) are directly supervised by the ECB. These banks hold almost 82% of the bank assets of the euro area.

² ROA – profit/loss ratio to assets.

³ ROE – profit/loss ratio to equity and reserves.

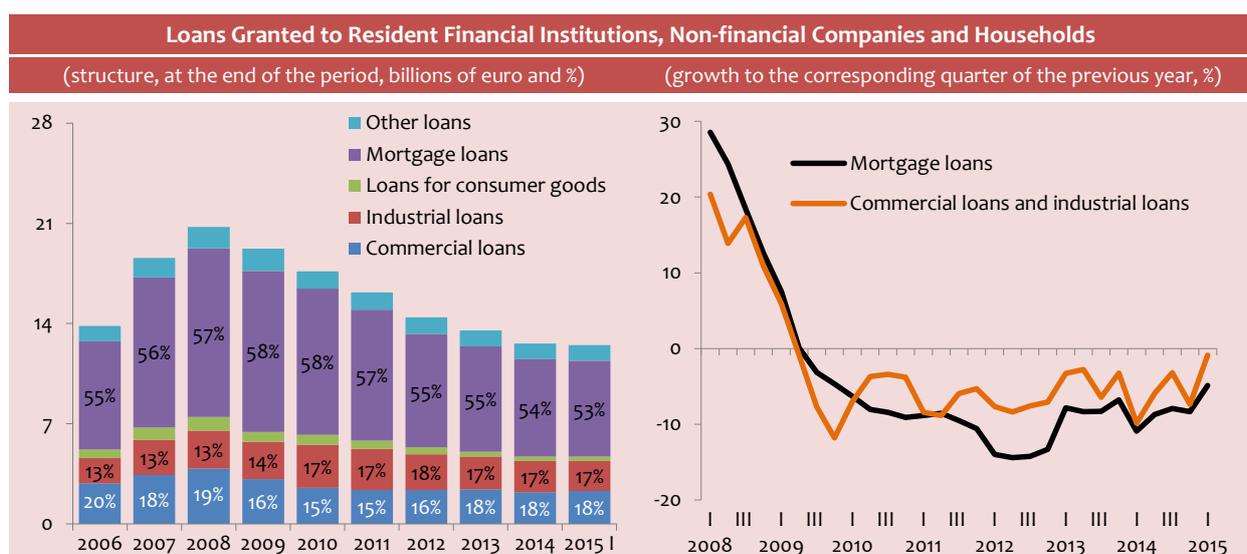
Table 4.8

Monetary Indicators of the Latvian Banking System									
At the end of the period, billion euro									
	2007	2008	2009	2010	2011	2012	2013	2014	2015 I
Net external assets	-6.4	-8.4	-4.3	-1.7	-0.3	0.9	1.2	-1.8	-1.7
Net internal assets	15.2	16.9	12.6	10.8	9.5	8.8	8.6	11.3	11.1
Domestic loans	18.5	20.3	17.4	16.0	15.7	13.7	13.5	12.6	13.3
to government (net)	-0.1	-0.5	-2.1	-2.0	-0.9	-1.3	-0.7	-0.5	0.2
to companies and individuals	18.6	20.8	19.5	18.0	16.7	14.9	14.1	13.2	13.1
Other assets (net)	-3.4	-3.5	-4.8	-5.1	-6.2	-4.9	-4.8	-1.3	-2.1
Broad money M2D	8.8	8.4	8.3	9.1	9.2	9.6	9.8	9.4	9.4
Cash in circulation (without balances in bank tills)	1.3	1.2	0.9	1.1	1.5	1.5	0.7	3.7	3.6
Deposits of individuals and companies including:	7.5	7.2	7.3	7.9	7.7	8.1	9.2	9.5	9.4
marginal deposits (residents)	4.1	3.3	3.1	4.0	4.4	5.1	6.6	7.0	7.0
fixed-term deposits	3.4	3.9	4.2	4.0	3.3	3.0	2.6	2.5	2.4
Changes in % to the same period of the previous year									
Domestic loans including:	31.8	9.7	-14.5	-8.1	-1.5	-13.1	-1.4	-5.9	-1.7
to companies and individuals	34.0	11.8	-6.6	-7.6	-7.4	-10.4	-5.3	-6.8	-3.9
Broad money M2D	12.6	-3.9	-1.9	9.8	1.5	4.5	2.0	-3.6	5.9
Cash in circulation (without balances in bank tills)	-7.1	-3.8	-22.9	21.0	28.8	4.1	-56.6	461.0	3.4
Deposits of individuals and companies	16.9	-3.9	1.7	8.3	-2.4	4.5	13.2	-3.6	5.9
Gross domestic product (at current prices)	32.3	9.3	-18.7	-2.2	11.7	8.7	5.6	3.6	2.6

At the beginning of 2015, the total credit portfolio of banks continued to shrink, yet the shrinking rates decreased. This is mainly related to the repayment of the previous credits and writing off of bad debts. The

balance of granted bank loans dropped by 3.5% at the end of the 1st quarter of 2015, compared to the same period of the previous year.

Figure 4.28



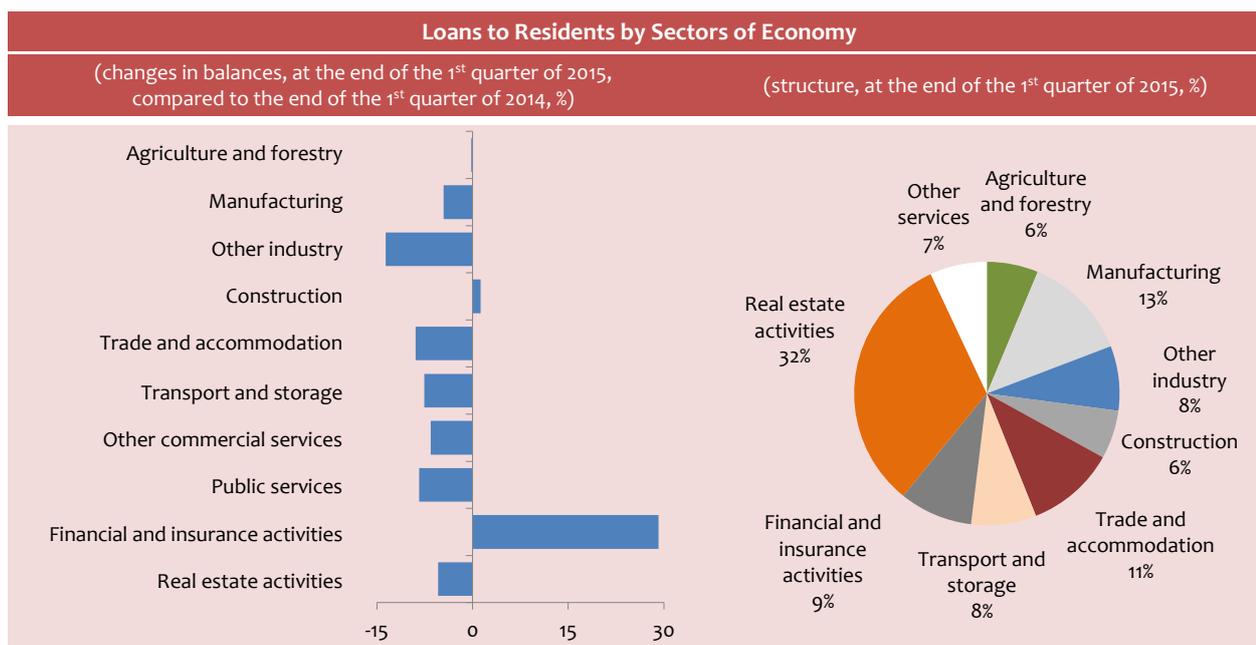
Although in 2014, the amount of newly issued credits shrank significantly (by 22%), compared to 2013, the situation improved at the beginning of 2015, and in the 1st quarter of 2015, in the whole banking sector, newly issued credits made 601.9 million euro which was by 21% more than the year before. However, it should be taken into account that the amount of issued credits in the 1st quarter of 2014 was very low. The amount of newly issued credits to non-residents has grown by almost 50%, and their ratio in the amount of newly issued credits is almost 60%, which is by 10 percentage points more than the year before. In the banking sector, the total ratio of credits issued to non-residents in the total credit portfolio makes 15.3 per cent.

Crediting of households is gradually improving, and in the 1st quarter of 2015 the amount of newly issued credits grew by 21% and made 14% or 83.6 million euro of the total amount of newly issued credits. However, the total dynamics of the household credit portfolio remains negative. In terms of amount, most of newly issued credits were issued for purchasing homes. Crediting of homes remains hindered by limited opportunities of

households to cover the first instalment, as well as insufficient income of households.

Crediting business also remains low, and companies tend to use internal company's financial resources. The readiness and the ability of companies to invest into development of companies is low. According to the SEB banks' research *Baltic Business Outlook*, 54% of the Latvian businessmen were ready to invest into business in 2013, only 37% of the respondents had such plans in 2014, and only 28% of the Latvian businessmen are going to implement investment projects in 2015. A similar downward trend shows up in crediting data. Since the beginning of 2015, the amount of newly issued credits to businessmen has slightly grown, however, it is still at a low level. In the 1st quarter of 2015, the amount of newly issued credits to companies grew by 5%, compared to the same period of the previous year and made 26% or 154.4 million euro of the total amount of newly issued credits; however, shrinkage is observed in almost all of the main sectors of the national economy. Growth (by 19%) was observed in the manufacturing. The entire dynamics of the credit portfolio of companies is still negative.

Figure 4.29

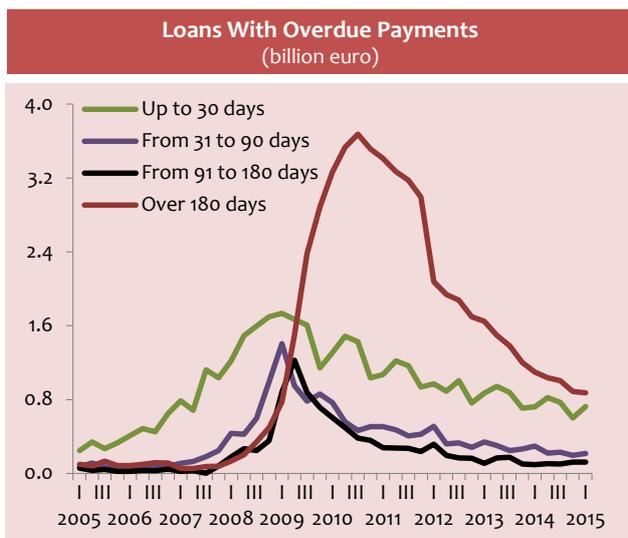


No significant changes are observed in the credit structure. Mortgage credits are still predominant in the credit structure issued to domestic companies and individuals, the ratio of which shrank to 53.5% in the 1st quarter of 2015. The ratio of commercial credits and industrial credits in the total credit structure has slightly grown and is 34.8%. The ratio of consumption credits in the total credit structure is 2.6%. At the end of the 1st quarter of 2015, balances of mortgage credits and industrial credits shrank the most (by 4.9% and by 3.7%,

respectively), but balances of commercial credits slightly grew in comparison to the same period of the previous year. In terms of amount, most credits were issued in real estate activities and manufacturing.

If broken down by sectors of the national economy, real estate activities make the largest credit balance ratio (32% of total credits issued). A relatively high ratio of issued credits is also in activities of the manufacturing (13%), trade, accommodation and catering services (11%) and financial and insurance activities (9%).

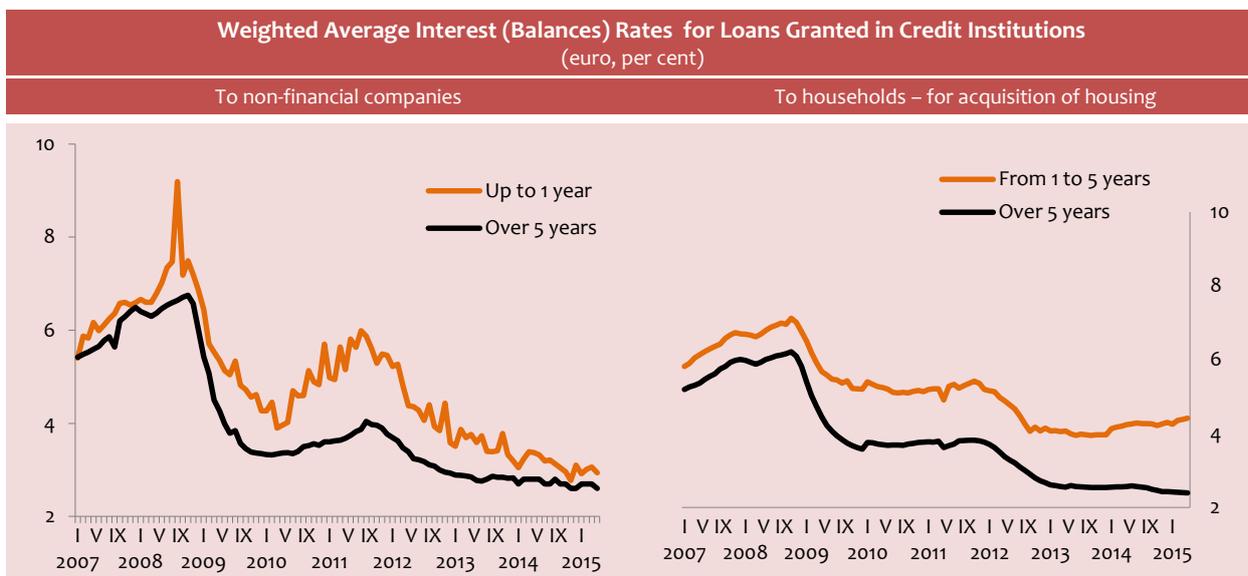
Figure 4.30



Although the quality of credits continues to gradually improve, in the 1st quarter of 2015, the amount of credits with outstanding payments in the total credit portfolio of banks was 13.1%, which is by 0.8 percentage points more than in the previous quarter. The improvement of the quality of the credit portfolio of banks is mainly related to writing off of the bad debts.

Banks still continue to work with customers who face difficulties to repay their credits. The ratio of restructured credits and credits in the process of recovery reduces in the total credit portfolio of banks. At the end of the 1st quarter of 2015, 15% of the total credit portfolio were restructured credits and credits in the process of recovery. The ratio of restructured credits in the total credit portfolio of banks reduced to 8.9%, while the ratio of credits in the process of recovery reduced to 6.1 per cent

Figure 4.31



Short-term and long-term interest rates (for balances) of credits issued to non-financial companies have been shrinking in the last three years and are now almost equal. Interest rates (for balances) of credits issued to

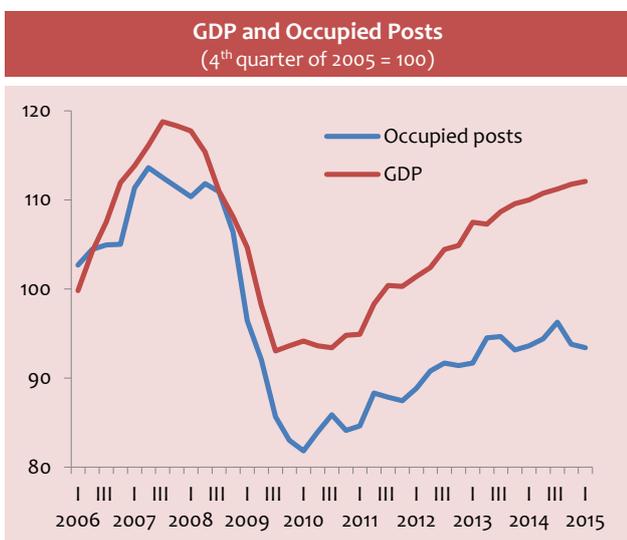
household for purchase of home have also been shrinking since 2012; however, medium-term (1-5 years) interest rates have slightly increased for credits issued to households for purchase of home since the end of 2014.

5. LABOUR MARKET

5.1 Employment and Unemployment

The gradual improvement of the economic situation also positively affects the situation in the labour market – unemployment is decreasing and employment is increasing. However, the improvements are slowing down due to a gradual decrease in the base effect in the labour market, as well as the drop in the pace of growth related to external tendencies.

Figure 5.1

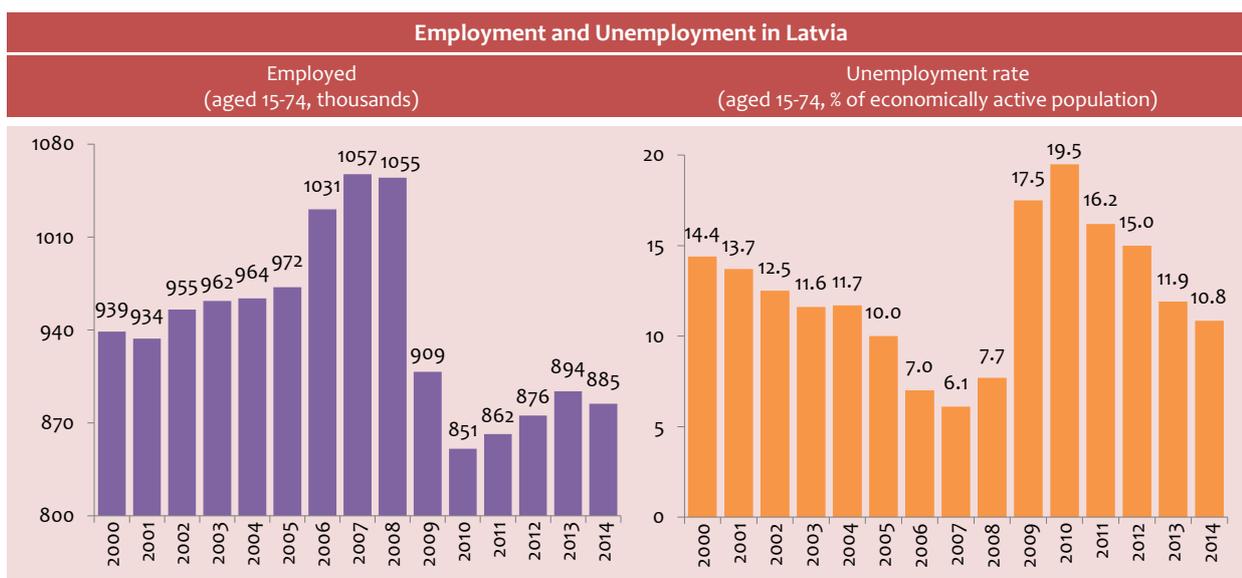


Since the middle of 2010, the number of employed people has been increasing gradually. According to the Labour Force Survey data, the number of employed people has increased by 33.9 thousand or on average by 8.5 thousand a year from 2011 until 2014. The increase in employment is due to the recovery of economy – the GDP has increased by one fifth since late 2009. At the same time, the increase in employment has promoted a decrease in unemployment. The unemployment rate has decreased by almost a half over 4 years.

Since 2007, the most rapid increase in the employment was observed in 2013 – the number of the employed reached 893.9 thousand, which is by 2.1% or approximately 18.3 thousand more than in 2012. Meanwhile, the employment rate increased to 58.2%, and it was by 2.1 percentage points higher than in the previous year.

In 2014, the situation in the labour market kept improving, though slower than in previous periods. On the one hand, this is due to the greater influence of demographic trends on the labour market, on the other hand – due to the slower growth rate and increased productivity.

Figure 5.2



The rate of unemployment decreased to 10.8% that was by 1.1 percentage points less than in 2013, but the rate of employment increased by 0.9 percentage points – up to 59.1%. In total, 884.6 thousand inhabitants were employed in 2014, but 107.6 thousand inhabitants were looking for jobs, which is by 12.7 thousand less than in 2013.

In 2014, the number of economically active population kept decreasing – it dropped by almost

22 thousand or 2.2% over the year, if compared to 2013. It should be noted that the economically active population has been on a downward trend since the beginning of 2013. The decrease of the economically active population is mainly affected by the negative demographic trends. Despite the above, the economic activity of the population increased by 0.3 percentage points and reached 66.3% among the inhabitants aged 15-74 in 2014.

Figure 5.3

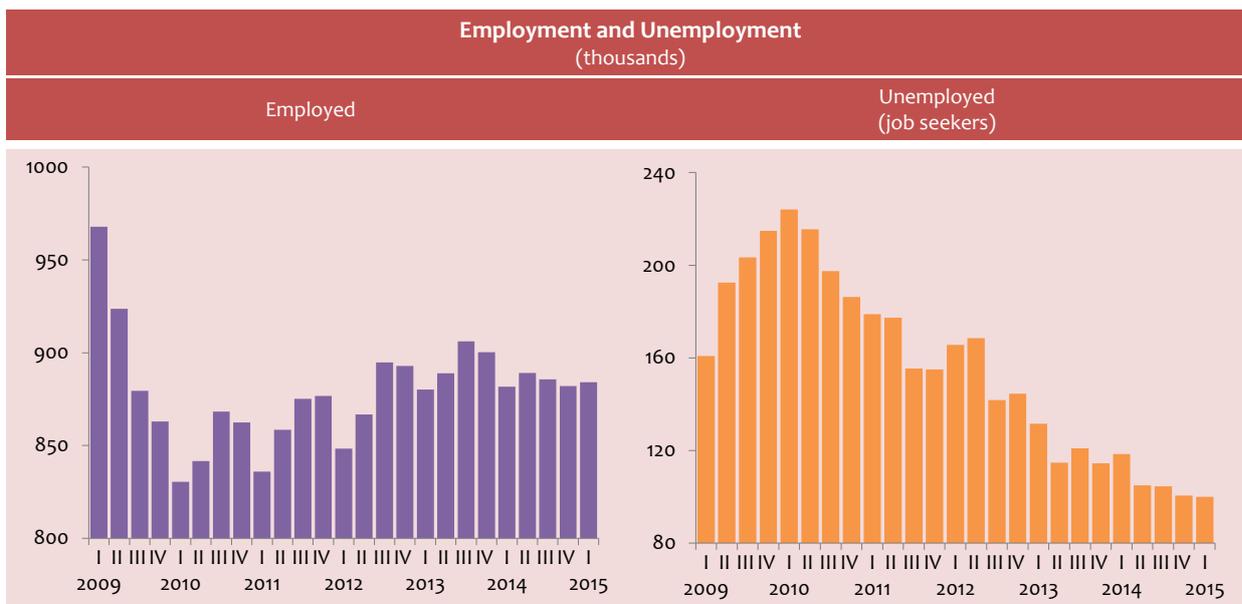
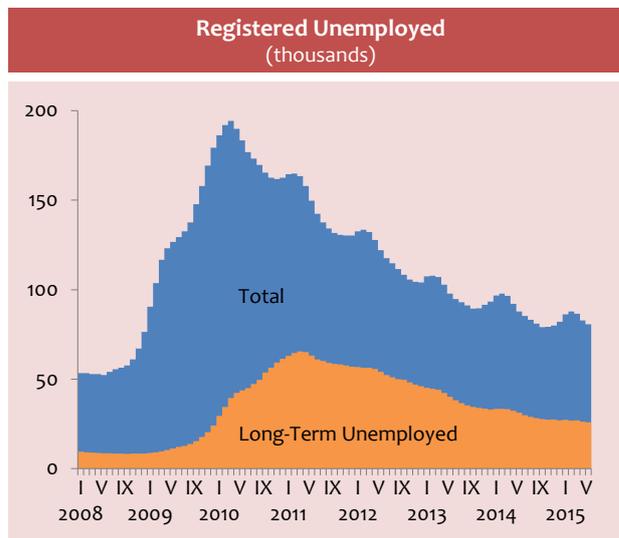


Figure 5.4

Positive trends were observed in the labour market also at the beginning of 2015. In the first quarter of 2015, the number of employed population increased by 0.4%, if compared to the corresponding period in the previous year. Overall, 884.1 thousand inhabitants or 59.7% of the population aged 15-74 were employed in the first quarter. Compared to the first quarter of 2014, the employment rate has increased by 1.1 percentage points.

The rate of unemployment, if compared to the corresponding period in 2014, dropped by 1.7 percentage points – to 10.2% in the 1st quarter of 2015. Meanwhile, if compared to the previous quarter, the unemployment rate remained unchanged.

Along with the overall decrease in unemployment, registered unemployment has decreased as well. The registered unemployment rate at the end of May 2015 decreased to 8.6% – 81 thousand unemployed were registered, which was by 7 thousand fewer than in May 2014. The highest registered unemployment rate remained in Latgale region (18.9%), but the lowest – in Riga (5%). Almost one third of the total number of registered unemployed people was long-term unemployed (jobless for more than a year).

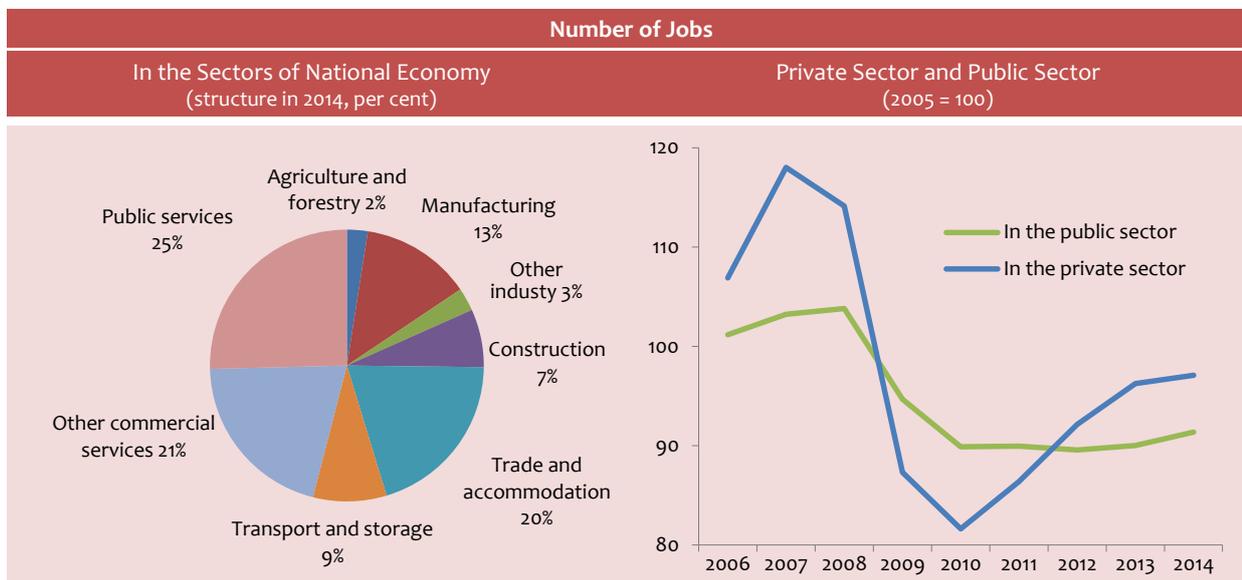


The current unemployment rate is mainly related to cyclical unemployment, i.e. the significant drop in production volumes and services provided during the crisis. Therefore, all measures related to the promotion of economic activities and entrepreneurship foster an increase in the labour demand and employment growth.

At the same time, there is a risk that some of the currently unemployed people will not be able to find a job for a longer period resulting in structural unemployment, as sectors that recover faster from the crisis are not the ones where people lost their jobs during

the crisis. The economy is going through structural changes and mismatch can occur between the labour supply and demand – skills of job seekers do not match the employers' requirements.

Figure 5.5

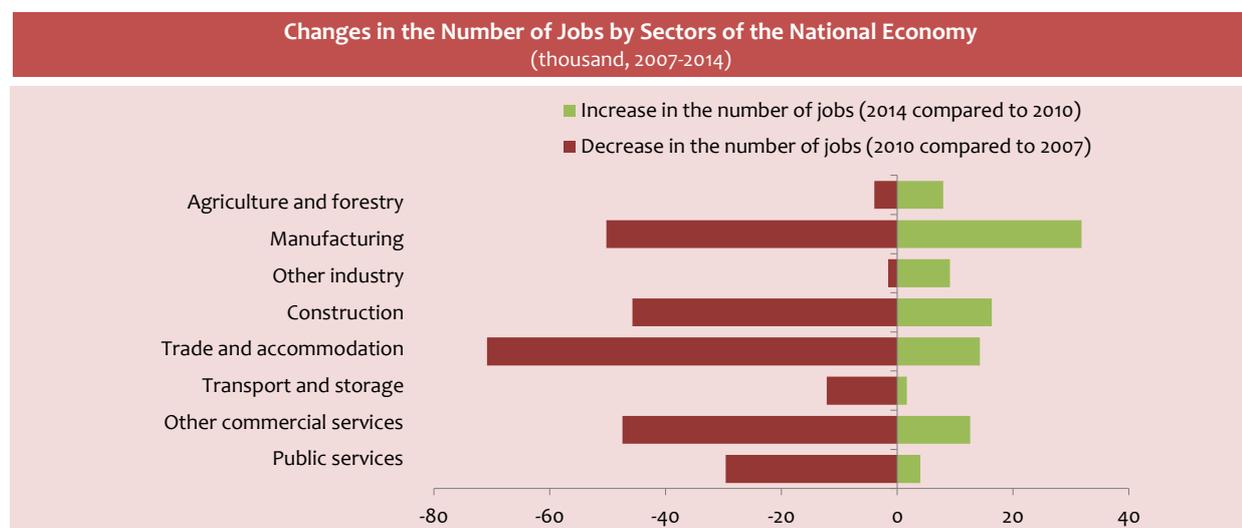


The number of long-term unemployed people increased along with the overall unemployment rate during the crisis. However, the number of long-term unemployed people has a tendency of decreasing along with the growing economic activity since early 2011. At the end of May 2015, there were 25.8 thousand long-term unemployed people registered with the SEA, which was by 5.4 thousand or 17% fewer than at the end of May 2014. Although the situation is improving gradually, the share of long-term unemployed people is still high – approximately 1/3 of the total number of registered

unemployed population. It should be taken into account that the high level of long-term unemployment can cause the growth of structural unemployment, namely, the longer these people are without a job, the higher the risk of losing work skills and knowledge.

At the same time, the balance between the labour force demand and supply is influenced not only by the education level and skills of the labour force, but also by wages, and therefore vacancies are not filled even under high unemployment conditions.

Figure 5.6



As the economic situation has stabilized, a steady growth in the number of jobs has been observed since mid 2010. According to the CSB data, the number of occupied posts in 2014 increased by 9.4 thousand or 1.1% if compared to 2013. Meanwhile, the number of vacancies increased by 5.9% or approximately 0.2 thousand jobs.

In 2014, the number of occupied posts mainly increased in the services sectors. The most rapid increase of jobs in 2014, as compared to 2013, was in the information and communication services sector (by 10.2%) and health care (by 6.3%). The most significant decrease of jobs was observed in the manufacturing – by 2.9 thousand or 2.5%, as compared to 2013. The sharpest decrease in the number of jobs in the manufacturing was in the metal production that was influenced by the termination of operations of JSC “Liepājas Metalurģs” in 2013, and in the production of clothing.

A slight decrease of occupied posts was observed at the beginning of 2015. In the first quarter of 2015, if compared to the corresponding period in 2014, the number of occupied posts decreased by 1.8 thousand or

0.2%, which was mainly due to the decrease in the manufacturing and construction.

Meanwhile, the most rapid increase of occupied posts in the first quarter of 2015 was observed in the health and social care sector, where the number of jobs increased by 3 thousand or 5%, if compared to the first quarter of 2014.

Over the past few years, the number of jobs has significantly increased in the private sector. Following the 30% drop in the number of jobs during the crisis from 2010 to 2014, the number of jobs in the private sector increased by 19 per cent.

Meanwhile, the increase in the number of jobs has been comparatively slow in the public sector, where it has increased only by 1.7 per cent in the period from 2010 to 2014.

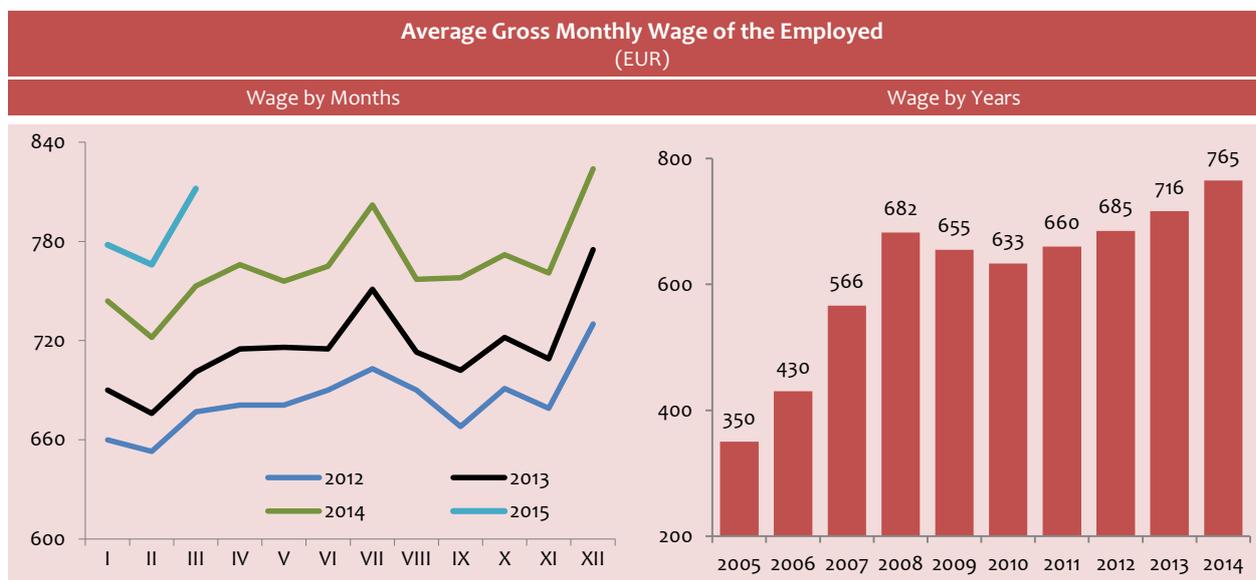
A more rapid increase in the number of jobs in the public sector was observed in 2014, when the number of occupied posts increased by 1.5%, if compared to 2013. In the private sector, the number of occupied posts increased only by 0.9 per cent in the same period.

5.2 Labour Costs and Productivity

The dynamics of labour costs and productivity in recent years was largely determined by the differences in the adjustment of labour and goods markets to the cyclic fluctuations of conjuncture. When the economic growth resumed, the increase in wages became more rapid, and it

was influenced by the increasing competition in the EU labour market and the low competitiveness of Latvia within it. The growth of productivity, in its turn, is more moderate, and this means that the competitive advantage of lower labour costs gradually is lost.

Figure 5.7



The average gross wage in 2014 was 765 euro that exceeded the level of 2013 by 6.8%. If compared to the pre-crisis period – 2008, the average gross wage in 2014 has increased by 12.2 per cent.

The average gross wage in the public sector in 2014 was by almost 10% higher than in the private sector (813 and 741 euro respectively). In the private sector, the wages increased by 7.5% in 2014, whereas in the public sector – by 6.1%. In the public sector, the wage in 2014

essentially was at the level of 2008, while the wage in the private sector was by 18.9% higher.

In 2014, as compared to 2013, the average net wage increased more rapidly than the average gross wage – by 8.6%. It is related to the amendments to the *Law On Personal Income Tax* made in 2014. It should be noted that the increase in wages in 2014 was fostered by the changes in the minimum monthly salary – the minimum monthly salary was increased to 320 euro in 2014.

Figure 5.8



In the first quarter of 2015, as compared to the corresponding period in 2014, the gross wage increased by 6.1%. The wages in the private sector grew more

rapidly – by 6.9%, whereas in the public sector – by 5.1 per cent.

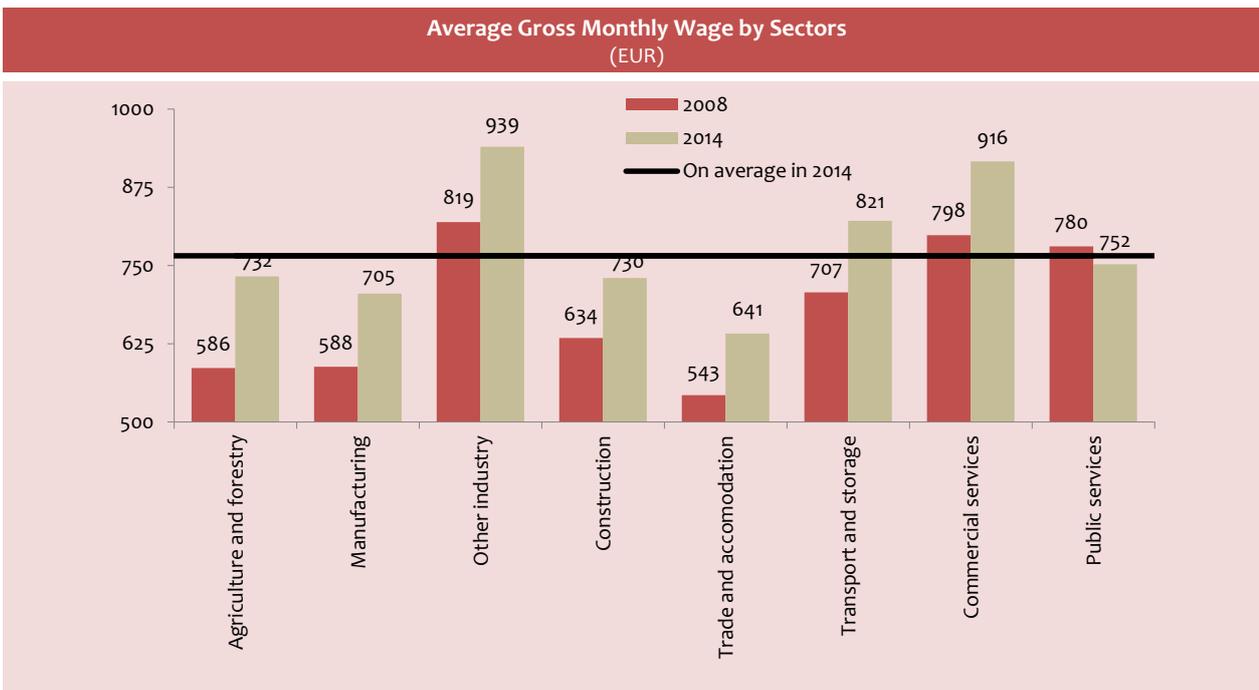
The difference in wages across sectors has considerably decreased over the past years. In 2008, the average gross wage in the private sector was by 22.7% lower than that in the public sector, while in 2014, the difference was only 8.9 per cent.

The balancing of wages was mainly due to various labour market correction mechanisms in the public and private sector. During the years of economic recession, the employment rate decreased considerably in the private sector, while the decrease in the wages of employees was relatively moderate. However, the decrease in the number of the employed people in the public sector was almost a half of that in the private sector; the wages of employees were reduced considerably due to the necessity to limit the government budget expenditures. Wages have been gradually growing since 2011, and their dynamics in the public and private sectors are relatively steady.

Over the last six years, the average gross wage has increased faster in the agriculture, manufacturing and trade sectors, whereas the wages in the public services sectors fall behind by almost 4% of the level during the pre-crisis period due to the drop in wages during the crisis to limit the government budget expenditures.

In 2014, as compared to 2013, the average gross wage increased in all sectors of the national economy. It increased more rapidly in agriculture, construction, trade and manufacturing. The wages keep growing in all sectors of the national economy in 2015.

Figure 5.9

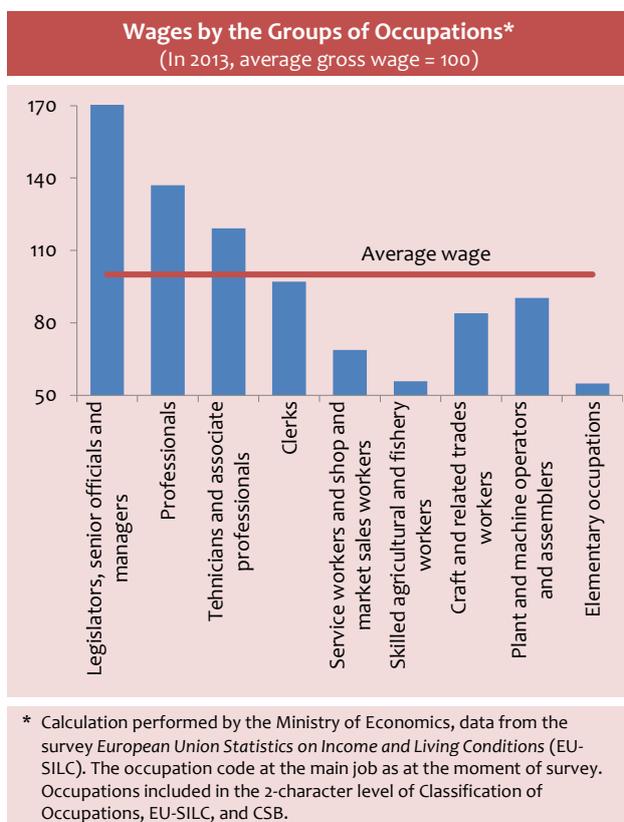


Since 2011, the average gross wage in the major exports sector of Latvia – the manufacturing – has increased more rapidly than on average in the national economy. In comparison to 2008, the average gross wage in the sector has increased by almost 20%. The rise in the average gross wage was fostered by the increase in the sector's output rate from 2009 to 2012, when manufacturing was the main driving force of the growth of the national economy. The most significant increase in wages since 2008 has been in the traditional sub-sectors of the manufacturing – production of non-metallic mineral products, wood processing, paper production and publishing, food production, as well as in the sector of high technologies – production of electrical and optical equipment. The comparatively more intense increase in wages in these sectors is largely related to the more rapid growth of production volume and productivity.

In 2014, as compared to 2013, the wages in the manufacturing increased by 7%, while in the first quarter of 2015, they were by 6% higher than a year before. The positive dynamics of the wages are observed almost in all sub-sectors of the manufacturing.

In terms of occupations, the wages increased in all groups of occupations over the last five years – more rapidly in the groups of occupations of high and medium qualifications, more moderately – in low-qualification occupations.

Figure 5.10



Despite a gradual growth in wages, significant differences in wages across different groups of

occupations remain. For instance, the wage in low-qualification occupations is 2.5 times lower than in high-qualification occupations and 1.5 times lower than in medium-qualification occupations, whereas in the high-qualification occupations wages are even by 1.7 times higher than in medium-qualification occupations.

When comparing the average gross wages in the groups of occupations with the average national gross wage, it should be noted that average wages in high-qualification occupation groups are by more than one third higher than the national gross wage. Despite the fact that wages in medium qualification occupations are closer to the average national gross wage, taking into account the specifics of certain groups of occupations, in general, the wages in the medium-qualification occupation groups are by almost one fifth lower than the average wage. In low-qualification occupations, the wages are almost by half lower than the national average.

Wages are a considerable factor of cost competitiveness, thus, the increase in wages must be balanced with the increase in productivity. Otherwise, competitiveness in the tradable sectors will be lost, which, as a result, will not ensure stable increase in the total revenue (welfare).

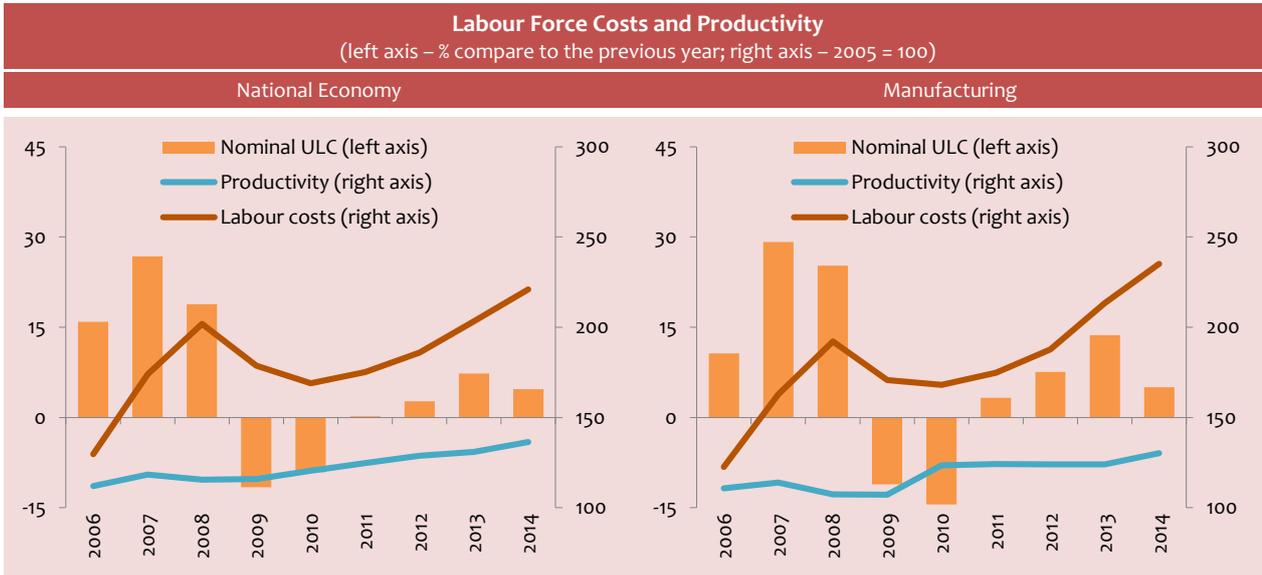
Within the period from 2004 to 2007, wages increased almost five times faster than productivity, negatively affecting the international competitiveness of Latvia, as evidenced by the dynamics of production unit labour costs (ULC)¹. Adjustments in the goods and labour markets caused by the crisis reduced the gap between productivity and labour force costs resulting in a gradual improvement of Latvia's competitiveness in foreign markets. However, in recent years, positive ULC dynamics that are more rapid than on average in the EU have been observed. It is largely due to a more rapid increase in labour costs if compared to productivity.

The ULC dynamics are largely related to the cyclical factors or crisis consequences since 2008. Commodity markets are much more sensitive to cyclical fluctuations than labour markets, thus, during the initial stage of economic recession, output decreased more rapidly than the number of the employed, and productivity decreased. In 2009, as compared to 2007, productivity in the national economy of Latvia decreased by 7% in general. Since labour force costs continued to grow in 2008 (mainly due to growing dismissal costs), production unit labour costs (nominal ULC) increased as well. In 2009, labour force costs reduced faster than productivity, and the growth of productivity in 2010 resulted in the decrease in ULC by nearly 10%, suggesting the rising competitiveness of the Latvian producers. Similar tendencies were also observed in the manufacturing. Since 2011, the dynamics of productivity have been more moderate than the dynamics of labour force costs. In 2014, if compared to 2011, average annual productivity

¹ ULC is defined as a relation between labour costs and labour productivity. If productivity is growing faster than wages, the ULC decreases, which means that the competitiveness of the national expenditure increases and vice versa.

increased by 3%, while the labour force costs increased by 8%, i.e., almost 2.5 times faster.

Figure 5.11

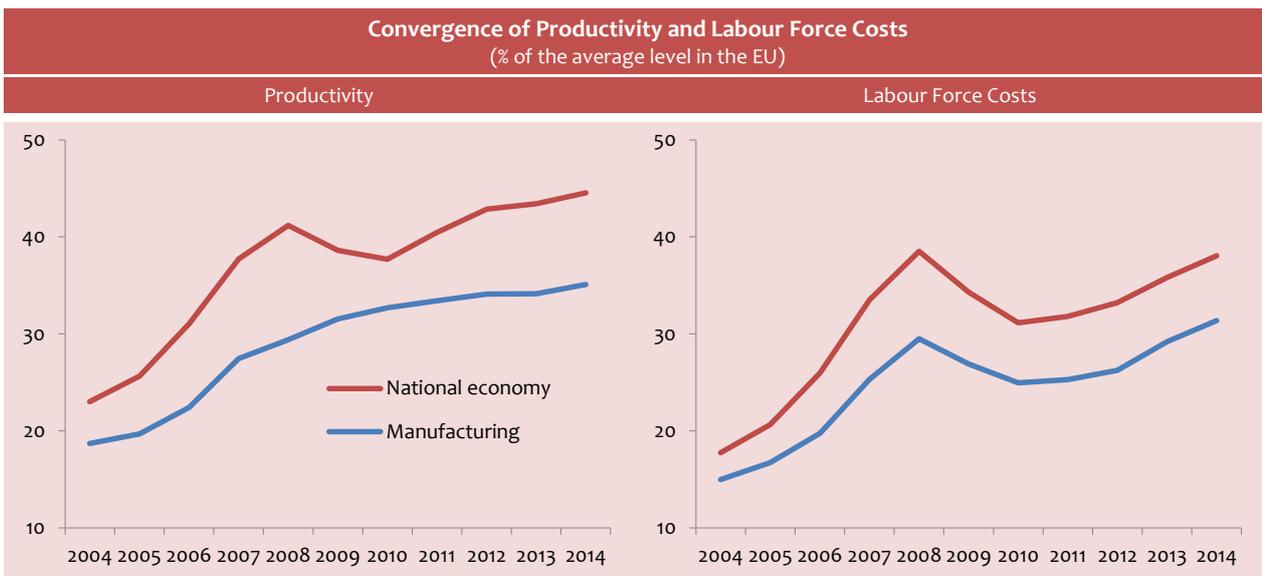


The labour force unit costs increased faster than productivity also at the beginning of 2015. In the first quarter of 2015, the labour force costs per employed person were by 5.4% higher than a year before, but productivity increased by 2% resulting in the increase of the nominal ULC by 3.3%. It should be noted that the overall gap between the growth rates of the labour force costs and productivity has decreased, if compared to the pre-crisis years, and the increase in ULC is comparatively moderate. However, the dynamics of ULC and productivity of the last two years show that production unit labour costs will continue to grow as the economic

activity rises. It means that the competitive advantage of cheap labour costs is gradually lost.

The dynamics of nominal ULC in the medium-term will be mainly affected by structural factors, while the influence of cyclical factors (for instance, economic fluctuations in foreign trade countries) is expected to be lower. One of the most significant factors for the increase in ULC is the increase in wages (convergence of wages), which is largely influenced by the increasing competition on the EU labour markets and the low competitiveness of Latvia in this area.

Figure 5.12



Labour force costs in Latvia are among the lowest in the EU. In 2014, labour force costs per one employee in Latvia were 38% of the EU average, including in the manufacturing – 31.4%. It should be noted that the gap of the labour force costs has decreased by almost 6 percentage points from 2011 until 2014, whereas the productivity of the national economy in Latvia in general falls behind by 4 percentage points, but in the – only by 2 percentage points. The equalisation of wages (convergence) is an objective process, which must be

taken into account in the future. A more rapid increase in wages may be related to the increase in the minimal wage, entrepreneurs' willingness to keep highly qualified employees, decrease in the unemployment level etc. On the other hand, the increase in wages may trigger considerable stimuli for innovations and investments in new technologies to decrease the costs and increase the productivity of production resources, though, negatively affecting competitiveness.

5.3 Labour Market Forecasts

Labour market forecasts until 2020 were developed according to the national economy development scenarios (see section 3.3).

The situation in the labour market is expected to continue to improve in the years to come, at the same time improvements will become more moderate, influenced by a higher base effect in the labour market and slower growth rates. Moreover, the situation will be influenced even more by the negative demographic trends which will be observable not only in labour market indicators, but also in labour force availability.

In total, 2015 is expected to show a low increase in employment: the employee numbers will grow only by 0.2% or by about 1.9 thousands, compared to 2014. At the same time, the level of employment will slightly exceed 60%. In total, in 2015, the employee number might reach 886.5 thousand.

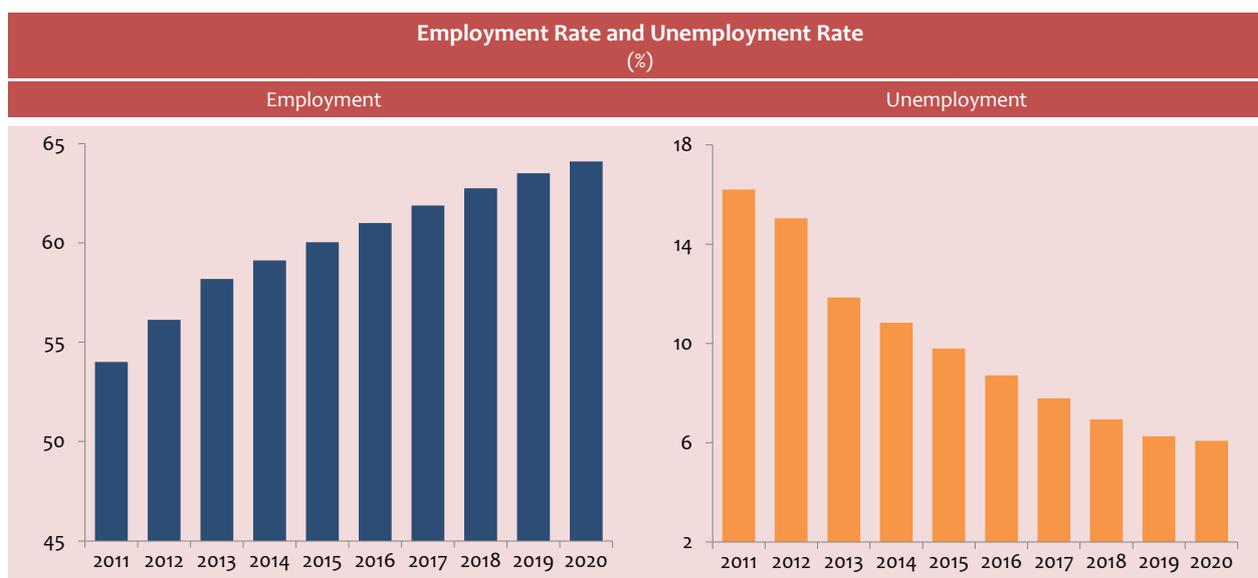
Unemployment will continue to grow as well: the level of unemployment will get close to 9.8% in 2015.

Whereas, compared to the year 2014, the number of job-seekers will reduce by more than 11 thousand – to about 96 thousands.

Demand for labour will continue its growth trend also in the medium-term. However, the increase of employment will be slower than growth, since output will be mainly based on an increase of productivity. Faster increase in employment will also be hindered by negative demographic trends/labour force ageing, mismatch between the demand for and supply of labour force, and regional disproportions in the labour market.

By 2020, the employee number is expected to grow by about 3.1% or by about 28 thousand compared to 2014. Thus, in 2020, the number of employed persons might exceed 912 thousand, while the percentage of the employed among the population aged 15-74 may grow to 64 per cent.

Figure 5.13



In the medium-term, unemployment will continue to drop as well. By 2017, the unemployment level will drop to 7.8%, and the problem of insufficiency of labour force will become even more pronounced. In total, by 2020, the unemployment level might drop by about 6-7 per cent.

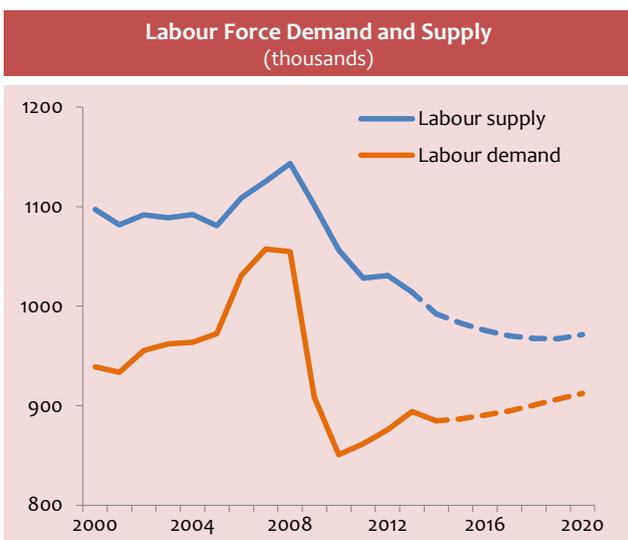
In 2014, the rates of economic growth in the majority of economic sectors slowed down which was reflected also in the growth of employment in sectors. Similar trends will be observed in 2015 – a weak increase in employment will be observed in the majority of economic sectors.

In 2015, compared to 2014, the most significant increase in the number of the employed is expected in sectors oriented to domestic demand: in sectors of commercial services (by 1.4 thousand or 0.8%) and in construction (by 0.3 thousand or 0.5%). The employee number will also slightly increase in the manufacturing, however, this increase will have slower rates than it was projected before, mainly because of high uncertainty in relation to further operations of “KVV Liepājas metalurģs”, as well as the extension of Russian import embargo to food products, incl. restriction of import of the Latvian fishery products for an indefinite period of time.

At the same time, it should be noted that the role of sectors oriented to domestic demand in the labour market will continue to grow in the years to come. Growth in tradable sectors will be mainly based on the growth of productivity which will have a critical impact on ensuring competitiveness, and therefore an increase of employment in these areas could be relatively slower.

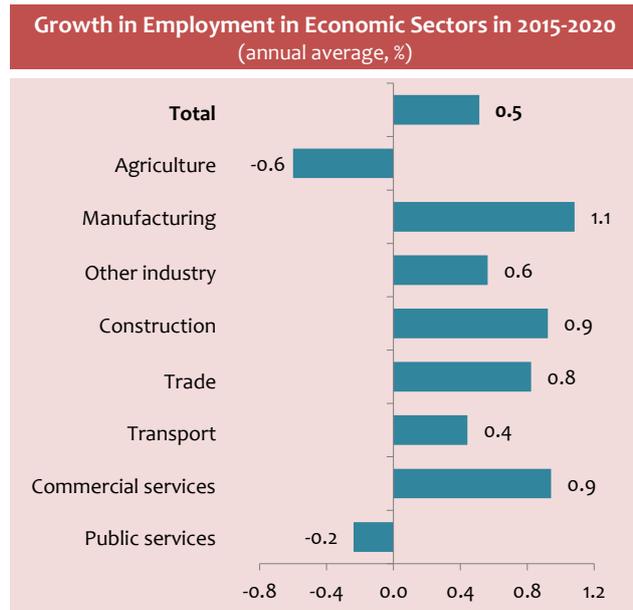
By 2020, the number of employees in the majority of the sectors will increase. The most significant increase in employee numbers will be observed in the manufacturing, in the sector of commercial services, in construction and trade.

Figure 5.14



At the same time, a decrease in employee numbers is expected in the primary sector: mainly in agriculture and fishery, as well as in the sector of public services. The drop in demand for labour force in agriculture is mainly related to the measures to increase the efficiency of the sector – the formation of co-operative partnerships of farmers and large farms, the implementation of systematised organisation of manufacturing, and the implementation of more complicated technological solutions into the manufacturing process.

Figure 5.15



Overall, the situation in the labour market in the medium and long term will be determined by the development of several significant factors. The most prominent uncertainty is still constituted by the development of external environment – weak external demand may hinder successful recovery of the labour market.

Although growth is predicted in the coming years in the EU, it is yet not expected that growth rates in the nearest years might return to the pre-crisis level. Moreover, the development of the Greek debt crisis brings even more uncertainty into the growth prospects of the EU countries, especially countries of the euro area.

Additional risks are created by further development of the geopolitical situation that is the result of the events in Ukraine, as well as by weaker growth and the strengthening of protectionism of Russia, which is the second largest sales market for the Latvian products following the EU.

At the same time, Latvia’s internal challenges are mainly related to the gradual drop in the population numbers (especially of working age), as well as to general labour force ageing trends.

According to the forecasts of the Ministry of Economics, the population numbers of working age (aged 15 to 62) will drop by more than 10% by 2030, compared to 2014. At the same time, the demographic load will increase by about 1/5. Significant changes are expected in the age structure of the population – the

proportion of elderly people in the population will continue to grow in the future.

Overall, by 2030, these trends will aggravate the problem of insufficiency of labour force which may strengthen the formation of different disproportions in the labour market.

5.4 Employment Policy

The quantitative target set by Latvia in the context of implementing the *Europe 2020 Strategy* is to reach an employment rate of 73% (see Section 6.1) by 2020 in the age group of 20-64. To reach this target, policy directions are planned for both the labour supply and labour demand.

The key elements of the employment policy of Latvia:

- fostering labour demand – stimulating economic activities and entrepreneurship, including labour tax reduction, combating undeclared employment, state-provided indirect and direct support measures for entrepreneurs, measures to eliminate administrative barriers, implementing support measures for micro-enterprises, business incubators, etc. (see Sections 6.7 and 6.8);
- strengthening labour supply – improving the competitiveness of the unemployed and persons at risk of unemployment on the labour market, including improving skills according to labour market demands, lifelong learning arrangements, consultations on business start-ups, etc.;
- fostering the match between labour demand and labour supply, including improving the educational system, involving employers' organisations in improving education quality, forecasting the conformity of labour demand and supply, educating the labour market participants, including pupils and students, about the labour market and career issues.

Demographic trends show a decline in the working-age population in Latvia and, therefore, the issues of **labour force availability** (see Section 5.3) will become increasingly topical in the upcoming years along with the growing economy and its changing structure. The labour demand increases along with the improving economic situation, and some fields already are faced with shortage of specialists. In the future, labour force shortage might become a factor impeding the growth. It may give rise to the need for attracting foreign labour force. The objective of Latvia is to fill in the vacant positions with the Latvian nationals who have left the country instead of immigrants from other countries. Therefore, the migration policy should encourage people and their families living in a country other than Latvia for various reasons, but are willing to return to their home country to either live and work in Latvia or develop business ties with Latvia, for instance, to start their own business (the re-emigration policy).

The main factors motivating people to return to Latvia are the possibilities of finding a job and the amount of remuneration. However, other circumstances related to social security, everyday life, child education, etc. are equally important. Ensuring a stable economic growth, new jobs, and increased wages are the main preconditions for reducing emigration flows and promoting the return of nationals residing abroad.

It should be noted that the *Re-emigration Support Measure Plan for 2013-2016* has been drawn up at the initiative of the Ministry of Economics, and it provides for ensuring support to nationals who are willing to or have already decided to return to Latvia (see Box.5.1). The support measures provided for in the plan mainly envisage:

- to provide information and consultations to people who consider the possibility of returning to Latvia, to strengthen the ties with the nationals residing abroad;
- to provide practical support and reduce difficulties that the nationals of Latvia and their families face upon returning to and settling in Latvia.

The arrangements included in the Re-emigration Support Measure Plan embrace different areas, thus a wide range of institutions has been involved in the implementation of the plan. The Ministry of Economics coordinates the implementation of the plan – regularly summarizes the information provided by the responsible authorities regarding fulfilment of the arrangements under their competency, as well as organizes meetings with the representatives of the institutions and NGOs involved to discuss the identified problems and to try to find solutions. It should be noted that the most significant obstacle for successful implementation of the plan is a lack of funding for the measures. In total, 1.6 million euro have been allocated additionally from the state budget for the implementation of different measures from 2014 to 2016. However, this is three times less than the estimated amount. Therefore, according to the information provided by the institutions, several measures are implemented partially or are not implemented at all.¹ The key issues to be solved in

¹ *Review on Implementation of Re-emigration Support Measures* of May 2015. Available at: https://www.em.gov.lv/lv/nozares_politika/reemigracijas_atbalsta_pasakumi/

relation to the implementation of the re-emigration support measures:

- establishing the one-stop agency principle providing consultations and information to people planning to return to Latvia, as well as helping re-emigrants to integrate in the Latvian society;
- improvement of portal www.latvija.lv to ensure convenient access for the nationals residing abroad to the information about the possibilities to live, work, start entrepreneurship in Latvia, as well as about the services provided by the government and local governments – regular updates of information, adding of the services provided by the local governments, etc.;
- provision of support measures to pupils in the educational establishments in Latvia, including individual classes, improvement of the professional qualification of teachers, availability of information to the parents of pupils, etc.
- ensuring the support (material help for moving to Latvia) to repatriates and their families who have been living abroad for at least 10 years. Since the funding was not allocated, the Draft *Repatriation Law* drawn up by the Ministry of Internal Affairs (submitted to the Saeima on 11 March 2015) does not envisage any changes as to the persons eligible to receive the material support.

Box 5.1.

The Re-emigration Support Measures Plan for 2013-2016

In August 2012, a working group was established for the development of a re-emigration support plan at the initiative of the Minister for Economics aimed at covering a wide range of re-emigration issues and promoting the co-operation between the institutions involved in the process, as well as identifying the existing measures and developing new ones to create favourable conditions for re-emigration. The working group involved representatives from state and local government authorities, trade unions, organisations of entrepreneurs and the Latvian organisations abroad.

The proposals of the working group for re-emigration support measures were passed on for public discussion held in November 2012 on the public online discussion platform www.musivalsts.lv.

After evaluating all of the received proposals by the working group, the Ministry of Economics prepared the Informative Report on the Proposals for Re-emigration Support Measures (approved by the Cabinet of Ministers on 29 January 2013) reflecting re-emigration support measures for creating favourable conditions for re-emigration proposed by the working group.

In 2013, the Ministry of Economics in co-operation with the involved institutions continued to work on specific re-emigration support measures incorporated in the Re-emigration Support Measure Plan for 2013-2016. The plan was approved at the sitting of the Cabinet of Ministers on 30 July 2013.

The Plan is aimed at supporting and assisting the nationals of Latvia living abroad and their families who are considering the possibility or have already decided to return to and work in Latvia, or want to establish their own company or develop business ties with Latvia. The plan is not aimed at encouraging all nationals of Latvia living abroad to rush back to Latvia without carefully considering the situation of employment and wages here. Neither is the plan aimed at proposing solutions to all problems of economics, society and the state in general neglected for years in Latvia.

The plan includes 33 measures according to following eight directions of support measures:

- ensuring the one-stop agency principle – providing information and consultations, also remotely, about moving to and residing in Latvia, helping to understand the required steps in various public authorities to the nationals of Latvia living abroad or their family members;
- access to the labour market information – improvement and promotion of the *CV/Vacancies database* of the State Employment Agency; the *CV/Vacancies database* contains comprehensive latest information about the specialists needed/ vacancies in Latvia, etc.;
- attracting highly skilled workers – support for attracting highly skilled specialists (attraction of scientists and academics living abroad) to promote the return of highly skilled youth who have acquired education abroad, to revise the requirements and the list of occupations where the state should repay study loans for persons working in these occupations, etc.;
- learning the Latvian language – provide support for Latvian language learning after returning to Latvia to all family members of the Latvian nationals, developed Latvian language learning materials, including electronic learning aids;
- expanding co-operation with the diaspora (developing and maintaining business ties) – measures to inform the diaspora members about the latest developments in Latvia and support for entrepreneurs, consultations on business start-up possibilities, etc.; to gather information about entrepreneurs and professionals of the Latvian diaspora abroad and promote their involvement in the development of the national economy of Latvia; collect and share experience stories about returning and co-operation with the diaspora, etc.;
- support to pupils returning to/integrating in the education system of Latvia, as well as their parents – improving and expanding the existing support mechanism for pupils returning from abroad, provided adaptation measures for pupils in education establishments;
- promoting the accessibility to public authorities and state enterprises – promoting transparent personnel selection procedures, including assessing the justification of requirements (for instance, foreign language knowledge) for candidates and their suitability for job duties, as well as providing an opportunity for those living abroad to have job interviews (in public administration institutions) through Web communication options;
- expanding the range of persons eligible to apply for the status of a repatriate, so that the persons who have left the country after 4 May 1990 and have been living abroad for at least 10 years would be eligible to obtain the status of a repatriate (a draft *Repatriation Law* has been developed and submitted to the Saeima).

The plan also envisages the necessary funding for the implementation of the measures, sources of financing, the expected result-based indicators, deadlines for the implementation of measures, as well as responsible and involved institutions.

Apart from this, the issue related to the improvement of the diaspora policy, as well as improvement of supervision and coordination of both policies (diaspora and re-emigration) should be solved as a complex.

In early 2014, a group of researchers from the University of Latvia initiated the implementation of ESF project *Emigrant Communities of Latvia: National Identity, Transnational Relations, and Diaspora Politics*. The aim of the project was to analyse the diversity of migration processes and provide substantiated information to policy makers to strengthen the Latvian diaspora, as well as to provide support to the nationals willing to return to Latvia.¹ At the end of the project (in August 2015), the results will be reflected in the report, which will be presented to the responsible institutions. Based on the results of the research, it is envisaged to evaluate the diaspora and re-emigration policies and the measures implemented, as well as to prepare proposals for further actions.

The state employment policy is targeted at creation of an inclusive labour market. In May 2015, the Cabinet of Ministers approved *the Guidelines for Inclusive Employment 2015-2020*. The aim of the guidelines is to promote development of the inclusive labour market on the basis of the potential of the inhabitants of Latvia, reducing the social consequences caused by unemployment, supporting return of jobless people to the labour market and maintaining the groups at risk of social exclusion into the labour market as long as possible, as well as improving the quality of work places.

Focusing on the necessity to reduce long-term unemployment, they set the aim to decrease the level of the long-term unemployment to 15% of all unemployed and to 2.5% of the economically active population by 2020 and in the long term further on.

The measures are planned within the framework of three key directions.

In order to promote inclusive labour market, it is planned:

- to expand provision of services to registered unemployed according to their individual needs identified in profiling;
- to increase the intensity of use of career services in the process of career planning;
- to increase the involvement of the unemployed from the risk groups in the labour market, finding solutions for the most significant reasons of unemployment;
- to develop social entrepreneurship;
- to increase regional mobility to promote the increase of economic activity.

In order to promote balanced labour market, it is planned:

- to expand availability of the information regarding labour market activities;

- to improve the efficiency of the analysis of the labour market situation;
- to improve the cooperation mechanism to ensure better results in the labour market;
- to increase the competitiveness of job seekers, improving the knowledge and skills necessary for the labour market;
- to increase the opportunities of the registered unemployed to become self-employed and to engage them in entrepreneurship;
- to promote improvement of workplace quality.

Promotion of the environment supporting the employment is planned to be ensured by developing a labour taxation and allowances system friendly to inclusive employment.

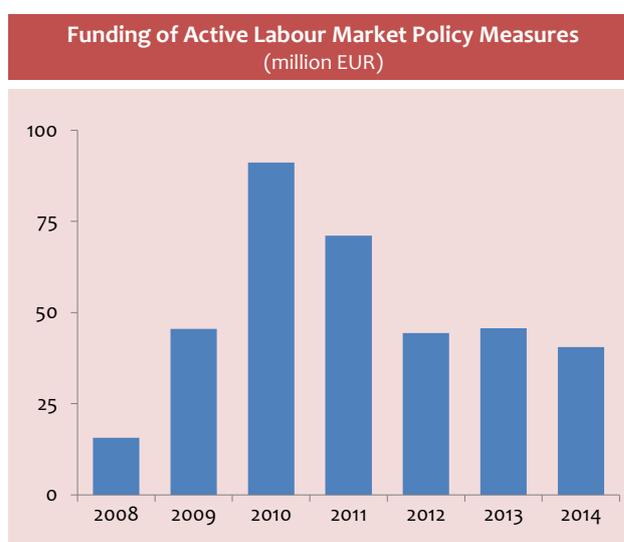
The **State Employment Agency (SEA)** is the institution implementing the state policy in the area of unemployment reduction and support to the unemployed and job seekers. For influencing the labour market, it uses both active and preventive labour market measures, thus promoting competitiveness of the target group in the labour market.

The key target audience of the employment measures implemented by the SEA are the unemployed people registered with the SEA. Although some measures are targeted for other groups of persons, overall, its activities are aimed at providing service to the unemployed.

The dynamics of the registered unemployment rates complies with the economic growth rates in the country. Over the past few years, the number of the unemployed people registered with the SEA and the registered unemployment rate has been dropping steadily (see Section 5.1).

The funding for active labour policy measures is related to the unemployment situation. As the number of unemployed people decreases; the same trend is observed in the funding allocated to the active labour policy measures.

Figure 5.16



¹ The information on the project and its interim results are available at <http://migracija.lv/>

More than 2/3 of the total funding are provided by the European Union Social Funds.

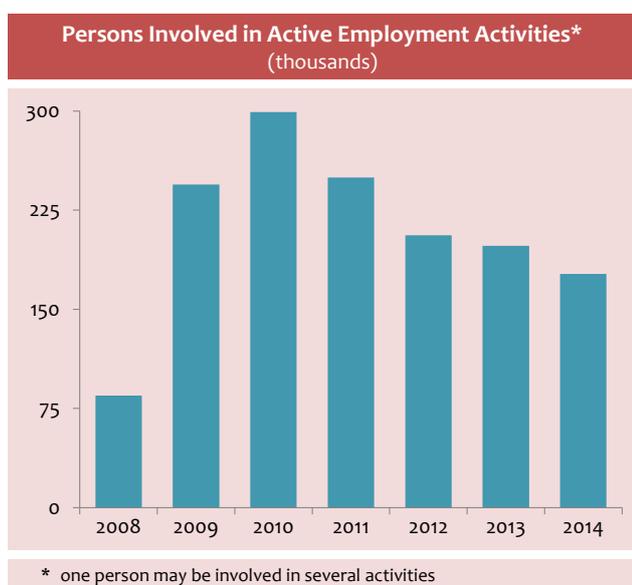
In 2014, the most part of the financing was used for training-oriented measures (professional training, retraining and increasing the qualification, acquisition of informal education, lifelong learning for the employed).

Analysing the structure of financing, it is evident that 44% of it is used for increasing and improving the qualification of unemployed, 29% – for the support of unemployed persons at the most unfavourable situation and development of grant-aided work places, including initiatives of young people and implementation of Youth Guarantee. The share of financing used for paid temporary public work is 21%, for increasing of the qualification of employed persons and entrepreneurship initiatives – 6% of the total funding.

Currently, the SEA is implementing the following **active employment measures**:

- professional training, retraining, and promotion of qualification, acquisition of non-formal education;
- measures to improve competitiveness;
- paid temporary public work (in 2010 and 2011 this measure completely replaces the measure *Work practice with a grant*);
- measures for business or self-employment start-ups;
- measures for specific groups of persons;
- complex support measures;
- promotion of regional mobility of persons employed by merchants;
- training at the employer (the measure will be resumed in 2015).

Figure 5.17



During the years of economic growth, the demand for active employment measures decreased, however, in 2009, it increased considerably due to the significant rise in unemployment. The demand remained at a high level in the following years, though it has started to drop.

Education programmes offered to the unemployed within the training measures are selected according to the proposals of the Training Commission or upon a written request of the employer.

A limited number of labour market measures can be used to reduce the mismatching labour market by professions. Out of all the implemented measures, the measure *Professional Training, Retraining, and Promotion of Qualification* can be used directly to reduce the mismatching labour market. Within the framework of the measure, the unemployed have an opportunity to obtain new professional knowledge, thus acquiring or improving professional qualification. Currently, the unemployed are offered to acquire knowledge only for medium-level qualification.

The rest of training measures can be considered as support for obtaining additional knowledge to improve competitiveness in the labour market. Informal education programmes are aimed at both the unemployed and job seekers. Yet, lifelong learning measures for employed persons are aimed at employed people over the age of 45 years (on certain conditions persons aged 25 to 44 years), except for public civil servants.

The SEA implements **preventive unemployment reduction measures**:

- career consultations;
- training programmes for involvement of adults in lifelong learning.

Career consultations is the most important preventive unemployment reduction measure in terms of the number of clients whom the service has been provided to. In 2014, career consultation services were provided to 45.6 thousand people, 39.7 of them were unemployed and job seekers, while in the first quarter of 2015 – 12 thousand, 10.4 thousand of them were unemployed or job seekers.

A training-oriented measure *Training Programmes for Involvement of Adults in Lifelong Learning* was launched in 2010. The target group includes employed and self-employed persons (except for employees of the public civil service) who have reached the age of 45, but have not reached the age for granting the state old age pension (on certain conditions persons aged 25 to 44 years). In 2014, 8474 persons started training (including 5405 transferred from 2013).

Adapting to the changes in the labour market, a number of new active labour market measures have been launched in 2014.

The Unemployed Profiling System developed in the previous year started its operation. The system is envisaged for the work with the unemployed to provide customized services to each unemployed. The profiling promotes efficient and targeted application of the SEA services to reduce the period of unemployment for a person and to eliminate the potential risks that might impede successful return to the labour market. At the end of 2014, almost all registered unemployed people (97 per cent) had been profiled.

The measure *Training Programmes for Involvement of Adults in Lifelong Learning* was completed in 2014. As from the launch of the measure in 2010, 28 thousand employed persons were involved in it.

Particular attention is paid to the promotion of the employment of young people. After interruption of five years, pupils' employment in summer employment measure was resumed. Thus, pupils have an opportunity to acquire first professional skills and an insight into their future professional choices.

Using the state support, pupils aged 15 to 20 attending general, special or vocational education institutions may work during their summer holidays. Within the measure, a pupil's salary is covered by the state in the amount of 50% of the monthly minimal salary in the state.

In 2014, the opportunity to work was taken by 4.3 thousand pupils. In 2015, it is planned to involve 3.5 thousand pupils in this measure.

To reduce youth unemployment, Latvia actively participates in the implementation of the EC initiative *Youth Guarantee*. The measures to implement youth guarantees in Latvia are planned to take place from 2014 to 2018. The total funding for the implementation of youth guarantees measures is 66.7 million euro.

The youth aged 15 to 24 years who are not working or studying will be eligible for the necessary support in a form of labour, training or education measures. Several measures are offered to the youth aged 13 to 15 years and 25 to 29 years. It is established that a youth of the target group within the guarantee is eligible to receive support for inclusion in the labour market not later than four months after abandonment of studies or obtaining the status of an unemployed.

In 2014, 24,445 young people got involved in the initiative *Youth Guarantee*, but in the first quarter of 2015 – 7,021.

In total, 4.7 million euro were used for the activities within the measure *Youth Guarantee*, 4 million euro of which were co-financing of the EU Funds.

A Consulting Board of the *Youth Guarantee* measure implementation was established in July 2014 in order to promote cooperation and provide proposals for efficient implementation of measures and their improvement.

The **social dialogue** is important in implementing the employment policy. The Employers' Confederation of Latvia and the Free Trade Union Confederation of Latvia are involved in improving the social dialogue at national, regional and sectoral level. In the partnership, other partners are involved too, including local governments of Latvia, and the Latvian Association of Local and Regional Governments.

An important aspect is **safety at work**, ensuring conditions for safe and healthy work environment.

To improve working conditions and reduce accidents at work and vocational diseases, the EU Occupational Safety and Health Strategic Framework 2014-2020 has been developed. The new strategy was published by the EC in June 2014. The main tasks at the EU level are:

- to improve the implementation of the current requirements for safety and health protection at work in the Member States, particularly focusing on the ability of micro-enterprises and small enterprises to implement useful and efficient measures for elimination of risks,
- to improve preventive measures related to occupational diseases, paying particular attention to the existing, new and potential risks,
- to take into account ageing of the EU labour force.

According to the said tasks, it is planned to draft *Guidelines for Work Safety Policy in Latvia 2015-2020*.

Reduction of administrative burden in the area of safety at work is continued in Latvia.

In 2014, the requirements for working at height and the equipment for persons who work at height have been improved, the working conditions will be improved and safer environment will be ensured, thus reducing the risk of accidents. The new requirements came into force on 1 September 2014.

In July 2014, the Cabinet of Ministers approved the improved labour security requirements in construction.

Latvia has a relatively high rate of **undeclared employment** in certain sectors that increases unfair competition and reduces the social security of employees.

In the developed policy planning documents, the measures to reduce undeclared employment were implemented in the following key directions: effectivization of the control mechanism for undeclared employment; reduction of unfair competition; revision of the penalties policy with regard to undeclared employment; informing and educating society about the negative consequences of undeclared employment.

The key directions of combating shadow economy and ensuring fair competition were tax policy, reducing the administrative burden, supporting honest entrepreneurs, and promoting a transition to legal economy, improving the capacity of controlling institutions, elaborating regulatory enactments, penalties policy, work with society, and eliminating shadow economy in risk sectors.

Understanding the need for the continuation of resolving these issues, in autumn 2014, the government established a high-level Shadow Economy Combating Council headed by the Prime Minister. The Council consists of ministers, heads of involved institutions, and social partners. The functions of the Council are to coordinate the development of draft policy planning documents on combating the shadow economy and to coordinate and improve co-operation in combating the shadow economy in order to ensure the effectiveness of the said activities.

The education system plays an important role in the context of labour market development, particularly emphasising the significance of **lifelong learning**. The introduction of the lifelong learning principle is emphasised also in the National Reform Programme of Latvia for the Implementation of the *Europe 2020 Strategy*.

Latvia has committed to foster continuous improvement and development of knowledge, skills, and competences of the population by providing the availability of lifelong learning to ensure that 15% of the population (aged 25–64 years) are continuously involved in educational process in 2020.

The dynamics of the lifelong learning lately evidences that the activities in the area of education of adults need to be more purposeful.

The indicators of participation of adults in the lifelong learning¹ have been dropping over the past few years. In 2014, 5.3% of inhabitants aged 25 to 64 were involved in the lifelong learning.

The lifelong learning principle is implemented in several directions:

- promoting cooperation and ensuring coordination between partners involved in the education of adults;
- developing a national qualification framework structure, and adjusting its levels to the European qualification structure;
- ensuring the evaluation of knowledge, skills, and professional competence acquired outside the formal education;
- offering a second chance education as a compensating mechanism to reduce the number of early school leavers;
- supporting qualification improvement of employees according to employers' requirements that are necessary for the training of employed within the framework of the sectors.

¹ The source of data – *Survey of Labour Force* by the CSB. The indicator is included in the EU structural indicators, and it describes the participation of adults aged 25 to 64 in the activities of the lifelong learning.

6. ECONOMIC POLICY AND PRIORITIES OF THE STRUCTURAL POLICY

6.1 Europe 2020 Strategy and National Reform Programme of Latvia

6.1.1 Europe 2020 Strategy and its Progress

On 3 March 2010, the EC published a communication, *Europe 2020: strategy for smart, sustainable and inclusive growth*, which laid down the Commission's vision of the *Europe 2020* strategy.

On 17 June 2010, the European Council officially approved the *Europe 2020* strategy and its principal elements: EU-level quantitative targets for 2020, *Integrated guidelines* (drafted according to Articles 121 and 148 of the *Treaty on the Functioning of the European Union*, which contains key economic and employment policies, and forming the basis for the development of national reform programmes for EU Member States), and agreed that EU Member States in co-operation with the EC should develop national reform programmes and submit them to the EC by the end of April 2011 along with their *Stability or Convergence programmes* (drafted and implemented to fulfil the requirements of the *Stability and Growth Pact*).

Monitoring of the implementation of the *Europe 2020* strategy consists of two pillars (see Figure 6.1) – macroeconomic and thematic monitoring (national reform programmes for the implementation of the *Europe 2020* strategy of EU Member States and their compliance with the *Integrated guidelines* are evaluated), as well as fiscal monitoring (*Stability or Convergence programmes* of EU Member States and their compliance with the *Stability and Growth Pact* are evaluated).

Figure 6.1

Surveillance Mechanism for National Reform Programmes and Stability or Convergence Programmes of EU Member States		
Quantitative targets of Europe 2020 strategy		
Integrated guidelines of Europe 2020 strategy		Stability and Growth Pact
Macroeconomic monitoring	Coordination of thematic areas	Fiscal monitoring
National level	National reform programmes	Stability or Convergence programmes
EU level	Commission Annual Growth Survey Annual recommendations EU's flagship initiatives and support pillars (i.e., internal market, trade and internal policy, EU financial support)	

On 5 March 2014, the EU published a communication called *Taking stock of the Europe 2020 strategy for smart, sustainable and inclusive growth*. The aim of the communication is to take stock of the first results and lessons learned in the first four years of the implementation of the Europe 2020 strategy, and to express an opinion about the future Europe 2020 strategy. To identify and collect opinions of all interested parties, the EC initiated a public consultation according to the Communication in the period from 5 May to 31 October 2014. The EC is planning to prepare a mid-term review of the Europe 2020 strategy by the end of 2015.

A **European Semester** has been conducted annually since 1 January 2011 to evaluate the economic situation in the EU as a whole and in EU Member States, as well as to propose recommendations to EU Member States for the implementation and strengthening of their economic policies.

The *Europe 2020* strategy and national reform programmes of EU Member States and *Stability or Convergence programmes* are the main elements in the coordination and monitoring of economic policies of EU Member States at the EU level within the European Semester (see Figure 6.2). Multilateral monitoring of both programmes is performed at the EU level, based on which the EC may give a policy warning if the economic policy of any EU Member State fails to comply with the EU *Integrated guidelines* and objectives set at the EU level. The national reform programmes are linked to the EU budget because a part of the measures are co-financed from the EU budget.

In 2015, several innovations were introduced into the European Semester process to make it more efficient and to allow more time for discussions between all stakeholders. The first innovation concerns faster publication of the *Commission Staff Working Document* which includes a *Country Report*, and also an *In-Depth Review on the Prevention and Correction of Macroeconomic Imbalances*, if macroeconomic imbalances are found. These Commission documents evaluate the progress achieved by EU Member States in addressing the country-specific recommendations issued by the EU Council and in the correction of macroeconomic imbalances. Commission Staff Working Documents for EU Member States were published on 26 February 2015. The second innovation is related to faster publication of an EC recommendation for country-specific

recommendations issued by the EU Council. The EC recommendation for country-specific recommendations issued by the EU Council was published on 13 May 2015. The third innovation concerns the time and the deadline, by which EU Member States have to prepare and submit

to the EC their comments on the draft EC recommendation for country-specific recommendations. In 2015, unlike in the previous years, EU Member States were given ten days to do so.

Figure 6.2

European Semester: Partnership between the EU and Member States							
	November-February	March	April	May	June	July	September-October
European Commission	Annual Growth Survey and Alert Mechanism Report	Commission Staff Working Document for each Member State (reform programme and imbalances)		Publication of recommendations			EU level review
European Council / Council	Discussions				Discussion of recommendations	Approval of recommendations	
European Parliament	Discussions						
Member States			Approval and submission of national reform programmes and <i>Stability</i> or <i>Convergence</i> programmes to the European Commission				National level decisions

The EC's *Annual Growth Survey* is an important element in the European Semester process, because its publication starts discussions in different EU Council formats at the beginning of the European Semester (see

Box 6.1). As a result of these discussions EU Member States agree on key economic policy priorities to be taken into consideration when updating national reform programmes, *Stability* or *Convergence* programmes.

Box 6.1

Annual Growth Survey 2015

The EC published its *Annual Growth Survey 2015* on 28 November 2014 along with other important documents, namely, the *Alert Mechanism Report*, the *Joint Employment Report*, and the report on the *legal framework of the Stability and Growth Pact* (“six-pack” and “two-pack”).

The *Annual Growth Survey 2015* reviews the economic and social situation in Europe and sets political priorities for the EU as a whole. This is the start of a new European Semester of economic policy coordination which ensures the coordination of economic policies between EU Member States to promote growth and jobs.

The EC believes that, in order to help Member States to return to higher growth levels and make progress towards sustainable development, structural, fiscal and monetary policies have to be combined in an integrated, growth-friendly approach, acting both on the demand and supply sides of our economies. This requires action at all levels of government from global to EU, national, regional and local levels. Thus, the Commission recommends three main pillars for the EU’s economic and social policy in 2015:

- **A coordinated boost to investment:** The EC is putting forward an *Investment Plan for Europe* which should mobilise at least EUR 315 billion of additional public and private investment over the period of 2015–2017 and improve significantly the overall investment environment.
- **A renewed commitment to structural reforms:** The EC notes that progress at national and EU level in areas like services, energy, telecoms and the digital economy, as well as in improving conditions for business creates new opportunities for jobs and growth. Therefore, cutting down bureaucracy at European and national levels as a part of the Better Regulation Agenda is essential to creating the right regulatory environment and promote a climate of entrepreneurship and job creation.
- **Pursuing fiscal responsibility:** The EC notes that Member States still need to secure long term control over deficit and debt levels. Fiscal policies should be differentiated, depending on the situation of each country. Member States with more fiscal space should take measures to encourage domestic demand, with a particular emphasis on investment. Moreover, the quality of public finance should be raised by improving expenditure efficiency and prioritising productive investment in government spending, by making the tax system more efficient and supportive of investment. It is also noted that addressing tax fraud and tax evasion is essential to ensure fairness and allows Member States to collect tax revenues due to them.

New monitoring rules for economic and fiscal policies (also known as the 'six-pack') consisting of five regulations and one directive entered into effect on 13 December 2011. The adoption of these new rules in the EU created a macroeconomic imbalances procedure (in addition to the existing excessive budget deficit procedure), the purpose of which is to timely identify

(using the scoreboard created by the alert mechanism) and correct macroeconomic imbalances (such as a high current account deficit, etc.) — see Box 6.2. Since the national reform programmes of EU Member States focus on the implementation of key structural reforms, this helps to promptly prevent excessive budget deficits and macroeconomic imbalances.

Box 6.2

Alert Mechanism and Scoreboard

Every year, the EC publishes an *Alert Mechanism Report* that analyses the situation in EU Member States based on set indicators and their thresholds:

- three-years current account balance rolling average% of GDP with a threshold at +6% of GDP and -4% of GDP;
- net international investment% of GDP with a threshold at -35% of GDP;
- five-years percentage change in country's global export market share with a threshold at -6%;
- three years' percentage change in one unit labour costs with a threshold at +9% for Eurozone countries and of +12% for non-Eurozone countries;
- three-years percentage change in consumer price index-adjusted real effective exchange rate compared to other 35 industrialised countries with a threshold at +/-5% for Eurozone countries and of +/-11% for non-Eurozone countries;
- private sector debt with a threshold at 160% of GDP;
- credits issued to the private sector debt with a threshold at 15% of GDP;
- annual change in house prices compared to the Eurostat consumption deflator with a threshold at 6%;
- government debt with a threshold at 60% of GDP;
- three-years unemployment rate rolling average with a threshold at 10%;
- annual change in total financial sector liabilities with a threshold at 16.5%.

If the situation in any EU Member State exceeds the threshold set for any indicator, the Commission should carry out an in-depth analysis and publish an *In-depth review*.

In its *Alert Mechanism Report 2015*, the EC identified 16 EU Member States which need an in-depth analysis. For the EU Member States that benefit from financial assistance (such as Greece and Cyprus), the monitoring of their imbalances and monitoring of corrective measures takes place in the context of their programmes.

For the other EU Member States, the EC did not at this stage carry out further analyses in the context of the Macroeconomic Imbalances Procedure. The EC is of the view that the macroeconomic challenges of the Czech Republic, Denmark, Estonia, Latvia, Lithuania, Luxembourg, Malta, Austria, Poland and Slovakia do not represent imbalances causing macroeconomic imbalances. At the same time, the EC points out that careful monitoring and policy coordination are necessary on a continuous basis for all EU Member States to identify emerging risks and propose the policies that contribute to growth and jobs.

6.1.2 National Reform Programme of Latvia for the Implementation of the Europe 2020 Strategy

The *National Reform Programme of Latvia for the implementation of the Europe 2020 strategy* (NRP of Latvia) was approved by the Cabinet of Ministers on 26 April 2011 together with the *Convergence Programme of Latvia 2011-2014*. Both programmes were submitted to the EC on 29 April 2011.

The NRP of Latvia describes the medium-term macroeconomic scenario, main macro-structural bottlenecks of Latvia and key measures to eliminate them, as well as national targets of Latvia for 2020 in the context of the *Europe 2020* strategy and key measures to achieve them.

Latvia's aim is to promote growth and jobs by ensuring the growth of GDP in the medium term by 4-5% and a high employment rate of 73% by 2020.

The NRP of Latvia reflects quantitative targets of Latvia for 2020 in the context of the Europe 2020 strategy (Latvian quantitative targets). They have been set taking into account the medium term development

scenario of the Latvian economy, as well as targets of the Sustainable Development Strategy of Latvia – *Latvia 2030*, and also reflect the *National Development Plan 2014-2020* ("NDP2020"), which was approved by the Saeima on 20 December 2012.

According to the quantitative targets of Latvia, the plans for 2020 are to achieve an employment rate of 73% in the population aged 20-64, to increase investments in research and development (R&D) to 1.5% of GDP, to increase the share of the population having acquired tertiary education to 34-36%, to reduce the share of early school leavers to 10%, to reduce the share of persons at risk of poverty to 21%, to increase the share of renewable energy sources in gross energy consumption to 40%, etc.

According to Section 6.1.1, one of innovations of the European Semester in 2015 was related to the publication of the *Commission Staff Working Document* for EU Member States, which reflects the EC's evaluation of the progress made in addressing the country-specific recommendations issued by the EU Council. Having evaluated the progress made by Latvia in addressing the country-specific recommendations issued by the EU Council, the EC admitted that there was just some progress (see Box 6.3), although Latvia had slightly exceeded the EU average recommendation

implementation progress indicator compared to other EU Member States.

Box 6.3

Commission Staff Working Document 2015 – Country Report for Latvia

26 February 2015 was the first day in the European Semester's practice that the EC published a *Commission Staff Working Document* which includes a *Country Report*, and also an *In-Depth Review on the Prevention and Correction of Macroeconomic Imbalances*, if macroeconomic imbalances are identified, for each EU Member State.

The *Commission Staff Working Document Country Report Latvia* evaluates the Latvian economy taking into account the *Annual Growth Survey* which was published in November 2014 and started the European Semester of 2015. In line with the Investment Plan for Europe, the *Country Report for Latvia* also explores ways to maximise the impact of public resources and unlock private investment. The Report also reviews the policy response since mid-2014, notably as regards the achievements of the country in the implementation of the country-specific recommendations issued by the EU Council in 2014.

According to the EC's evaluation, the *Country Report for Latvia* also provides that, overall, Latvia has made some progress in addressing the recommendations, which, according to the evaluation score introduced by the EC, means that the EU Member State has informed about activities or has started activities to address the recommendations.

The *Country Report of Latvia* also identified problems and challenges:

- labour tax reforms are not sufficiently targeted at reducing the high tax burden on low-income earners. Shifting of the tax burden away from labour towards property and environment taxes will have a potential to support a growth-friendly tax shift away from labour taxation;
- the credibility of the medium-term budgetary plans is hampered as revenue and expenditure measures are not explained. The lack of clarity on revenue plans affects timely decision-making on spending priorities and progression of structural reforms;
- there is room for improvement of the supply of skills to increase labour productivity. Higher education suffers from inadequate public funding and a lack of impartial study field accreditation. There is a lack of attractiveness in vocational education and apprenticeships. Inadequately concentrated public funding for internationally competitive institutions negatively affects research and innovation system outcomes.
- important challenges include the capacity of the social safety net, access to healthcare for vulnerable groups and a sufficient labour supply. The social safety net is not sufficiently strong, pension adequacy is at risk and the financing and coverage of active labour measures is inappropriate. On health, waiting times for diagnostics are high, there is a lack of sickness prevention and health promotion, and the health care workforce strategy is not yet implemented;
- for the full opening of the gas market from April 2017, regulatory and ownership issues would need to be settled over the coming months, in order to ensure predictability and a smooth transition. Implementation of the EU energy efficiency scheme relies on rolling out ambitious energy efficiency projects in buildings, heating systems, and low-carbon transport;
- time needed to resolve administrative, civil and commercial cases is excessively long. The role of the Judicial Council in implementing judicial reforms is not strong enough. The state-owned enterprise management reform is not complete, a public administration reform is not planned, and the capacities of the Competition Council are not sufficiently strong.

According to the progress of the European Semester, the Cabinet of Ministers approved the fourth ***Progress Report on the Implementation of the NRP of Latvia*** and the *Latvia's Stability Programme for 2015-2018* on 13 April 2015. Both documents were submitted to the EC.

The Progress Report on the Implementation of the NRP of Latvia contains an updated medium-term macroeconomic scenario described in the NRP of Latvia, evaluates the progress of Latvia in addressing the recommendations issued by the EU Council in 2014, gives a detailed description of NRP policy directions, including national quantitative targets of Latvia in the context of the Europe 2020 strategy, and reflects information on the use of EU funds.

It should be noted that the *National Reform Programme of Latvia* and the *Stability Programme of Latvia* are being implemented in close co-operation with the EC. The progress of the implementation of both programmes is discussed regularly in **bilateral dialogues**. For example, a bilateral dialogue between Latvia and EC representatives was held in Brussels on 24 April 2015. During the bilateral dialogue, they discussed Latvia's plans concerning shifting of the tax burden away from labour towards consumption, property and environment taxes, funding and availability of health care, career

guidance, institutional and financial independence of the Competition Council. The European Commission and Latvia also discussed further steps in the implementation of the European Semester 2015.

Based on the *Commission Staff Working Documents published in 2015* for EU Member States, having evaluated the updated *National reform programmes, Stability or Convergence programmes*, which were submitted by EU Member States, and the progress in their implementation, on 13 May 2015, the EC presented a recommendation for **Council Country-specific recommendations for EU Member States**, including Latvia. After discussions in various EU Council formats, these recommendations will be approved in the EU Council in July 2015.

According to the Commission's recommendation, the following recommendations are made for Latvia for 2015-2016:

- Ensure that the deviation from the medium-term objective in 2015 and 2016 is limited to the allowance linked to the systemic pension reform.
- Improve vocational education and training, speed up curriculum reform and expand apprenticeship offer. Ensure that the new financing model of the higher education system rewards quality. Better target research financing and incentivise private

investment in innovation on the basis on of the *Smart Specialisation Framework*.

- Take concrete steps to reform social assistance, ensuring adequacy of benefits, and take measures to increase employability. Reduce the high tax burden for low-income earners by shifting the tax burden to other sources less detrimental to growth. Take action to improve accessibility, cost-effectiveness and quality of the healthcare system and link hospital financing to performance mechanisms.
- Improve efficiency of the judicial system, by increasing accountability of all parties (including insolvency administrators), by providing adequate means to fight tax evasion and by strengthening the role of the Judicial Council. Improve the public service legislation to strengthen the conflict of interest regime and link remuneration to responsibilities.

Council recommendations to Latvia are a vital element when setting national priorities, formulating the necessary reform and policy activities, as well as successfully implementing *National reform programmes of Latvia* and *Latvia's Stability Programmes*. In the view of the scale, impact, implementation costs of individual recommendations (e.g., concerning reforms in education, research, healthcare) and the need to discuss them with representatives of social partners, non-governmental organisations and the community, it is unlikely that they can be implemented within one year.

The Ministry of Economics will continue to monitor the implementation of the activities addressing the NRP of Latvia and Council recommendations, and the information on progress in the implementation of these activities will be included into the *Progress Report on the Implementation of the National Reform Programme of Latvia within the Europe 2020 strategy* for 2016.

6.2 Inclusion of Latvia into the EU Economic and Structural Policies

6.2.1 Use of the European Union's Structural Funds and the Cohesion Fund

Being an EU Member State, Latvia benefits from financial assistance coming from the EU structural funds (SF) and the Cohesion Fund (CF), which are tools for the implementation of the EU's regional cohesion policy.

2007-2013 Programming Period

In the 2007-2013 programming period, the CF support was primarily intended for education of the population, technological excellence and flexibility of enterprises, and development of science and research in order to foster the creation of a knowledge-intensive economy in the country and to strengthen other necessary prerequisites for sustainable economic development and human life in Latvia as a whole.

The programming of SF and CF funds is carried out on three levels: the EU level strategy or *the Community Strategic Guidelines*, the Member States' strategy or *the National Strategic Reference Framework* (NSRF) and the Member States' *Operational programmes* (OP).

The NSRF, on which the allocation of the SF and CF funding of 4.53 billion euro available to Latvia in the 2007-2013 programming period is based, was approved by the Cabinet of Ministers on 19 June 2007. The Commission approved it on 20 September 2007.

Based on the decision of the EU Council of Ministers on the multiannual financial framework for the 2007-2013 programming period, Latvia received 4.53 billion euro for the implementation of cohesion policy objectives through the EU funds (the European Regional Development Fund – ERDF; the European Social Fund – ESF) and the CF.

Breakdown of the funding of a total of 4.53 billion euro of the EU funding between the OPs in the 2007-2013 programming period:

- 1. OP *Human Resources and Employment* (ESF) – 583 million euro. 653 million euro together with ancillary liabilities;
- 2. OP *Entrepreneurship and Innovations* (ESF) – 696 million euro. 833 million euro together with ancillary liabilities;
- 3. OP *Infrastructure and Services* (ERDF+CF) – 3.2 billion euro. 3.4 million euro together with ancillary liabilities.

Figure 6.3

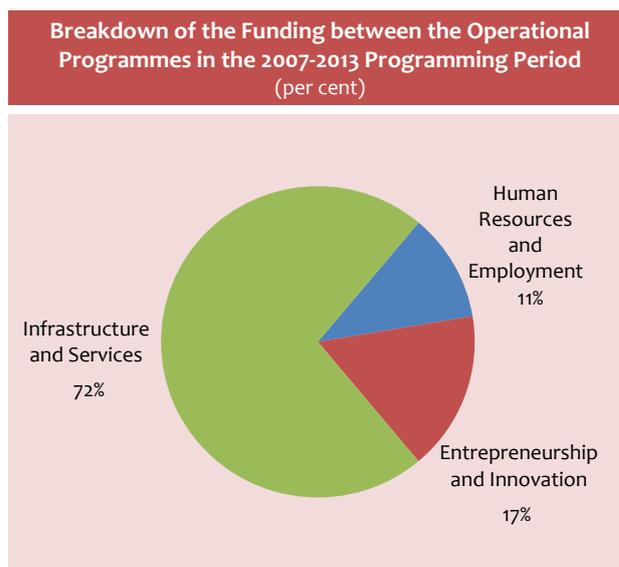


Table 6.1

Financial Progress of the EU Funds in the 2007-2013 Programming Period until 31 March 2015							
	Funding from EU fund	Concluded agreements		Paid to beneficiaries		Repayments received from EC (including advances)	
	million euro	million euro	%	million euro	%	million euro	%
ESF	583.1	644.3	111	607.1	104	553.9	95
ERDF	2407.6	2576.0	107	2108.3	88	2006.6	83
CF	1539.8	1521.1	99	1276.3	83	1238.1	80
Total	4530.5	4741.4	105	3991.7	88	3798.6	84

105% of projects for the funding from the EU funds available to Latvia in this entire programming period have been approved and agreements for a total of 4741 million

euro have been concluded by 31 March 2015. 3991.7 million euro have been paid to beneficiaries by 31 March 2015.

Box 6.4

Activities within the Competence of the Ministry of Economics in the 2007-2013 Programming Period

741.4 million euro of the EU funds are available for the activities of the Ministry of Economics in the 2007-2013 programming period, which break down as follows:

1. OP Human Resources and Employment – 50.9 million euro;
2. OP Entrepreneurship and Innovations – 474.4 million euro;
3. OP Infrastructure and Services – 216.1 million euro.

Agreements Concluded within the Activities Supervised by the Ministry of Economics by 31 March 2015:

- 30 agreements for a total contract amount of 31.6 million euro were concluded within the activity *Support for Employee Training to Foster Competitiveness of Undertakings – Support for Training Organised in Partnerships*.
- 84 agreements for a total contract amount of 2.7 million euro were completed within the activity *Support for Individual Training Organised by Undertakings*.
- 6 agreements for a total contract amount of 6.4 million euro were concluded within the activity *Support for Creation of Jobs*.
- 3 agreements for a total contract amount of 143.6 thousand euro were completed within the activity *Attraction of Highly Qualified Employees*.
- 6 agreements for a total contract amount of 53.17 million euro were concluded within the activity *Competence Centres*.
- 8 agreements for a total contract amount of 2.2 million euro were concluded within the activity *Technology Transfer Contact Points*.
- 80 agreements for a total contract amount of 7.1 million euro were concluded within the activity *Development of New Products and Technologies*.
- 116 agreements for a total contract amount of 37.8 million euro were concluded within the activity *Introduction of New Products and Technologies in Production*.
- 3 agreements for a total contract amount of 0.07 million euro were concluded within the activity *Development of New Products and Technologies – Support for Strengthening of Industrial Property Rights*.
- 21 agreements for a total contract amount of 0.2 million euro were concluded within the activity *Programme for Development of New Products and Technologies of Micro, Small and Medium-Sized Enterprises*.
- 215 agreements for a total contract amount of 210.1 million euro were concluded within the activity *High Value Added Investment*.
- 2615 agreements for a total contract amount of 14.53 million euro were concluded within the activity *Entering into Non-Domestic Markets – External Marketing*.
- 2 agreements for a total contract amount of 18 million euro were concluded within the activity *Entering into Non-Domestic Markets – Strengthening of International Competitiveness of Industries*.
- 1298 projects of starters for over 24.7 million euro were supported within the activity *Support for Starting Self-Employment and Business*.
- The following results were achieved within the financial instruments implemented within the activity *Investment Fund*:
 - 1) venture capital – an agreement on the creation of a venture capital fund was concluded with BaltCap Management Latvia on 22 January 2010. In addition to 20 million euro invested by the Investment Fund, BaltCap Management Latvia also invested 10 million euro co-funding from private investors. BaltCap Management Latvia concluded 12 venture capital investment agreements for 15.2 million euro by 31 March 2015;
 - 2) seed and initial capital – an agreement on the creation of a seed and initial capital fund was concluded with Imprimatur Capital Baltics on 16 June 2010. The funding available for total seed and initial capital investments is 9.5 million euro (an agreement was concluded with Imprimatur Capital Baltics on 10 May 2013 to increase the seed capital investment to 6.4 million euro). By 31 March 2015, Imprimatur Capital Baltics concluded 54 seed capital investment agreements for 5.2 million euro and 9 initial capital investment agreements for 4.1 million euro;
 - 3) high-risk loans – agreements with AS “Swedbank” and AS “SEB Banka” were concluded on 26 March 2010. The programme had been implemented until 26 September 2012. 18 loan agreements for 68 million euro were concluded within the programme;

Box 6.4 continued

- 4) microloans – two microloan funds started their operations in August 2014: Capitalia and Grand Credit. 33 agreements for 0.5 million euro were concluded within the programme;
- 5) growth capital instruments – three new growth capital instruments started their operations in 2013: ZGI Capital, EXPANSION Capital, FlyCap. 33 agreements for 10.3 million euro were concluded within the programme.
- 274 credit guarantee agreements for a total amount of 104 million euro and 159 agreements on export guarantees for a total amount of 14.8 million euro were concluded within the activity *Guarantees to Improve Enterprise Competitiveness*. On 30 May 2013, LGA started granting guarantees to housing insulation projects. By 31 March 2015, 45 guarantees for a total of 6.1 million euro were granted for housing insulation projects.
 - 122 mezzanine loans for a total amount of 28.7 million euro were granted within the activity *Mezzanine loans*.
 - 158 loans for a total amount of 78.6 million euro were granted within ERDF part of activity *Loans to Improve Competitiveness of Enterprises*.
 - 1 agreement for a total amount of 2.85 million euro was concluded within the activity *Activities for Raising Motivation for Innovation and Starting Business*. 40,929 persons were involved in the events, seminars and contests organised within the activity.
 - 15 agreements on provision of business incubation services in the Latvian regions and 2 agreements on provision of business incubation services to enterprises in creative industry in Riga were concluded within the activity *Business incubators*. 603 undertakings received support in business incubators within the activity.
 - 101 contracts for a total amount of 7.4 million euro were concluded within the activity *Support for Investments for Micro, Small and Medium-Sized Enterprises in Special Assisted Areas*.
 - 11 agreements for a total amount of 4.6 million euro were concluded within the activity *Cluster Programme*.
 - 21 agreements for a total amount of 9.8 million euro (ERDF) were concluded within the sub-activity *Preservation, Renovation of National Level Urban Building Monuments and Adjustment of Infrastructure for Development of Tourism Products*.
 - 7 agreements for a total amount of 5.2 million euro (ERDF) were concluded within the sub-activity *Development of a National Level Bicycle Tourism Product*.
 - 859 agreements for a total amount of 75.5 million euro (ERDF) were concluded within the sub-activity *Activities to Improve Heat Insulation of Multi-Apartment Buildings*.
 - 55 agreements for a total amount of 5.2 million euro (ERDF) were concluded within the sub-activity *Activities to Improve Heat Insulation of Social Residential Buildings*.
 - 134 agreements for a total contract amount of 57 million euro (CF) were concluded within the activity *Activities to Increase the Efficiency of Centralized Heat Supply Systems*.
 - 10 agreements for a total amount of 28.8 million euro (CF) were concluded within the sub-activity *Development of Cogeneration Plants Using Renewable Energy*.

Absorption of the Funding from the EU Funds by the OPs *Human Resources and Employment, Entrepreneurship and Innovations and Infrastructure and Services*

Overall, 7.4 thousand agreements on the implementation of projects for 5.3 billion euro, i.e. 106.8%, were concluded for 5 billion euro of the public funding available for the implementation of projects of the EU funds, which include the funding from the EU funds and state budget and the local government budget co-financing (the funding for ancillary liabilities at 404.5 million euro granted from the state budget not included). 4.3 billion euro or 87.2% were paid to beneficiaries.

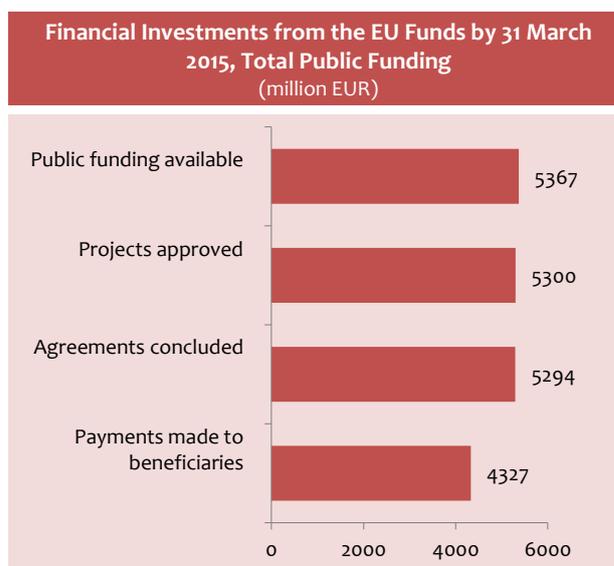
If we select only the funding from the EU funds, the total amount of concluded contracts is 4750.7 million euro or 104.9% from the funding available from the EU funds. This means that contracts are being concluded for already granted amount of ancillary liabilities.

In the area of entrepreneurship and innovations, projects are moved from the OP *Infrastructure and Services* (urban environment area) to the OP *Entrepreneurship and Innovations* (entrepreneurship and innovations area).

In the area of education, the scope of funding has been updated according to actual costs of completed projects in the activities *Modernisation of Equipment and Improvement of Infrastructure for Implementation of Vocational*

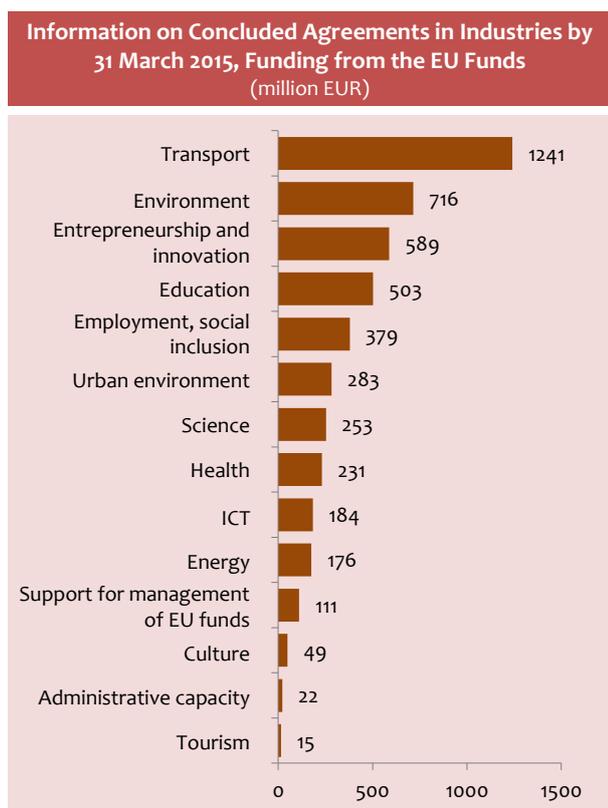
Education Programmes and Support for Optimisation of the Network of Vocational Education Institutions.

Figure 6.4



In the area of science, the scope of funding has been updated according to actual costs of completed projects in the activity *Support for Science and Research*.

Figure 6.5



In the environment area, the amount of funding for selection round 2 projects was updated in the activity *Creation of Infrastructure in Natura 2000 Areas*. When updating costs of construction works and having found a significant non-compliance in costs of construction works with the calculations provided in the project application, the Nature Conservation Agency revoked the only project application submitted for selection round 3 because the project had become more expensive.

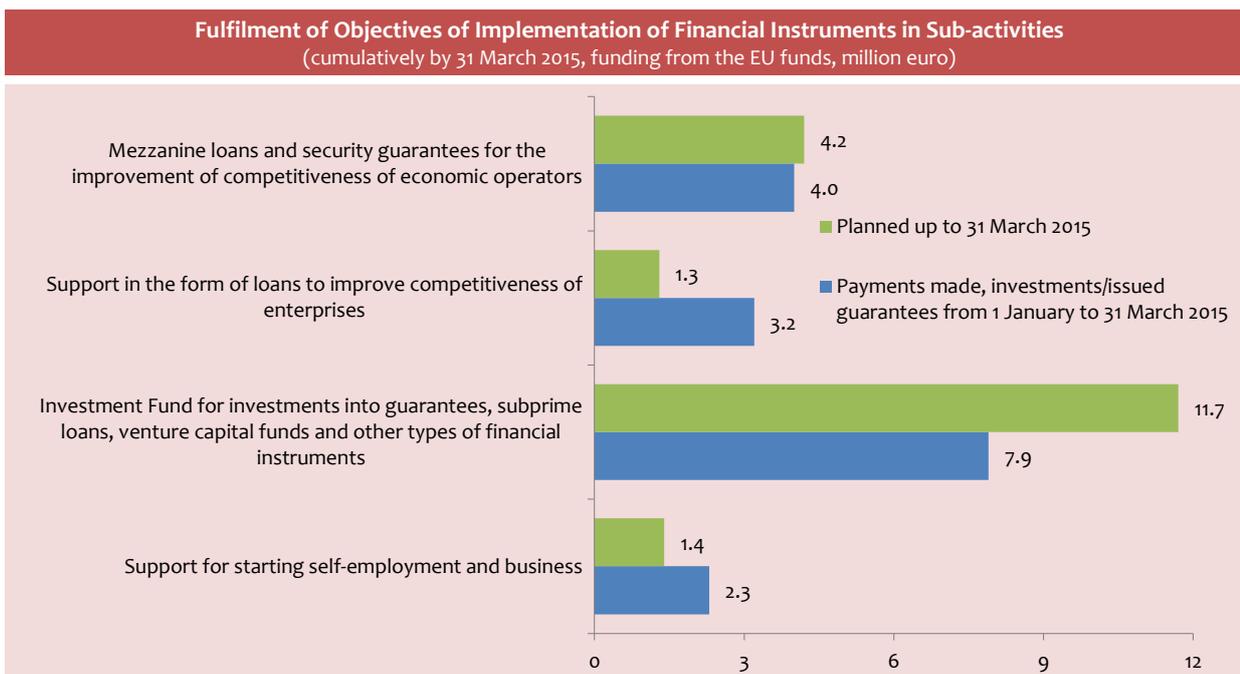
In the area of employment and social services, large-scale amendments were made to sub-activity *Training of the Unemployed and Job-Seekers*, taking into account the savings which occurred during the implementation of the project.

In the energy area, 14 projects were suspended by the end of 2014 in sub-activity *Activities to Increase the Efficiency of Centralized Heat Supply Systems*.

In the ICT area, a decrease in the number of concluded agreements is anticipated taking into account that, when evaluating the feasibility and eligibility of expenses of the project *Development of Portal www.skolas.lv (round 2)*, the CFCA found that the objective of the project has not been achieved and made the decision to apply a financial adjustment in the amount of 100% from eligible costs of the project.

Overall, the implementation of **financial instruments** does not reach the desirable indicators. Investments, loans actually paid and guarantees issued to undertakings within the OP *Entrepreneurship and Innovations* by 31 March 2015 make 106.3 million euro or 72.1% of the funding available from the EU funds. The funding for the OP *Human Resources and Employment* has been used in the amount of 10.4 million euro, which is the entire funding available from the EU funds.

Figure 6.6



The most significant deviations from the target are observed in the activities *Investment Fund for the Investments in Guarantees, High-Risk Loans, Venture Capital Funds and Other Financial Instruments* – in high-risk funds, the ZGI-3 target as at 31 March 2015 was achieved at 37.9%, the target of *BALTCAP* was achieved at 36.5%. In the seed instrument – *Imprimatur* and in the start-up capital instrument – *Imprimatur* the target has been overachieved.

Overall, progress is being observed in the implementation of financial instruments, although new growth risk capital funds need large-scale investments within a comparatively short period of time. It is important to emphasise that the number of deals under examination and the quality of business products significantly improved in the last quarter which will have a positive effect on the allocation of funding from the EU funds.

2014-2020 Programming Period

The Commission officially approved the OP *Growth and Employment* for the 2014-2020 programming period of the EU funds on 11 November 2014.

On 6 November 2014, the Cabinet of Ministers received a draft order on the composition of the Monitoring Committee (MC) for the 2014-2020 programming period of the EU funds which entered into force on 21 November 2014; therefore, the MC for the 2014-2020 programming period of the EU funds officially started to perform its job duties, including monitoring of the efficiency of use of the funding from the EU funds, the progress of the implementation of projects and the compliance with approved programming documents, as well as taking decisions related to the implementation and monitoring of the EU funds.

The OPs were prepared based on principles such as coherence with the *EU 2020* and other programming documents, a strategic vision which is based on the analysis of shortages and needs, on efficient, sustainable development and result-oriented solutions. The priority axes and specific objectives defined in the programming documents focus on the achievement of specific results with the maximum pay-off for economic development and contributing to the achievement of objectives of the Cohesion policy.

Table 6.2

Breakdown of the Funding from the EU Funds and Total Investments in the 2014-2020 Programming Period in the OP Growth and Employment (the European Commission Officially Approved it on 11 November 2014)			
	Scope of EU funding, million euro	Structure of EU funding, %	Total scope of funding, millions euro
Strengthening research, technological development and innovation	467.5	10.8	550.0
Enhancing access to, and use and quality of, information and communication technologies	172.8	4.0	203.3
Improving competitiveness of small and medium-sized enterprises	314.3	7.3	369.7
Supporting the shift towards a low-carbon economy in all sectors	480.6	11.1	565.4
Protecting environment and facilitating efficiency of resources	623.1	14.4	733.0
Facilitating sustainable transportation and eliminating deficiencies in the main network infrastructures	1159.8	26.9	1364.4
Promoting employment, supporting labour mobility and social inclusion	164.4	3.8	188.3
Investing in education, skills and lifelong learning	934.5	21.6	1099.4
Total	4316.9	100	5073.6

The new 2014-2020 programming period of the EU funds will provide our country the possibility to receive and invest 4.4 billion euro in the development and growth of Latvia and its population. Latvia will be the fourth largest net beneficiary among all other Member States and will receive about 3000 euro per capita from the EU budget in the 2014-2020 period. Latvia's target in the next programming period is to get closer to the level of welfare of the EU, using the opportunities provided by the EU funds wisely and responsibly.

The development of a supplement to the OP *Growth and Employment* was completed on 30 April 2015 to add more details to the OP.

Several important steps in the development of programming documents for the 2014-2020 programming period of the EU funds have been made. The *Law on Management of the EU Structural Funds and the Cohesion Fund in the 2014-2020 Programming Period* entered into effect on 11 July 2014, as well as the development of the rules of the specific objectives which need to be started as soon as possible continues.

Inter-institutional agreements have been concluded with the Ministry of Transport on cooperation in the 2014-2020 programming period within 6.1.5 SAM *Reconstruction and Increase of Carrying Capacity of Dressing of the Main National Roads*, 6.1.3.SAM *Providing Necessary Infrastructure on Riga's Main Flyovers and Eliminating*

Fragmentary Nature of the Main Roads and 6.3.1.SAM *Increasing Regional Mobility by Improving the Quality of Regional Roads*. The monitoring of these SAM projects has started (procurement plans were evaluated, preliminary inspections of procurements were carried out, first inspections at project sites were carried out, there was communication with the responsible authority and the implementers of projects in relation to identified gaps and risks in eligibility of costs).

In their projections made in August 2014, the responsible authorities planned costs for a total of 53.2 million euro. The plan was to use most of the planned funding for the SAMs supervised by the Ministry of Transport which address national and regional road improvement activities – 47.1 million euro. 8.5 million, or 18.1% of this amount, have been allocated by the end of the year. Although the coordination of the regulations regarding the implementation of 6.1.5.SAM *Reconstruction*

and Increase of Carrying Capacity of Dressing of the Main National Roads and 6.3.1.SAM *Increasing Regional Mobility by Improving the Quality of the Regional Roads*, which should be started as soon as possible, started in January 2014; failure to adhere to the budget can be explained by the long coordination of these regulations, taking into account that parallel coordination of the OP *Growth and Employment* with the Commission is ongoing and there were discussions between state administration authorities regarding the form of regulation of the implementation of SAM, which should be started as soon as possible. The Ministry of Welfare and the Ministry of Health also planned to use 5.5 million euro for guarantees for young people and 0.5 million euro for the development of health guidelines, respectively. The Ministry of Welfare used 4.7 million or 85.5%, but the Ministry of Health used 0.2 million euro or 40%.

Box 6.5

Activities within the Competence of the Ministry of Economics in the 2014-2020 Programming Period

764.15 million euro in EU funds are available for the activities of the Ministry of Economics in the 2014-2020 programming period, which break down as follows:

1. Innovation – 193.5 million euro;
2. Fostering competitiveness of small and medium-sized enterprises – 237.1 million euro;
3. Energy efficiency and energy – 333.6 million euro.

Innovation:

Innovation vouchers – 7 million euro.
 Technology transfer – 49.5 million euro.
 Competence centres – 102.3 million euro.
 Motivation for innovation – 4.8 million euro.
 Training for the unemployed – 29.9 million euro.

Fostering competitiveness of the small and medium-sized enterprises:

Availability of financing – 61.4 million euro.
 Contributing to awareness of Latvia as a travel destination and attraction of events – 20 million euro.
 Entering into non-domestic markets – 31.8 million euro.
 Risk capital – 45 million euro.
 Business incubators – 31 million euro.
 Development of industrial areas – 21.7 million euro.
 Cluster programme – 6.2 million euro.
 Technology accelerators – 20 million euro.

Energy efficiency and energy:

Energy efficiency in residential buildings – 150 million euro.
 Energy efficiency in public buildings – 97.8 million euro.
 Energy efficiency at industrial sites – 32.55 million euro.
 Centralised heat supply systems – 53.2 million euro.

The work on matters of the management and control system in the 2014-2020 programming period is ongoing:

- a draft description of the management and control system has been developed and sent to the bodies involved in the management of the EU funds to get recommendations and comments;
- the *Risk Management Strategy for Bodies Involved in the Management of the European Social Fund, the European Regional Development Fund and the Cohesion Fund in the 2014-2020 Programming Period* has been developed;
- the work is ongoing on the preparation of a communication on necessary human resources to

ensure functions defined for the 2014-2020 programming period of the EU funds and monitoring mechanisms for the SAM's responsible authorities, which, according to the decision made by the Cabinet of Ministers, has to be submitted within three months after the Commission's approval for the OP *Growth and Employment* is received;

- the work is ongoing on the creation of a Cohesion Policy Unified Information System (CP UIS), incl. an expert working group for CP UIS has been created, tests of the project application form in the electronic environment have started, meetings

were organised with holders of public registers (Register of Enterprises, State Land Service, State Regional Development Agency) on cooperation in exchange of information available in the registers of these authorities.

- improvements to the ICT and transport infrastructure, which directly affect the productivity of the economy, serve as a basis for innovations, and increase the internal and external mobility of persons and goods.

The most significant investments of the 2014–2020 programming period of the EU funds are planned for the following objectives:

- reduction of the number of residents at-risk-of-poverty by providing respective training, improving their health conditions and integrating them into the labour market;
- promotion of employment by integrating the long-term unemployed and young people into the labour market;
- decreasing primary energy consumption by improving energy efficiency of private and public buildings, improving energy efficiency in manufacturing and supporting increase in energy efficiency for public transport;
- increase in investments into research and development by fostering raising of private investments, as well as cooperation between research institutions and businessmen;

6.2.2 Foreign Economic Policy

Bilateral Economic Co-operation

To foster and deepen bilateral economic co-operation with the most important trade partners, Latvia has concluded bilateral economic co-operation agreements with Russia, China, Belarus, Ukraine, Kazakhstan, Azerbaijan, Georgia, Moldova, Uzbekistan, Kyrgyzstan, Turkmenistan, Tajikistan and Armenia. Intergovernmental commissions for economic, scientific and technical co-operation matters (IGC) and United Committees (UC) were formed within these agreements, with the aim to activate bilateral co-operation in various areas and to search for opportunities to improve further co-operation. Therefore, Latvia has concluded a Declaration with Turkey on the establishment of the United Economy and Trade Commission.

Box 6.6

Bilateral Economic Co-operation of Latvia in the First Half of 2015

Latvia-Georgia

On 8–9 January 2015, the Prime Minister of Georgia came on an official visit to Latvia. During this visit, the Minister of Economics participated in the Prime Minister's meeting with the Georgian delegation, which included the Georgian Vice Prime Minister, Minister of Economic and Sustainable Development, Minister of Foreign Affairs, as well as Minister on European and Euro-Atlantic Integration. During the meeting they discussed economic co-operation and possibilities of its extension.

On 15–17 April 2015, the President of Georgia came on an official visit to Latvia. Several ministers and vice-ministers, as well as a small delegation of businessmen accompanied the Georgian President on his visit. A Latvian-Georgian business meeting was organised during this visit. It was attended by representatives of Latvian companies, from sectors such as education, healthcare, pharmaceuticals, tourism, logistics, territory improvement, marketing, industry of arms, production of transport systems, etc.

Latvia-Finland

On 28–29 January 2015, the Minister of Economics visited Finland within the framework of the visit of the Latvian President. A Latvian-Finnish business forum was held during this visit. It was attended by more than 80 Latvian businessmen, representing sectors such as transport and logistics, metalworking, chemistry and pharmaceuticals, food processing, construction, wood processing, education, tourism, etc. Panel discussions with experts in the sectors of education and tourism were also held during the visit, for the discussion of prospects for further co-operation in the area of education, as well as the future and competitiveness of the travel and tourism industry.

Moreover, during the visit, the Minister of Economics met the Minister of Economics of Finland, to discuss bilateral economic co-operation between Latvia and Finland, the co-operation in the energy sector of the two countries, as well as the latest news on the Latvian Presidency of the Council of the European Union. The Minister also met the Head of the Property Rights Management Department of the Cabinet of the Prime Minister of Finland, the Minister for International Development of Finland, to discuss issues in managing capital companies.

Alongside to this visit, *Days of Latvia* were held in Finland for the first time from 15 January until 15 February, in order to promote the awareness of the Latvian products already present in the Finnish market, to widen access for new producers, as well as to introduce the population of Finland with the rich Latvian culture and art. During the *Days of Latvia*, the people of Finland could see products of Latvian interior and fashion designers, there was an exhibition of cartoons, demonstration of documentaries, presentations of Latvian literary works, master classes of Latvian chefs, etc.

Box 6.6 continuedLatvia-Norway

On 18–19 March 2015, the Minister of Economics visited Norway within the framework of the visit of the Latvian President, who was also accompanied by a large delegation of businessmen. During the visit, a seminar on Norwegian economics and business culture was organised for the delegation of Latvian businessmen. There was also a Latvian-Norwegian business forum, which was attended by 57 Latvian businessmen from sectors like the wood processing, transport and logistics, food processing, chemistry and pharmaceuticals, metalworking, construction, education, IT, agriculture, etc. The business forum was followed by bilateral meetings between Latvian and Norwegian businessmen.

During the visit, the Minister of Economics met with the Norwegian Minister of Petroleum and Energy, to discuss co-operation in the energy sector, the development of legislation in the area of accessing underground resources, as well as matters of managing Norwegian state capital shares. The Minister also met the Norwegian Minister of Trade and Industry, to discuss the bilateral economic co-operation between Latvia and Norway and its prospects.

Latvia-Austria

On 8–9 April 2015, the Minister of Economics visited Austria within the framework of the visit of the Latvian President, who was also accompanied by a large delegation of businessmen.

A *Latvian-Austrian Business Forum* was held during the visit. It was attended by 33 representatives of Latvian companies, representing transport and logistics, metalworking and machinery, financial and legal services, food and beverages, construction, textiles and design, education, tourism and other sectors. In the course of the visit, the Minister of Economics met the Austrian Federal Minister of Science, Research and Economics, with whom she discussed matters of Latvian-Austrian bilateral economic relationship, latest news on the Latvian Presidency of the Council of the European Union and matters of dual education. Together with the Latvian businessmen, the Minister of Economics also visited an Austrian school of dual education, to gain insight into Austrian experience on better ways to combine the supply of vocational education institutions with the labour market.

Latvia-Italy

On 10–12 June 2015, the Minister of Economics made a work visit to Italy.

During the visit, the Minister participated in the opening of Days of Latvia in Milan. The purpose of this event was to further the bilateral economic relationship between Latvia and Italy, as well as to inform about investment and business opportunities in Latvia. The Minister also attended business seminars in Naples and Milan, and met with Italian officials and businessmen. A delegation of more than 10 Latvian businessmen, representing sectors such as transport and logistics, IT, financial and legal services, textiles, design, metalworking and machinery, participated in this visit.

In the first half of 2015, in order to promote the enlargement of economic co-operation, the Minister of Economics as well as businessmen have been on official visits to Finland, Norway, Austria and Italy, and senior officials from the Ministry of Economics have held

meetings with senior officials from Belarus, Germany, China, United Kingdom, Georgia, Armenia, Sweden, Tajikistan, Japan, countries of the Eastern Partnership, etc.

Box 6.7Latvia on Its Way to the OECD

It is important for Latvia to become a member of the OECD, because Latvia will be able to take part in the process of developing new OECD's recommendations and standards, Latvian experts will be able to share their experiences with OECD Member States, discussions, scientific research and the analysis of economic policies in the OECD will help Latvia to identify its economic priorities, potential problems and the best methods for resolving them.

When Latvia joins the OECD, it will be included into OECD's statistical databases and economic policy reports, which have gained a higher degree of trust from the foreign investors and businessmen. Latvia would have a higher OECD credit rating which would in turn make Latvia more attractive for investments, as well as facilitate access to credit markets for the funding of significant economic projects. The increased recognition of Latvia as an OECD Member State will help also the domestic businesses to conquer non-EU markets.

It is important to actively participate in the work of this organisation at the expert level, in order to ensure the optimal active and qualitative participation in OECD committees, working groups and programmes.

Today several OECD Member States admit that thanks to Latvia's active work in the OECD, it is one of the most prominent candidates for accession.

According to the individual roadmap approved by the OECD, the process of accession of Latvia started at the end of 2013. When the OECD's "roadmap" of Latvia's accession negotiations was approved, the *Initial Memorandum* of Latvian accession negotiations was prepared and submitted to the OECD on 14 February 2014. In accordance to this memorandum, an in-depth evaluation of Latvia's readiness to join the OECD has been started. It describes and arguments the degree to which Latvia meets OECD standards and best practices according to each (250) OECD instrument.

Accession negotiations entail an evaluation by OECD committees (21 committees in total) on the compliance of active Latvian laws and regulations and their application to OECD's legal instruments, as well as the best practices of OECD Member States. At the conclusion of the negotiations the commission will provide its official opinion, which will lay the foundation for the decision of OECD Member States, whether to invite Latvia to become a member of this organisation. Currently, most of the committees have completed their job on the provision of information on the situation in the specific sector in Latvia. Based on this information, the OECD Secretariat has started or — in the case of individual committees — has already prepared draft reports on the compliance of Latvia to OECD standards and best practices of Member States, as well recommendations for improvements in the area of specific policies.

Box 6.7 continued

Concerning the competence areas of the Ministry of Economics, at the end of 2014, in Riga, the OECD has conducted research missions in areas of economy and development, public capital and privatisation practices, consumer protection policies, competition policies and statistics.

In December 2014, the OECD distributed an in-depth report on the compliance of Latvia to OECD Guidelines on Corporate Governance of State-Owned Enterprises. The report will be included in the OECD Corporate Governance Committee's final report, which will be discussed in October 2015.

In February 2015, the OECD published the *Economic Survey of Latvia*.

In April 2015, a meeting of the Committee on Consumer Policy was held in Paris. During this meeting, the OECD presented its Consumer Policy Report on Latvia. Representatives of the Ministry of Economics and the Consumer Rights Protection Centre informed about the OECD's *Draft revised 1999 e-commerce recommendation*.

In April 2015, the European Consumer Protection Conference was held within the Latvian Presidency of the Council of the European Union, in which OECD representatives presented the implementation of the Consumer Policy Toolkit for setting priorities.

In the first half of 2015, experts from the Ministry of Economics and its subordinate institutions participated in the meetings of the OECD Working Group on Privatisation and Corporate Governance of State Owned Assets, OECD Tourism Committee, Committee on Consumer Policy, Economic Policy Committee.

According to today's projections, technical negotiations might end by the end of 2015, and in 2016 Latvia might become a full member of the OECD.

Latvian Presidency of the Council of the European Union

Each EU Member State holds the Presidency of the Council of the European Union on a rotating basis and runs the work of the Council of the European Union for six months. Latvia held the Presidency of the Council of the European Union in the first half of 2015.

The Presidency is implemented in co-operation with three Member States. The Presidency of three was started by Italy on 1 July 2014, Latvia followed in the first half of 2015, and Luxembourg will complete this presidency in the second half of 2015. In 2014, Latvia, together with its partner countries – Italy and Luxembourg, developed and approved their joint work programme. Whereas, Latvia's individual six-month work programme was published on 22 January 2015.

During its Presidency, Latvia organised and ran about 1500 meetings in Brussels and Luxembourg. Representatives of ministries, their subordinate institutions and the Permanent Representation of Latvia to the EU were involved in the preparation and implementation of the Latvian Presidency.

The task of the Presidency was to be a fair and neutral mediator of negotiations. As the acting Presidency, Latvia co-operated with other EU Member States, the General Secretariat of the Council of the European Union, the European Commission, the European Parliament and the President of the Council of the European Union. Latvia, as the acting Presidency, represented the Council of the European Union in its relationship with the Commission, and also represented the Council of the European Union outside the EU.

Latvia hosted about 200 meetings in an informal atmosphere, in order to contribute to the co-operation and to promote the decision-making process. The National Library of Latvia was the main host institution in Latvia. About 25 thousand officials from other EU Member States visited Latvia.

The Latvian Presidency proposed the following values or *3i – Involvement, Growth and Sustainability (Iesaistīšanās, Izaugsme, Ilgtspēja in Latvian)*.

Three priority axes were set for the Latvian Presidency of the Council of the European Union:

– **a competitive EU as a basis for growth and improvement of the quality of human life**

Latvia actively involved in the implementation of the EU's growth and employment strategy, promoting measures to increase competitiveness of the EU, as well as developing a roadmap for coordination of the European Semester. Latvia's priority was improvement of the business environment, incl. support to small and medium-sized enterprises, creation of qualitative jobs, availability of services and education, as well as fostering of external competitiveness. Latvia hosted the Conference of EU-Asian Ministers for Education. (See achievements of the Ministry of Economics in Box 6.8)

– **reinforcement of the information society**

Latvia's priority was EU's actions in reducing the digital gap and creating an informed society. Latvia has outrun many EU Member States in the area of information technologies and digital solutions. In the first half of 2015, there was an active discussion on the potential of digital economy to raise EU's competitiveness compared to North American and Asian countries. Latvia participated in the development of EU policies updating the creation of the EU Digital Single Market, e-management and improvement of e-skills of the population, as well as information security in the digital environment and matters of the freedom of Internet. During the Presidency, Latvia used the opportunity to present its achievements in different formats, including e-management solutions and e-platforms for the promotion of civic participation.

– **reinforcement of the role of the EU on a global scale, formation of a welfare and security space in the neighbouring regions of the European Union**

During the Latvian Presidency, special attention in this direction was focused on neighbourly relations of Europe, as it actively implemented the present policies

and initiatives in Eastern Partnership and Central Asian countries already in 2014, both in regard to the economic dimension, as well as by reinforcing democratic and security processes. Latvia continued to support the reinforcement of transatlantic ties, with a special

emphasis on the preparation of the EU-US Trade and Investment Partnership Treaty, as well as in the framework of strategic partnerships of the EU, promoting co-operation with Brazil, Japan, Russia, India and China.

Box 6.8

Achievements of the Latvian Presidency in the Areas of Competence of the Ministry of Economics:

Energy:

- Commencement of the process of creation of the Energy Union – on 6 February 2015, an agreement on the creation of the European Energy Union was reached at a high-level conference in Riga. On 25 February, the Commission presented its *Framework Strategy* for a strong Energy Union. On 5 March, the first discussion between European Energy Ministers was held. The discussion later contributed to the conclusions of the Council of the European Union of 19 March. On 8 June, European Energy Ministers approved Council's Conclusions *On the implementation of the Energy Union: empowering consumers and attracting investments in the energy sector*.
- On 15–16 April, an informal meeting of European Environment and Energy Ministers was held, where they discussed one of the aspects of the Energy Union — heat supply and air conditioning market barriers, centralised heat supply, availability of funding and existing regional co-operation framework, best practices, obstacles, and further co-operation potential.
- On 29 May, there was a meeting of a high-level working group on the *Baltic Energy Market Interconnection Plan* — reform of the plan, new *Memorandum of Understanding and Action Plan 2015–2020*.

Competitiveness:

- On 2 March, the Council of European Competitiveness Ministers adopted Council's conclusions *On EU Single Market Policy*.
- To contribute to the *EU Digital Single Market Strategy*, which was published on 6 May, on 3 March, ministers of the Council of European Competitiveness Ministers discussed possibilities of creating a true digital single market and the benefits of such a market for customers and enterprises across the EU. On 25–25 March, European Competitiveness Ministers had an informal meeting, where they held discussions and exchanged views in three discussion panels: *Role of the EU Single Market in digital economy, Digital transformation of industry and Digital business*. Furthermore, on 28 May, the Council of European Competitiveness Ministers discussed a new *EU's strategy for the digital single market*. A summary of their opinions was included into Conclusions of the Council of the European Union on 25–26 June.
- On 28 May, the Council of European Competitiveness Ministers reached a political agreement on a directive on package travel and assisted travel arrangements, which will significantly reinforce protection of consumer rights when purchasing travel services;
- On 28 May, the Council of European Competitiveness Ministers adopted Council's conclusions *On digital transformation of European industry*.
- On 23–24 April the Ministry of Economics in co-operation with the Consumer Rights Protection Centre organised a Consumer Protection Conference. The international conference, which was devoted to the latest news in the area of consumer protection gathered together high-level policy makers in the area and consumer supervision authorities from the EU, EFTA Member States, OECD representatives, as well as representatives of European-scale consumer and business organisations, as a platform for exchange of views and best practices. The conference provided a possibility to discuss the development of consumer policy at the highest level, in discussing the priorities of the upcoming periods, listening to the views and examples of the best practices offered by the participants of the conference.
- On 7 May, the European Competition Day conference was held. Broader opportunities for more effective protection of competition were a platform for discussing matters of competition policy, which are important for all EU Member States. Participants of the conference — EC's representatives, leaders and experts of national competition supervision authorities, judges, academic teaching staff, representatives of non-governmental organisations and companies met, to share their experiences and exchange views, whilst jointly creating such a competition policy, which would protect the interests of EU's population in the best possible way.
- On 3–5 June, a European Standardization Summit was held in Riga. It gathered together high-level representatives from 33 European standardization organisations (CEN/CENELEC), international standardization organisations (ISO, IEC), 50 national standardization organisations, EC and international business environment. The summit provided a great opportunity to emphasise Latvia's priorities and to answer the question, how standardization can promote a transfer to a cleaner and wiser economy. The summit's main focus was the construction sector, which has a high economic value across the EU and is especially important for the Latvian community today.
- On 15–17 June, the first conference of the Week of Innovative Business *Financial instruments for innovation and business 2015* was held. The conference promoted understanding the potential of financial instruments of EU support funds and their availability, according to the EU's science and research programme *Horizon 2020* and the opportunities that this programme provides, for promoting the availability of funding for research, innovation and development of small and medium-sized enterprises. The conference especially targeted the interaction between financial tools *Horizon 2020*, COSME, European structural funds and investment funds (ESIF) and national and local level initiatives, as well as the use of other financial instruments on a national and local level. The event gathered policy makers, financial intermediaries, as well as representatives of science, innovation and business.

6.2.3 European Union Single Market

The EU Single Market consists of 31 countries (28 EU Member States and 3 countries of the European Economic Area (EEA) – Norway, Iceland and Liechtenstein) – with over 500 million consumers. The EU Single Market is a territory without internal borders, where a free movement of goods, services and capital, and people is ensured. After a lengthy and coordinated work within the EU, unified principles and rules for economic operators have been developed, border control has been cancelled, a more competitive business environment has been created, consumers have been provided with a wider range of goods and services, new jobs are created, the people are provided the possibility to live, work and study in other Member States, a possibility to introduce a single currency has been established, and many other benefits are ensured.

However, the potential of the EU Single Market is still not implemented to its full potential, and its improvement still continues, promoting a sustainable and stable development of the EU's economy, as well as welfare of its population.

By May 2015, Latvia's transposition deficit of EU's laws and regulations in the area of the EU Single Market was 0.7% (7 out of 1115 directives), thus Latvia remained in the group of Member States within the limits of the EU average of 0.7 per cent.

Based on Article 34-36 and 49-62 of the *Treaty on the Functioning of the European Union* (TFEU), the freedom of provision of goods and services and the right to do business in Latvia is supervised and coordinated by the Ministry of Economics, which is constantly identifying legal provisions as well as evaluating the laws and regulations, which are still in the drafting stage, that may potentially or actually hinder the implementation of freedoms of the EU Single Market.

Based on the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions of 8 June 2012 *Better Governance for the Single Market*, an electronic **Single Market Centre** was created on the website of the Ministry of Economics (https://www.em.gov.lv/lv/eiropas_savieniba/es_vienota_tirgus_centrs/), which provides information on EU information and aid services. The main purpose of the EU Single Market Centre is to help businessmen to use all the advantages related to the EU Single Market, as well as to provide practical assistance in relation to the limitations on freedom of provision of goods and services.

The Ministry of Economics has also created an online inquiry form, which enables reporting on barriers to business 24 hours a day (https://www.em.gov.lv/lv/eiropas_savieniba/zino_par_skersliem).

The **technical regulations notification procedure** serves as a preventive, uniform and transparent monitoring tool, to evaluate and prevent the inclusion of such requirements into laws and regulations, which might

create barriers for the free movement of goods and the information society's services. The process of coordination of technical regulations is carried out not only by the responsible authorities of the EU Member States, but also by any economic operator, who wants to become a part of it, by providing comments and objections, regarding the drafts prepared by other EU Member States, if these drafts might potentially affect that economic operator's product export or cross-border provision of information society services. The information on draft technical regulations notified by Member States is freely available in the database of the *Technical Regulations Information System* (TRIS) <http://ec.europa.eu/enterprise/tris/lv/> where draft technical regulations can be viewed in Latvian. If any economic operator has any objections to draft technical regulations of other countries, which might potentially or actually affect sales of its product in the market of the respective EU country, the economic operator has the right to submit its objections to the responsible ministry, competent to coordinate the respective policy area in Latvia.

The **mutual recognition principle** is a legal mechanism to ensure free movement of goods in the European Union. This principle, in fact, envisages that destination Member States are not allowed to prevent sales of those goods in their territory, which are already legitimately sold in another Member State, even if they are produced according to requirements differing from the requirements of the destination Member State. This principle is applicable to goods, which are not subject to harmonised EU laws and regulations (free movement of goods in a non-harmonised area).

To improve the application of the mutual recognition principle, the *Regulation (EC) No 764/2008 of the European Parliament and of the Council laying down procedures relating to the application of certain national technical rules to products lawfully marketed in another Member State and repealing Decision No 3052/95/EC* entered into effect on 2 September 2008. Its purpose is to define the procedure of observation of the mutual recognition principle in the work of public authorities, as well as in communication with economic operators. *Regulation 764/2008* also obliges countries to create **Product Contact Points** (PCP). PCPs provide companies and responsible authorities of Member States information on the regulations, which are applicable to a specific type of products, and information on any product type that needs to receive permits before being placed on the market. In Latvia, the Ministry of Economics fulfils functions of a PCP (e-mail: pcp@em.gov.lv). From January until May 2015, the PCP responded to 9 information requests from economic operators.

To ensure administrative co-operation between EEA's national regulatory authorities, the EC has created an **Internal Market Information System** (IMI). The IMI system allows contacting responsible authorities of the countries of the European Economic Area at national, regional and local level in a fast and effective

way. Using the IMI system, authorities of Member States can verify the information indicated in applications of legal entities and individuals, authenticity of documents issued in other Member States, and clarify other matters according to respective EU laws and regulations. Hence, the applicant is freed from bureaucratic barriers in the resolution of different cross-border matters in the EU Single Market. The Ministry of Economics is the national coordinator of the IMI system in Latvia. Today, the IMI system in Latvia is operating in the sectors of *Services Directive (2006/123/EC)*, *Professional Qualifications Directive (2005/36/EC)*, *Posting of Workers Directive (96/71/EC)*, *Patients' Rights Directive (2011/24/EU)*, *Commission Implementing Decision on train drivers' licences (2014/89/EU)* and *Regulation on the cross-border transport of euro cash by road (1214/2011)*, and in the form of pilot drafts in the areas of – *Directive on the return of cultural objects unlawfully removed (2014/60/EU)*, *E-Commerce Directive (2000/31/EC)* and *Public Procurement Directive (2014/24/EU and 2014/25/EU)*. The *Services Directive* obliges Member States to inform about services which can cause significant harm to human health, life and the environment, therefore, the IMI system has an *Alert mechanism* which ensures co-operation between supervisory authorities for risk prevention. 77 responsible authorities are registered in the IMI system in Latvia — 61 authorities are related with the area of services, 19 with the area of professional qualifications, 6 with the posting of workers, 4 with the area concerning patients' rights, 2 with the area of e-commerce, 2 with train drivers' licences, and 2 with the area of public procurement (one authority can be related to several areas). The introduction of *Directive No 2013/55/EU* into national laws and regulations must be completed by 18 January 2016. It regulates the creation of a European Professional Card in the IMI system, which will be electronic and will be issued to those representatives of regulated professions who want to pursue the same profession in another EU Member State or a Member State of the European Economic Area. Furthermore, a new tool is envisaged – an *alert mechanism* to inform all Member States about a professional whose pursuit on the territory of that Member State of the following professional activities in their entirety or parts thereof has been restricted or prohibited in professions related to healthcare or child care or education.

Within the five months of 2015, Latvia has sent 8 information requests to other Member States, within the IMI system: 4 in the area of professional qualifications and 4 in the posting of workers area; Latvia has received 57 information requests: 1 in the area of services, 43 in the area of professional qualifications, 7 in the posting of workers area, and 6 in the area of patient rights.

An alternative EU Single Market problem solution network, *SOLVIT Centre*, created by the EC and Member States, has been operating in Latvia since 2004. Its task is to find a fast and practical solution to the problems of the EU Single Market caused by activities of

public authorities, by incorrectly applying EU laws and regulations. In situations, when a resident or a businessman is harmed by the wrongful decisions taken by the responsible authorities of other Member States, the *SOLVIT Centre* acts as a free problem solution tool. Every EU Member State (as well as Iceland, Norway and Liechtenstein) hosts a *SOLVIT Centre*. The Latvian *SOLVIT Centre* has received 7 complaints from January until May 2015. To submit a complaint to the *SOLVIT Centre*, the case must meet the following criteria: (1) the decision has been taken by a public authority; (2) the public authority is located in another Member State (a cross-border element); (3) EU's legal norms (regulations, directives, etc.) have been violated. The Latvian *SOLVIT Centre* most frequently solves cases reported by citizens, related to social benefits and the issue of residence permits, and cases reported by businessmen, related to restrictions on freedom of provision of goods and services, repayment of value added tax and recognition of professional qualifications.

To promote commercial activities and innovation in the services sector, as well as gradual modernisation and simplification of state administration, one of Latvia's priorities is **promotion of freedom of provision of services**. In co-operation with non-governmental organisations and national regulatory authorities, the requirements of laws and regulations in the area of services, are regularly analysed and recommendations for required changes, to reduce the administrative burden on undertakings, are prepared. Administrative barriers and procedures are reviewed, by respectively removing or simplifying requirements for the issue of permits (licences, certificates, certifications and other documents), as well as creating the possibility to settle necessary procedures electronically. In addition, the implementation of a one-stop shop principle continues, by improving the availability of services provided by public administration in a Single Control Point — a single national and local government services portal www.latvija.lv.

The “silence means consent” principle is one of the tools for promoting modernisation of public administration to reduce delays in decision-taking by authorities, costs and unfavourable consequences to small and medium-sized enterprises. This principle suggests that in case a responsible institution fails to make a timely decision on the application for a permit, it shall be considered that the service provider has received the permit and is entitled to start service provision. The *Action plan for the implementation and application of the “silence means consent” principle into administrative practices of responsible authorities* was approved on 12 June 2012. It prescribes the initial implementation of the “silence means consent” principle for 15 services. The work on the implementation of the principle continued and amendments to the *Action Plan for Improvement of the Business Environment 2014-2015* were developed and adopted in May 2015, prescribing that the “silence means consent” principle will be implemented for 17 other services by the end of 2016.

Latvia also participates in the **frontrunners initiative**. This initiative was started by national regulatory authorities of the United Kingdom, Denmark, Sweden and the Netherlands, and today it already unites 16 EU Member States. The purpose of the frontrunner initiative is to resolve problems faced by businessmen and consumers in the EU Single Market through co-operation and exchange of best practices. The Member States co-operate in important areas such as:

- the creation of a *Single Market Centre*, so that businessmen would have a centralized access to information on EU Single Market's help and information centres in one place;
- the development of single contact points in the area of services, where businessmen can settle all necessary formalities to operate in the area of services, incl. in other Member States;

- recognition of professional qualifications to reduce the number of regulated professions and remove barriers in the process of recognition of professional qualifications in other Member States;
- reviewing regulations with regard to electronic trade, by identifying potential barriers for doing business in the area of e-commerce, as well as researching barriers in the process of registration of highest level domain names.

Results of the above mentioned projects were summarised and presented at the meeting of the Council of Competitiveness Ministers on 2 March 2015. Additional areas in which Member States can co-operate within this initiative are being identified right now.

6.3 Industrial Policy

The framework of *Latvian National Industrial Policy* (NIP) planning documents consists of a document portfolio, the most important of which are the *National Development Plan*, *Smart Specialization Strategy* included in the *Science, Technology Development and Innovation Guidelines*, *Guidelines on National Industrial Policy*, *Education Development Guidelines*, and other sectoral policy planning documents.

Guidelines on National Industrial Policy

Latvian Guidelines on National Industrial Policy were approved by the Cabinet of Ministers on 28 May 2013, and they aim to promote the structural changes of economy in favour of the production of goods and services with a higher added value, including an increase in the importance of industry, modernization of industry and services, as well as complexity of export.

In order to achieve the objective defined in the Guidelines, the following performance indicators to be achieved have been established:

- the share of the manufacturing in GDP in 2020 – 20%;
- the growth in productivity of the manufacturing in 2020 compared to 2011 – 40%;
- the growth of the manufacturing in 2020 compared to 2011 – 60%;
- investments in research and development – 1.5% of GDP.

To identify market shortcomings, the potential of the most exportable niches and products and services with a higher added value was determined and an in-depth analysis of producers was carried out, which led to the conclusion that the most important challenges of the NIP to which government activities are to be directed are:

- funding restrictions;
- labour costs and price competitiveness;

- low productivity and weak innovation performance;
- transformation of international business;
- demographics (aging of the labour force).

Taking into account the advantages and main challenges of Latvian companies, the lines of action established in the NIP are focused on the following:

- issues related to the **availability and skills of the labour force**, such as implementation of further reforms of the vocational education system and higher education system by consolidating and introducing vocational education programmes that meet labour market demands, as well as increasing the practical part of the programme; continuing the use of state aid instruments aimed at the improvement of the qualifications and skills of professionals employed by a company, opportunities for retraining in specialities that are in demand in the market; reduction of the number of students acquiring general secondary education in favour of the vocational education system;
- issues related to the **development of industrial zones**, such as adaptation of the existing industrial zones, improving the condition of roads and utilities (electricity, water supply, sewerage, gas, lighting, etc.) to production facilities, creation of new industrial zones in the centres of international, national and regional importance;
- issues related to the **access to finance**, such as providing the necessary funding to start-ups, micro- and small enterprises, providing support for ensuring the operating capital or making initial investments, continuing the issue of loan guarantees, continuing the provision of corporate income tax relief to encourage the production when acquiring new production equipment, creation of venture capital instruments that would

stimulate investments in the development of businesses and expansion of their activities;

- issues related to the **promotion of innovation**, such as increasing the research and innovation capacity of economic operators, replacement of corporate income tax relief on research and development costs with a new incentive, establishing write-off of particular research and development costs to the extent of triple the amount, development of the research base and excellence;
- issues related to the **facilitation of export**, such as supporting the cluster initiative, minimizing the risks of export transactions, entering external markets and compensating certification costs;
- issues related to the **energy costs**, such as development of a support programme solutions for increasing the energy efficiency and reducing emissions in the industrial sector.

A plan of activities for the period of time until 2017 has been drawn up in compliance with the proposed lines of action, providing a certain set of activities for each line of action, determining the institutions responsible for the implementation of activities, as well as defining the operational performance indicators to be achieved.

Within the framework of the action plan, the Ministry of Economy has begun developing support measures

planned within the framework of the EU programming period 2014–2020.

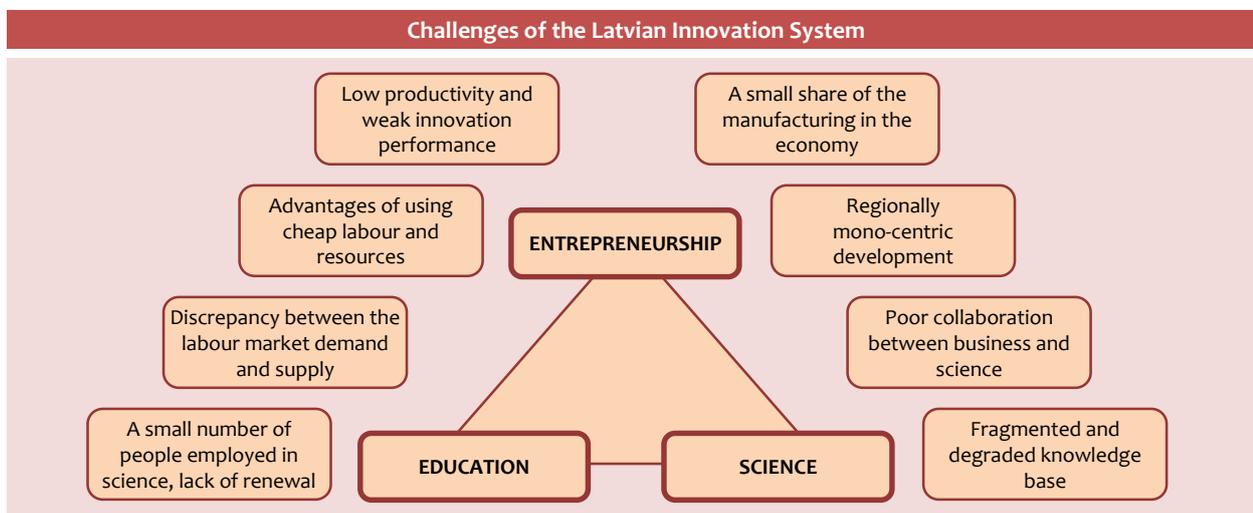
Smart Specialization Strategy

Smart Specialization Strategy provides for the development of a vision, finding the competitive advantages, choosing strategic priorities and a policy that maximally unleashes the regional potential of knowledge-based development and thus ensures economic growth.

The strategy has been included in the *Science, Technology Development and Innovation Guidelines 2014–2020* and approved by the Cabinet of Ministers on 28 December 2013 along with the adoption of the Guidelines.

When developing a smart specialization strategy, it is important to take into account the scenario of growth of national economy. When analysing the economic growth of Latvia, it has been concluded that it is necessary to promote the structural changes of economy in favour of production of goods and services with a higher added value, including the increase in the role of industry, modernization of industry and services, as well as development of complexity of export, for sustainable growth of the economy. This is an essential prerequisite for the convergence of the Latvian economy with the developed EU countries and for the growth of welfare of the population that can be achieved by increasing the competitiveness of the Latvian economy that is based on innovation.

Figure 6.7



At the same time, while developing a smart specialization strategy, it is necessary to identify the existing problems of the innovation system (see Section 6.9). From the perspective of Latvian and EC export, there are eight main challenges in the Latvian innovation system depicted schematically in Figure 6.7.

According to the analysis carried out, it has been identified that challenges can be found in all of the most important pillars of the innovation system.

Based on the conclusions and analysis, a framework of the *Smart Specialization Strategy* has been developed

defining the directions of economic transformation, directions of economic growth, and areas of smart specialization (see Table 6.3).

To clarify the performance indicators for achieving policy objectives defined in the *Smart Specialization Strategy* and areas of specialization, the Ministry of Economics, Ministry of Education and Science and Ministry of Agriculture organized 14 public discussions where more than 500 representatives of scientific institutions, educational institutions, and industry association took part. The main conclusion — Latvian industry is

characterized by high relative specialization, so the industry specialization as a whole is not a problem of the Latvian economy. It was recognized that, when implementing the *Smart Specialization Strategy*, one-sided

support of economic growth must be avoided — economic environment facilitating the economic activity and the development of human resources must be ensured.

Table 6.3

Framework of the Smart Specialization Strategy		
Directions of Economic Transformation	Priorities of Growth	Areas of Smart Specialization
1. Change of the production and export structure in the traditional sectors of the economy	Priority No 1: A more efficient use of primary products for the production of products with a higher added value, creation of new materials and technologies and diversification of use. More extensive use of non-technological innovation and the potential of the Latvian creative industry for the production of products and services of a higher added value in the economic sectors.	1. Knowledge-intensive bioeconomy
2. Future growth sectors where there are products and services with a high added value or they may appear	Priority No 2: The creation of an innovation system providing support for the development of new products and technologies within the existing sectoral and cross-sectoral frameworks, as well as new sectors with a high growth potential that is based on the key technologies defining growth and provides an effective system for the identification of new products/services, is able to find and support the creation of new products within the existing sectoral and cross-sectoral frameworks, as well as to create new industries with a high growth potential.	
3. Sectors with a significant horizontal impact and contribution to economic transformation	<p>Priority No 3: Increased energy efficiency, which includes the creation of new materials, optimization of the production process, implementation of technological innovations, use of alternative energy sources, and other solutions.</p> <p>Priority No 4: Development of a modern ICT system in the private and public sector that meets today's requirements.</p> <p>Priority No 5: A modern education system that meets the requirements of the labour market in the future and promotes the economic transformation and development of expertise, entrepreneurial ability and creativity necessary for the implementation of the Smart Specialization Strategy priorities at all levels of education.</p> <p>Priority No 6: A well-developed knowledge base (fundamental science and scientific infrastructure) and human capital in the areas of knowledge where Latvia has comparative advantages and which are important for the process of economic transformation: areas of knowledge related to the areas of smart specialization, such as (1) knowledge-intensive bioeconomy, (2) biomedicine, medical technology, biopharmacy and biotechnology, (3) smart materials, technology and engineering systems, (4) smart energy industry, and (5) ICT, as well as the key technologies identified by the EC (nanotechnologies, micro- and nanoelectronics, photonics, advanced materials and production systems, biotechnology).</p> <p>Priority No 7: Identification and specialization of the existing resources of the territories, proposing the prospective opportunities and directions of economic development, including the main and prospective business directions in the local government territories.</p>	
		2. Biomedicine, medical technology, biopharmacy and biotechnology
		3. Smart materials, technology and engineering systems
		4. Smart energy industry
		5. Information and communication technologies

In a number of discussions, improvement of productivity was mentioned as the main objective. The industry representatives see new products and improvement of the existing production techniques and technology as a way of improving the productivity. Latvian companies have a relatively low productivity, and labour productivity in particular – in Latvia, specialisation is carried out both in the production and service sectors with a low added value, while in sectors where the overall added value is above the average, Latvian companies are

often involved in production stages, where the added value is relatively low, and one of the main ways of increasing productivity in low- and medium-tech sectors is a gradual transition to high-tech industries and products. It was also stressed that science requires diversity of knowledge. Specialization for the needs of the industry can be provided with operational focus on dealing with specific problems, involving the representatives of industries in the approval of research grants and projects.

6.4 Energy Policy

The key directions of the efficient, well-balanced, market-principle based energy policy of Latvia established by the informative report *Long-term Energy Strategy 2030 – Competitive Energy for Society (Energy Strategy 2030)* approved by the Cabinet of Ministers in the meeting of 28 May 2013 are aimed at the development of the state economy's competitiveness promoting welfare of the society.

The main task of the *Energy Strategy 2030* is to ensure positive impact of the energy sector on the national economy of Latvia, at the same time striving to achieve the security and sustainability of the energy supply:

- secure energy supply – a stable energy supply and developed infrastructure provided to energy consumers;

- sustainable energy – reduced dependency on imported energy resources, new and efficient technologies for the use of renewable resources are encouraged, measures to improve energy efficiency are implemented.

Based on the energy policy development directions laid down in the *Energy Strategy 2030*, the Ministry of Economics is developing new *Energy Policy Guidelines for 2014-2020*, which will supersede the *Energy Development Guidelines for 2007-2016*, approved by the Cabinet of Ministers Decree of 27 June 2006. The guidelines will include measures to be implemented until 2020 to achieve the energy sector development objectives in Latvia.

Box 6.9

Energy Sector in Latvia

Both the imported (natural gas, electricity, petroleum products, coal, coke, etc.) and local (hydropower, wind energy, firewood, charcoal, straw, other biomass, biogas, bioethanol, biodiesel, peat, used tyres, municipal waste for heating) energy resources are used in Latvia to supply fuel, electrical energy and heat to sectors of the economy, commercial consumers, and residents. A part of electricity is generated by Latvian HPPs, CHPs, biomass, biogas and wind power plants, whereas the rest is imported. The amount of produced electrical energy in Latvia depends on the flow rate of the Daugava and other rivers. Mainly, the local fuels – firewood – and imported fuel – natural gas – are used in heating energy generation.

In 2013, the total volume of delivered electrical energy was 7,564 GWh that is by 3.7% less than in 2012. JSC “Latvenergo” produced 64.2% of the total amount of the delivered electrical energy in its plants, 17.9% bought from small producers of electrical energy, and the net imports of the electrical energy was 17.9%.

In 2013, energy resource generation and recycled products in Latvia reached 89.8 PJ, but the import of energy resources was 169.9 PJ, out of which 58.4 PJ was the import of natural gas. The total consumption of primary energy resources in Latvia amounted to 187.1 PJ, which is by 1.8% lower than in 2012 (see table 6.5). In 2013, 41.2% of the total electricity consumption were used for end consumer services, 27.5% – for industry and construction, 27.1% – for households, 2.2% – for agriculture, and 1.9% – for transport.

Table 6.4

Electricity Supply in Latvia (GWh)							
	2000	2005	2009	2010	2011	2012	2013
Total electricity supply	5922	7053	7223	7500	7340	7859	7564
Gross electricity generation including:	4136	4905	5569	6627	6094	6167	6209
from renewable energy resources:	2824	3414	3555	3635	3078	4109	3534
large HPPs*	2794	3263	3391	3445	2823	3627	2852
small HPPs	25	62	66	75	64	80	60
biomass power stations	–	6	4	9	13	65	215
biogas power stations	–	36	44	57	107	223	287
wind power stations	5	47	50	49	71	114	120
from fossil energy resources:	1312	1492	2014	2992	3017	2059	2675
large CHPs**	1163	1278	1476	2402	2425	1409	1957
other CHP	149	214	538	590	592	650	718
Net electricity imports	1786	2148	1654	873	1245	1691	1355

* Daugava cascade – Riga HPP, Ķegums HPP, and Pļaviņas HPP

** Riga CHP-1 and Riga CHP-2, source: JSC “Latvenergo”

Table 6. 5

Consumption of Primary Energy Resources in Latvia (PJ)							
	2000	2005	2009	2010	2011	2012	2013
Total consumption* including:	163.9	192.1	189.0	194.8	184.2	190.5	187.1
coal and coke	3.1	3.3	3.5	4.5	4.6	3.8	3.0
peat	2.5	0.1	0.0	0.1	0.0	0.0	0.0
petroleum products	56.4	61.9	62.4	64.6	59.5	58.4	59.3
natural gas	45.6	56.9	51.4	61.3	54.0	50.8	50.3
firewood	39.7	49.4	52.6	45.6	46.9	52.5	53.1
electricity**	16.6	19.9	18.6	16.0	15.1	19.8	15.8
other energy resources***	-	0.6	0.5	2.7	4.1	5.2	5.6

* Calculations for all energy resources are based on the lowest calorific value
** Hydropower, wind energy and electrical energy net imports
*** Used tyres, municipal waste for heating, charcoal, straw, other biomass, biogas, bioethanol, biodiesel

Electricity Market

The electricity market in Latvia is fully open as of 1 January 2015. Pursuant to the amendments to the *Electricity Market Law* of 18 September 2014, households have an opportunity to freely choose the provider and agree on the electricity price based on an agreement just

like legal entities. The amendments to the *Electricity Market Law* of 18 September 2014 further envisage special tariffs for the protected consumers.

Along with complete opening of the electricity market as of 1 January 2015, a support instrument for protected consumers was introduced (see Box 6.10).

Box 6.10

Social Support Instrument

A protected consumer is a poor or low-income family (person) or a large family, using electrical energy in their household for personal needs (final consumption).

In 2015, the support to the protected consumers will be ensured by JSC "Latvenergo":

- support to a poor or low-income family (person) will not exceed 100 kilowatt-hours per month for the price of 0.0131 euro per one kilowatt-hour;
- support to a large family will not exceed 300 kilowatt-hours per month for the price of 0.0131 euro per one kilowatt-hour.

In 2015, the total price of electricity (including electricity price, trade services, mandatory procurement component, value added tax and network services) will be equal to the Start Tariff of 2014 – 11.64 euro per one kilowatt-hour.

The terms and conditions for provision of the services to the protected consumers, their financial amount and procedures as of 2016 will be established by the Cabinet Regulations that have to be drafted and adopted in 2015. The trade services for the protected consumer will be provided by the enterprise, selected by the Ministry of Economics in tender procedures based on the ability to ensure trade services with the lowest co-funding from the state budget.

According to the provisions set in the EU Third Internal Market Liberalization Energy Package, one of the factors ensuring optimum functioning of the electrical energy market will be a separation of network services from production and trading activities.

During the procedure of restructuring of JSC "Latvenergo" – a vertically integrated energy supply merchant with the Ministry of Economics as the shareholder, electrical energy transfer and distribution system operators have been legally separated.

Pursuant to the Electricity Trade Register of the Public Utilities Commission, 68 traders are registered as of 29 April 2015, 24 of them have concluded a contract on the use of the system with JSC "Sadales tīkls". On 1 January 2012, JSC "Augstsprieguma tīkls" – an independent transmission system operator – started its operation outside "Latvenergo" group. JSC

"Augstsprieguma tīkls" is in charge of the development of a transmission network, safety of the electric power transmission, stability of the power system and quality of electrical energy, providing it in accordance with technical and economic requirements and modern technologies. The Ministry of Finance is a shareholder of JSC "Augstsprieguma tīkls". The owner of the transmission system assets is the JSC "Latvenergo"'s subsidiary company JSC "Latvijas elektriskie tīkli", which started operating on 1 April 2011. As of 1 January 2015, all employees serving the high voltage network work for JSC "Augstsprieguma tīkls".

Since 1 July 2007, the operator's functions of the electrical energy distribution system are performed by JSC "Sadales tīkls" – an independent subsidiary company of the JSC "Latvenergo". JSC "Sadales tīkls" ensures the supply of electrical energy to over one million consumers,

covering 99% of the entire territory of the state with their service. Overall, there are 11 distribution operators in Latvia. The main requirements in relation to the quality of distribution services are laid down in the Cabinet Regulations on *Requirements for Voltage of Public Electric Power Supply Networks* of 4 October 2011, laying down mandatory application of the EU Standard LVS EN 50160: 2010 *Voltage characteristics of electricity supplied by public electricity networks adopted in Latvia*.

Thus, the evaluation of the options to improve the tariff structure for distribution services takes place. Currently, the tariffs for distribution systems for households are based only on the consumption of the electrical energy. It is planned to divide the existing tariff in two parts – flat and variable. The flat rate would be determined as a payment per ampere, its amount would depend on electricity amount (amperes) of the input protection appliance used for a connection, and it will determine the relevant costs. The variable part could be determined based on the consumed electrical energy. Such structure of tariffs would reflect more precisely the grid costs, as they are not solely related to the amount of distributed costs, it would ensure more efficient use of the grid that would result in lower investments in the long term, and it would stimulate consumers to reasonably determine the necessary capacity, i.e., the capacity of the input connection appliance, thus ensuring efficient use of grid capacity when the electrical energy consumption changes.

In addition, to promote the development of entrepreneurship, the distribution system operator currently evaluates the possibility to optimize the terms and conditions for connections that, in addition to the right of the consumers of electrical energy to recover the initial connection cost when complying with the criteria set in the Conditions for Efficient Load Use, would envisage the right of a consumer of electrical energy not to pay the initial connection cost, if the consumer undertakes to comply with the criteria set in the Conditions for Efficient Load Use.

Complete integration of the Latvian, as well as Lithuanian and Estonian **electric power markets into the EU common market**, joining the Nordic electric power market and ensuring sufficient interconnections, is a significant aim not only for the Baltic States but also for the EU.

From the point of view of history, the electric power transmission networks of Estonia, Lithuania and Latvia are closely integrated in the transmission networks of Belarus and Russia, operating in a parallel, synchronous mode. Operational functions of energy systems are governed by BRELL contract concluded between Belarus, Russia, Estonia, Latvia and Lithuania. Domestic trade of electrical energy in Russia and Belarus, as well as other CIS member states, fluctuations and emergency situations in energy system modes technically affect and overload electric lines of the Baltic States, limiting the possibility of the Baltic States to fully implement the legal regulation of the EU in the electricity market, in

particular, in relation to calculation of capacities and planning, overload management, balancing of networks.

The Nord Pool Spot (NPS) Latvian trade region began its operations on 3 June 2013. Currently, NPS trade regions are opened in all three Baltic States – Estonia, Lithuania and Latvia – and trade of electric power across the entire Baltic Sea region is coordinated.

The open electric power NPS trade region of Latvia and the implemented next day market ELSPOT allow market players to submit their price offers for transactions which will take place the following day. The next step for the development of the electricity market in Latvia was the introduction of the same day market – ELBAS. The ELBAS market in Latvia was successfully opened on 10 December 2013. The difference between the same day market and the following day market is that the price offers are submitted on the following day after publishing ELSPOT trade session results. Presence of both markets ensures not only more liquidity of the Latvian energy markets, but also a more effective use of throughput and a reliable and transparent electric power price to market players.

The electricity market of Latvia, just like the entire Baltic energy market, is currently connected to the European energy market only through two underwater cables between Estonia and Finland *Estlink I* with transmission capacity of 350 MW, and *Estlink II* with transmission capacity of 650 MW. Transmission capacity of both interconnection cables is sufficient to level the prices in the Estonian and Finnish NPS trade areas. Despite the fact that the implementation of such a project may potentially have a positive influence on the integration of the Estonian-Finnish energy systems and liquidity of the Estonian-Finnish trade areas, it does not reduce the risk of overload in the Latvian-Estonian interconnection, which is a highly seasonal issue, but has a characteristic negative influence on energy pricing dynamics in the Latvian and Lithuanian NPS trade areas. Besides, *Estlink II* load transmission from Finland to Estonia might cause an extra load in the Latvian-Estonian interconnection, thus increasing the risk of overload or line outage.

The current transfer capacity in the Estonian-Latvian interconnection is insufficient for the necessary energy trade in the Baltic region: between Estonia which has a surplus electricity produced in a year and Latvia and Lithuania where there is a clear electricity deficit. This situation has a particular influence on electricity trade in the Baltic States in the summer season. The said limit of transfer capacity causes considerable impediments for Latvia and Lithuania, as well as the Kaliningrad region to import electric power from cheaper electricity regions – Estonia and Scandinavia; as a result, the average electricity price in Latvia and Lithuania is higher than in Estonia and Scandinavia.

To improve the capacity of the interconnections, it is planned to finish the Lithuanian-Swedish interconnection “NordBalt” with the transmission capacity of 700 MW. Within the framework of the project, also the project

Kurzeme Circle, envisaging the construction of a 330kV overhead line in the western part of Latvia to ensure the possibility of increased capacity connection, to ensure the development of wind farms and improve the safety of electric power supply in Kurzeme, is being implemented. The first stage of *Kurzeme Circle* includes the construction of a 330 kV high voltage line, connecting the Riga city 330kV sub-station “Rīgas TEC-1” to the sub-station “Imanta”; the line construction works, including inspections, were completed by 25 September 2013. The second stage of *Kurzeme Circle* includes the construction of the 330kV high-voltage line Grobiņa-Ventspils; design stage initiated in 2010, but all works were finished in 2014. Construction costs of the first and the second stage of *Kurzeme Circle* are 98.5 million euro, 38.5 million euro of which are from the European Energy Regeneration Programme. To date, 66 million euro have been invested in the first and second stage of the project. Costs of the third stage of *Kurzeme Circle* are 127.42 million euro, and it must be finished by the end of 2018.

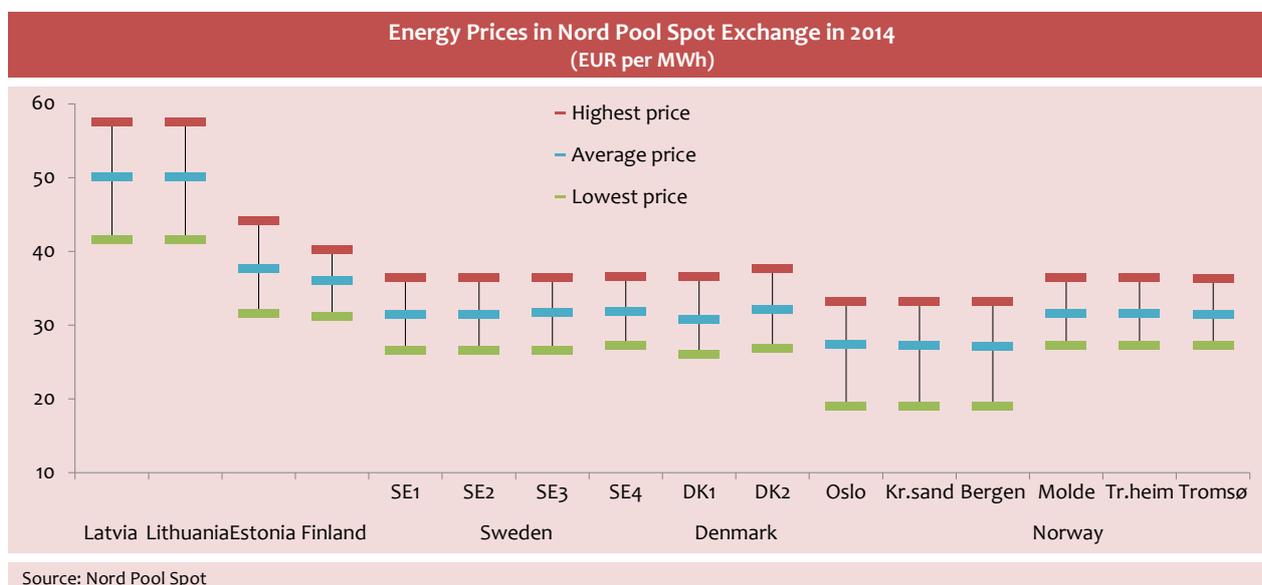
The third Latvian-Estonian interconnection is strategically important since it allows preventing overload of the current transmission networks and increasing the available transmission capacity of the Estonian-Latvian interconnection. The third Latvian-Estonian interconnection project will significantly improve the electricity supply security in the interconnection between Estonia and Latvia, as well as electric systems of both countries, by ensuring an efficient power transit corridor between the Baltic and Northern energy systems. The

third Latvian-Estonian interconnection would facilitate also the development of infrastructure of Latvia, Estonia and Lithuania, since implementation of the third stage of the transmission network modernization and reconstruction project *Kurzeme Circle* will allow creating a third Latvian-Estonian interconnection point. Total costs of the Latvian-Estonian interconnection are approximately 112 million euro. Depending on the length of the line to be constructed, Latvia will have to assume costs amounting to 102.3 million euro, while Estonia ~ 9 million euro, and the EU co-funding will be attracted to this project. Currently, the environmental impact assessment of the project is being carried out, and the route is surveyed. It is planned to put the interconnection into operation in 2020.

Both projects – *Third Stage of Kurzeme Circle* and the *Third Latvian-Estonian Interconnection* – were included in the first list of the Projects of Common European Interest (PCEI), and they may further apply for the Connecting Europe Facility (CEF).

Upon assessing the decisive effect of the submitted projects on the development of electricity market in Latvia and in the Baltic States within the framework of CEF, funding in the amount of 55.1 million euro has been granted for the project *Third Stage of Kurzeme Circle*, whereas 112.3 million euro have been granted for the project *Third Latvian-Estonian Interconnection*. As the PCEI list is updated once in two years, the approval of the second PCEI list is envisaged at the end of October/November of 2015.

Figure 6.8



For the development of the energy sector of Latvia and the Baltic States and market integration in the long term, the issue of synchronising of the Baltic electricity transmission system with the continental Europe is significant. In October 2013, the EC published the statement the *Long-term Opinion in the Field of Infrastructure*

in Europe and Outside Europe, which states that one of the challenges in the field of electrical energy is synchronization of the Baltic electrical energy transmission systems with the energy systems of the continental Europe, terminating actual isolation thereof from other EU states.

On 17 July 2009, the Memorandum of Understanding on development of the *Baltic Energy Market Interconnection Plan* (BEMIP) was concluded between the European Commission and eight Baltic States, including the Republic of Latvia. Taking into account that a range of initial BEMIP objectives have been accomplished since 2009, new Memorandum of Understanding and Action Plan was drafted at the end of 2015. On 8 June 2015, the EC, Germany, Estonia, Latvia, Lithuania, Poland, Finland, Sweden, in the presence of Norway as an independent observer, signed the new Memorandum of Understanding. Denmark will sign the document later, as it expects new elections and a new government in the near future.

The Action plan defines six main areas of activity, namely, electricity and gas market, security of supply, energy infrastructure, nuclear energy, renewable energy and energy efficiency, in which new competitive projects are necessary in order to achieve the objectives and indicators laid down in the Action Plan.

Among the most significant issues in the Baltic Region the following are to be mentioned:

- complete implementation of the internal market requirements in the States of the Baltic Sea, including opening of the market to households;
- overload management based on market principles, auctions of indirect capacities among the Baltic States managed by Nord Pool Spot (NPS) (useful for overload management between Latvia and Estonia);
- development of a common reserves and balancing power market;
- development of a market place for financial products in Latvia and Lithuania, starting operations of *Nasdaq OMX Commodities*;
- implementation of the Baltic State infrastructure projects included in the PCEI list;
- improvement of the elements of the regional dimension of the Pan-European electricity market models being currently developed;
- desynchronizing of the electric power systems of the Baltic States from the electric power systems of Russia in the long term.

Box 6.11

Mandatory Electricity Procurement Component

Taking into account the risk assessments carried out by the Ministry of Economics in 2012 and 2013 in relation to the increase in the total electricity price, as well as in order to gain assurance regarding the validity of intensity of the mandatory procurement of electricity and the guaranteed payment for the installed electric capacity, in 2014, complex measures were implemented with an aim to keep the mandatory procurement component (hereinafter referred to as the MPC) at the level of 2.69 euro cents per kilowatt-hour, including measures aimed at receiving the decision of the European Commission on the compatibility of aid with the internal market.

In 2015, similarly to 2014, additional funds are planned to be used from the state budget for the aid to electricity consumers. The funds are mainly ensured from the subsidised electricity tax (SET) introduced on 1 January 2014, and directly reduce the impact of the MPC costs on all end users of electricity. Pursuant to Annex 4 to the *Law on State Budget for 2015*, the sub-programme 29.02.00 *Aid to Electricity Consumers* provides for the funds of 28 million euro in 2015. The MPC volume has not increased for electricity consumers in Latvia since 1 April 2014. The implementation of aid to electricity consumers from the state budget funds is planned until 2017.

The increase of the mandatory procurement component and respectively the total price of electricity has a negative impact on the competitiveness of the national economy of Latvia, including creation of the added value. It is necessary to implement the policy that ensures the growth of the economy and eliminates worsening of the living standard of population.

In the meeting of state secretaries on 7 May 2015, the Ministry of Economics announced the draft Cabinet Regulation "Procedures, according to which energy-intensive enterprises of manufacturing are to obtain the right to the reduced participation for the compensation of losses to a public seller occurred within the mandatory procurement of electricity and guaranteed price" (VSS-500), its annexes and annotation.

The Cabinet Regulations are aimed at the improvement of the international competitiveness of the energy-intensive enterprises, creation of positive signals to increase the amount of the investments and the number of well-paid jobs, and promotion of the national economy by gradually increasing the share of the manufacturing in the gross domestic product.

The precondition for the implementation of the Cabinet Regulation is ensuring conformity of the aid mechanism to new EC Guidelines on State aid for environmental protection and energy 2014–2020, obtaining an agreement from the European Commission on its conformity to the internal market of the European Union prior to commencing the aid, and non-increase in the MPC costs for other electricity consumers as a result of the said aid mechanism.

A great challenge for the Ministry of Economics is related to further development of renewable energy and possibilities of creating a new aid mechanism. Until then, a decision must be made in 2015 regarding the need to continue moratorium in relation to the aid mechanism in the form of mandatory electricity procurement and a guaranteed payment for the installed capacity (Cabinet Regulations No.221 of 10 March 2009 and Cabinet Regulation No. 262 of 16 March 2010), including by understanding that the further aid for fossil energy resources will not comply with the new EC Guidelines on State aid for environmental protection and energy 2014-2020.

Natural Gas Market

The Latvian gas supply system is not connected to the European Union common gas supply system. Latvia receives natural gas only from Russia, however, since Klaipeda liquefied gas terminal started its operation at the beginning of 2015, Latvia can obtain a limited volume of

gas deliveries from Lithuania. The only natural gas storage in the Baltic States – the Inčukalns underground gas storage facility (UGSF) with the total capacity of 4.3 billion cubic meters, including the volume of the active natural gas of 2.3 billion cubic metres – is located in Latvia. In 2013, natural gas consumption was 1,461

million m³ or by 3.1% lower than in 2012. The largest consumers of natural gas in 2013 were CHP and heat supply enterprises of JSC “Latvenergo” – 68.9%, manufacturing and construction – 11.9%, other

consumers – 16.8%, while the remaining part was formed of the consumption and loss of natural gas in the energy sector. The Riga region uses about 65% of the natural gas consumed in Latvia.

Figure 6.9

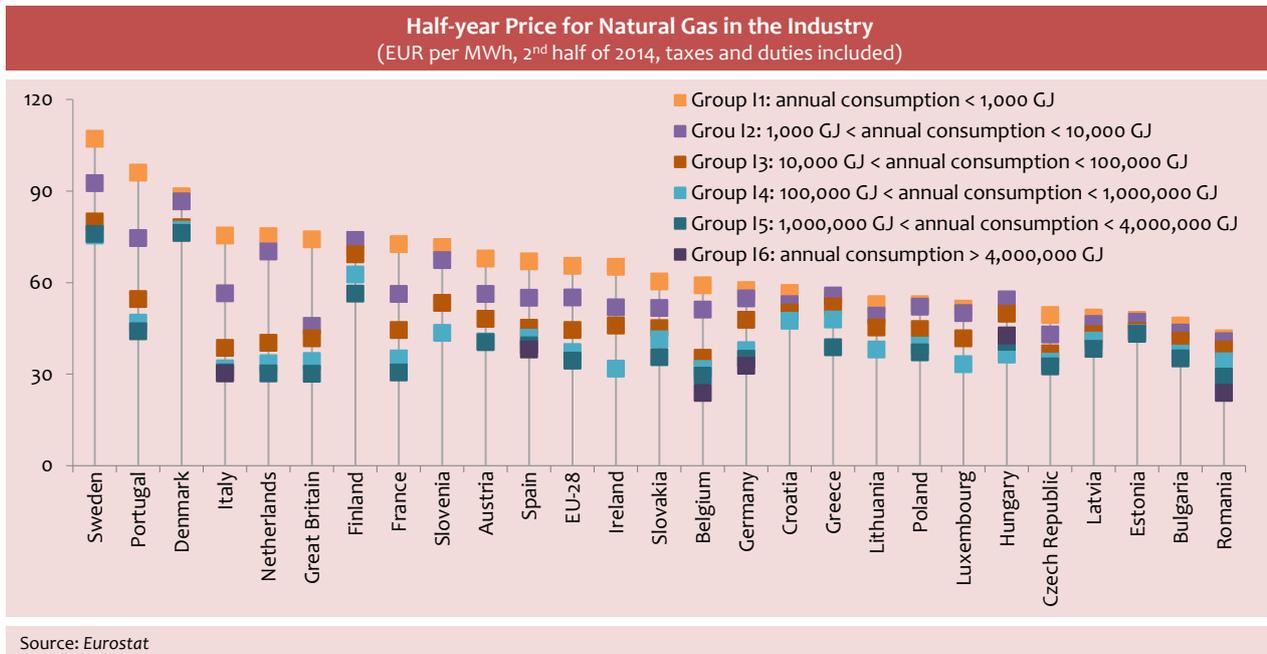


The wholesale prices for gas in the Baltic States are higher than on average in the EU. At the same time, it should be noted that retail sales prices for households and industrial consumers in the Baltic States are close to the average level of the EU. It is due to several factors, for instance, the costs of the infrastructure, including

storage options and transmission tariffs, as well as the tax policy.

Currently, JSC “Latvijas Gāze”, which, according to the *Privatisation Agreement* signed in 1997, has the exclusive rights to carry out transmission, distribution, storage, and trade of natural gas until 2017, is the only enterprise operating in the Latvian natural gas market.

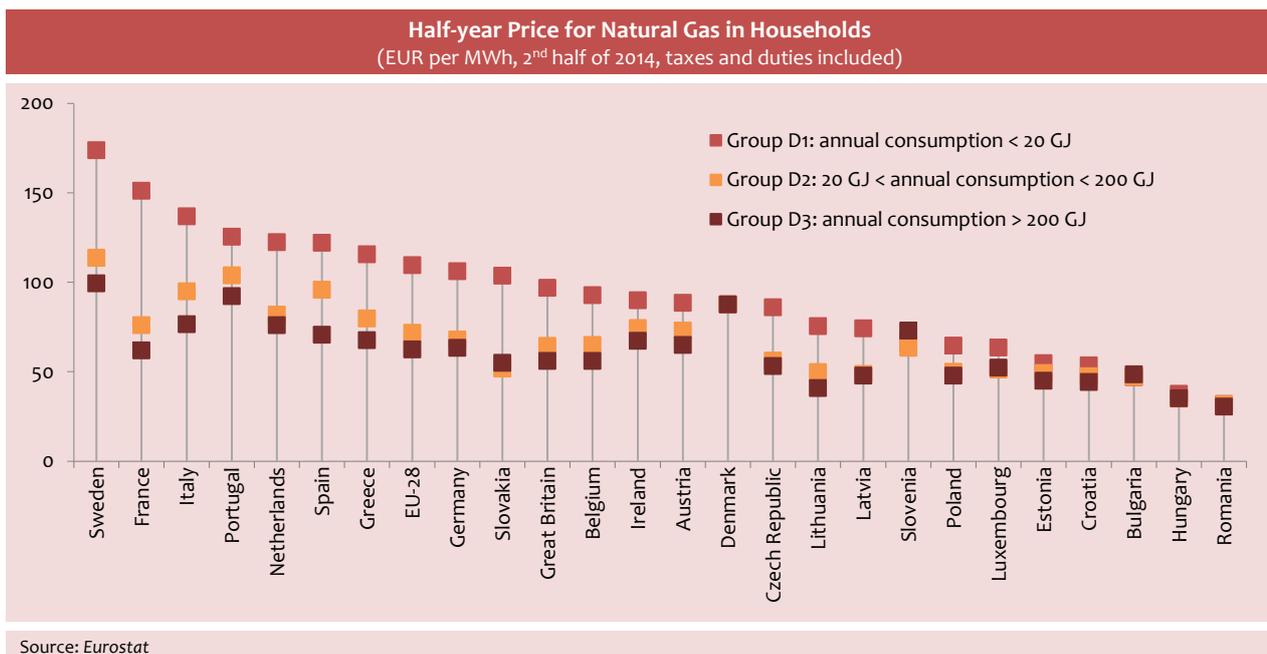
Figure 6.10



The natural gas market at the EU level is regulated by the *Directive 2009/73/EC* of the European Parliament and of the Council of 13 July 2009 concerning common

rules for the internal market in natural gas and repealing *Directive 2003/55/EC (Directive 2009/73/EC)*.

Figure 6.11



Considering the fact that the Latvian natural gas supply system is not connected to the EU common natural gas supply system, Latvia applies the exemption “isolated market” from *Directive 2009/73/EC* until 2017. On 20 March 2014, the Saeima approved the draft law *Amendments to the Energy Law*, envisaging gradual market liberalization, stating that all consumers of natural gas will be entitled to choose a natural gas supplier from 3 April 2017. The separation of the distribution system operator must be completed by that time. The separation of the distribution system operator must be completed by 3 April 2017, unless one of the following conditions occurs:

- the natural gas system of Latvia is directly connected to an interconnected natural gas system of a EU Member State, except for that of Estonia, Lithuania and Finland;
- the dominant supplier’s share in the total natural gas consumption of Latvia is less than 75 per cent.

At the same time, the amendments envisage that as of 4 April 2014 the operators of the natural gas transmission, distribution, storage and liquefied natural gas system must ensure equal and open access to the respective system to all users of the system and applicants requiring such access, providing natural gas transmission, distribution, storage and liquefied natural gas system services to them. Taking into account that the first commercial natural gas supplies under the first long-term contract in Latvia were carried out on 3 April 2004, Latvia applied the exemption from requirements related to third party access to the natural gas supply system of *Directive 2009/73/EC* until 4 April 2014.

In relation to third persons' access to the natural gas system pursuant to the *Energy Law*, the Public Utilities Regulator shall approve the regulations on natural gas transmission, distribution and storage or the regulations on the use of the system or the use of natural gas depository drawn up by the system operator, which shall be objectively based, economically justified, fair, equal,

transparent and accessible to all system users and applicants who request access to the relevant system. At the same time, pursuant to the Law, the regulator shall approve balancing calculation regulations drawn up by the system operator, which shall be transparent and non-discriminating to all users of the balancing service, and criteria for requesting guarantees, and the procedures to ensure payments for the balancing service.

In September 2014, JSC “Latvijas Gāze” submitted to the Public Utilities Regulator the draft JSC “Latvijas Gāze” Regulations on the Use of Natural Gas Transmission System and draft JSC “Latvijas Gāze” Regulations on the Use of Inčukalns Underground Storage Facility. The draft Regulations on the Use of Natural Gas Transmission System establish procedures, according to which users can apply for free capacity of international transmission system owned by JSC “Latvijas Gāze”, the rights and obligations of the transmission system operator and users, payment procedures for use and balancing of the transmission system, terms and procedures for publishing internal information by the transmission system operator. The draft Regulations on the Use of Inčukalns Underground Storage Facility lay down the procedures, according to which users can make reservation of the free capacity of the underground storage facility, the rights and obligations of the storage facility operator and users, payment procedures for use of the storage facility, and terms and procedures for publishing internal information by the storage facility operator. Several public discussions regarding the regulations were held, and currently, the draft regulations will be detailed to ensure compliance of their provisions to the existing situation and regulatory enactments.

Continuing the liberalization of the gas market, the Cabinet of Ministers approved the further road map for the reforms of the market on 3 March 2015, as well as passed a resolution about the model of separation of the transmission system operator – complete separation of the ownership as of 3 April 2017.

Box 6.12

Natural Gas Supply Diversification Projects

GIPL will connect the Rembelszczyzna gas compressor station in Poland with the Jauniunai gas compressor station in Lithuania. The aim of the project is not only to integrate the isolated natural gas market of the Baltic States into the EU, but also to ensure access to the EU gas trade platforms (for example, to the Central European Gas Trade Platform (CEGH)) and the Global Liquefied Natural Gas (LNG) market. A preliminary survey was carried out in 2011, and a feasibility study of the project was prepared in 2013. Construction of GIPL is planned for 2016–2019, though, considering the scale and nature of the project, time limits for implementation may be changed. The project investors are the Lithuanian company “Amber Grid” and the natural gas transmission operator of Poland GazSystem S.A. For the development of the feasibility study of the project, 50% of funding were received from the EU. GIPL has been included in the list of the EU priority projects, and funding of 306 million euro was allocated to the project in November 2014 within the framework of CEF. The total construction costs of GIPL are estimated at 558 million euro. Construction of GIPL will provide Latvia with access to other sources of natural gas supply, apart from Russia, and it will integrate the isolated natural gas market of the Baltic States in the EU natural gas market.

The EC research carried out by an independent expert concludes that the optimum site for a regional LNG terminal is the Gulf of Finland. It should be noted that a significant role in the operation of the Baltic region natural gas market is played by Inčukalns UGSF in all scenarios.

In order to diversify the natural gas market in Latvia and the entire Baltic region, it is necessary to ensure an alternative supplier of natural gas in the market. It is possible by (see Box 6.12):

- constructing the interconnection GIPL of the gas supply systems between Lithuania and Poland provided for in BEMIP;
- implementing a regional liquefied natural gas (LNG) terminal project;
- ensuring third party natural gas supplies to the region through the existing infrastructure (i.e. diversifying sources of natural gas rather than ways).

Since Inčukalns UGSF is an essential element of the Baltic region natural gas supply system, ensuring gas supply not only to Latvia, but also to Estonia and Russia, as well as serves as a security reserve for Lithuania, the project *Modernization and Enlargement of Inčukalns UGSF* will be implemented.

The aim of the project is to increase the level of energy supply security in the Baltic Sea region, as well as to enhance diversification of ways and sources for the supply of energy resources after the completion of GIPL and Estonian-Finnish interconnections. The estimated project costs for modernization are 191 million euro, for enlargement – 360 million euro. The first stage of the Modernization and Enlargement of Inčukalns UGSF project provides for increasing the natural gas retrieval capacity. Currently, 30 million cubic meters of natural gas can be retrieved in 24 hours. It is expected that the natural gas retrieval capacity in 2020 will be 32 million cubic meters in 24 hours. In situations when the natural gas demand will be higher than normally, for instance, due to weather or interruptions in natural gas supplies from third countries, Inčukalns UGSF will be able to grant the required volume not only in Latvia, but also in Lithuania and Estonia.

Box 6.13

Centralized Heat Energy in Latvia

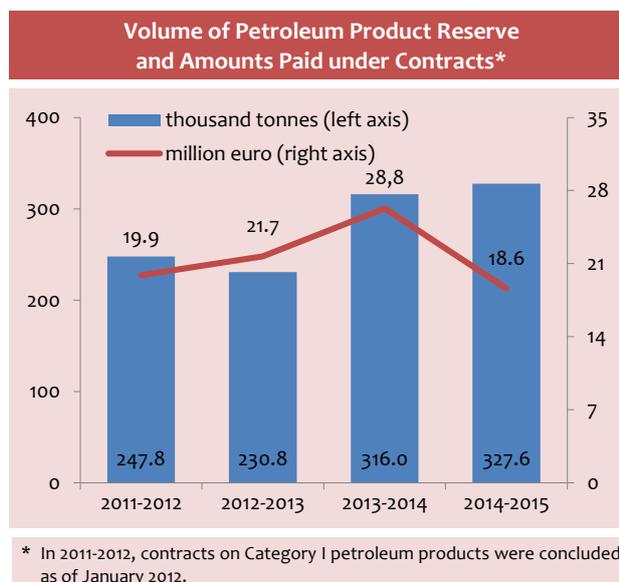
In 2013, centralized heat energy was produced for sale in 638 boiler houses and 166 co-generation stations, in total, they produced 7.3 TWh centralised heat energy. Natural gas was the main resource for generating heat energy and electricity. The share of the centralized heat energy produced using natural gas as fuel was 69.8%, 20.1% woodchips, 2.8% firewood, 0.2% heavy fuel oil, and other types of fuel – 4.1 per cent.

The consumption structure of centralized heat supply has remained unchanged over the past years, with central heating comprising 65-70% and hot water supply – 30-35%. Since 2013, 71.1% of the total centralized heat energy final consumption has been distributed to households, 25.6% – to services, 2.2% – to industrial and construction sector, 1.1% – to agriculture. The breakdown of the centralized heat energy final consumption distributed by regions is the following: Riga region – 55.8%, Pierīga region – 10.6%, Vidzeme – 6.6%, Kurzeme – 9.8%, Zemgale – 7.4%, and Latgale – 9.8 per cent.

Security Stocks of Petroleum Products

As of 1 January 2013, the method for calculation of the petroleum product security reserve has been changed, thus, an EU Member State within the Community territory must ensure the largest stock of petroleum products of the two recommended by the Community: either for 90 net import average volume days or for 61 average domestic consumption days. Since Latvia is an importer of petroleum products, petroleum product security reserves are formed for 90 net import average volume days.

Figure 6.12



Renewable Energy Resources

Latvia, like other EU Member States, has committed to achieving the quantitative target set in the *Directive 2009/28/EC* on the promotion of the use of renewable energy resources and amending and subsequently repealing *Directives 2001/77/EC* and *2003/30/EC*, and in the *National Reform Programme of Latvia for the Implementation of the “Europe 2020” Strategy* – to achieve a 40% share of renewable energy in the gross final energy consumption, as well as a 10% share of renewable energy in the gross final energy consumption in the transport sector in 2020. Cost-efficient use of local energy resources and safe energy supply are among the main conditions of national economic independence and energy supply safety. Therefore, it is even more important to improve the efficiency of the existing heat supply systems and use energy resources more efficiently, thus contributing greatly to the reduction of greenhouse gas emissions.

Amendments to the Cabinet Regulation No. 382 *Application of Electricity Tax Exemption Procedures* adopted on 12 June 2007 have been introduced by increasing the liquidity and transparency of the Latvian trade region of the electrical energy exchange NordPoolSpot, ensuring conformity of electricity prices to the current market situation, which will ensure a positive effect on the development of the Latvian national economy in future.

To find a solution for the support of energy intensive enterprises in Latvia, reducing the negative effect of the increase in electricity costs on competitiveness of these enterprises, the Ministry of Economics has announced the draft Cabinet Regulation “*Procedures, according to which energy-intensive enterprises of manufacturing obtain rights to reduced participation in the compensation of mandatory electricity procurement and guaranteed payment expenses to public trader*” (*VSS-500*), its annexes and annotation in the meeting of state secretaries on 7 May 2015.

Table 6.6

Share of Energy Produced from Renewable Energy Resources (per cent, in accordance with the methodology of Directive 2009/28/EC)							
	2000	2005	2009	2010	2011	2012	2013
In the gross energy final consumption	33.0	32.3	34.3	30.4	33.5	35.8	37.1
In the electricity sector	50.5	43.0	41.9	42.1	44.7	44.9	48.8
In heating and cooling	39.7	42.7	47.9	40.7	44.8	47.4	49.7
In the transport sector	1.5	1.4	1.1	3.3	3.2	3.1	3.1

By 2020, not only the contribution of the existing instruments, but also the support measures for energy produced from renewable resources chosen to be implemented during the following years will be critical for Latvia to contribute to the prevention of climate changes and reduction of the import of fossil energy resources,

making a particular emphasis on the sector of heat supply. When implementing new support measures for electrical energy produced using renewable resources, development of economically disadvantageous projects shall be limited.

Insert 6.14.

Renewable Energy in Latvia

Taking into account the objective of Latvia under the *Directive 2009/28/EC* and the *National Reform Programme of Latvia for implementation of the EU 2020 strategy* to reach 40% share of renewable energy by 2020, a share of 37.1% was achieved in 2013.

In 2013, the gross electricity production volume reached 6209 GWh, which is by 0.7% more than in 2012. 56.9% (3534 GWh) of the total gross electricity volume produced was generated from RE (HPPs, wind, biogas, biomass, etc.).

In 2014, the total installed capacity for electricity production from RE increased by 16 MW, as compared to 2013, constituting 1780 MW in total. In 2014, the total installed capacity of wind generators was 69 MW (67 MW in 2013), whereas the installed capacity of biomass and biogas plants – 121 MW (108 MW in 2013), increasing the volume of the produced electrical energy as well.

A total of 24.5 thousand tonnes of biofuel (pure biofuel or mixture of fossil fuel and biofuel) was used for transport in Latvia in 2012. In 2013, compared to 2012, the consumption of biofuel in the final energy consumption for transport decreased, dropping to bioethanol consumption of 264 TJ (279 TJ in 2012) and biodiesel fuel consumption of 521 TJ (526 TJ in 2012).

The decision of the European Council on the framework of the EU climate and energy policy for the period until 2030 adopted at the meeting of 23-24 October 2014, and objectives of policies arising out of the framework must be also taken into account.

In order to significantly increase the production of electricity and heat energy from renewable resources, diversify primary energy resource supply and increase the

coverage of electricity, the activity 3.5.2.2 **Development of Co-generation Power Plants Utilising Renewable Energy Sources** of the supplement to the Operational Programme Infrastructure and Services is being implemented. Contracts on implementation of 10 projects have been concluded within the selection of project applications for the Cohesion Fund’s (CF) financing in the amount of EUR 28.8 million.

Table 6.7

Final Consumption of Energy in the Transport Sector							
	2000	2005	2009	2010	2011	2012	2013
TJ							
Final Consumption of Energy	32239	45746	48401	50855	45984	44713	45315
Fossil fuel	31692	45106	47792	49265	44603	43444	44084
Biofuel, including:	–	107	173	1137	935	705	785
Bioethanol	–	–	108	350	318	279	264
Biodiesel fuel	–	107	65	787	617	526	521
Electricity	547	533	436	453	446	464	446
per cent							
Fossil fuel	98.3	98.6	98.7	96.8	96.9	97.1	97.2
Biofuel	–	0.2	0.4	2.3	2.1	1.8	1.8
Electricity	1.7	1.2	0.9	0.9	1.0	1.1	1.0

In order to achieve the set objective for the share of renewable energy generated from renewable energy resources in the gross final energy consumption in the transport sector, the consumption of biofuel should be promoted in various sectors, as well as the use of environmentally-friendly private and public means of transport and additional measures aimed at the development of the public and private electric transport infrastructure, for example, electrification and private electric vehicle charging should be introduced.

Energy Efficiency

While implementing the energy efficiency measures within the sector of energy final consumption and energy transformation, Latvia attempts to achieve the set energy saving target – to save 0.67 Mtoe by 2020. Along with this, Latvia must also achieve the state mandatory energy final consumption saving of 0.850 Mtoe by 2020, as well as to renovate 3% of the area of the central governmental buildings each year.

The adoption of the requirements of the *Directive 2012/27/EU* of the European Parliament and of the Council of 25 October 2012 on energy efficiency, amending *Directives 2009/125/EC* and *2010/30/EU* and repealing *Directives 2004/8/EC* and *2006/32/EC* in laws and regulations is being continued. The draft law *Energy Efficiency Law* has been approved in the Cabinet of Ministers on 19 May 2015. The aim of the law is to ensure energy efficiency in the energy production, distribution and final consumption, imposing obligations on the public sector, local governments and private sector.

In addition, new informative regulatory enactments and amendments thereto have been and will be developed.

To standardise the registration of the energy efficiency, the Ministry of Economics together with the associations representing the sector and the companies

have developed *Energy Saving Catalogue* that is available on the website of the Ministry.

The largest challenges of the Ministry of Economics in the coming years will be related not only to the development of the support instruments for increasing energy efficiency of multi-apartment residential houses, the public sector and heat supply, but also with identification of additional alternative measures with the purpose to reduce the amount of energy efficiency duty scheme and implementation of comprehensive centralised heat supply and high efficiency co-generation evaluation.

To increase the efficiency of energy production, to minimize the loss of thermal energy in the transmission and distribution systems and to promote the substitution of fossil fuel with renewable fuel, several projects are implemented within the framework of CF. 135 agreements on the implementation of projects for the total amount of 75.87 million euro of CF funding have been concluded by 21 May 2015 within the framework of the activity 3.5.2.1.1 *Measures to Increase Efficiency in the Centralized Thermal Supply Systems of the supplement to the Operational Programme Infrastructure and Services*, of which 67 projects for the amount of 48.04 million euro of CF funding have been completed. Agreements on the implementation of five additional approved projects have not been concluded (CF funding – 3.15 million euro). In total, 349 MW thermal capacity is planned to be installed within the projects, 180 km of the heat networks are planned to be reconstructed.

Energy Efficiency of Energy-Consuming Products

The EC continues working on improving energy efficiency (eco-design) of energy-consuming products to reduce the negative impact of such products on the environment and to achieve higher energy savings over their lifetime, as well as on the development of energy

labelling for various product groups to raise consumer awareness of energy efficiency.

More than 30 EC regulations on eco-design and energy labelling have been adopted since 2008, setting specific energy efficiency and labelling requirements for energy-consuming products, which are binding on the Latvian producers, importers and distributors. Eco-design and energy labelling regulations apply to such product groups as household and office equipment, lighting, household appliances (including TV sets, washing machines, air cooling devices, vacuum cleaners,

etc.), heating and cooling equipment, etc. (a full list of adopted eco-design regulations is available on the EC Directorate-General for Enterprise and Industry websites (eco-design – http://ec.europa.eu/energy/efficiency/ecodesign/doc/overview_legislation_eco-design.pdf; energy labelling – http://ec.europa.eu/energy/efficiency/labelling/doc/overview_legislation_energy_labelling_household_appliances.pdf). Regulations are expected to be adopted for at least another 15 product groups, including compressors, windows, wastewater pumps and showerheads, within the next two years.

6.5 Construction and Home Policy

The improvement of the business environment, the improvement of the national supervision system, as well as the reduction of the administrative burden are some of the main aims in the national **construction policy**. One of the tools to achieve these goals is the improvement of the system of laws and regulations governing the area of construction and the improvement and optimisation of the institutional system of the sector.

In 2014, a new *Construction Law* has entered into force. It was prepared to create a state-of-the-art and modern regulatory framework for the construction process, in order to harmonise national law with EU laws and regulations and to promote the development of the construction sector, as well as to advance the possibilities for the society to co-operate in the decision-making, by ensuring maximum protection of the person proposing construction and the interests of society. To ensure the complete settlement of the construction process, in relation to the law, Cabinet regulations were developed and construction codes are currently reviewed and updated, according to the *Construction Law*. Related construction codes should be revised by 1 July 2015.

To ensure complete adaptation of the *Eurocode standards* into the system of laws and regulations regulating construction and to improve the national standardization system for construction in Latvia, the Ministry of Economics, in co-operation with the Latvian Association of Structural Engineers and the Standardization Technical Committee LVS/STK 30, ensured the translation of 17 *basic Eurocode standards*, 31 amendments to standards and 5 supplements to standards into Latvian and their transposition into the national standardization system, as well as developed 26 national annexes to the *Eurocode standards*.

On 23 December 2014, the Cabinet of Ministers approved two Latvian construction codes – LBN 204-14 “*Design of steel structures*” and LBN 206-14 “*Design of wood structures*”, which set the requirements for the design of steel and wood structures in buildings and engineering structures.

On 26 May 2015, five Latvian construction codes were approved at the Cabinet of Ministers’ session: LBN 203-15 “*Design of concrete structures*”, LBN 212-15 “*Design of*

steel and concrete composite structures”, LBN 205-15 “*Design of stone structures*”, LBN 215-15 “*Design of earthquake-resistant structures*”, LBN 213-15 “*Design of aluminium structures*”, which set the requirements for the design of concrete, stone, aluminium, steel and concrete composite structures, as well as earthquake-resistant structures in buildings and engineering structures.

On 2 June 2015, the Cabinet of Ministers approved the Latvian construction code LBN 207-15 “*Geotechnical design*”, which sets the requirements for geotechnical design.

According to the regulations of construction codes, the limited liability company “*Standartizācijas, akreditācijas un metroloģijas centrs*” (Standardization, Accreditation and Metrology Centre) publishes on the website of the Standardization office www.lvs.lv a list of those Latvian national standards and national annexes to respective standards, which are applicable to the implementation of construction codes for structures.

Regulation (EU) No 305/2011 of the European Parliament and of the Council of 9 March 2011 laying down harmonised conditions for the marketing of construction products and repealing the Council *Directive 89/106/EEC* prescribes several measures to simplify the acquisition of CE marking thus reducing the administrative burden on companies, especially microenterprises, which will be offered a simplified opportunity to provide their products with CE marking, if the construction products they place in the market do not raise safety considerations.

On 10 February 2015, the Cabinet approved amendments to the Cabinet of Ministers Regulations *Procedures for the Market Surveillance of Construction Products*, laying down the procedure for evaluation of compliance of construction products, which are not subject to harmonised technical specifications and Latvian national standards defined in the Annex 1 to the Regulations — the regulations now include minimum requirements for documentation to be enclosed with each batch of produced construction products, when offering the construction product in the Latvian market. These amendments updated the *Procedures for the Market Surveillance of Construction Products*, which ensure the

availability of information on all construction products offered in the Latvian market.

To ensure quality and safety of construction, as well as to improve the state surveillance system in the construction sector, the Building Control Bureau ensures the monitoring of the operation of public buildings as of 1 January 2015, and will start to ensure national control of construction works of new public buildings and commissioned public buildings as of 1 July 2015.

The Latvian Construction Council is operating in Latvia in 2015, to promote public participation in the development and implementation of construction policies, and its goal is to provide the Ministry of Economics and other sectoral ministries with recommendations for draft laws and regulations and draft policy planning documents, as well as draft EU international laws and regulations affecting the construction sector according to public interests, and to inform the public on the latest news in the construction sector.

By 20 May 2015, 5286 merchants (the number of active construction merchants), incl. 392 construction merchants in 2015, have been registered in the **Register of Construction Merchants** maintained by the Ministry of Economics, which was created on 1 July 2005 and has

been available in the Construction Information System (https://bis.gov.lv/bisp/lv/construction_merchants) since 2014.

The registration in the Register of Construction Merchants entitle merchants to perform commercial activities in one or more construction areas, as well as in the area of architecture or electric energy. The Register of Construction Merchants includes data on merchants and construction specialists employed by them (architects, engineering research specialists, designers, construction experts, managers or supervisors of construction works), data about the scope of construction works provided by construction merchants themselves and by the use of subcontractors, data about the average number of persons employed in construction and the violations committed by construction merchants in construction, which have been found according to laws and regulations and reported to the register, as well as remarks about exclusion from the Register of VAT Payers of the State Revenue Service for violations of laws and regulations.

8580 construction specialists (the number of active construction specialists), to whom 10 691 certificates have been issued, including 668 certificates issued in 2015 (including re-registered certificates), are registered in the **Register of Construction Specialists** (<https://bis.gov.lv/bisp/lv/certificates>).

Box 6.15

Improvement of the Regulatory Framework

The Following Cabinet of Ministers orders and regulations were issued according to the *Construction Law* and Cabinet of Ministers' Regulations of 7 October 2014 No 610 *Regulations for Evaluation of Competence and Supervision of Permanent Practice of Construction Specialists* to delegate the evaluation of competence and the supervision of independent practice of construction specialists in engineering research, design, management and supervision of construction works:

- Cabinet of Ministers decree No 181 of 14.04.2015 *On delegation of the evaluation of competence and the supervision of independent practice of construction specialists to the "Latvian Union of Heat, Gas and Water Technology Engineers";*
- Cabinet of Ministers decree No 182 of 14.04.2015 *On delegation of the evaluation of competence and the supervision of independent practice of construction specialists to the "Latvian Association of Electric Energy and Energy Construction Specialists";*
- Cabinet of Ministers decree No 183 of 14.04.2015 *On delegation of the evaluation of competence and the supervision of independent practice of construction specialists to the "Latvian Association of Architects";*
- Cabinet of Ministers decree No 184 of 14.04.2015 *On delegation of the evaluation of competence and the supervision of independent practice of construction specialists to the "Latvian Association of Construction Engineers";*
- Cabinet of Ministers decree No 185 of 14.04.2015 *On delegation of the evaluation of competence and the supervision of independent practice of construction specialists to the "Latvian Fraternity of Electricians";*
- Cabinet of Ministers decree No 186 of 14.04.2015 *On delegation of the evaluation of competence and the supervision of independent practice of construction specialists to the Railwaymen Association of Latvia;*
- Cabinet of Ministers Regulations No 176 of 07.04.2015 *Price list of paid services provided by the "Latvian Union of Heat, Gas and Water Technology Engineers" at the order of the public administration;*
- Cabinet of Ministers Regulations No 177 of 07.04.2015 *Price list of paid services provided by the "Latvian Association of Architects" at the order of the public administration;*
- Cabinet of Ministers Regulations No 178 of 07.04.2015 *Price list of paid services provided by the Railwaymen Association of Latvia at the order of the public administration;*
- Cabinet of Ministers Regulations No 179 of 07.04.2015 *Price list of paid services provided by the "Latvian Association of Construction Engineers" at the order of the public administration;*
- Cabinet of Ministers Regulations of No 180 07.04.2015 *Price list of paid services provided by the "Latvian Fraternity of Electricians" at the order of the public administration;*
- Cabinet of Ministers Regulations of No 181 07.04.2015 *Price list of paid services provided by the "Latvian Association of Electric Energy and Energy Construction Specialists" at the order of the public administration.*

On 15 April 2015, delegation agreements were concluded with the authorities verifying competence of construction specialists.

Starting from 2016, the Building Control Bureau will be in charge of evaluation of competence and the construction examinations, supervising the independent practice of construction specialists.

The Register of Construction Specialists registers persons, who have obtained rights to independent

practice in engineering research, design, management and supervision of construction works and construction

inspections, or have obtained a construction specialist certificate. The Register of Construction Specialists includes information on the construction specialist's education, independent practice (list of works in the performance of which the construction specialist has participated), information about the certificate, which is granted to the construction specialist (area, speciality and area of activities), information about decisions made by the competence verification authority and documents related to these decisions, with regard to the specialist, and the information on professional improvement of the construction specialist.

By 20 May 2015, 233 persons (the number of active construction inspectors) who are granted construction control rights, incl. 15 construction inspectors in 2015, have been registered in the **Register of Construction Inspectors** maintained by the Ministry of Economics, which was created on 4 November 2010 and has been available in the Construction Information System (https://bis.gov.lv/bisp/lv/building_inspectors) since 2014.

The Register of Construction Inspectors:

- **for the acquisition of public control rights for construction works and structures**, registers persons who have obtained a second level vocational higher education in the area of architecture in a study programme for architects or in the area of construction in the study programme for construction engineers, a certificate of a construction specialist and have at least five years long independent practice in the area of architecture or construction;
- **for the acquisition of the public control rights for construction works and use of structures**, registers persons who have obtained a second level vocational higher education in the area of architecture in a study programme for architects or at least a first level professional higher education in the area of construction in the study programme for construction engineers, a certificate of a construction specialist and at least five years long independent practice in the area of architecture or construction;
- **for the acquisition of public control rights for construction works of railway engineering structures**, registers persons who have obtained a second level vocational higher education in the area of railway in a study programme for engineers or at least five years long practice experience in construction of railway engineering structures.

In the process of developing the **Construction Information System**, an e-service was created, to provide information to competence verification authorities on education, independent practice and professional improvement of construction specialists, for the evaluation of competence and supervision of independent practice.

As the development of the project progressed, besides the already existing registers of construction merchants, construction specialists, construction inspectors and managers, a Register of Independent Experts in the Area of Energy Efficiency of Buildings, and a Register of Energy Certificates of Buildings were included in the Construction Information System, and also e-services are developed, including a review of a construction concept, issue of a construction permit, coordination of simplified reconstruction or renovation and commissioning of buildings, as well as electronic application forms in registers.

When the system is implemented in full, the public will obtain a convenient and expedient mechanism to trace processes in the construction sector, and an option for public control of the construction, which will reduce the possibility of starting illegal construction or corruption.

In the area of **housing policy**, Cabinet *Regulations on Determination, Calculation and Registration of the Portion to be Paid by Owners of Residential Houses* are being drafted. It prescribes the criteria or methods for the distribution of all the services required for maintenance of a residential house under Section 6(2)(1)(b) of the *Law On Administration of Residential Houses* — heat energy, also natural gas, water supply and sewerage, and removal of domestic waste.

Cabinet *Regulations on Public Aid for Acquisition or Construction of a Residential Space* entered into effect on 5 August 2014. These regulations prescribe that Joint Stock Company “*Latvijas attīstības finanšu institūcija*” (Latvian Development Financial Institution) issues a guarantee to persons, who live together with or have in their custody at least one minor. From the start of the support programme and until 31 March 2015, 78 guarantees for the total guarantee amount of 448.2 thousand euro have been granted.

By 20 May 2015, 618 managers (the number of active managers), incl. 17 managers in 2015, have been registered in the **Register of Managers of Residential Houses** maintained by the Ministry of Economics. It was created on 1 January 2012 and has been available in the Construction Information System (https://bis.gov.lv/bisp/lv/house_managers) since 2014.

The main task of the Register of Managers of Residential Houses is to provide the latest information on persons handling or wishing to handle the management of residential houses and meeting the requirements of the law. This register includes information about services of managers according to the NACE classification, the territory of provision of the services, qualification of the manager or its employees, and the register also contains a remark on the rights of the manager to offer management services in the market, depending on the professional qualification acquired. The data of the register on the residential houses managed by the manager are available to registered users of the system.

6.6 Tourism Policy

The tourism policy in Latvia is developed with a view of promoting the development of domestic and international tourism, increasing the competitiveness of the tourism industry and export of tourism services.

In 2010, *the Latvian Tourism Marketing Strategy 2010-2015* was developed and approved, defining the vision of development of tourism in Latvia and objectives for achieving it, as well as determining Latvian priority tourism products, key principles of their development and target markets. According to the priorities set out in the strategy and involving the representatives of the tourism industry, a new image of Latvian tourism was developed, which has become a unifying idea and common element of the product and marketing development activities in the public and private sectors.

On 1 July 2014, a medium-term tourism policy planning document *Latvian Tourism Development Guidelines 2014-2020* was adopted, where MICE tourism (meetings, incentives, conferences, and exhibitions), wellness tourism, nature tourism, culture tourism and creative industries were established as the strategic forms of tourism. Sustainable development of Latvian tourism, promoting the increase of competitiveness of tourism services in foreign markets, has been set as the objective of the tourism policy. The policy results and performance indicators to be achieved are:

- an increase in the number of foreign overnight travellers;
- an increase in the average occupancy (bed occupancy rate) of accommodation establishments outside the busy summer season (except for June-August);

- an increase in the daily average expenditure of a foreign overnight traveller;
- an increase in the total annual expenditure of foreign overnight travellers.

The main lines of action:

- to ensure the recognition of the Latvian tourism offer in the target markets, especially through modern means of communication;
- to promote the improvement of the quality of tourism products, also by ensuring a better regulatory framework of the industry and support both to the tourism businesses and consumers of the products;
- to promote the development of competitive tourism products, supporting the development of new, innovative tourism products with a higher added value, by developing an infrastructure for the growth of tourism, promoting the formation of regional tourism clusters and inclusion of the Latvian tourism product into the common tourism offer of the Baltic Sea Region.

Further development of tourism products must be based on such fundamental values as quality, sustainability (including the introduction of green technologies and approaches), individualization, high added value, cooperation, involvement of tourists/gaining experience and cooperation for ensuring competitiveness.

Box 6.16

Tourism Development Indicators

According to the data provided by the UN World Tourism Organization, the number of international tourists in 2014 reached 1.138 billion, which is by 4.7% or 51 million more, if compared to 2013. America (+ 7%) has shown the best results among the regions, while in other regions the increase is more moderate: + 5% in Asia and Oceania, + 4% in the Middle East and + 2% in Africa. There was a 4% increase in Europe, largely facilitated by the increase in the number of travellers in the Mediterranean countries and Northern Europe (+ 7%).

Traveller survey data show that the number of trips of foreign overnight travellers in Latvia increased by 20% in 2014 (1.8 million), if compared to 2013. In 2014, 1.4 million foreign visitors used the accommodation services in Latvia, which is by 14.5% more than in the previous year. Tour operators in Latvia served 175.1 thousand foreign travellers who purchased package travels in Latvia or abroad. Upon assessing the incoming tourism structure by countries, it can be concluded that, in 2014, Latvia was most often chosen as the destination for overnight travel by tourists from Russia (19%), Lithuania (14%), Estonia (10%), Sweden (9%) and Germany (9%) which, making up 61% of all foreign travellers, corresponds to the high-priority markets defined in the *Latvian Tourism Marketing Strategy 2010-2015*.

Upon assessing the incoming and domestic tourism, it can be concluded that Latvian hotels and other accommodation establishments served 2.1 million Latvian and foreign visitors in 2014 who spent 4.2 million nights there. If compared to 2013, the number of people served increased by 14.1%, while the number of nights spent increased by 10.1%. In terms of bed occupancy rate describing the hotel demand, a moderate increase in hotel occupancy can be observed. However, large seasonal fluctuations can still be observed. The highest rate of hotel occupancy in 2014 was observed in July in the hotels of Latvia in general at 69% and in Riga at 78.9%.

Export of tourism services in Latvia grew by 4.4% in 2014. The expenditure of foreign visitors for recreation and other personal trips in Latvia increased by 14.7%, while the expenditure for business travel decreased by 3.1%. In 2014, the travellers' balance remained positive reaching 182.5 million euro. The travellers' balance in Latvia has been positive since 2011, when the balance was only 3.6 million euro.

To ensure a consistent involvement of industry partners in the implementation of tourism policy, the Advisory Council of the Latvian Tourism Development

Agency (LTDA) has been working actively to bring together authorized representatives of professional and regional tourism associations, the advertising industry, as

well as the Ministry of Foreign Affairs and the Riga Tourism Development Bureau.

Support Measures

In 2015, the main priorities of LTDA, a subordinate institution of the Ministry of Economics, concern the facilitation of a single tourism information system, promotion of the Latvian tourism image and promotion of Latvia as a tourist destination, conducting marketing research in the domestic and international tourism market, improvement of the quality of tourism services, as well as the development of domestic tourism and implementation of international cooperation.

Annual state budget co-financing for facilitating the development of tourism within the framework of the ERDF Operational Programme *Entering External Markets – Strengthening the International Competitiveness of Industries* is redirected towards the following activities:

- organizing national stands at international exhibitions abroad;
- organizing advertising campaigns abroad.

In the first half of 2015, LTDA has ensured the participation of the national stand of Latvia in 9 international tourism exhibitions, organized Latvian tourism presentation events, press conferences and workshops in the priority tourism markets, implemented the Latvian cultural tourism campaign in 8 countries, organised visits of foreign media and tour operators to Latvia, published tourism information materials, regularly published information in the official tourism portal www.latvia.travel and Facebook page *If you like Latvia, Latvia likes you*. A number of marketing studies have been launched, the results of which will be used for the development of the *Latvian Tourism Marketing Strategy 2010-2015*.

In 2015, the total amount of funding (state budget funds and ERDF co-funding, as well as funding for the implementation of the project EDEN) for tourism marketing is 3.6 million euro.

Box 6.17

Improvement of the Regulatory Framework

In the Cabinet meeting of 19 November 2013, the draft decree prepared by the Ministry of Economy was approved granting the status of a resort to the administrative territory of the Jurmala City, except the territories of Varnukrogs, Priedaine and Braziems. The Cabinet Regulations *Procedures for the Granting and Cancellation of the Status of a Resort* regulating the process of granting the status of a resort were adopted on 18 December 2012, while the Jurmala City requested this status in February 2013.

To ensure the inclusion of the “silence means consent” principle (in compliance with the *Directive 2006/123/EC* of the European Parliament and of the Council of 12 December 2006 on services in the internal market) in the registration of tourism agents and operators in the *Travel Agents and Tour Operators (TATO) database*, amendments to the *Regulations Regarding the Rights and Duties of Tourism Operators, Tourism Agents and Clients, the Procedures for the Preparation and Implementation of a Package Tourism Service, the Information to be Provided to a Client and the Procedures for Deposition of Security Guarantee of Money* of 13 April 2010 came into force on 8 February 2013.

To ensure effective implementation of the Council *Directive 90/314/EEC* of 13 June 1990 on package travel, package holidays and package tours, informing both the consumers and other interested parties on the activities of the business operators of the industry, as well as contributing to the prevention of fraud in the industry, the Ministry of Economics established the TATO database (<http://tato.em.go.lv>) in 2010. As of 18 May 2015, a total of 660 business operators were registered in the database, 53 of whom have registered their activity as tour operators, 186 as travel agents and tour operators, but 421 as travel agents. The information contained in the database is publicly available to anyone interested, and the Ministry of Economics invites Latvian travellers to make sure that the activities of the service provider comply with the laws and regulations, in particular regarding the security guarantees on the money paid by the tourists.

International Cooperation in the Field of Tourism

In 2015, Latvia continues to develop closer cooperation in the field of tourism with other countries, especially with high-priority tourism target markets: Lithuania, Estonia, Finland, Sweden, Russia, and Germany. Issues related to the promotion of cooperation in the field of tourism are regularly included on the agenda of foreign visits of intergovernmental commissions and senior government officials.

The funding allocated to the LTDA is primarily used for advertising campaigns and marketing activities in the said target markets.

During the *12th European Tourism Forum* that took place on 17 October 2013 in Vilnius, Lithuania, a protocol was signed on amendments to the *Agreement of the governments of the Republic of Latvia, Republic of Estonia and Republic of Lithuania* on cooperation in the field of

tourism, which can be considered as an international acknowledgment of the progress of the Baltic states in building regional cooperation in the field of tourism.

The amendments to the agreement aim to promote the integration of the Baltic States into international tourism activities. One of the most important amendments provides for the possibility to establish shared tourism information offices or appoint shared tourism representatives in the relevant and third countries. Similarly, amendments to the Agreement clarify and complement the directions of cooperation of the parties, for example, by providing for cooperation in the development of the Baltic tourism brand, reduction of the administrative burden, usage of advanced technology for the development of tourism, as well as development of the projects of various international assistance programmes (e.g., EU funds).

An important step in promoting international cooperation has been the fact that in October 2013, Latvia received an invitation to join the OECD Tourism Committee. Latvian authorities responsible for tourism are expecting to work together with the rest of the OECD Member States in developing the prospects of national and international tourism, as well as promoting sustainable growth of tourism.

In 2015, the national tourism organizations of the Baltic States are cooperating in the implementation of joint marketing activities in the distant markets (Japan, the USA, China), as well as implementing other cooperation activities – organizing an international workshop for tourism professionals, *Baltic Connecting 2015*, visits of journalists and tour operators, publishing informative materials about the Baltic tourism, organizing tourism presentations and a press conference of the Baltic States.

At the international level, representation of Latvia's interests in the field of tourism is mainly ensured by the participation in the work of European tourism authorities. Latvia regularly participates in the work of the European Commission's Tourism Advisory Committee and is an active member of the European Travel

Commission, which deals with facilitating the recognition of Europe, including Latvia, as a tourist destination. In April 2015, the general meeting of the European Travel Commission was organized in Riga with the participation of the representatives of European national tourism organizations and the United Nations World Tourism Organisation.

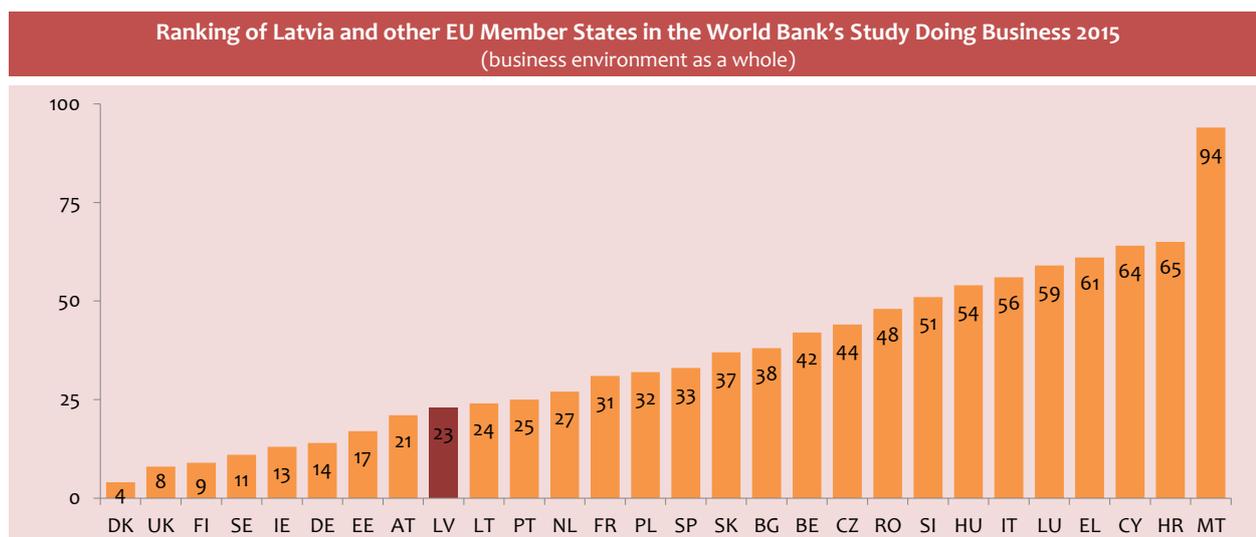
The Latvian Tourism Development Agency continues to implement two EC-funded projects in 2015: the project *European Destinations of Excellence – EDEN* in cooperation with the Lithuanian State Department of Tourism, as well as the project *The Iron Curtain Trail – Euro Velo 13*, which aims to facilitate the development of the *Euro Velo 13* route in countries where it is not yet completed, to develop tourism products for bicycle travellers in order to encourage the flow of tourists along this route. In order to achieve the project objectives, the leading partner of the project and coordinator of *Euro Velo* routes in Europe – the European Cyclists' Federation – after evaluating the current situation and development of the route in each of the countries, has involved national and regional tourism organizations, tour operators and educational institutions as partners, a total of 13 organizations from 8 countries.

6.7 Improvement of the Business Environment

There are several essential tools for assessing the business environment: the World Bank's international survey *Doing Business*, as well as the *Study of the Impact of Administrative Procedure on the Business Environment* that help to find out the views of entrepreneurs on the factors

hindering their activity. Thanks to the said tools, a list of tasks to be carried out has been prepared within the framework of the annual *Action Plan for Improvement of the Business Environment*.

Figure 6.13



In the World Bank's study *Doing Business 2015*, the reference period of which is from 2 June 2013 until 1 June 2014, Latvia ranks 23rd among 189 countries. In the assessment of environment favourable to

entrepreneurs, Latvia ranks 9th among the EU Member States, giving way to Denmark, the United Kingdom, Finland, Sweden, Ireland, Germany, Austria, and Estonia.

Table 6.8

The Benchmark Figures of Latvia in the World Bank's Study Doing Business 2014-2015			
	2014	2015	Changes
Starting a business	26	36	-10
Building permits	48	47	-1
Electricity connections	82	89	-6
Registration of real estate	33	32	+1
Credit register	19	23	-4
Protection of investor (minority) rights	48	49	-1
Payment of taxes	28	24	+4
Cross-border trade	26	28	-2
Fulfilment of contractual obligations	15	16	-1
Closing a business	38	40	-2

It should be noted that methodological changes have been made to a number of indicators of the *Doing Business 2015*, thus the evaluation now includes indicators that were measured differently thus far, and the evaluation of Latvia has changed accordingly. Consequently, it is not possible to make a completely unbiased comparison of the results of participating countries from the previous years with *Doing Business 2015*.

The *Study of the Impact of Administrative Procedure on the Business Environment 2014* shows that Latvian entrepreneurs spend, on average, 13% of their working time addressing issues related to administrative requirements. Regulatory areas, administrative procedures, and potential obstacles to entrepreneurship, included in the set of instruments of the study in 2014, were considered as hindering the development of business less often than in the previous studies (since 2001).

Measures to improve the business environment are implemented in Latvia since 1999. The Ministry of Economy, with the participation of a wide range of sectoral ministries and organizations representing entrepreneurs, prepares the *Action Plan for the Improvement of the Business Environment*, which is updated and approved by the government annually.

On 28 November 2014, the Cabinet of Ministers approved the *Action Plan for the Improvement of the Business Environment 2014-2015*. The plan includes 70 tasks. As of 20 May 2015, 25 tasks have been completed. The main tasks:

- **in the field of starting a business** – as of 1 June 2015, the payers of micro-enterprise tax will no longer need to separately provide the SRS with details on the acquisition of the employee's status when registering a company in the Register of Enterprises;
- **in the field of construction** – the State Building Control Bureau has been established, monitoring

of the operation of public buildings has been launched, control and commissioning of construction works will be launched as of 1 July 2015, and it is planned to start the monitoring of construction specialists in the field of expertise as of 1 January 2016;

- **in the field of real estate registration** – electronic registration of real estate has been introduced and the principle of one-stop agency has been introduced in the real estate registration process – as of 29 October 2014, certain persons can submit electronically signed corroboration requests to the Land Register, using a specially developed form at www.zemesgramata.lv; as of 1 January 2015, a person who wishes to register a real property does not have to visit two institutions anymore — back-up data exchange has been launched in the State Unified Computerised Land Register and the information system of the Immovable Property State Cadastre;
- **in the field of taxation and accounting:**
 - a new *Draft Law on Annual Accounts and Consolidated Annual Accounts* has been drafted to transpose the *Directive 2013/34/EU*. The draft law was supported in the first reading at the Saeima on 13 May 2015;
 - a decision was made by the Ministry of Finance on the introduction of tax payments according to the FIFO method and the introduction of a single account for all tax payments. Currently, the concept of the ERDF project *Modernization of Tax Information Services* is being agreed upon (it is expected to approve it at the Cabinet of Ministers by 1 September 2015 and sign the ERDF project implementation agreement by 1 February 2016 — it is planned to complete the task by 2021 (provides for changes in the system of the State Revenue Service (SRS), and amendments to laws and regulations will be necessary);
- **in the field of cross-border trade:**
 - Information has been published on the SRS website on 1 January 2015 on the process of transit cargo clearance for the export of goods from the Freeport of Riga;
 - as of 13 February 2015, companies can make customs payments calculated by the customs authorities online via the portal www.latvija.lv. As from April 2015, entrepreneurs can submit data for the registration of temporary storage of goods electronically;
- **in the field of fulfilment of contractual obligations** – as from 1 January 2015, natural persons can follow the data of court proceedings online, in the portal www.tiesas.lv, in cases where the represented legal entity is a party to the case;

- **in the field of closing a business** – as of 1 March 2015, amendments to the *Insolvency Law* have come into force providing for the improvement of the legal framework in order to avoid problems that have been observed in practice and are related to the application of the *Insolvency Act*. The amendments, among other things, provide for ensuring that the protection of the creditor's and debtor's rights is strengthened.

The simplified registration of employees of persons paying the micro-enterprise tax in the company foundation process, the introduced electronic registration of real estate, as well as the expected changes in the procedure of obtaining building permits will have a positive impact on the rating of *Doing Business*. The work commenced on the simplification of administrative procedures in the field of accounting and taxes, fulfilment of contractual obligations and procedures related to closing a business, will facilitate entrepreneurship in Latvia, as well as contribute to the improvement of the international assessment in future periods.

The following priority tasks have to be carried out within the next year:

- **in the field of starting a business**, e-service *Registration in the Registers Maintained by the Register of Enterprises* of the Register of Enterprises must be reviewed in order to improve the efficiency of the service, and digitalization of the documents kept in the archive of the Register of Enterprises must be carried out, territorial jurisdiction of companies must be given up;
- **in the field of construction**, complete operation of the Construction Information System project as of 1 July 2015 must be ensured; classification of construction merchants must be established;
- **in the field of real estate registration**, the amount of information to be received in the Land Register electronically from local governments, namely, the information regarding the waiver of pre-emptive rights, must be increased;
- **in the field of accounting and taxes**, introduction of the accounting of tax payments on

an accrual basis must be continued and one account for all tax payments must be ensured providing for making these payments according to the FIFO method (first in, first out);

- **in the field of investor protection** the provisions of the *Commercial Law* must be reviewed and the possibility to determine the force, effect and enforceability of contractual provisions for shareholders of enterprises must be assessed, along with the possibility to verify the accuracy of information submitted to the commercial register on its merits and the possibilities to establish mandatory provisions in the *Commercial Law* in relation to joint-stock companies (or possibly also to limited liability companies). In case of a substantial violation of the said provisions, the respective decisions of public administration institutions and other actions shall be automatically declared as null and void;
- **in the field of fulfilment of contractual obligations**, the regulatory framework for the implementation of electronic document circulation in judicial authorities must be aligned, strengthening of the principles of specialization of judges must be continued, and case load indicators must be determined.

On 28 November 2014, the Cabinet of Ministers approved the amendments to *Action Plan for Improvement of the Business Environment 2014–2015* providing for the introduction of the “silence-consent” principle in the services of 17 state administration institutions, for example, in the certification and re-certification of judicial experts, issuing a certificate for experts in the field of conservation of species and habitats, registration of veterinary medical service providers, as well as the operation of animal cemeteries. The principle is planned to be implemented by 2017. It should be noted that by now the principle has been introduced in 15 state administration services. Along with the integration of the “silence-consent” principle, the amount of resources (time, expenses) needed for the holders of permits and certificates in dealing with administrative formalities in public administration institutions will be reduced.

6.8 Small and Medium-Sized Enterprises

Small and medium-sized enterprises (SMEs) in Latvia, as well as elsewhere in Europe, account for a large part of the economy, and they have a significant role in the formation of the GDP and employment.

Support Measures for Micro-Enterprises

On 30 October 2009, the Cabinet of Ministers approved *The Concept of Support Measures for Micro-Enterprises* which aims to create the necessary prerequisites for urging the unemployed to start business activities, to create a business environment that facilitates

the activities of micro-enterprises, thus reducing the level of unemployment, as well as to develop entrepreneurial skills, thereby increasing the share of entrepreneurs in the total number of employed people. The concept is being implemented successfully.

Amendments to the *Commercial Law* of May 2010 significantly reduced the costs of starting a business, prescribing that a limited liability company (SIA) may be formed with a reduced share capital (starting from 1 euro). Also the stamp duty for registering such a limited

liability company was reduced. According to the data of the Register of Enterprises, there were 12 thousand limited liability companies registered as of 20 May 2015,

60.7% of which were limited liability companies with a reduced share capital.

Box 6.18

The Number of Small and Medium-sized Enterprises in Latvia

According to the CSB data from 2013, there were 93,775 economically active individual merchants and commercial companies in Latvia (excluding agricultural and fishing farms and self-employed persons performing economic activity), 99.6% of which corresponded to the SME category. The distribution of the economically active SMEs in Latvia: 86.2% are micro enterprises, 11.1% are small enterprises, 2.3% are medium-sized enterprises, whereas 0.4% are large enterprises. The number of economically active merchants and companies (including agricultural and fishing farms and self-employed persons performing economic activity) per 1000 inhabitants is an important indicator of economic activity. The indicator of Latvia has grown constantly over the last 10 years from 17 in 2001 to 78 in 2013.

It is equally important to highlight the number of individual workers (self-employed persons) reaching 50,882 in 2013 (25 per 1000 inhabitants), and the number of agricultural and fishing farms reaching 11,366 in 2013 (6 per 1000 inhabitants). Given the fact that there is no single methodological practice in the EU Member States for the calculation of such an indicator characterizing economic activity as the number of enterprises per 1000 inhabitants, it is difficult to conduct an objective comparative analysis of this indicator. The current practice of the competent EU institutions shows that the calculation of the number of enterprises per 1000 inhabitants included both individual merchants and commercial companies, as well as self-employed persons, agricultural and fishing farms, etc. Thus, by applying an analogous practice, there were 78 performers of economic activity per 1000 inhabitants in 2013 in Latvia.

According to the statistics of the Register of Enterprises, 16,404 entities were registered in the registers maintained by the Register of Enterprises and 6664 entities were excluded from the said registers in 2014. 18,035 entities were registered in the registers and 4300 entities were excluded from the registers in 2013.

Definition of SMEs

Definition of SMEs given in the Commission Recommendation 2003/361/EC:

medium-sized enterprises:

- number of employees: 50–249;
- annual turnover not exceeding 50 million euro;
- annual balance sheet total not exceeding 43 million euro;

small enterprises:

- number of employees: 10–49;
- annual turnover not exceeding 10 million euro;
- annual balance sheet total not exceeding 10 million euro;

micro-enterprises:

- number of employees: 1–9;
- annual turnover not exceeding 2 million euro;
- annual balance sheet total not exceeding 2 million euro;

The *Micro-enterprise Tax Law* came into force on 1 September 2010 providing for the possibility of legal and natural persons to acquire the status of a payer of the micro-enterprise tax, subject to meeting certain criteria (shareholders are natural persons, turnover does not exceed 100 thousand euro a calendar year and the number of employees is not more than five), and to make micro-enterprise tax payments in the amount of 9% (includes all the national tax payments, excluding consumption taxes) of turnover or business income. As of 1 January 2015, there were a total of 41,343 registered micro-enterprise tax payers, who employed more than 78.4 thousand employees in 2014. It is easier for the micro-enterprises to perform the formalities at the SRS (4 reports a year).

It should be noted that significant changes have been made to the *Micro-enterprise Tax Law* in the past two years.

On 6 November 2013, the Saeima adopted amendments to the *Micro-enterprise Tax Law*, introducing changes to the procedure of calculation of the micro-enterprise tax rate. The amendments prescribe that the rate shall be 9% for a micro-enterprise tax payer, the annual turnover of which does not exceed 7 thousand euro, while in case the turnover exceeds the said amount,

the rate will be 11% in 2015, 13% in 2016, and 15% starting from 2017. This was introduced to increase the social guarantees of the employees of micro-enterprise tax payers.

At the same time, amendments to the *Micro-enterprise Tax Law* entered into force on 13 May 2015 providing for maintaining the micro-enterprise tax rate of 9% in 2015 and later on during the first three years of operation with the status of a micro-enterprise tax payer, but starting from the fourth year of operation the micro-enterprise tax rate will increase to 12 per cent for micro-enterprise tax payers with a turnover exceeding 7000 euro.

Additional changes to the *Micro-enterprise Tax Law* provide for authorizing the Cabinet of Ministers to determine the sectors in which micro-enterprises will not be able to acquire the status of a micro-enterprise tax payer, and amending the *Law on State Social Insurance* by 1 January 2016, prescribing that micro-enterprise employees, in addition to the provisions of the *Micro-enterprise Tax Law* can be socially insured to achieve the amount of mandatory social insurance contributions within three years corresponding to the amount of employer and employee contributions calculated from the minimum monthly wage established by the Cabinet of

Ministers. In case the relevant amendments to the *Law on State Social Insurance* have not come into force by 1 January 2016, a micro-enterprise tax rate of 13% will be established in 2016, but in 2017, 15%, according to the amendments to the *Micro-enterprise Tax Law* adopted on 6 November 2013.

As of 1 January 2010, a natural person performing economic activity in certain professions or activities may choose to pay a **license fee**, which is a final tax payment for economic activity of the natural person in a given

profession (mostly craft services). The payers of license fees are provided with respective social guarantees. 2698 payers of license fees have been registered at the SRS during the time period from 1 January 2010 until 1 May 2015. The average monthly number of license fee payers during the said period was 317. Primarily the representatives of such professions as photographers, nurses, stylists, make-up artists, crochet and embroidery specialists, hairdressers and manicurists choose to register as payers of a license fee.

Box 6.19

EU Activities for the Support of Entrepreneurship

Small Business Act for Europe

On 25 June 2008, the EC approved the report *Small Business Act for Europe*, the main goal of which is to improve the overall policy approach to entrepreneurship by integrating the use of the principle *Think Small First* in the policy document drafting process, in particular by promoting the development of SMEs and helping to prevent the obstacles hindering the development. The Act includes 10 proposals for politically binding guidelines and a number of specific regulatory proposals for laws and regulations. So far, various activities have been implemented at the EU and national level that comply with the guidelines set out in the *Small Business Act*.

On 8 September 2014, the EC launched a public consultation to gather the views and ideas of the Member States and organizations representing entrepreneurs on who the *Small Business Act for Europe* should be revised, continuing the European Policy to Support SMEs 2015–2020. The consultation is based on research carried out by the Network of SME Envoys, and it takes into account the political debate on the future SME policy, which took place in September 2013 at the Competitiveness Council of Ministers. Four main directions of the *Small Business Act*, namely, to facilitate SMEs' access to finance and markets, to reduce the administrative burden and to promote entrepreneurship, are also priorities in the coming years. In addition, after a proposal by the SME Envoys, a fifth priority has been proposed: to prevent the lack of skilled labour.

The public consultation on the *Small Business Act for Europe* ended on 15 December 2014. On 2 March 2015, the EC provided the EU Competitiveness Council with an overview of the results of the public consultation the *Small Business Act for Europe*, stressing that the consultation had a high response rate. Responses of approximately 1800 respondents were received, more than 60% of which were companies. The respondents have recognized the following as important SME support pillars: reduction of the administrative burden, access to markets, access to finance, skills and abilities, as well as support for innovation. Currently, the EC is carrying out a detailed analysis of the results of consultations, and they have been published on the EC website.

European Small and Medium-Sized Enterprises (SME) Week

In order to implement the objectives of the *Small Business Act for Europe*, the EC organized the annual European-wide campaign *European Small and Medium-Sized Enterprises (SME) Week* in 2014 to provide the existing and future entrepreneurs with information (seminars, conferences, discussions, etc.) about the activities of the EU, national, regional and local government institutions related to regulation of entrepreneurship, thus promoting entrepreneurship and showing recognition to entrepreneurs for their investment in Europe's prosperity, creation of jobs, innovation and competitiveness.

During the *Small and Medium-Sized Enterprises (SME) Week 2014 in Latvia*, 46 events were organized from September until November, involving more than 2000 entrepreneurs. These events were dedicated to the implementation of innovative business ideas, starting a business, facilitating export and strengthening of co-operation networks between entrepreneurs, the science sector and potential investors. The event *Small Business Day* was organized within the framework of these measures in Latvia to provide practical information to entrepreneurs about how to expand the customer base, to approach potential partners and how to spot new business opportunities. Small Business Days were organized in Daugavpils, Ogre, Liepaja, Ventspils, Valmiera, Jelgava and Riga, involving more than 300 participants. Information about the process of the *SME Week 2014* can be found on the website of the Ministry of Economics: https://em.gov.lv/lv/nozares_politika/nacionala_industriala_politika/uznemejdarbibas_vides_uznemejdarbibas_veicinasana/es_mvu_nedela/

Measures Facilitating the Start of a Business

In order to facilitate the formation and development of new, viable and competitive economic operators in the regions of Latvia, providing them with the environment and advisory services necessary for business, LIDA is implementing the ERDF co-funded project ***Development of Business Incubators in Latvia***.

Overall, from 2009 until 2014, incubation services were received by 603 micro-, small and medium-sized enterprises in 10 Latvian regional business incubators and the business incubator of creative industries in Riga. These economic operators ensured (maintained) 1364 jobs. By the end of 2014, 22.1 million euro had been spent for ensuring the support measures provided by business incubators within the framework of the

programme. The total funding available within the framework of the programme is 28.6 million euro (including ERDF co-funding of 24.4 million euro).

In order to use all the project funding available, on 2 September 2014, LIDA announced a procurement procedure on the provision of business incubation services (the total contract price is 4 million euro, the contract performance deadline is 31 October 2015). LIDA accepted tenders until 11 December 2014. As of 22 May 2015, 7 contracts have been concluded:

- with the society "Latgale Machinery and Technology Centre" regarding the facilitation of formation and development of new businesses in the Latgale Planning Region 2 (Rezekne, Vilani municipality, Rezekne municipality, Ludza

- municipality, Zilupe municipality, Cibla municipality, Karsava municipality, Rugaji municipality, Balvi municipality, Vilaka municipality);
- with the general partnership “Riga Region Business Development Incubator” regarding the facilitation of formation and development of new businesses in the Riga Planning Region (Ogre municipality and Tukums municipality);
- with LLC “B-CAP” regarding the formation and development of new businesses in Kurzeme Planning Region 1 (Ventspils, Ventspils municipality, Dundaga municipality, Roja municipality, Talsi municipality, Mersrags municipality);
- with LLC “Kurzemes Biznesa inkubators” regarding the formation and development of new businesses in the Kurzeme Planning Region 2 (Liepaja, Kuldiga municipality, Saldus municipality);
- with LLC “HUB Riga” regarding the formation and development of new businesses in the business incubator of creative business industries in Riga;
- with the Riga Technical University regarding the formation and development of new businesses in the Vidzeme Planning Region 2 (Cesis municipality and Madona municipality);
- with LLC “Energo Consult” regarding the formation and development of new businesses in the Zemgale Planning Region 2 (Jelgava municipality and Dobeles municipality);

Ensuring Access to Finance for Entrepreneurs

On 15 April 2015, the single financial institution JSC “Attīstības finanšu institūcija Altum” was formed by merging three companies that provided support in the form of financial instruments: “Latvijas attīstības finanšu institūcija Altum” (ALTUM), “Latvijas Garantiju aģentūra” (LGA) and “Lauku attīstības fonds” (LAF). JSC “Attīstības finanšu institūcija Altum” continues the implementation of all the previous state aid programmes of ALTUM, LGA, and LAF (see Box 6.20).

Box 6.20

Establishment of the Development Finance Institution

On 15 April 2015, the single financial institution JSC “Attīstības finanšu institūcija Altum” was formed by merging three companies that provided support in the form of financial instruments: “Latvijas attīstības finanšu institūcija Altum” (ALTUM), “Latvijas Garantiju aģentūra” (LGA) and “Lauku attīstības fonds” (LAF).

JSC “Attīstības finanšu institūcija Altum” takes over all the rights and obligations of ALTUM, LGA, and LAF.

After the formation of a single institution, the full spectrum of state aid programmes and financial instruments — loans, venture capital, guarantees, aid to farmers — are available in one place:

Programmes implemented by LGA to date:

- Credit guarantees;
- Export credit guarantees;
- Mezzanine loan;
- Venture capital;
- Microcredit;
- Support for training.

Programmes implemented by ALTUM (until 1 January 2014, the Mortgage and Land Bank of Latvia) to date:

- Start programme;
- Microcredits;
- SME microcredit programme;
- SME growth loans;
- Loans for investment in the improvement of infrastructure;
- Loans for the improvement of competitiveness;
- Loans to farmers;
- Loans for the acquisition of land;
- Housing guarantee programme;
- other services.

Programmes implemented by LAF to date:

- Credit guarantees for farmers;
- Loans for the acquisition of land.

The establishment of the development finance institution was carried out in two stages. The first stage included the transfer of shares of ALTUM, LGA, and LAF to JSC “Attīstības finanšu institūcija” (AFI), forming a concern of development finance institutions. The second stage included the reorganisation of AFI, ALTUM, LGA, and LAF, forming a single development finance institution. This stage was finished on 15 April 2015. All the shares of the single development finance institution JSC “Attīstības finanšu institūcija Altum” are owned by the government of Latvia: the Ministry of Finance, the Ministry of Economics and the Ministry of Agriculture are the shareholders.

The aim of JSC “Attīstības finanšu institūcija Altum” (Altum) is to effectively and professionally provide support to certain target groups in the form of financial instruments (loans, guarantees, investments in venture capital funds, etc.) with the help of state aid financial instruments, supplementing the said support with non-financial aid (advice, training, mentoring, etc.) within the framework of specific programmes, as well as to fulfil other functions delegated by the government.

Currently, the most significant support programme in terms of the amount of loans is the **Support Programme for the Improvement of Competitiveness of Businesses** approved by the Cabinet of Ministers in May 2008. Micro-, small and medium-sized enterprises registered in Latvia that have economically justified plans for further activities, but do not have the access to the funding of credit institutions due to increased risks, are supported within the framework of the programme. Investment loans (up to 1.4 million euro) and current assets loans (up to 0.7 million euro) are granted within the framework of the programme. If a loan exceeds 500 thousand euro, before receiving the loan from ALTUM the customer must receive an approval from their commercial bank, if they have commitments with it. From the commencement of the Support Programme for the Improvement of Competitiveness of Businesses until 31 March 2015, 158 loans in the amount of 78.6 million euro have been granted within the framework of the ERDF-funded part of the programme. Wood processing, power generation, pharmaceutical product and food industry are the most frequently represented industries of the projects supported.

The ESF co-funded programme **Support for Starting Self-employment and Business** approved by the Cabinet of Ministers in March 2009 offers complex support to persons who wish to start a business and newly established businesses, namely, advice, training and loans (up to 85 thousand euro) and interest rates in the form of subsidies to start their business. Population of working age, including the unemployed, who have expressed a wish to start a business or self-employment, as well as new businesses are eligible for the support. For the purposes of this programme, start-up businesses are the economic operators that have registered their activity according to the law not earlier than three years prior to requesting support within the framework of the programme, as well as entrepreneurs with business experience who intend to produce a new product or provide a new service if they establish a new business for this purpose. The cost of the project provided for in the business plan may not exceed 85 thousand euro, while co-financing of at least 10% of the cost of the project provided for in the business plan for the implementation of the business plan must be provided for projects for which the amount of loan exceeds 7 thousand euro.

Since the commencement of the programme, 1298 start-up projects have been supported for the total amount of loans of 24.7 million euro.

In September 2009, the Cabinet of Ministers adopted regulations on the loans for facilitating the development of micro-, small and medium enterprises and co-operative partnerships of agricultural services. According to these regulations, ALTUM launched the **SME Growth Loan Programme** in February 2010. The programme aims to improve access to funding for economic operators registered in Latvia, thus contributing to economic development. The maximum loan amount per economic operator is 430 thousand

euro, for farmers — 3.1 million euro. In addition, in accordance with the conditions of the programme, the maximum loan amount for small businesses operating in the service sector is 43 thousand euro. Until October 2014, 1128 loans in the total amount of 65.5 million euro were granted within the framework of the programme.

In May 2010, ALTUM launched the **Current Asset Loan Programme for Agricultural Producers**. Current asset loans from 7 thousand to 1 million euro for a period of up to 2 years can be received by agricultural producers, as well as groups of fruit and vegetable producers. The maximum amount of loans to co-operative partnerships of agricultural services may reach 2.8 million euro. LAF guarantees can be attracted to these loans. To date, 1118 loans in the total amount of 51.6 million euro have been granted within the framework of the programme.

In September 2011, the Cabinet of Ministers approved the **Latvian and Swiss Micro Lending Programme**. The programme aims to improve the opportunity of micro-enterprises to receive financial support for business start-up or development. The programme is implemented within the framework of the Latvian-Swiss Cooperation Programme, and the total funding of the programme is 7.2 million euro¹. 6.6 million euro are provided for micro loans for investments and current assets of up to 14.2 thousand euro, but 620 thousand euro for grants to repay loans. The programme will be implemented until June 2015. So far, micro loans have been granted to 1070 micro-enterprises in the amount of 8.9 million euro.

In May 2012, the Cabinet of Ministers approved the regulation on the **Lending Programme for Acquisition of Agricultural Land**. Within the framework of the programme, loans in the amount up to 430 thousand euro are available for the acquisition of agricultural land for the production of products and acquisition of the buildings located on the piece of land, if the cadastral value of the buildings does not exceed 30% of the cadastral value of land. According to the Cabinet Regulation, ALTUM accepts the loan applications, assesses them, grants and administers the loans within the framework of the programme, but the decision on granting a loan, based on the bank's recommendation, is made by the LAF. Practical activities of the programme were launched in July 2012, and 517 loans in the amount of 25.9 million euros have been granted so far.

On 10 March 2009, the Cabinet of Ministers adopted **Regulations on the Activity 2.2.1.3 "Guarantees for the Development of Enterprise Competitiveness" of the Appendix to the Operational Programme "Business and Innovation"**. The Regulations aim to provide enterprises with the access to finance for

¹ Loan Fund has been established for the provision of financial aid – micro loans and grants – within the framework of the programme, and 80% of the funding is provided by Switzerland, 20% by ALTUM. Whereas 80% of the programme management costs are covered by Switzerland, 20% from the state budget.

development of their business and implementation of the projects of EU funds, providing guarantees in situations where the financial means of the enterprise are insufficient for receiving a loan and banks consider the enterprise to be too risky, as well as to facilitate competitiveness of Latvian enterprises, to foster entering new markets, and strengthening the position in the existing markets.

In April 2009, LGA launched the activity **Guarantees for the Development of Enterprise Competitiveness**. The amount of ERDF funding granted within the framework of this activity was 15.4 million euro. In late 2013, the activity was discontinued. The funding granted within the framework of the activity is still used for the provision of state aid, including the granting of guarantees.

The LGA provides credit guarantees for such financial services as investment loans, current asset loans, financial leasing, domestic factoring, as well as bank guarantees (bid, advance payment, payment, performance or time guarantee). The guarantees cover up to 80% of the principal amount of the financial service, but no more than 1.5 million euro per company.

From 2009 until 31 March 2015, 274 credit guarantees for the total amount of 104 million euro were issued within the framework of the **Credit Guarantee Programme**.

Until 31 March 2015, most of the guarantees in terms of amount within the framework of the credit guarantee programme were granted to companies operating in the following industries: 44% in the manufacturing, 22% in construction, 8% in electricity, gas supply, heat supply and air conditioning. Most of the guarantees in terms of the number consist of current asset guarantees amounting to 44%, 21% investment guarantees, and 24% financial leasing guarantees.

On 30 May 2013, the LGA started granting guarantees to housing insulation projects. Until 31 March 2015, 45 guarantees for the total amount of 6.1 million euro were granted for housing insulation projects. Most of the guarantees in terms of the amount were granted in Kurzeme reaching 29%, with 27% in Vidzeme and 21% in the Riga region.

In May 2009, the Cabinet of Ministers adopted the *Regulations on Short-term Export Credits* prescribing the coverage and recipients of **short-term export credit guarantees**, the procedure of providing guarantees and the procedure of covering the losses by the guarantor. The LGA's export credit guarantee covers up to 90% of the deferred payment, but no more than 1 million euro or an equivalent amount in another currency. The period of the deferred payment shall not exceed 2 years.

From the launch of the export credit guarantee programme until 31 March 2015, 159 agreements on export guarantees have been concluded for the total amount of 14.8 million euro within the framework of the **Export Credit Guarantee Programme**.

Most (99%) of the companies that have concluded agreements represent the manufacturing (such as production of communication equipment, household electrical equipment, products of veneer sheets and wooden panels, soaps, detergents, cleaning and polishing agents, food products, etc.). When considering the distribution by countries, most guarantees have been provided to the markets of CIS countries: Russia (31%), Kazakhstan (19%) and Belarus (18%), as well as to such countries as Azerbaijan (6%), Indonesia (5%), Uzbekistan (4%), etc.

In August 2011, the Cabinet of Ministers adopted the *Regulations on Mezzanine Loans for the Improvement of Competitiveness of Economic Operators* prescribing the conditions for granting support in the form of a **mezzanine loan** for the improvement of competitiveness of economic operators. The maximum amount of a mezzanine loan is 5 million euro. The amount of a loan may not exceed 40% of the total costs of the investment project.

As of 31 March 2015, 122 mezzanine loans for the total amount of 28.7 million euro had been granted. A mezzanine loan is intended to provide long-term funding to Latvian entrepreneurs in addition to the loan issued by a bank, to cover all the costs of the investment project in tangible and intangible assets that are related to the formation of a new enterprise, expansion of the existing enterprise, diversification of production with new additional products or a fundamental change of the overall production process.

Box 6.21

Growth Capital Funds

Expansion Capital Fund focuses on growth-stage companies that have already completed the product development stage and need funding to start commercial production, more aggressive marketing and sales of the product. Priority is given to export-oriented companies, as well as companies with a high growth potential. The team of the fund has extensive experience in the fields of woodworking, metalworking, machinery and equipment production, chemical industry, transport, food, IT services, waste processing, printing, healthcare and packaging.

In addition to funding of growth-stage companies, **FlyCap Investment Fund I** is planning to invest 20–30% of the available funding in newly established companies which already have a developed business model and proven product viability, by attracting the first customers. The priority sectors are manufacturing, IT, health care and business services.

ZGI-3 plans to diversify its portfolio by investing about 10% of the available funding in the companies of the seed capital stage, 20% in the stage of start-up capital, while the remaining funds, in the companies of the growth capital stage.

On 6 August 2013, three new venture capital funds were established that operate in accordance with the new venture capital state aid programme **For Growth Capital Funds** approved by the Cabinet of Ministers on 29 May 2012. These funds – *Expansion Capital Fund*, *FlyCap Investment Fund I*, and *ZGI-3* (see Box 6.21) – continue providing Latvian SMEs with the access to venture capital funding for starting or developing a business, as well as promote competitiveness and growth of entrepreneurs. Growth capital funds improve and expand the venture capital sector in Latvia, adding to the offer of other venture capital funds implemented by the development finance institution Altum. Growth capital funds allow receiving venture capital in situations where the company's own funding is insufficient and the risk of the company's planned investment is too high, in order to attract the necessary amount of funding from credit institutions. As of 31 March 2015, 33 investments for the total amount of 10.3 million euro have been made.

Growth capital funds may make investments in micro-, small and medium-sized enterprises carrying out their economic activities in Latvia. Investments of up to 1.5 million euro may be received by a single company to finance the research, assessment and development of the initial concept of the company's product or business idea, product development and initial marketing, growth and

expansion of activities, increasing production capacity, developing markets and products. Growth capital funds make investments in companies with a high growth potential. Growth capital funds are financed from the funding available within the framework of the sub-activity of the EU Structural Funds *Investment Fund for the Investments in Guarantees, High-Risk Loans, Venture Capital Funds and Other Financial Instruments*. It is planned that the total investment amount of growth capital funds in Latvian companies could reach 30 million euro.

Two **microloan funds** commenced their activities in August 2014: *Capitalia* and *Grand Credit*. Microloans are medium-term loans for small and medium-sized enterprises to finance investments in current assets and capital assets. This type of financing is particularly appropriate for cases when bank funding is not available to the company or it does not meet the requirements for receiving a loan, such as the company's branch and duration of activity, the available security or other reasons. The amount of a microloan is up to 25 thousand euro, which is granted to finance the formation, growth and expansion of activity of economic operators, as well as to attract current assets for the implementation of viable business projects. As of 31 March 2015, 33 microloans for the total amount of 0.5 million euro have been granted.

6.9 Innovation and New Technologies

In the report on results of innovation in EU Member States *Innovation Union Scoreboard 2015* (Report) published by the EC for the year 2014, where 28 EU Member States were surveyed, Latvia ranks 26 (Estonia – 13, Lithuania – 25). Latvia, together with Bulgaria and Romania, is placed in the group of *Modest innovators*, as performance of these states in the field of innovation is lower than 50% of the EU average. At the same time, in the period from 2007 until 2014, the average growth of Latvia's indicators included in the Report constituted 3.4%, which is the highest indicator among EU Member States (the average growth in the EU is 1%).

It can be concluded from the Report that Latvia has relatively better results in the development of human resources (the number of inhabitants with higher education, the number of young people with the highest level secondary education), as well as the indicator which characterises company expenses for innovation other than research and development (R&D). Whereas a drop can be observed in such indicators of the report as company expenses for R&D, innovative SMEs which cooperate with other companies, fast growing innovative companies, publications prepared collectively by the public and private sectors. Such indicators as the number of public and private scientific publications, the number of doctoral programme students outside the EU, income from licences and patents abroad, expenses of companies for R&D are below the EU average.

According to the data of the Central Statistical Bureau (CSB), the total funding for research and development (R&D) in Latvia in 2013 was 0.6% of the GDP or 139.2 million euros (in 2012, 0.66% or 145.4 million euros). The investment of the private sector (companies) in R&D in 2013 constitutes 21.8% of total investments in R&D or 0.13% of the GDP (in 2012, 0.16% of the GDP). Funding of the state and universities for R&D activities has also decreased in 2013, in actual figures constituting 37 million euros or 0.16% of the GDP in 2013, compared to 38.5 million euros (0.16% of the GDP) in 2012. The amount of foreign funds, including the EU structural funds, for R&D has slightly decreased in 2013 compared to that in 2012 and was 71.8 million euros (in 2012, 73.3 million euros), which constitutes 0.31% of the GDP (in 2012, 0.33%).

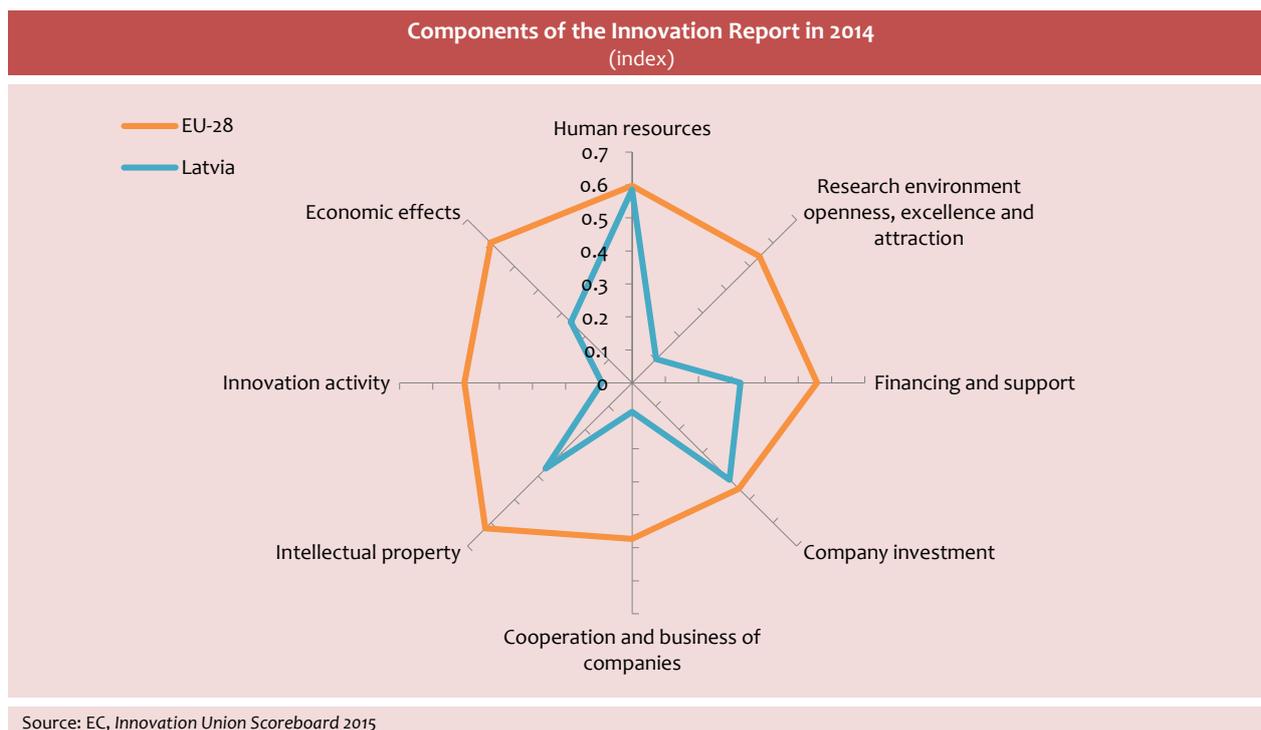
Upon assessment of the current tendency which shows a drop of total expenses for R&D in the last two years, it is important to emphasize that the aim of R&D investment, promoted in the *Latvian National Reform Programme for Implementation of the "EU 2020" Strategy*, which provides for increasing the total amount of R&D investment in Latvia in 2015 to 1% of the GDP, and to 1.5% of the GDP in 2020, might not be achieved.

According to the innovation survey conducted by the CSB for 2010-2012, it can be observed that in the report period, the number of companies active in the field of innovations has increased, constituting 30.4% of the total number of companies (in the period 2008-2010, 29.9%).

By analysing the structure of innovative companies by their size, it can be concluded that large companies are more active in the field of innovations – 64.6% of all large companies have been assessed as innovative. In the group of medium-sized companies, 43.2% of all companies have been innovative, whereas in the category of small companies only 26.5% were assessed as innovative. The potential and performance of innovation of small and medium-sized enterprises is affected by limited human resources and available own financial

resources for these companies for implementation of research, development and innovation activities, including limited opportunities to attract finances because of high technological and business risks. It should be noted that in the period from 2010 until 2012, when 30.4% of companies being active in the field of innovation were surveyed, 64% of them had implemented innovations of products and processes, whereas 36% of all innovative companies had implemented marketing or organizational innovations.

Figure 6.14



In compliance with the existing policy planning documents, the main directions for improving the Latvian innovation system in 2015 are as follows:

- development of the potential of scientific activity;
- promotion of long-term co-operation between companies and scientists;
- support for development of innovative companies.

Within the direction of **development of the potential of scientific activity** implementation of activities was continued in Latvia in 2015 in order to develop internationally competitive scientific institutions with modern material technical provision, and to increase the number of employees in the sector of science and research.

According to 14 *National Research Programmes*¹ for 2014-2017 approved by the Cabinet of Ministers,

¹ National Research Programmes (NRP) approved by the Cabinet of Ministers: (1) NRP *Energy Efficient and Low Carbon Capacity Solutions for Secure, Sustainable and Climate Variability Reducing Power Supply*; (2) NRP

implementation of *National Research Programmes* was continued in 2015. *National Research Programmes* is a government order to conduct scientific research in a certain sector of economy, education, culture or any other national priority, in order to promote development of this sector. The financing for national research programmes is allocated within the framework of the

Value of Latvian Ecosystems and Its Dynamics under the Climate Impact; (3) NRP *Multifunctional Materials and Composites, Photonics and Nanotechnologies*; (4) NRP *Innovative Materials and Smart Technologies for Environmental Safety*; (5) NRP *Cyber-physical Systems, Ontologies and Biophotonics for Safe and Smart City and Society*; (6) NRP *National Programme for Research of Next Generation Information and Communication Technologies*; (7) NRP *Biomedicine for Public Health*; (8) NRP *Research and Sustainable Use of Forest and Subsoil Resources – New Products and Technologies*; (9) NRP *Agricultural Resources for Sustainable Production of Qualitative and Healthy Food Products in Latvia*; (10) NRP *Innovative Solutions in the Social Telerehabilitation in Latvian Schools in the Context of Inclusive Education*; (11) NRP *Transformation, Smart Growth, Management and Legal Framework of Economics for Sustainable Growth of the State and Society – New Approaches for Development of Sustainable Knowledge Society*; (12) NRP *Innovation and Sustainable Development: Latvian Post-crisis Processes in the Global Context*; (13) NRP *Sustainability of Latvian Cultural Traditions in Innovative Environment*; (14) NRP *Letonika*.

annual state budget financing. In 2014, a tender was announced for *National Research Programmes 2014–2017*, which resulted with the Decree of the Cabinet of Ministers No. 558 of 7 October 2014 “*On National Research Programmes*”, approving 10 programmes with the total financing of 20.67 million euros, whereas under the order No. 559 “*On Additional National Research Programmes*” the Cabinet of Ministers approved another four *National Research Programmes* with the total financing of 5.34 million euros. In total, 28 draft programmes were submitted for the *National Research Programmes 2014–2017* procurement with the total required amount of financing amounting to 32.9 million euros. In 2015, 6.15 million euros are allocated for implementation of the second stage of *National Research Programmes*.

For improvement of the infrastructure of the leading national significance research centres and ensuring modern material technical basis for research activities, implementation of the activity of the EU structural funds *Development of Research Infrastructure* is continued in 2015. The total co-financing of the EU structural funds for the activity constitutes 103.9 million euros, and it is implemented in two rounds of selection. In the first round with the total co-financing of the EU structural funds in the amount of 80.1 million euros, 9 projects are being implemented since the end of 2011, modernizing and appropriately equipping 9 research centres of national significance, covering 27 national scientific institutions. In the second round of selection of projects of the activity in 2014, implementation of two projects was completed with the total co-financing of the EU structural funds constituting 7.5 million euros, whereas in 2015 implementation of three projects is continued with the total co-financing of the EU structural funds equal to 11.1 million euros. Implementation of projects results in the development of research infrastructure in the private sector and ensures the provision of research services for the private sector. Since the launch of these projects until 1 May 2015, financing of the EU structural funds in total of 86.1 million euros and the state budget financing of 1.5 million euros has been allocated to the beneficiaries for the improvement of science infrastructure.

In 2015, also the EU structural funds activity *Support for Science and Research* continues, providing support for the implementation of applied research projects in national priority directions of science. In 2015, implementation of 24 projects approved in the second round of selection with the total amount of the EU structural funds co-financing constituting 6.2 million euros and implementation of 41 projects approved in the third round of selection with the total amount of the EU structural funds co-financing of 10.76 million euros continues. By 1 May 2015, 810 internationally recognized publications have been published and 92 international patent applications have been submitted within the framework of the projects approved in the three rounds of selection of project applications of the activity.

For promotion of long-term cooperation between companies and scientists, implementation of activities

was continued in 2015 in order to accelerate the processes of commercialisation of research results, and to improve the system of technology transfer. A significant activity in this direction is the support available within the framework of the programme *Centres of Competence*, as well as the work started on implementation of a new system of technology transfer.

In 2015, the Investment and Development Agency of Latvia (IDAL) continued supporting co-operation of scientists and companies for conducting collective industrial research and development of new products and technologies within the EU structural funds programme *Centres of Competence*. Centres of competence are established in 6 sectors which are significant for the economy: the pharmaceutical and chemical industry, ICT, the forest sector, manufacturing of electric and optical devices, environment, the sector of bioenergetics and biotechnologies, and the sector of transport and mechanical engineering. The programme *Centres of Competence* will be implemented by 31 December 2015, and its total public financing constitutes 53.17 million euros. It is estimated that additional private financing of at least 20 million euros will be attracted for R&D activities as a result of the operation of all competence centres. In 6 centres of competence established within the programme, a total of 231 projects of industrial studies and development of new products and technologies are implemented, 84 of which were completed by the end of 2014. Centres of competence involve a total of 165 companies and 24 scientific institutions, and 705 research and development jobs have been created, during the implementation of the projects.

Furthermore, implementation of the *Cluster Programme*, administered by IDAL and co-financed from the EU structural funds, was continued in 2015. The Cluster Programme is created to improve co-operation between unrelated companies of one sector, research, educational and other institutions in order to raise competitiveness of sectors and companies by collectively implementing activities for development of new products and services, and to plan coordinated conduct for acquisition of new export markets. The *Cluster Programme* provides support for 11 cluster projects, which involve more than 300 companies and more than 20 educational and research institutions in total, as well as a range of non-governmental organizations and municipalities. The total public financing of the programme until 2015 constitutes 4.95 million euros.

At the same time, improvement of a system of technology transfer took place in 2014, for the operation of which it is planned to attract financing of the EU structural funds planning period 2014–2020. The system of technology transfer is established to raise the income of scientific institutions from commercialization of state financed studies, and to achieve that the results of studies conducted by scientific institutions are market-oriented and are implemented in the practical business. The framework of the system of technology transfer provides for a creation of a two-level transfer system, thereby

strengthening the capacity of the state agency both in the field of technology transfer and provision of services to scientific institutions, and supporting creation of 1–2 technology transfer centres at the level of universities and scientific institutions. At the same time, knowing the necessity to increase the degree of preparedness of commercialization offers and to promote attraction of licentiates/investors, it is planned to create a fund intended specifically for this purpose.

For the development of innovative companies, support measures for projects of such companies were continued in 2015, envisaging the development of new products and technologies, and their introduction in the manufacturing process, as well as having a tendency to develop technologies with reduced impact on the environment, and to support investment of companies for the development of new production units.

In 2015, within the framework of the EU structural funds co-financed programme *Implementation of New Products and Technologies in Manufacturing*, support was provided to company projects, which provide for the implementation of new or significantly improved products, technologies or technological processes in the manufacturing process. Additionally, implementation of 115 projects (with the total financing of 36.2 million euros), supported in the first and second round of selection of the programme, was continued in 2015, 114 of which (with the total financing of 35.7 million euros) are completed as of 1 May 2015. The main support within the programme was provided to medium-sized enterprises which operate in the manufacturing, where the average amount of support provided within the programme was 0.37 million euros per project. Likewise, performance of three agreements concluded within the programme *Development of New Products and Technologies – Support for Strengthening of Rights for Industrial Property* was continued in 2015 with the total amount of financing from the EU structural funds constituting 0.054 million euros, where 1 project has been completed with the total amount of financing from the EU structural funds constituting 0.013 million euros.

In the framework of the EU structural funds co-financed state support programme *High Value Added investment*, implementation of 209 projects supported in the first, second, third and fourth (took place in 2014) round of selection of project applications was continued in 2015 with the total financing constituting 205.7 million euros. Simultaneously with the decision of the Cabinet of Ministers on allocation of financing for the fourth round of the programme it was decided to increase the support intensity for all projects from 35% to 45%, and also an agreement was reached that the minimum amount of total eligible costs for one project will be reduced to 50 thousand euros, whereas the maximum amount of public financing for one group of related persons of a project submitter will be increased to 2.13 million euros. By the mid-2015, the implementing parties of projects supported within the first, second and third round of the programme have received a total of 110.8 million euros,

and 56 projects have been completed for 74.03 million euros. The aim of this programme is to raise the potential of Latvian manufacturing companies to implement knowledge or technology in intensive projects, besides attracting foreign investment in areas with a high value added, and supporting purchase of manufacturing equipment, and construction or modernization of production units in order to promote creation of new jobs.

Furthermore, implementation of projects within the framework of the *Programme for Development of New Products and Technologies of Micro, Small and Medium-sized Merchants*, administered by IDAL and co-financed from the EU structural funds, was continued in 2015. The aim of this programme is to promote innovation activities of micro-, small- and medium-sized enterprises in the area of development of new products or technologies, by providing support for the purchase of external services in order to conduct research, corroboration of industrial rights and certification of a new product or technology. The total financing of the EU structural funds available in the programme in the period from the end of 2012 until April 2014 was 2.85 million euros, however, one beneficiary of the financing was eligible to receive 14.23 thousand euros with the maximum permissible financing intensity of 60%. During the programme, 41 project applications were submitted, 22 of which were supported (agreements were concluded) for the total financing of 0.25 million euros. As of 1 May 2015, 13 of these projects for the total financing of 0.14 million euros were completed (incl. disbursed financing).

In the *Green Technology Incubator*, created within the framework of the Norwegian financial instrument programme, provision of pre-incubation services to 99 business ideas, which were supported in the five rounds of project selection, organised in 2014 and 2015, is continued in 2015. At the same time, the Green Technology Incubator has started providing incubation services to 10 business ideas in 2015 with the total amount of allocated financing constituting 1.19 million euros, incubation of which was supported under the *Small Grant Scheme*. Simultaneously, the third round of selection of projects was announced (the deadline for applications was 1 June 2015) within the framework of the *Small Grant Scheme*, thereby providing an opportunity for a wider circle of idea developers to receive financing for commercialization of environmental products, technologies and services. Within the framework of the Norwegian financial instrument programme *Open Competition*, the process of implementation of 18 supported company projects is continued in 2015 with the total amount of co-financing constituting 7.27 million euros. As a result of implementation of projects, it is planned to introduce new products and technologies in the manufacturing process with a reduced impact on the environment.

For the sixth year in a row, IDAL has been continuing the implementation of activities within the framework of the EU structural funds co-financed

programme *Activities for Raising Motivation for Innovations and Starting Business* (hereinafter — the Motivation Programme). The aim of the Motivation Programme is to promote understanding about innovation and business, as well as to practically involve different society groups in business activities, and development and further implementation of innovative ideas and solutions. The target audience of the Motivation Programme includes students and the teaching staff of general and vocational education institutions, university students, next and existing entrepreneurs, developers of innovative ideas, individual inventors etc. In 2015, various activities are implemented for idea developers within the Motivation Programme, for example, support for the co-operation platform of students and companies *DEMOLA* is continued, and also networking seminars are organised for business starters and developers. In the first half of 2015, the work on implementation of the popular competition in Latvia *Ideju kauss 2015* has been started, as well as activities are performed for ensuring advice of experienced mentors to new entrepreneurs and support for improvement of business in the framework of the *Mentoring Programme* in the second half of 2015.

In 2015, the activity is continued, during which support is available to developers of innovative start-ups, providing them with the necessary consultations and knowledge for drafting and implementation of projects, as well as for the attraction of external financing. By 1 May 2015, consultations have been provided to 11 authors of business ideas within the framework of this activity: consultations have been ensured on drafting a business plan, intellectual property, market research and marketing, or initial consultations for the development of industrial design, and also a meeting of authors of business ideas and potential investors was organised in March 2015. The total financing available in the Motivation Programme is 3 million euros. In 2015, which is the extension year of the Motivation Programme,

financing of 0.17 million euros is estimated for the implementation of all activities planned in the programme.

Starting from 1 July 2014, companies in Latvia can use the corporate income tax incentive for R&D costs of companies, which can be written off in the year when such costs have occurred, by applying a value increasing coefficient of “3”. The tax incentive can be applied to the following eligible R&D costs:

- costs of the scientific and scientific technical staff, which are related to the research and development work performed by a company;
- costs for research services provided by scientific institutions;
- costs for certification, testing and calibration when receiving services provided by accredited certification, testing or calibration institutions.

The R&D tax incentive was introduced according to the amendments made to the law *On Corporate Income Tax* on 6 November 2013. On 1 July 2014, Regulations of the Cabinet of Ministers *On Research and Development Activity for Application of Corporate Income Tax* came into force, setting the requirements for compliance and assessment of R&D activity for the calculation of corporate income tax, requirements for R&D project documentation, as well as requirements for accounting procedure of R&D costs and compliance and assessment of R&D costs. In order to ensure advisory assistance to entrepreneurs and the State Revenue Service, the Ministry of Economy has established a *Commission for Assessment of Research and Development Activities*, which has a task to ensure assessment of activities included in the documentation of a research and development project, and to prepare an opinion of recommendatory nature on compliance of activities included in the project with the status of research and development activities.

6.10 Information Society

Information society is a stage in the development of society, which is based on free mutual exchange of information and develops knowledge-based economy. The information society is formed with the help of the technological basis (infrastructure, software), a range of information services available to society, as well as the level of skills and knowledge of individuals.

The development of information and telecommunication technologies (ITT) has resulted in an increasingly broader use of information and knowledge at work, in business communication, in studies, as well as in households (see Box 6.22).

In the preparation of the new multi-annual budget period (2014-2020), guidelines, concepts and informative

reports have been developed. For example, the *Information Society Development Guidelines for 2014-2020*, the guidelines *Latvian Cybersecurity Strategy for 2014-2018*, the *Guidelines for Protection and Ensuring of Intellectual Property Rights for 2015-2018*, the *Development Concept for the State Education Information System (SEIS)*, the *Concept of the Official Electronic Address*, the informative report *On Secure and Protected Circulation of Documents in the Public Administration*, the informative report *On Activities for Reduction of the Administrative Burden for Development of Broadband Electronic Communications Network*, the informative report on the conceptual architecture of public administration information systems etc.

Box 6.22**The Role of the ITT Sector**

According to the data of the Central Statistical Bureau of Latvia (CSB), the proportion of the ITT sector in the GDP constituted 3.7% in 2013. In 2013, the ITT sector in Latvia was represented by 5053 companies, which employed more than 23.6 thousand employees. The turnover of these companies exceeded 3.1 billion euros and staff costs constituted 362 million euros. The added value of ITT manufacturing reached 47 million euros, and in the provision of ITT services – 620 million euros. The balance of ITT external trade was negative, constituting -105.9 million euros, because the amount of import exceeded export, respectively, 873.1 million euros and 767.2 million euros. It must be noted that import of ITT products in 2013 increased by 18.6%, and export by 27.1%, compared to the year 2012.

According to the data of the survey *Use of Computers and the Internet by Households*, performed by the CSB, in 2014, 73% of households (households with at least 1 person aged 16-74) had an Internet connection. Most frequently used devices by households with an Internet access were the following: laptops 68%, desktop computers 58%, mobile phones and other mobile devices 37%, other devices 10%. In terms of Internet accessibility, the best situation among households was in the Riga region with 80% and the Pieriga region with 79%, whereas in other regions the situation was worse: in the Zemgale region, 71%, Kurzeme region, 69%, Latgale region, 66%, and Vidzeme region 63%. Computer and Internet were regularly (at least once a week) used by 72% of the population aged 16-74. Broadband Internet connection was available to 98% of households having an Internet connection.

In 2014, computers were used by 98% of companies with 10 or more employees, Internet connection was available to 96% of these companies, whereas 56% of these companies had their own website on the Internet. In 2014, 41% of all employees of companies used computers connected to the Internet.

At the beginning of the academic year 2013/2014, comprehensive schools used 25.6 thousand computers in their study process, which is approximately one computer per 8 students. Out of 827 schools with Internet connection, 615 schools or 74.4% had their own home page.

The *Information Society Development Guidelines for 2014-2020* adopted by the Cabinet of Ministers on 1 October 2013, include the results achieved in the previous 7 years and the determined priorities until 2020.

The most significant achieved political results are the high number of regular Internet users, the relatively high proportion of households having broadband Internet connection, the high number of employees using a computer and the Internet on a daily basis, as well as the relatively high proportion of people who are using distance learning services. Whereas, such a political result as the determined proportion of the ITT in the GDP is not achieved, and there is a small number of people who shop online, as well as a small turnover of companies achieved from sales on the Internet.

The guidelines for the new planning period set the following goals:

- to raise the efficiency of the operation of public administration (by optimizing processes);
- to improve the business environment (by improving the commerce indicators);
- to raise the level of e-skills of the population (by improving the average level of skills and decreasing the proportion of people not using the Internet);
- to increase Internet accessibility (by increasing Internet accessibility to households);
- to ensure easy access of services in the electronic environment (by raising the proportion of the population and companies, which are using the Internet for co-operation with public and local authorities, as well as with medical institutions);
- to increase the investment in research and innovation (by increasing the amount of investment and the proportion of innovative companies).

For developing the electronic administration and the information society, by 2014 the financing of EU

structural funds as well as the public and local government budget funds in the amount of 149 million euros were acquired. In total, more than 120 projects in various areas of economy were implemented. The planned results have not been achieved only in the project *Skolas.lv*, with the total costs constituting 3.5 million euros, because there has been a lack of administrative capacity for qualitative supervision of the project, as well as analogous services have been more successfully provided by several private companies.

In the multi-annual budget period (for 2014–2020), it is planned to use the financing of EU structural funds in the amount of 192.8 million euros.

By implementing activities of the priority direction of the Cohesion Policy *ITT Accessibility, E-administration and Services*, it is planned to provide support to promoting a balanced development in the entire territory of Latvia, creating or improving the infrastructure of electronic communication, and simultaneously developing an environment, which promotes the economic activity and is based on availability of information, repeated use of the public sector information, ITT solutions integrated by public and private sectors, and involvement of Latvia in the European single digital market, as well as improvement of the overall quality of life of the population, contributing to the accessibility of services, raising the productivity of the public, reducing the administrative burden and raising the mobility.

Furthermore, NGOs of the sector take active participation in the formation of information society. In 2012, the Latvian Information and Communications Technology Association (LIKTA) developed the *Chart on Priorities of the ITT Sector* specifying 6 target directions for the next 5 years. Whereas, on 9 April 2014, the LIKTA, the Ministry of Environmental Protection and Regional Development, “Lattelecom” Ltd, the Latvian Association of Local and Regional Governments (LALRG), the Latvian Association of Large Cities (LALC) and the

Latvian Chamber of Commerce and Industry (LCCI) signed a co-operation memorandum on the e-administration efficiency measurement for national-scale public authorities and local governments – the *Latvian e-index*.

In 2013, during the *E-skills Week*, a co-operation memorandum was signed on the establishment of *E-skills Partnership* in Latvia. It was signed by representatives of the public sector, the ITT sector and NGOs, in response to the EU initiative the *Grand Coalition for Digital Jobs Creation*.

The *E-skills Week 2015* took place in 88 regions and towns of Latvia. More than 150 public and non-

governmental organisations participated in ensuring these activities, involving 23.6 thousand people in the training process.

Since the accession to the EU, the EU initiatives related to the formation of the information society have become binding for Latvia.

In the declaration *Digital Agenda for Europe*, adopted by the EC on 26 August 2010 (see Box 6.23), a goal was set to gain economic and public benefits from the single digital market, which is based on fast and ultra-fast Internet, in accordance with the *EU 2020* strategy.

Box 6.23

Action Plan for the Digital Agenda for Europe

Seven priority activities (areas of action) have been determined for the *Digital Agenda for Europe*: establishment of a single digital market, improvement of main conditions for the interoperability of ITT tools and services, raising of the Internet security and trust of users, faster access to the Internet, more investment in the research and development, improvement of digital skills, abilities and inclusion, as well as adaptation of ITT, in order to solve current societal problems, for example climate changes, health care and ageing of the public. In total, 132 activities are planned in the areas mentioned in the agenda.

The following areas are specified in the action plan as particularly supportable:

- *accessibility to fast and ultra-fast Internet*. In order to ensure equal access of electronic communication services in the entire territory of Latvia: a national broadband network implementation plan must be developed and realized, and appropriate legislation, which will facilitate investment in broadband networks, must be implemented, also the financing provided by the EU structural funds (see the section on the broadband Internet) and the Rural Development Fund must be fully used, and the European Radio Spectrum Policy Programme must be implemented;
- *improvement of digital skills, abilities and inclusion*. In order to promote development of the information society by providing an opportunity for the Latvian population to acquire e-skills according to the level of their education and professional activity: a long-term policy for using e-skills and digital means must be implemented, and a respective motivation of SMEs and groups being in an unfavourable situation must be promoted; regulations on invalidity of the telecommunications legal framework and the *Audiovisual Media Services Directive* must be implemented; e-studies must be integrated in the public education and training modernization policy;
- *reliability and security*. In order to increase the trust of people in using the Internet: the European scale *Information Technology Security Incident Response Network* (CERT network) must be joined and used; an extensive attack imitation must be performed and the prevention strategy must be tested; a hotline for reporting offensive or harmful content must be introduced, and educational campaigns for children on the Internet security must be organized.

The action plan provides for activities also in other areas of action. In the area of action *Digital Single Market*: the main directives, which support the single digital market, must be implemented, including the *Services Directive*, the *Unfair Commercial Practices Directive* and the legal framework on telecommunications, and also the legislation on the conditions of invoicing must be adapted. In the area of action *Interoperability and Standards*: the *European Interoperability Framework* must be applied (also in the field of geospatial information) and the obligations in the area of interoperability and standards, determined in the *Malmö and Granada Declarations* must be implemented. In the area of action *Research and Innovations*: by 2020 the total ITT expenses of the public sector must be doubled, by accordingly attracting equivalent private expenses, and participation in large-scale test projects must be taken in order to test and develop innovative and interoperable solutions in areas of public interest. In the area of action *Benefits of the EU Society from ITT*: the smart meters must be introduced, also agreeing on their additional functions; conditions of total service life costs of the devices must be included in the purchase specifications of the lighting equipment; the interoperability of e-administration services must be improved; compliance of points of single contact with the *Services Directive* must be ensured; an agreement must be reached on a common list of main cross-border public services; the requirements of the *European Railway Traffic Management System* must be fulfilled.

In order to assess the results achieved by the *Digital Agenda for Europe*, in May 2014, the European Commission published the information on the progress in the implementation of the programme since its beginning (*Progress Report Digital Agenda Targets 2014*). In general, the results can be viewed as positive: the use of Internet has rapidly increased (by 12 percentage points), reaching 72% of the population; the level of online shopping has increased by 10 percentage points, reaching 47%; the high-speed broadband Internet is available to 62% of the population (increase by 33 percentage points), although majority are residing in towns (these indicators are significantly lower in rural regions). The following shortcomings have been identified: the slow increase of using the e-administration (only by 4 percentage points in 4 years), and even falling of this indicator in separate countries; the low increase of e-commerce in the sector of SME, reaching 14% (2 percentage points in 4 years), which is indicated as an obstacle for creating new jobs; the low level of public support for research and development of ITT; and the very slow increase of the cross-border online trade.

Unlike the general trends in the EU, Latvia has exceeded the EU average of using e-administration and next generation broadband access network coverage (in towns). The level of digital skills and the proportion of employees in the ITT sector against the total number of employees are slightly below the EU average. However, the increase of e-commerce in the SME sector and the public support for research and development in the ITT sector is not sufficient. In 2013, in comparison to the EU average, the largest difference was detected in the accessibility of the fixed broadband Internet in rural regions (in Latvia, 44%, the EU average 90%), which was partially compensated by the relatively high coverage of the next generation broadband access network (in Latvia, 29%, the EU average 18%).

Box 6.23 continued

Upon summarizing the results of 2014, the EC has published the *Digital Economy and Society Index (DESI 2015)*, which contains 5 different digital area aspects on all the EU states:

- (1) compatibility which describes the development of the broadband Internet infrastructure;
- (2) human capital which describes the different level of e-skills of the Internet users;
- (3) the use of the Internet which describes the online activities of citizens;
- (4) integration of digital technologies which describes the digitalization and online activities of companies;
- (5) digital public services which describes the digitisation of public services (mainly e-administration and e-health).

According to the assessment of the *DESI 2015* index, Latvia is positioned among low-performance countries (ranking 18th position in the EU), which are recommended to improve their performance. According to the aspect of the Internet use (8th position) and compatibility (9th position), the indicators of Latvia exceed the EU average, whereas the indicators of human capital (20th position), digital public services (20th position) and integration of digital technologies (28th position) aspects are lagging behind.

Compared to *DESI 2014*, the number of the Internet users has slightly increased in Latvia, the e-skills of the Internet users have improved, and also the range of digital public services has been extended, however, the share of SMEs selling goods online and also the e-commerce turnover have decreased. Furthermore, the use of such digital technologies as the electronic information exchange, cloud computing services, use of social networks, which is necessary in the digital economy, is expanding very slowly in Latvia.

In the first half of 2015, Latvia was the presidency state of the Council of the European Union. One of the three priorities of the Latvian presidency was the creation of a truly digital Europe, paying special attention to raising trust in the Digital Single Market, digitalization of the public sector, as well as promotion of security in the digital environment.

During the Latvian presidency, Riga hosted such significant events as the conference *Open Europe: Open Data for Open Society*, the conference *E-skills for*

Employment, the *Single Market Forum*, the *Riga Summit 2015* on the multilingual single digital market, the conference *SEMIC 2015*, the conference *CONTACT RIGA 2015*, the conference *Role of ITT for Accessibility of Information in the Study Process*, the *Digital Assembly 2015* etc.

On 6 May 2015, the EC in the *European Digital Single Market Strategy* determined 16 basic activities within the framework of three pillars, which must be implemented by the end of 2016 (see Box 6.24).

Box 6.24**EC Communication on European Digital Single Market Strategy****Pillar I – better access to digital goods and services for consumers and companies around Europe**

This pillar includes basic activities, which will facilitate the cross-border e-commerce (by coordinating the regulations on agreements and protection of consumers), ensure better protection of consumers (reviewing the Regulation on Cooperation in the Area of Protection of Consumers Rights), achieve more efficient and accessible (in terms of price) delivery of parcels, prevent unjustified blocking of consumers due to their geographical location, determine competition problems of the e-commerce market (launching the anti-monopoly competition investigation in the e-commerce sector of the EU), develop draft laws for coordination of copyright regimes among countries, increase cross-border accessibility to broadcaster services in Europe (by reviewing the Satellite and Cable Directive), decrease the administrative burden (faced by companies due to differences in the VAT regimes).

Pillar II – creation of appropriate conditions and equal conditions of competition for the development of digital networks and innovative services

This pillar includes basic activities in the area of telecommunications, which should improve the coordination of radio frequencies spectrum at the European level, promote investments in the high-speed broadband and ensure equal competition for all market participants (by performing an extensive reform of EU regulations on telecommunications), review audiovisual media sources (by adapting the Directive on Audiovisual Media Services), analyse the role of online platforms on the market and the capacity to fight against illegal content, strengthen the trust in digital services (by reviewing the E-privacy Directive), and co-operate with the sector concerning the cybersecurity issues.

Pillar III – maximum use of the digital economy growth potential

This pillar includes basic activities, which should promote free data circulation in the EU (by proposing the *European Initiative for Free Flow of Data* and the *European Cloud Computing Initiative*), improve the standards and interoperability in the e-health, transport planning, power industry (smart measuring) and other areas, support an inclusive digital society (by improving skills, developing an e-administration action plan for connecting registers of enterprises in the EU, and speeding up the implementation of e-purchases and interoperable e-signatures).

Electronic Services

The single point of contact of Latvia for access to public and local government services, which is also a part of the European “EUGO” network of e-administration Internet portals, is the Internet portal *www.latvija.lv*. By 2015, it is planned to improve this portal in compliance with the general guidelines of the *European E-administration Action Plan 2011-2015*.

Since 2012, Latvian inhabitants can receive electronic identification cards (eID), which are equivalent to a passport and, at the same time, is a secure carrier of the electronic signature (it includes 120 free time stamps for signing documents with a secure electronic signature).

In order to encourage people to use electronically signed documents more actively, at the beginning of 2015, the e-environment was promoted within the

framework of several informational campaigns and advisory activities. According to the data of the Register of Enterprises, in the five months of this year, the number of electronically submitted documents has increased by 76%, compared to the corresponding period in 2014.

On 4 October 2014, prior to the 12th Saeima elections, the issue of electronic voting possibilities was brought to the forefront. Taking into consideration that the only identity document of a part of Latvian citizens (27.5 thousand) was the eID card, in order to participate in the elections, these people had to receive a single voter's card, issued in the departments of the Office of Citizenship and Migration Affairs, however it was taken out only by approximately 20% of citizens. Prior to the Saeima elections, the initiative *Elections on the Internet* was submitted to the Saeima, however, on 4 December 2014, the Saeima adopted a decision to reject this initiative, justifying this decision with the lack of appropriate and secure technological solutions.

Significant savings of human resources, time and money (approximately 10–20%) is ensured by application of the *Electronic Purchase System*, which is mandatory for public authorities. According to the data of the State Regional Development Agency, in 2014, public and local government authorities have acquired goods in the *Electronic Purchase System* for 45.9 million euros (in 2013, 31.1 million euros). A major part of these purchases was comprised of purchases of hardware and software, medicinal products, accessories of printing equipment, and stationery.

According to the *Eurostat* data, in 2013, 17% of Latvian companies (excluding the financial sector) with 10 or more employees, used the Internet for offering goods or services in the electronic purchase system for public authorities in Latvia (the EU average is 13%) and 6% in other EU Member States (the EU average is 2%).

Broadband Internet

According to the *Eurostat* data, at the end of 2013, 97.4% of all Internet connections in Latvia offered broadband Internet speed (the EU average is 97.3%). The speed of 50.8% of all broadband connections was above 30 Mbit/s (the EU average is 21.2%) and 35.6% even exceeded 100 Mbit/s (the EU average is 5.3%).

According to the data, published by the Internet research company "Ookla Net Metrics" on the Internet speed measuring website *speedtest.net*, in mid-May 2015, among 200 of the world's countries, Latvia was ranked 15th and 10th, with the download speed of 45.9 Mbit/s, and the upload speed of 38.8 Mbit/s, respectively.

On 9 November 2011, the EC, in compliance with the EU public aid regulations, approved an aid package worth 101.7 million euros, aimed at extending the ultra-high speed broadband Internet network in Latvia.

From October 2012 until the end of August 2015, by using ERDF funding of 23.1 million euros and private funding of 3.4 million euros, it is planned to implement the first stage of the project *Development of Next Generation Electronic Communications Networks in Rural Regions*. The

project is implemented by the State Joint-Stock Company "Latvia State Radio and Television Centre" (VAS "Latvijas Valsts radio un televīzijas centrs"), creating 177 Internet access points and installing optical cable routes with the total length of 1866 km, which will allow to provide people and companies with qualitative Internet, with the speed from 30 to 100 Mbit/s, and will reduce the digital gap among urban and rural areas. In the second stage of this project, it is planned to continue the construction of new access points and installation of optical cable routes. Completion of the second stage is planned by the end of 2018. The planned financing constitutes 92.5 million euros, 78.7 million euros of which is the financing of the EU structural funds.

In order to determine further directions for the development of a next generation electronic communication network, on 7 December 2012, the Cabinet of Ministers supported the first solution versions offered by the *Next Generation Broadband Electronic Communication Networks Development Concept for 2013–2020*, which determines further development of main networks, development of new points of optical access to the Internet in rural municipalities (for 281 territorial units), attraction of new electronic communications merchants for network development, development of a state aid programme for the creation of subscription lines ("the last mile"), and other activities.

In order to promote the provision of private investments in the 4G network development, the major investors were granted corporate income tax incentives. On 21 May 2013, the Cabinet of Ministers supported the granting of corporate income tax incentives to "Latvijas Mobilais Telefons" Ltd for the implementation of the investment project *Development of Next Generation Mobile Communications Network in Less Densely Populated Areas of Latvia*, and on 26 November 2013, the Cabinet of Ministers supported the granting of corporate income tax incentives to "Bite Latvija" Ltd for the implementation of the investment project *Development of the BITE 4G Network Outside the Major Cities of Latvia*.

Combating Computer Piracy

According to the data of the international software protection organisation "Business Software Alliance" (BSA), in 2013, the level of computer piracy in Latvia reached 53% (the average in Central- and Eastern European countries is 61 per cent). The losses caused to the Latvian economy by computer piracy constituted 39.6 million euros.

The latest study conducted by BSA – *EU Cybersecurity Dashboard* – has compared the activities of EU Member States in the field of cybersecurity. Latvia has not been indicated among the problem countries in this study, because the relevant legislation has been adapted and, in 2014, the *Latvian Cybersecurity Strategy for 2014-2018*, which provides for implementation of certain activities, was approved. It is indicated that the Latvian cybersecurity strategy formally intends to implement a public and private partnership in the area of cybersecurity, however, it is not implemented yet (similar to most EU countries).

E-commerce

According to the data of *Eurostat*, in 2014, goods or services were bought online by 34% of the Latvian population (the EU average is 50%), whereas goods or products from other EU countries were bought online by 16% of the Latvian population (the EU average is 15%).

In 2014, 32% of companies (excluding the financial sector) with 10 or more employees have purchased goods

or services by using the Internet or other computer networks (the EU average is 38%). Whereas, 9% of companies (excluding the financial sector) with 10 or more employees have sold goods or services by using the Internet or other computer networks in 2014 (the EU average is 18%). The e-commerce turnover constituted 8% of the total turnover of these companies (the EU average is 15%).

6.11 Competition Policy

The goal of the competition policy is to ensure an opportunity for each company to work in conditions of free and fair competition, as well as to promote competition development in all sectors of economy in the public interest. Competition promotes development of each individual company and economy, and ensures lower prices, a wider choice, better quality and innovative solutions for consumers.

The authority responsible for the implementation of the competition policy is the Competition Council (the CC); it investigates and prevents infringements of competition rights, makes sure that the state and local government normative enactments do not create unjustified obstacles to free and fair competition among companies, and educates the representatives of companies, the state and local governments, thereby promoting their understanding about competition rights and intolerance towards infringements of these rights.

The main directions of operation of this authority is the protection and control of competition, prevention of infringements, as well as development of the competition culture, helping to create a favourable environment for fair competition among companies.

Protection and Control of Competition

The CC protects competition, turning against infringements of the *Competition Law* – forbidden agreements and abuse of the dominant position – and controlling mergers of large companies.

The priority of the CC is to detect and prevent the most severe infringements of the *Competition Law* – such forbidden agreements and abuse of a dominant position which pose the greatest harm to markets, competition and consumers.

According to the *Competition Law*, any such agreements between companies are forbidden, the aim or consequences of which include restriction of competition. Thus, for example, it is forbidden for companies to set a price level for similar goods, on division of the market in order to avoid competition in the same territories, on participating or, on the contrary, not participating in public procurements and other activities, which lead to a competition between companies that is beneficial for consumers being replaced by forbidden cooperation.

Box 6.25**A Cartel has been Revealed Maintained for at least Five Years by the Official Volkswagen dealers**

The CC adopted a decision to impose a fine on the official dealers and the importer of *Volkswagen* for entering a forbidden agreement, because for at least five years these companies systematically coordinated their participation in procurements, thereby eliminating mutual competition, deforming the supply and preventing customers from purchasing *Volkswagen* cars on better conditions.

Six companies – SIA “SD AUTOCENTRS”, SIA “RIPO AUTOCENTRS”, SIA “MOLLER AUTO KRASTA”, SIA “MOLLER AUTO VENTSPILS”, SIA “MOLLER AUTO LATVIA” and SE “MOLLER BALTIC IMPORT” – were imposed a fine in total of 7.6 million euros for participating in the infringement. One company was fully released from punishment within the framework of the tolerance programme, because the information provided by it allowed the CC to reveal the infringement.

The CC found that these companies had mutually agreed not to compete in procurements. For example, these companies have allowed a pre-selected applicant to win in a procurement, whereas other have submitted agreed upon and less beneficial offers to the customer, or have refused to participate in the procurement at all. The dealers have informed each other on a regular basis about their plans concerning any procurement, requesting other parties not to compete by waiving participation or avoiding to offer lower prices.

Whereas the car importer in Latvia – the wholesaler SE “MOLLER BALTIC IMPORT” – was not only aware of the existing market division among the dealers and did not object it, but also to some extent promoted and supported such infringement, by acting as an intermediary for information exchange.

Although it is impossible to gather information about the exact number of suffered parties which have overpaid as a result of the cartel activities, it is clear that it is very high as the infringement lasted for a long time and new *Volkswagen* cars are among the most popular in Latvia. During the investigation, the CC obtained information about mutual correspondence among the cartel participants concerning procurements made by private companies, state administration authorities and agencies, as well as municipalities, schools (school buses), old people's homes, authorities of the interior, etc.

In the first half of 2015, the CC investigated nine cases on possible forbidden agreements concluded

between companies. In the same period, the CC informed the public on the most extensive forbidden

agreement recently detected in Latvia – a cartel between the official dealers of new *Volkswagen* cars in Latvia (see Box 6.25). This is the second infringement to date in Latvia which has been detected following a report filed within the tolerance programme.

Similar to forbidden agreements, a significant harm to competition and consumers can be caused by dominant

companies on the market if they abuse their power on the market. Abuse of their dominant position is forbidden to large companies according to the *Competition Law*. In order to solve less serious infringements as fast and efficient as possible, the CC can operate as a mediator in negotiations between companies (see Box 6.26).

Box 6.26

The CC Mediates to Prevent an Infringement by a Waste Management Company

Upon a warning by the CC, the waste management company SIA “Eco Baltia vide” changed the provisions of the agreement on the provision of additional services, because some customers were forced to pay for services which they did not use, due to unclear wording of agreement conditions.

The CC started negotiations with SIA “Eco Baltia vide” after receiving the submissions of customers of “Eco Baltia vide” — SIA “RavLat Group” and SIA “Tukuma Auto”. As a result of a procurement, “Eco Baltia vide” had obtained the rights, for a period of five years, to be the only household waste manager in the Adazi region and the Piejura region. In addition to basic services of waste collection, on the provision of which the municipality had concluded an agreement with the waste management company, the company was entitled to conclude individual agreements with customers on the provision of additional services, for example, more frequent waste collection.

Due to the unclear wording of the agreement, customers had, in addition to the agreement with “Eco Baltia vide” on basic services, concluded an agreement on additional services, however, they had not understood that they will have to pay for these additional services each month irrespective of whether they have used them or not.

Having assessed the conditions of additional services, the CC concluded that the conditions are ambiguous and show willingness to unfairly sell the additional services together with the basic service, thereby gaining extra income. Such conduct of the company may be considered as an infringement of competition law. To prevent the harm caused to consumers as quickly as possible, the authority requested “Eco Baltia vide” to change the provisions of the agreement on additional services, initially without opening a case on infringement. The company admitted that the conditions of the agreement are ambiguous and changed them, as well as provided an option for customers to withdraw from this agreement.

In order to prevent significant weakening of competition as a result of mergers of companies, the CC performs the control of mergers of large companies, by allowing only those merging transactions, which do not pose harm to the market. Furthermore, by allowing a merger, the CC is entitled to apply binding conditions to the merging companies, which prevent potential harm caused by the merging. According to the *Competition Law*, receiving a permit from the CC is required in cases when the total turnover of the merger participants in the territory of Latvia in the previous accounting year has been at least 35.6 million euros or if the total market share of the merger participants exceeds 40%.

In the first half of 2015, the CC has examined seven merger transactions. In all cases, companies have been

granted a permit to perform the planned transaction, however, in one instance, the merger participants, in order to complete the merging process, are required to observe binding conditions applied by the CC, which prevent potential harm caused by the merger to competition.

If companies merge without receiving a permit from the CC, the state cannot perform its obligation to protect competition on the market, and irreversible harm can be done to the structure of competition. Therefore, a fine is imposed on companies if they fail to give a timely notice on merging. One such merger of companies without notice was detected also at the beginning of 2015 (see Box 6.27).

Box 6.27

CC Punishes Fuel Traders for Failure of Merger Notice

The CC imposed a fine of 104.4 thousand euros on “LUKoil Baltija R” Ltd and “Akselss” Ltd for the failure of giving timely notice on merging.

The cooperation between “LUKoil Baltija R” Ltd and “Akselss” Ltd developed under a franchise agreement and, starting from December 2010, “LUKoil Baltija R” Ltd and “Akselss” Ltd covertly started to operate as one company — “LUKoil Baltija R” implemented a unilateral decisive influence on “Akselss” Ltd. The companies submitted the merger notice to the CC only at the beginning of 2015 — after the CC had paid particular attention to the operation of these companies.

The fine imposed on the companies is the largest fine imposed by the CC for this type of infringement. At the same time, in calculating the extent of fine, the CC took into consideration that the companies provided the required information about the merging and concluded an administrative agreement with the authority according to which the company has already paid the imposed amount of fine into the state budget.

During the assessment of the already performed merger, the CC concluded that it does not pose harm to competition and, accordingly, is permissible.

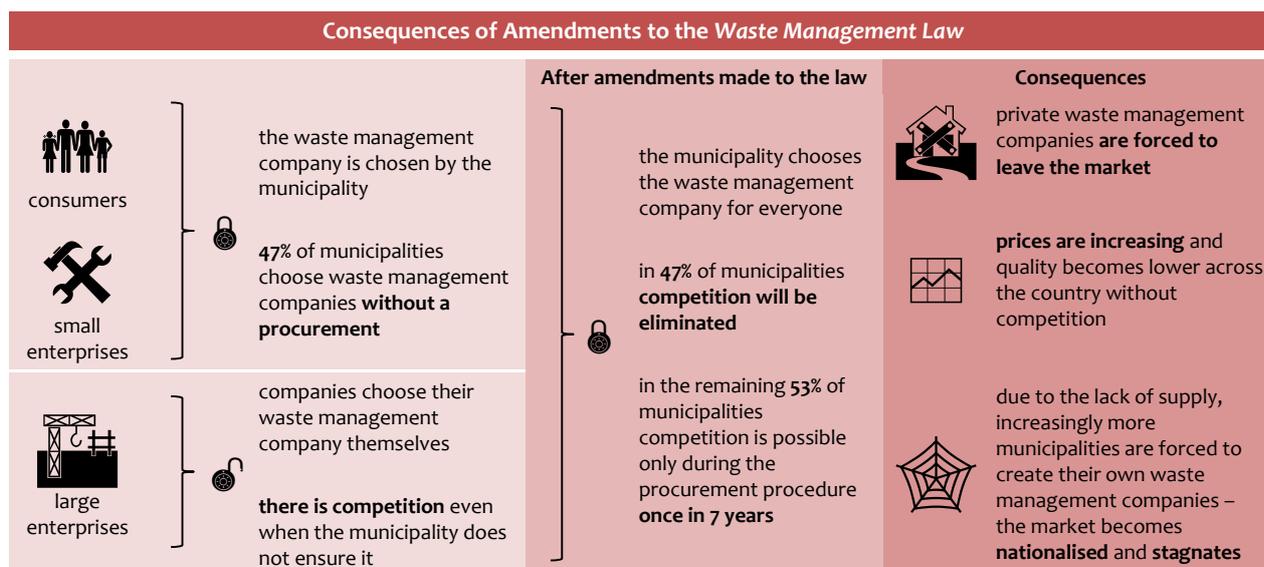
One of the most important tools for control and promotion of competition is market supervision or in-depth competition situation analysis, conducted by the CC in one particular market. The market supervision allows the authority not only to detect and prevent infringements of the *Competition Law*, but also to find the existing administrative obstacles, develop and submit to responsible institutions suggestions for improvement of the competition situation, and to inform society about the competition situation on specific markets. Supervision of the electricity market is among the most significant market supervision activities completed in the first half of 2015 resulting in a conclusion made by the CC that the opening of the market for competition generally can be assessed positively, however, for successful further development of the market it is necessary that consumers use their rights to choose the best offer as actively as possible, thereby promoting competition. Whereas, to expand the supply and make it more beneficial, the state has to maintain an environment in which companies will be able to operate under conditions of equal and fair competition.

Development of Competition Culture

To promote competition in all sectors of economy, the CC helps to eliminate and prevent administrative obstacles to free competition and educates entrepreneurs and the general public about competition rights and the role of competition in ensuring the public well-being. The CC also co-operates with competition supervisors and international organisations of other states, thereby participating in the formation of the international competition policy and using the information and experience shared by other states to ensure efficient protection of competition in Latvia.

To reduce administrative obstacles, which may arise to free competition of companies due to normative acts, the CC examines draft normative acts and gives its opinion, if it concludes that the normative act can cause unjustified harm to competition and, respectively, it must be corrected. Thus, in 2015, the CC got actively involved in preventing the inclusion of competition-distorting amendments in the *Waste Management Law*. To demonstrate the potential harm of these amendments, the CC has developed a special infographic (see Figure 6.15).

Figure 6.15



The CC pays special attention to informing and educating the public, thereby promoting intolerance towards infringements of competition rights, and eliminating instances when companies violate the law due to ignorance as much as possible. To explain to different target audiences the aspects of application of competition rights which are significant for them, the CC has organised seminars, conferences and other activities, which allow to meet with audiences, speak about current issues and answer questions. The seminar for entrepreneurs in Cesis is among the major activities, as well as participation in two conferences dedicated to competition in the area of procurements and the car sector.

Seminars were also organised for the employees of the criminal police and specialists from the Consumer Rights Protection Centre, thereby strengthening mutual co-operation in detecting and investigation of infringements.

By strengthening the principles of good management, the CC developed the *Guidelines for the Oral Hearing Procedure*, thereby setting the standards for opportunities of companies to express their opinion on infringement case materials available to the CC, before the authority has adopted the final decision.

The first half of 2015 has been particularly active for the CC in the field of international co-operation. Within the framework of the Latvian Presidency of the Council

of the European Union, the CC of Latvia organised the conference of the European Competition Day. This event allowed meeting the world's leading competition law experts, representatives of EU competition supervision authorities, Latvian entrepreneurs, non-governmental institutions and state administration authorities, as well as judges and lawyers specialised in competition rights. The conference *Wider Opportunities for More Efficient Protection of Competition* was dedicated to three central issues which are important for the majority of the EU member states — ensuring equal conditions for companies of private and public persons, current

issues in combating cartels and the procurement power of large retailers.

In continuation of the co-operation traditions of Baltic competition authorities, the annual Baltic Competition Conference took place in Riga on 8 May. In this conference, representatives of national competition authorities from Latvia, Lithuania, Estonia, as well as Finland, Austria, Sweden, Germany and Poland discussed the current issues concerning investigation of infringements and operation of authorities, shared their experience and established further co-operation opportunities.

6.12 Policy for Export Promotion and Attraction of Foreign Investment

To achieve the Latvian “economy breakthrough” included in the *National Development Plan* and successfully implement goals mentioned in the *National Guidelines of Industrial Policy* (see: Section 6.3), the meeting of the Cabinet of Ministers of 28 May 2013, supported *Guidelines for the Promotion of Export of Latvian Products and Services and Attraction of Foreign Investment in 2013-2019*.

Boosting competitiveness of Latvian companies, targeted activities for the attraction of foreign direct investment and supporting merchants for acquiring external markets are the main directions of conduct mentioned in the guidelines, which will ensure the development of Latvia as a beneficial environment for investment, will promote its recognition at the international level, and will help Latvian companies to enter external markets.

These guidelines define the main goals, principles and directions of operation for the policy of export and promotion of foreign direct investment (FDI) attraction for the next seven years. For successful implementation of guidelines, it is important to create a unified and dynamic co-operation model of all parties, to include public and municipal institutions, the private sector and scientific institutions.

Specific measures in these directions of operation are implemented in compliance with the *Plan for Tasks and Activities Provided for in the Guidelines for Promotion of Export of Latvian Products and Services and Attraction of Foreign Investment in 2013-2019*, which is added to the document of guidelines.

Attraction of Foreign Direct Investment

The FDI attraction policy is aimed at raising competitiveness of Latvia as an attractive environment for investment, taking into consideration the aspects which are significant for investors: macroeconomic indicators of states, business environment – simplicity of bureaucratic procedures and a stable tax policy, availability of adequately qualified workforce, market potential, accessibility of the necessary infrastructure, support instruments and incentives offered. It is important to attract foreign investment in sectors, which

ensure changes of the economy structure in favour of external demand oriented¹ sectors, especially in sectors that are defined as medium-high and high technology sectors².

FDI is significant for the promotion of further growth of Latvian economy both through acquisition of various manufacturing and management skills, and with creation of new jobs, which provides an opportunity to use new technologies and preconditions for technology transfer, promotes integration of the state in the international trade and involvement of companies in the chains of production sales.

The priority in the process of attracting foreign investment must be the geographically closest neighbouring countries where Latvia is recognized and no additional resources have to be invested for informational activities, economically stable and developed countries where the development potential and needs of economy sectors are relevant for perspective co-operation opportunities with Latvia, and countries with the globally largest investment outflows (the USA, France, Germany, the United Kingdom, Japan, China, Russia, India).

In order to successfully compete on the investment attraction market and to improve the progress of local and foreign investment projects which are important for the state, starting from 2010, the IDAL has been implementing the investment attraction methodology *Polaris*, which provides for a unified and coordinated conduct of ministries, local governments, infrastructure companies and public companies in the implementation

¹ External demand oriented sectors: agriculture, extractive industry, manufacturing, transport and storage, information and communication services.

² Medium-high and high technology sectors: production of pharmaceutical products, computers, electronic, optical equipment, aircraft and its equipment, and medical instruments, as well as production of chemical substances, weapons, electric equipment, mechanisms and working machines, automobiles, ships, railway and other types of transport (excluding aircraft) and repairs and installation of equipment and devices (NACE version 2 20, 25.4, 27, 28, 29, 30 (excluding 30.3), 33)

of strategically important local and foreign investment projects, as well as involvement of the private sector, universities and scientific institutions.

To concentrate the available resources in a targeted manner and increase return from them in the attraction of FDI they include basic principles for further conduct:

- extended and active methodology for the attraction of FDI – the *POLARIS process*, according to which further activities related to the attraction of investment are implemented;
- marketing activities for the attraction of investment.

Taking into consideration the limited resources, focusing of activities towards small number of target countries (Nordic countries, Germany, the United Kingdom) and specific target sectors (metal processing and mechanical engineering, wood processing and information technologies, including the creation of shared service centres) is planned for attraction of FDI in 2013-2015.

Along with the existing tax incentives, in order to promote investing activities and create an attractive environment for business in Latvia, the Cabinet of Ministers approved *Regulations on the Sub-activity "Support for Creation of Jobs" of the Addition 1.3.1.1.6 of the Operational Programme "Human Resources and Employment"* on 13 March 2013, focusing on increasing the number of well-paid jobs and growth of the value added and export. Currently, implementation of six supported projects takes place with the total project expenses constituting 24.4 million euros, where the financing of the EU structural funds is equal to 6.5 million euros, and it is planned to create 863 new jobs. Four supported projects are related to combined administrative office services, one project application is received from a producer of plastic packaging, and one from a car producer. Currently, the projects are being implemented, and 466 new jobs have been created within the framework of these projects by 31 March 2015.

To promote investment attraction, the Saeima adopted amendments to the *Law on Corporate Income Tax* on 6 November 2013, which suggest extension of the state support programme *Tax Privilege for Initial Long-term Investment Made in the Framework of Project of Supported Investment* until 31 December 2020, at the same time increasing the minimum required sum of investment to 10 million euros. In order for entrepreneurs to be able to submit investment project applications for receiving support in 2015, the Cabinet of Ministers approved amendments to Regulations of the Cabinet of Ministers of 24 January 2012, *Procedure for Approval and Implementation of Supported Investment Project* on 19 May 2015, expressing these Regulations in a new version and providing that the legal framework included in this version is coordinated with the new EU-level legal framework for state support, which came into force on 1 July 2014. By 31 December 2013, the Cabinet of Ministers has supported 25 large investment projects with the total

investments constituting 285.7 million euros. The majority of them or 23 of 25 supported investment projects will be implemented in the manufacturing sector, whereas two investment projects — in the sector of information communication technologies.

More detailed information about the attracted foreign direct investment is provided in Section 4.3.3 of the report.

Export Supporting Instruments

Latvian exporters have access to a wide range of direct services for supporting export, which include consultations on issues related to export, among them consultations on foreign markets, specific trade requirements and searching for business partners. In addition, seminars about export skills and informational seminars about external markets are organised, and identification and promotion of export and investment projects is implemented.

To promote external competitiveness of Latvian companies, the IDAL has organised 37 trade missions in 2014, involving 201 entrepreneurs, and 11 delegations of entrepreneurs in the framework of visits of senior officials and intergovernmental commissions established abroad, with the participation of 302 entrepreneurs. During this period, 17 national sectoral stands have been organised for international exhibitions abroad, and support is provided for participation of 62 Latvian companies in 30 international exhibitions abroad. Furthermore, 66 individual business visits abroad have been organised and 616 consultations on external markets, and searching of business partners have been provided for Latvian entrepreneurs. Implementation of the above-mentioned activities is also continued in the first half of year 2015.

Latvian external economic representations and the IDAL provide services to merchants using the "one stop shop" principle, thereby these representations ensure individual business visits for entrepreneurs, provide support for participation of companies in international exhibitions abroad, process export requests and projects, and ensure processing of requests for consultations and information in the area of attraction of foreign investment.

Use of export supporting instruments is continued in 2015 for mitigation of negative consequences of embargo for import of food products, introduced by Russia, by providing merchants with the support in acquisition of new markets.

In 2014, operation of Latvian external economic representations was ensured in Belarus, Denmark, France, Japan, Russia, China, Germany, Lithuania, the Netherlands, Norway, Poland, Sweden, Ukraine, and the United Kingdom, whereas in the first half of 2015, temporary representations were opened in Azerbaijan, Finland, Italy, Kazakhstan, China (the second representation in Shanghai in addition to one existing in Beijing), Singapore, and the UAE for mitigation of consequences of the import embargo introduced by Russia. These representations provide support to Latvian

commercial companies in creating and maintaining business contacts, and for implementation of external marketing activities, and also to provide consultations on market requirements of respective foreign countries.

From 24 November until 10 December 2014, *Latvian Days in Georgia*, from 17 November until 16 December 2014, *Latvian Days in Japan*, and from 15 January until 15 February 2015, *Latvian Days in Finland* took place, organised by the IDAL. Activities of Latvian Days include presentations of company products, marketing campaigns, forums, cooking master classes and other activities, which promote recognition of products of Latvian companies in the target countries.

Under the activity *Business Support Activities* within the *EU Structural Funds Operational Programme for 2007-2013 Business and Innovations* the activity 2.3.1.1. **Acquisition of External Markets – External Marketing** is being implemented. In this activity, merchants are provided with extensive support for implementation of external marketing activities: participation in exhibitions, fairs, trade missions, organisation of seminars and conferences, and, since November 2014, also for the assessment of conformity of production units and products with the requirements determined in the target markets. 654 project applications have been assessed in 2014.

Since July 2014, when the General Administration of Quality Supervision, Inspection and Quarantine of China accepted the dairy certificate submitted by Latvia, Latvian dairy processors are given an opportunity to export their

products to the Chinese market. Henceforth, only exchange of certificates will be required to start trading and no additional agreements have to be signed, except an approval from the Chinese counterpart has to be received, which takes place after verification of companies. In April 2015, the Certification and Accreditation Administration of the People's Republic of China published on its homepage the list of 10 Latvian food product producers, which are allowed to export several types of milk products to China, for example, cheese, milk powder, sour cream and ice cream. In order to promote growth of export (especially to countries with a high level of risk) and expansion of export markets (the CIS region, rapidly growing economies etc.), and to strengthen the position in the existing export markets, short-term export credit guarantees are available, as described in more detail in Section 6.8.

To supplement the range of insurance instruments available on the financial market and to promote development of export-oriented companies, the Ministry of Economics plans to develop a medium and short-term credit guarantee programme in 2015. The programme and its implementation model will be developed in accordance with the results of market research, as well as taking into consideration the experience of other countries in implementation of insurance instruments, and results achieved by them – impact on the flow of export transactions and, consequently, on the development of export-oriented companies.

6.13 Consumer Protection and Market Surveillance

The consumer protection system in Latvia undergoes continuous consolidation and development to ensure efficient market surveillance and consumer protection. The Ministry of Economics is working to improve and develop the existing regulation and to ensure a high level consumer protection.

Measures in the Area of Consumer Protection during the Latvian Presidency of the Council of the European Union

On 9 July 2013, the EC approved the proposal for the Directive of the European Parliament and of the Council on package travel and assisted travel arrangements, the purpose of which is to improve the operation of the internal market and to achieve a high consumer protection level by approximating rules for package travel services. The proposal for the directive was discussed at the expert level in the Working Party on Consumer Protection and Information of the Council of the European Union (CONSOM) and during the Italian Presidency of the Council of the European Union. In December 2014, the Competitiveness Council of the Council of the European Union approved the *General approach on the proposed Directive*, thus certifying its readiness to start negotiations with the European Parliament and the EC on the text of the Directive.

According to its mandate, the Latvian Presidency started negotiations with the European Parliament and the EC at the beginning of 2015. Four informal dialogues were conducted during the Latvian Presidency of the Council of the European Union, which resulted in a (provisional) political agreement between the Council, the EC and the European Parliament on the text of the proposal for the directive. On 28 May 2015, the Competitiveness Council of the Council of the European Union received support of the Member States for the *proposal for the Directive*, according to the content of the political agreement.

The Directive will improve the rules with regard to purchasing, execution of package travel and assisted travel arrangements and the liabilities arising from the agreements concluded between holidaymakers and service providers (organisers, wholesalers, traders). The renewed Directive will extend the current protection for traditional package travels (with regard to various kinds of combinations of travel services), as well as support those travels and packages, which are combined and purchased online (dynamic packages, assisted travel arrangements).

Box 6.28**Improvement of the Regulatory Framework**

Amendments to the *Unfair Commercial Practice Prohibition Law*, the *Advertising Law* and the *Latvian Administrative Violations Code* will enter into effect on 1 July 2015, thereby extending the authority of the CRPC and other supervisory authorities in cases of unfair commercial practices, as well as increasing the maximum fine for unfair commercial practices. The amendments to the laws have been developed to motivate businessmen to use fair commercial practices and to observe the requirements set for advertising, at the same time providing enterprises with the possibility to voluntarily eliminate violations without the application of penalties. Today, the regulation in force is not sufficiently efficient to deter offenders from prohibited commercial practices, because it is more advantageous to pay a fine rather than implement decisions of a supervisory authority and stop using unfair commercial practices. To reverse this situation and ensure a more efficient consumer protection, the maximum fine envisaged for prohibited commercial practices is up to 100 000 euro. If any offender continuously does not fulfil decisions taken by the supervisory authority or a significant harm to consumers is found, supervisory authorities will be able to restrict or close the operation of the electronic tool (such as a website or a domain name) of the user of unfair commercial practices, as well as to suspend the operation of the user of unfair commercial practices or his/her company (business unit).

Directive 2014/17/EU of the European Parliament and of the Council on credit agreements for consumers relating to residential immovable property and amending *Directives 2008/48/EC* and *2013/36/EU* and Regulation (EU) No 1093/2010 entered into force on 4 February 2014. The Directive prescribes to set requirements for advertising of mortgage services, the information to be provided before the conclusion of the agreement, the assessment of consumer's creditworthiness, the calculation of the annual percentage rate of charge, early repayment of credits, access to creditworthiness assessment databases, as well as a supervision mechanism for credit intermediaries and creditors and competence requirements of these service providers. On 11 July 2014, the Ministry of Economics created a working group for the development of a *Draft Consumer Crediting Law*. The working group includes representatives of sectors, non-governmental organisations protecting the interests of consumers, and representatives delegated by the involved public authorities. The deadline for the implementation of the Directive is 21 March 2016.

On 28 May 2015, the Saeima adopted an *Amendment to the Consumer Rights Protection Law*, which prohibits concluding credit agreements from 23.00 to 8.00 in the morning, restricts the total cost of the credit to the consumer (0.55% from 1 to 7 days, 0.25% from 8 to 14 days, 0.2% from 15 to 30 days, 0.25% over 30 days), restricts repayment the credit in one payment, if it is longer than 30 days, restricts the growth rate of the interest rate (36% per year above the loan rate), restricts all credit-related costs to 100% from the amount of the issued credit and prohibits to use a promissory note as a payment tool. The nature of these amendments is that interest, incl. late fees, the cost of extension of the credit maturity and other credit-related costs will not be able to exceed 100% of the amount of the initially granted credit. This restriction will ensure that consumers do not become subjects of an excessive and constantly growing debt. The restriction of the total cost of the credit will ensure that consumers, who diligently repay their credits within the set deadlines, do not overpay for the borrowed amount, by covering credits of those consumers who do not repay them, and, in conditions of limited profit, creditors will be forced to use a stricter approach when assessing solvency of consumers and will not issue credits to those whose solvency is insufficient. The restriction to repay the credit in one payment will ensure that consumers will be given credit repayment schedules, which will increase the possibility that credits are repaid on time. The restriction on late fees will ensure that late fees will grow slower, so that in cases, when a consumer has delayed a payment, they would be able to pay it and cover their payment commitments towards the creditor. The law will enter into force on 1 January 2016.

The *Law on the Credit Information Bureaus* entered into effect on 1 January 2015 and promotes wider availability of credit information for the purposes of assessment of creditworthiness. The purpose of the *Law on the Credit Information Bureaus* is: (1) to reduce the credit risk and to promote wider availability of the credit risk related service; (2) to promote responsible and fair undertaking of commitments; (3) to ensure more effective availability of credit information and to improve management of the credit risk. The Law sets rules for operation of the credit bureau and processing of credit information, periods of storage of credit information, as well as rules of issue of credit information and responsibility for the processing of credit information. A licence, which is issued by the Data State Inspectorate, should be received to start operations of a credit information bureau. Operations of a credit bureau include data processing which allows economic operators to assess creditworthiness of potential customers before concluding an agreement. It also collects information on undertaken payment obligations (fulfilled and unfulfilled), as well as information from respective National information systems, which can be valuable for the assessment of creditworthiness.

The new rules will not only ensure a transparent, understandable set of rules, but will also significantly strengthen the consumer protection with regard to travel services. The most significant benefits are improved information provision requirements, rules which will promote provision of transparent information about prices of services, thus eliminating the risk of unfair commercial practices, improved trip cancelling rights, stricter requirements with regard to the responsibility of organisers when something goes wrong during any trip, higher holidaymaker protection in case of unpreventable and unexpected circumstances, and more effective and

harmonised rules with regard to holidaymaker protection if service providers become insolvent. The new rules will not only benefit EU holidaymakers, but also the travel industry in general: firstly, by getting rid of old problems (such as the obligation to provide the holidaymaker with a hard copy of a printed brochure), secondly, by creating uniform, transparent rules in the EU, which will not only promote cross-border trade, but also improve co-operation, thus providing more possibilities to enterprises, especially taking into account the needs of SMEs.

Box 6.29**Improvement of Resolution of Individual Consumer Disputes**

The Ministry of Economics prepared draft laws, the *Law on Resolvers of Out-Of-Court Consumer Disputes* and the *Amendments to the Consumer Rights Protection Law* (submitted to the Saeima on 9 April 2015), to promote consumer protection by providing consumers the possibility to use and protect their legal rights using independent, fast, efficient and fair out-of-court solution options. These draft laws will implement the requirements of the *Directive 2013/11/EU* of the European Parliament and of the Council of 21 May 2013 on *alternative dispute resolution for consumer disputes* and amending *Regulation (EC) No 2006/2004* and *Directive 2009/22/EC*, and will ensure compliance with the principles laid down in the OECD Recommendation C(2007)74 on *Consumer Dispute Resolution and Redress* of 12 July 2007.

The draft *Law on Resolvers of Out-Of-Court Consumer Disputes* prescribes setting requirements for out-of-court resolvers of disputes who wish to examine disputes between consumers and sellers or service providers. The draft law sets the following requirements for resolvers of out-of-court consumer disputes: (1) availability; (2) competence, independence and objectivity; (3) transparency of activities; (4) efficiency of the process; (5) fairness and legitimacy. When the requirements of the law are fulfilled, any resolver of out-of-court disputes may be included on the list maintained by the CRPC, which will serve as a certification for the fact that this resolver of out-of-court disputes is competent and sufficiently objective to examine disputes between consumers and sellers or service providers. It is expected that the information on resolvers of out-of-court disputes will be published on the website of the Consumer Rights Protection Centre.

The draft law *Amendments to the Consumer Rights Protection Law* prescribes the creation of the Consumer Dispute Resolution Commission as one of resolvers of out-of-court disputes. The plan is that the Commission as an independent decision-making authority will operate at the Consumer Rights Protection Centre and will secure resolution of disputes arising from contractual obligations of consumers and sellers or service providers (individual disputes of consumers) in the areas, in which no other resolvers of out-of-court disputes meeting the requirements of the *Law on Resolvers of Out-Of-Court Consumer Disputes* are established and included on the list or if dispute resolvers of the area concerned refuse to resolve the dispute. The draft law envisages that experts from consumer and merchant non-governmental organisations will participate in the decision-making, thus ensuring maximum objectivity in achieving a dispute resolution. Advantages of the Commission:

- disputes are resolved faster (90 days) contrary to the current situation, when disputes are resolved within administrative proceedings, which can last up to 3 years;
- it is intended to involve experts in the area (representatives of consumer and merchant non-governmental organisations) into dispute resolution;
- the dispute resolution process will be less formal and focused on the achievement of an agreement between the parties with regard to the dispute;
- the process will be free of charge (today an examination of the product should be performed by the consumer or the merchant depending on the situation).

The right of consumers to contact the CRPC will not change and, like before, consumers will be able to receive consultations and help in dispute resolution.

It is expected that these laws will enter into force on 9 July 2015 and the new out-of-court dispute settlement procedure for consumers should be applicable from 1 January 2016.

On 13 February 2013, the Commission proposed a package of regulations on safety and market surveillance of products, which included a proposal for the Regulation of the European Parliament and of the Council in relation to market surveillance of products and a proposal for the Regulation of the European Parliament and of the Council on consumer product safety. The drafts aim to significantly improve safety of the products circulating in the single market and to strengthen market surveillance with regard to all non-food products. The draft of the regulation on consumer product safety provides that consumer products must be safe and specific obligations must be imposed on economic operators, as well as rules should be laid down for the development of standards for support of claims. This new draft of market surveillance regulation is sought to harmonise the application of market surveillance rules in various EU Member States, by providing consumers and other users with better protection, as well as reducing the administrative burden on economic operators and regulate information exchange between market surveillance authorities. Unfortunately, further development of this package in the European Union has stopped, because of a politically disputable matter

whether to include a mandatory indication of the country of origin in the product marking, because Member States could not agree on a compromise with regard to the principle of the country of origin in the draft Product safety regulation.

Surveillance of Consumer Rights

The Consumer Rights Protection Centre (CRPC) is the main coordinating authority in the area of surveillance of laws and regulations on consumer protection, and the goal of its operations is to ensure efficient protection of consumer rights and interests. To ensure the performance of functions of the authority, the CRPC implements surveillance of observation of consumer rights (in the area of protection of economic interests of consumers and surveillance of observation of consumer rights in draft agreements and agreements, which consumers conclude with producers, sellers or service providers), examines consumer complaints, ensures information for consumers and businessmen and provides consultations, as well as implements measures to ensure surveillance of unfair commercial practices, e-commerce and advertisements, licences non-banking creditors and out-of-court debt collection service providers, ensures safety and compliance surveillance

measures for goods and services, ensures public metrological surveillance, surveillance of dangerous

equipment and investigation of emergencies involving dangerous equipment.

Box 6.30

European Consumer Protection Conference

The European Consumer Protection Conference *Future Priorities of Consumer Policy in the Digital Era*, organised by the Ministry of Economics in co-operation with the CRPC, was held on 23–24 April 2015 in Riga, within the framework of the Latvian Presidency of the Council of the European Union. The conference brought together high-level policy makers and consumer supervision authorities from the EU, EFTA Member States, OECD representatives, as well as representatives of European-scale consumer and business organisations.

During the conference, discussions were held on future priorities in the creation of consumer policies and new challenges, faced by the consumers in the digital environment. Special attention was devoted to matters such as safety of goods and services, problematic markets, strengthening of consumer rights and trust. It was admitted that, to promote cross-border deals and to increase the level of consumer trust, measures to reduce market fragmentation should be implemented, new directions in consumer behaviour and business models should be taken into account and the level of consumer awareness should be increased. During the conference, the participants agreed that in the global and digital environment it is especially important to promote closer and wider co-operation between EU and national legislative authorities, consumer protection associations, as well as business and consumer representatives.

The CRPC set priorities for surveillance of consumer rights in 2015 in the areas such as commercial practices in consumer crediting, commercial practices, when providing electrical energy services and beauty products, commercial practices and conclusion of agreements in house management, commercial practices in group

buying online, incl. package travel service offers, commercial practices in the electronic environment, commercial practices in internet shops, when offering construction materials, safety guarantees and terms and conditions of agreements proposed to consumers of package travel service providers.

Box 6.31

CRPC Activities in the 1st quarter of 2015

Within the framework of its activities, in the 1st quarter of 2015, the CRPC provided 9805 consultations to consumers and legal entities. The number of provided consultations grew by 3% compared to the 1st quarter of 2014. When asking for consultations, consumers were most frequently interested in matters related to their rights, in cases when a low-quality product was purchased or a low-quality service was received. Most questions were about actions to be taken, when footwear, mobile phones, electrical appliances that do not meet the provisions of the agreement are purchased or problems with services based on a distance contract and air services are encountered. In some cases the consumers were interested in the advisable actions, if the deadline of product delivery or service fulfilment is not observed. In the same way, consumers ask about the areas beyond the competence of the CRPC or about areas, in which the CRPC is not entitled to take a binding decision, but only to provide consultations, especially on the quality of electronic communication, costs of insurance indemnity, as well as utility services.

In the 1st quarter of 2015, the CRPC received 593 consumer complaints, thus there have been no significant changes compared to the 1st quarter of 2014. Most frequently, consumers complained about purchased products and services, which did not meet agreed upon conditions. Many complaints were also received about commercial practices, advertising and e-commerce, and about disregarding the principle of legal equality of parties in agreements. Most complaints about products concern electrical appliances, followed by complaints about mobile phones and the quality of footwear. In the area of services, most complaints concern services based on distance agreements. Problems in the area of rental, utility and air services continue to be relevant. In contrast, in the area of financial services, the number of received applications has dropped by 22%, which is explained by the improvement of solvency of the population and the state-implemented policies for improving the consumer crediting system and the regulatory framework.

In the three months of 2015, 46 cases were initiated about the violation of collective interests of consumers, incl. in the areas of commercial practices, advertising, e-commerce and terms and conditions of agreements. The cases were mainly initiated in relation to commercial practices and terms and conditions of agreements in the area of crediting services, when offering food supplements, in the area of e-commerce, commercial practices in the area of collective purchases, commercial practices and terms and conditions of agreements in the area of electrical energy. Licensing and re-registering of licences of creditors, which do not meet that status of a credit institution, and debt recollection service providers, as well as regular surveillance of businessmen continues.

The European Consumer Centre (ECC Latvia) continues to provide support and information in case of unsuccessful **EU cross-border purchases**. The ECC

Latvia is a member of the European Consumer Centre Network (ECC-NET), which is operating within the Consumer Rights Protection Centre with the support of the European Commission. In the 1st quarter of 2015, 197 consultations were provided on cross-border problems within the EU and 47 complaints were examined on cross-border problems within the EU. The population mostly contacted the ECC Latvia in relation to cross-border online purchases, which can be explained by an increased activity of the consumers in using the advantages provided by the internet environment for their purchases.

The CRPC set the following priority directions in **market surveillance** in 2015: the improvement of safety and compliance of products in areas such as construction products, electrical appliances, machinery, pressure

vessels, radio and telecommunication terminal equipment, and toys. A project for the inspection of dangerous equipment – surveillance of the use of lifting equipment is also planned.

Taking into account the tragic events of 2013, when the roof of a supermarket collapsed, and the results of inspections in the area of construction products, where significant non-compliances were found at all inspected construction sites, as well as during tests of construction materials, the surveillance and activities to raise public awareness, which started in 2014, continues in 2015, to improve the level of awareness and professional competence of merchants and persons involved in the construction process.

Surveillance activities to inspect measuring devices, such as non-automatic weighing instruments, electrical energy meters and heat meters are planned as a part of **national metrological surveillance** in 2015. In the 1st quarter, the CRPC evaluated the compliance of measuring instruments with regulatory requirements in

14 manufacturing, trade and service provision companies, where 213 measuring instruments were subjected to the national metrological surveillance.

Metrological surveillance of in-can products in the segment of alcoholic beverages was last performed in 2007, and, since then, the number of producers of alcoholic beverages in Latvia has dropped, while the number of companies importing and distributing alcoholic beverages has grown. Since Latvia is responsible for metrological control of products with “e” marking, which are placed in the EU market for the first time, a draft plan for metrological control of alcoholic beverages was prepared, according to which, 6 producers of alcoholic beverages and 29 distributors and importers of alcoholic beverages were identified in 2015. In the 1st quarter, the control of products was carried out in 11 companies. Violations of regulations with regard to the actual amount of in-can products were stated in 5 batches of in-can products.

6.14 Quality Assurance

6.14.1 Quality Structural Policies

The main task of public authorities in the area of quality assurance of products and services is to promote correct application and observation of the requirements of regulations in the regulated and non-regulated area, as well as to improve the regulatory framework according to EU requirements, taking into account the needs of the national market and national economy, ensuring the compliance of products and services, promoting the growth of competitiveness of businessmen and the reduction of cross-border trade barriers.

In Latvia, the system of quality infrastructure is mainly regulated by the *Law On Conformity Assessment*, the *Standardisation Law*, the *Law On Uniformity of Measurements*, and related laws and regulations.

Main policy directions:

- ensuring and improving the conformity assessment infrastructure (incl. testing and calibration laboratories, inspection and certification authorities, environmental verifiers) according to the needs of the Latvian economy, to protect people and the environment from non-compliant products and services, to promote competitiveness of businessmen and trust in Latvian producers and service providers;
- improvement of the respective reference and advisory framework;
- ensuring the membership of national accreditation, standardisation and metrology bodies in international organisations, by maintaining their international recognition and the compliance of the Latvian quality assurance infrastructure to international requirements;

- maintenance and international comparison of the national base of metrology benchmarks to ensure traceability of necessary measurements, and to protect the population from incorrect measurements;
- promotion of the implementation of quality management, environment and other voluntary management systems in companies, to ensure production of high-value products, provision of services and to promote the competitiveness of Latvian merchants in international markets;
- promotion of efficient market surveillance, to ensure equal conditions for all market participants and to protect consumers from potential unfair competition of merchants.

6.14.2 Accreditation, Standardization, Metrology

Functions and tasks of national standardisation, accreditation and metrology bodies are performed by the bureaus of Limited Liability Capital Company “Standartizācijas, akreditācijas un metroloģijas centrs” (*Standardisation, Accreditation and Metrology Centre*), which is supervised by the Ministry of Economics: the Standardisation Bureau (LVS), the Latvian National Accreditation Bureau (LATAK) and the Metrology Bureau (LATMB).

Standardisation

According to the *Standardisation Law*, the LVS as a national standardisation organisation supervises and coordinates operations of Latvian merchants and organisations in the area of standardisation. Main

functions of the LVS are to register Latvian standards and to form and maintain the collection of Latvian standards in co-operation with international and European standardisation organisations. The LVS has been a full-fledged member of the European Committee for Standardization (CEN) and the European Committee for Electrotechnical Standardization (CENELEC) since 2004, and became a full-fledged member of the International Organization for Standardization (ISO) on 1 January 2015. The LVS is also an associate member of the International Electrotechnical Commission (IEC).

According to the approved plans, priority directions of business of the LVS are distribution of standardisation information, supplementation and maintenance of the collection of Latvian standards, improvement of the electronic system of sales of standards, co-operation with international, European and national standardisation organisations.

378 standardisation documents, incl. 282 European standards adapted to the status of Latvian standards, were registered by the LVS in the 1st quarter of 2015. 19 standards, incl. 8 Eurocodes, were translated into Latvian. 11 national annexes to Eurocodes were drafted and registered. Standardisation information services were provided to 1010 legal and natural persons. 5 seminars for businessmen on construction standards and the European Standardisation Summit were organised with the Latvian Chamber of Commerce and Industry and the State Building Control Bureau.

2 applications were received from interested parties, regarding the creation of a new standardisation technical committee (STC) – “E-invoice” and “Management of projects, programmes and project portfolios”. Interested persons are being identified and coordinated.

Within the framework of the concluded co-operation agreement on exchange of information with the Official Gazette “Latvijas Vēstnesis”, lists of applicable standards are published on the website www.likumi.lv and on the LVS website www.lvs.lv in Section *Standarti likumdošanā* (Standards in Legislation), providing users of standards with information about mandatory and applicable standards listed in laws and regulations.

An e-commenting website www.viedoklis.lvs.lv has been created and is maintained, where businessmen and experts of sectors can voice their opinion on draft Latvian and European standards. The public commenting website was developed within the framework of the European Entrepreneurship and Innovations programme.

A new distribution system of standards was created. It provides detailed information about standards, their development and their link to the Latvian and European law. For the convenience of businessmen, a new notification system was created, which allows receiving the necessary information about changes in the specific standard or any group of standards. The new system also allows reading standards and provides other services.

The General Assembly of European standardisation organisations and the 4th European Standardization Summit were held in Latvia on 3-5 June 2015. The topic of the summit *How standardisation can contribute to a cleaner and smarter economy* is based on priorities of the presidency: sustainability, growth and involvement. The summit focused primarily on the construction sector and comprised such prospects of the sector like the energy efficiency of buildings, sustainable construction, construction of smart cities, and building design and management.

According to CEN/CENELEC Guide 20:2013A, a working plan for MRMC recommendations regarding the LVS self-assessment was submitted to CEN/CENELEC this April.

Documentation is gradually prepared for the implementation of and certification according to *LVS EN ISO 9001:2009*.

To facilitate students' access to the necessary technical documents during their studies, online reading of Latvian standards was provided in libraries of the Riga Technical University, the Rezekne Higher Education Institution and the Fire Safety and Civil Protection College. Online reading rooms for the reading of standards were also created for employees of the Consumer Rights Protection Centre, the State Building Control Bureau and the State Fire and Rescue Service. Standards can also be read at the National Library of Latvia.

Additional information about standardisation is available on the LVS website www.lvs.lv.

Accreditation

The LATAK ensures the operation of the national accreditation authority, according to the *Regulation No 765/2008* of the European Parliament and of the Council.

The LATAK ensures the compliance of the accreditation system with the European Accreditation (EA) Multilateral Agreement (MLA) in seven areas:

- accreditation of testing laboratories (ISO/IEC 17025), including accreditation of medical laboratories (ISO 15185);
- accreditation of calibration laboratories (ISO/IEC 17025);
- accreditation of product certification bodies (ISO 45011/ISO/IEC 17065);
- accreditation of bodies certifying individual persons (ISO 17024);
- accreditation of inspection bodies (ISO/IEC 17020);
- accreditation of management system certification bodies (ISO/IEC 17021);
- accreditation of verifiers of greenhouse gas (GHG) emission reports and tonne-kilometre reports (ISO 14065).

Accreditation as a tool for acknowledging competence and trust is included in more than 120 national regulations. In addition, the LATAK ensures accreditation of verifiers of eco-management and audit schemes (EMAS), according to the Regulation (EC) No 1221/2009 of the European Parliament and of the Council of 25 November 2009 on the voluntary participation by organisations in a Community eco-management and audit scheme (EMAS).

To constantly ensure compliance with the set requirements and harmonise accreditation procedures among EA members, LATAK employees participate in all EA's technical committees and working groups, Council meetings of the *Multilateral Agreement* and EA General Assemblies, as well as EA's comparative evaluations of national accreditation bodies of other states.

LATAK employees also participate in meetings organised by the Forum of Accreditation and Licensing Bodies (FALB) and in comparative evaluations of FALB of other states in the EMAS area, as well as meetings and trainings in the area of the Good Laboratory Practice, organised by the Organisation for Economic Co-operation and Development and the Commission.

The LATAK has contributed to the participation of national laboratories in international inter-laboratory testing programmes and has organised tests of capabilities.

Training seminars for conformity assessment bodies and experts involved by LATAK are organised.

The growth in the number of accredited institutions in the recent years is an evidence of the importance of the accreditation process and stability in the conformity assessment area. An increasing number of bodies choose to certify their competence by accreditation. Many bodies extend their area of operations. Currently 264 accredited bodies are maintaining their accreditation status.

Simultaneously, accreditation is maintained for three laboratories in the Russian Federation, one laboratory in Kazakhstan and three laboratories in Azerbaijan. In addition, within the framework of interstate co-operation, co-operation is maintained with national accreditation institutions of Georgia, the Russian Federation, Belarus, Moldova and Ukraine.

In the 1st quarter of 2015, the LATAK started accreditation in 3 new areas, i.e.:

- inspections of electric safety and testing and assessment of conformity of functions of radiological devices (regulated area);
- accreditation of industrial energy auditors (regulated area);
- photometric, colorimetric measurements for luminaries (non-regulated area).

Priorities in activities and planned measures in the area of accreditation for 2015:

- to promote the accreditation of all medical laboratories by the end of 2015;
- to start the process of LATAK's accession to ILAC/IAF;
- to improve surveillance of conformity assessment bodies;
- to improve co-operation with supervisory authorities, professional organisations in the conformity assessment area and with market operators.

Additional information on accreditation and accredited bodies is available on the LATAK website www.latak.lv.

Metrology

The purpose of the LATMB as the Latvian national metrology body is to ensure and develop credibility and traceability of the country's measurements. The Metrology Bureau fulfils the tasks set by the *Law On Uniformity of Measurements* in the area of metrology.

Within the framework of maintaining the national benchmarks of units, the national benchmarks of units are calibrated at EU's national metrology institutes (NMI).

In May 2015, national benchmarks of electrical units were calibrated in the Finnish NMI "Mikes".

The list of approved types is regularly updated on the website of the Metrology Bureau.

The *Regular review of the Metrology Bureau's quality management system* was prepared in the first half of 2015 and submitted for evaluation to the Technical Committee for Quality (TC-Q) of the European Association of National Metrology Institutes (EURAMET). Instructions for the improvement of the system were received as a result of the presentation of the quality management system. Necessary measures to maintain international recognition of calibration and best measurement capabilities were carried out using the database (KCDB) of the International Bureau of Weights and Measures (BIPM).

14 reference benchmarks and 2 mass comparators of SIA "Latvijas Nacionālais metroloģijas centrs" (Latvian National Metrology Centre) were calibrated.

In 2015, the Metrology Bureau continues to maintain co-operation with the EURAMET, as well as the International Organization of Legal Metrology (OIML) and the European co-operation in legal metrology (WELMEC). In the years to come, the plan is to participate in measurement comparison projects organised by the EURAMET, as well as to take part in the bilateral measurement assessment project organised in Serbia. The climate provision system will be improved to enhance the stability of measurements.

Additional information about the LATMB is available on the website: www.latmb.lv.

6.15 Privatisation

The aim of privatisation is to create a favourable environment for private capital operation in the interests of the development of the Latvian national economy and to narrow the commercial activity performed by the state and local governments, by changing the owner of state or local government property.

Taking into the consideration that the aim of mass privatisation implemented in Latvia is basically achieved,

on 1 September 2005, the *Law on Completion of Privatisation of State and Municipal Property and Use of Privatisation Certificates (Privatisation Completion Law)*, adopted by the Saeima, came into force stipulating the completion of the privatisation process and land reform and the completion of the use of privatisation certificates (see Box 6.32).

Box 6.32

Law on the Completion of Privatisation of State and Local Government Property and Use of Privatisation Certificates

The *Privatisation Completion Law* determines:

- the term – 31 August 2006, until which each legal or natural person could propose a transfer of any state or local government property for privatisation;
- the procedures, according to which a proposal for privatisation submitted by a person shall be examined, and a decision on the transfer of state or local government property for privatisation is adopted;
- that a transfer for privatisation, and preservation of a property in the ownership of a local government can be refused in case of property which is necessary for the performance of a state administration function, or state or local government business activity;
- that decisions on the transfer for privatisation of state or local government property regarding which an ownership dispute has arisen or it corresponds to a status of an abandoned property, is adopted after coming into force of a court judgement;
- that the state joint stock company “Latvenergo”, the state joint stock company “Latvijas Pasts”, the state joint stock company “Starptautiskā lidosta “Rīga””, the state joint stock company “Latvijas Dzelzceļš”, the state joint stock company “Latvijas Gaisa Satiksme” and the state joint stock company “Latvijas valsts meži” are not subject to privatisation or alienation;
- the term until which the persons who want to redeem the land allocated for permanent use, must submit a land redemption request to the State Land Service (30 November 2007), the term until which a respective land boundary plan or certification on making a land redemption payment in privatisation certificates before the conclusion of a land redemption agreement (1 September 2008), as well as an application for the adoption of a decision concerning the transfer of land into ownership for a charge (31 August 2011), and that a land purchase agreement had to be concluded until 30 December 2011;
- that privatisation certificates do not have a specific period of validity, however, they can be used only within the framework of the privatisation process;
- the procedure according to which allocation of privatisation certificates is terminated. The deadline determined for individuals is 28 December 2007, until which they could submit an application for allocation of privatisation certificates.

To ensure a successful and open privatisation completion process, the Cabinet of Ministers has adopted a procedure on how the institutions which perform privatisation and land reform must develop a publicly available register for privatisation proposals and land redemption.

Privatisation of State Property Objects and Land

According to the *Law on Privatisation of Objects of State and Municipal Property*, privatisation of state property objects and land is performed and privatisation proposals are processed by the state joint stock company “Privatizācijas aģentūra” (Privatisation Agency).

A decision on the transfer of a state property object, including capital shares and an undeveloped plot of land, for privatisation is adopted by the Cabinet of Ministers, whereas the Privatisation Agency adopts decisions on the transfer of a developed plot of land on which buildings and structures owned by another person are situated. The decision is adopted on the basis of a privatisation proposal submitted by any natural or legal person.

From 1 September 2005, when the *Privatisation Completion Law* came into force, until 30 April 2015, the register of privatisation proposals of the Privatisation Agency has registered 636 privatisation proposals for real estate, 57 privatisation proposals for state capital shares and 4490 proposals for privatisation of plots of land or privatisation continuation. After 31 August 2006, those

privatisation proposals are registered in the privatisation proposals register, which have been incorrectly submitted to other public or local government institutions before the abovementioned date, and later have been forwarded to the Privatisation Agency on the basis of jurisdiction.

The Cabinet of Ministers has not yet examined 4 privatisation proposals which have been received concerning state property objects, as their examination is currently encumbered by legal problems.

The Privatisation Agency received privatisation proposals for 79 property objects, ownership of which have not been clarified. The Privatisation Agency is authorized to address a court or a notary on behalf of the Republic of Latvia in order to recognise these property objects as abandoned property or escheat. The Privatisation Agency has not addressed the court concerning 12 property objects, as these property objects are owned by a local government or a private person, or it is established that such a structure does not exist on site. The Privatisation Agency has addressed the court concerning 67 property objects in order to establish a

legal fact and recognize objects as abandoned property pertaining to the state. The legal proceedings have been completed in 54 of such cases and a court judgement has come into force satisfying an application of the Privatisation Agency and establishing a legal fact that real estate is abandoned and is pertaining to the state. In 13 instances, an application of the Privatisation Agency has been left without examination on the basis of Section 258 of the Civil Procedure Law, because a dispute about rights has arisen within special proceedings, therefore, such dispute must be solved in court in a claim procedure. After the delivery of court judgements on the recognition of a property as abandoned, draft orders of the Cabinet of Ministers are prepared on the transfer of property objects for privatisation, or justified refusal to transfer property objects. The Cabinet of Ministers has already adopted a decision for 25 property objects concerning the transfer for privatisation or refusal to do so.

In three instances, the privatisation had to be suspended, as legal problems were detected which prevent the privatisation of state property objects. Whereas in four instances orders on termination of privatisation of a state property object have been issued by the Cabinet of Ministers, as there were no applicants for the privatisation of respective objects or no applicant was approved as a buyer.

A subject of privatisation of state-owned property (real estate, capital shares, land) can be a natural person or legal person having the rights to acquire movable property or real estate in Latvia. Payments for property objects are made in the euro currency and/or privatisation certificates.

In the period from 17 April 1994 until 30 April 2015, regulations on privatisation of 2547 state property objects (excluding land) have been approved in compliance with the procedure stipulated by the law. 94 companies have been transformed into public joint stock companies, issuing 439.14 million shares in public circulation. During this period, income of 2.380 billion euros has been obtained from privatisation of state property objects (excluding land and sales of shares obtained as a result of debt capitalization, and alienation of capital shares and apartments), including 578 million euros for privatisation certificates with a nominal value of 1.802 billion euros. The new owners have overtaken the obligations of privatised public companies in the amount of more than 280.86 million euros. The amount of determined investment was 214.23 million euros, whereas the amount of actual investment constitutes 383.01 million euros.

Since 1997, the Privatisation Agency has been handling the privatisation of state-owned plots of land.

5287 plots of state-owned land have been privatised as of 30 April 2015. The total price of privatised plots of land owned by the state constitutes 291.48 million euros, 145 million in cash and 146.48 million euros in property compensation certificates. Income from privatisation of plots of land by 30 April 2015 — 286.81 million euros, of

which 144.72 million euros in cash and 142.09 million euros in property compensation certificates.

The state property which is not transferred for privatisation can be alienated according to provisions of the *Law on Alienation of the Property of a Public Person* and the *Law on the Management of Capital Shares and Enterprises of Public Persons*.

Procedure for the Privatisation of Residential Houses

The procedure for privatisation of residential houses of the state and local governments is stipulated by the *Law on Privatisation of State and Local Government Residential Houses*. According to the *Law on Privatisation of State and Local Government Residential Houses*, the privatisation of state residential houses is performed by the state joint stock company “Privatizācijas aģentūra”, whereas the privatisation of local government residential houses is performed by a commission for privatisation of residential houses in cities and regions.

As of 30 April 2015, the Privatisation Agency had the following in its possession and under its management:

- 241 residential houses;
- 1329 state apartment properties of which:
 - 700 state apartment properties are located in houses possessed by the Privatisation Agency;
 - 629 state apartment properties are located in residential houses transferred for the management of owners of apartment properties.

Procedure for the Privatisation of State Residential Houses

In the period from 1 November 2014 until 30 April 2015, privatisation in 20 state residential houses has been initiated on the basis of decisions adopted by the Board of the Privatisation Agency.

In the period from 1 November 2014 until 30 April 2015, 34 notices have been sent to the tenants of state apartments to be privatised, and 72 agreements on the purchase of apartment property have been concluded following the procedure stipulated by the *Law on Privatisation of the State and Municipality Residential Houses*.

Procedure for the Management of Residential Houses and Apartments

From 1 November 2014 until 30 April 2015, 15 residential houses have been transferred for the management of owners of apartment properties.

From 1 November 2014 to 30 April 2015, 10 state apartment properties have been transferred into ownership of municipal and regional local governments.

Privatisation Certificates

A privatisation certificate is a state-granted dematerialised security, which can be used only once as means of payment for a state or local government property to be privatised.

According to *Regulations on Delegation of the Administrative Task of Privatisation Certificates Circulation* adopted by the Cabinet of Ministers on 1 April 2014, the

state joint stock company “Privatizācijas aģentūra” has been delegated to perform the state administration task in the framework of which granting, issuance, use and redemption of certificates is controlled, as well as other operations are performed related to the monitoring of the circulation of certificates.

The granting and use of privatisation certificates is performed in accordance with the *Law on Privatisation Certificates*. 2.4 million people have been granted a total of 112.38 million privatisation certificates as of 30 April 2015. 103.58 million of these certificates have been granted for the time resided in Latvia, whereas 794.7 thousand privatisation certificates have been granted to 41.4 thousand politically repressed persons. 117.2 thousand former owners or their heirs have been granted 8.01 million property compensation certificates, including 691.7 thousand for property preserved for the state needs in privatised specialised state agricultural

companies, 4896.4 thousand for land in rural areas, 969.8 thousand for housing properties, 816.0 thousand for land in towns, 461 thousand for companies and other property objects, 89.8 thousand for property alienation from politically repressed persons, 85.6 thousand for unlawfully alienated property.

According to Section 27 of the Privatisation Completion Law, 58.2 thousand persons have lost their rights to transfer 1.64 million privatisation certificates to their account in the period from 1 December 2007.

In compliance with the *Law on Land Privatisation in Rural Areas*, by 30 April 2015, 11,076 decisions have been adopted on the disbursement of a monetary compensation for former land properties in rural areas. The compensation has been paid to 8411 persons in the total amount of 25.04 million euro, redeeming 0.63 million property compensation certificates.

Table 6.9

Use of Privatisation Certificates (as of 30 April 2015)			
Type of Property	Quantity	Number of Privatisation Certificates (million)	Including the number of Property Compensation Certificates (thousand)
Residential houses	446 thousand apartment privatisation objects	38.0	589.8
Companies and other properties	no precise data	7.3	109.6
Capital shares (shares) including:	no precise data	44.5	954.0
Total:		107.3	6820.1
% of the total number of granted certificates		95.5%	85.1%

By redeeming 165.73 thousand privatisation certificates granted for political repressions, monetary compensations in the amount of 6.6 million euros have been disbursed to 26.23 thousand politically repressed persons by 30 April 2015. According to Section 28 of the *Privatisation Completion Law*, 3.5 thousand politically repressed persons have lost their rights to redeem 16.16 thousand privatisation certificates.

107.32 million privatisation certificates or 95.5% of the total amount of granted certificates have been used for the privatisation of state and local government property (see: Table 6.9) by 30 April 2015. During the privatisation process, from 1 April 2008 until 30 April 2015, 752.48 thousand privatisation certificates have been used instead of 601.77 thousand property compensation certificates.

In April 2015, owners of privatisation certificates were able to use the services of 8 licensed brokerage companies for the execution of transactions on the market of privatisation certificates. The total monthly amount of transactions with privatisation certificates (purchase from natural persons and sales) performed by brokerage companies by 30 April 2015, fluctuated from 4.78 thousand privatisation certificates in January to

10.02 thousand privatisation certificates in April, and from 0.16 thousand property compensation certificates in January to 0.71 thousand property compensation certificates in February.

On 30 April 2015, in privatisation certificate accounts of 379.18 thousand natural persons, there were 2.255 million privatisation certificates or 2% of the total amount of granted privatisation certificates, including 0.105 million property compensation certificates. In privatisation certificate accounts of legal persons there were 0.334 million privatisation certificates or 0.3% of the total amount of granted privatisation certificates, including 0.006 million property compensation certificates.

On 1 January 2014, *Amendments to the Law on Privatisation Certificates* came into force stipulating that the handling of privatisation certificate accounts is the task of the state administration. These amendments also determined that the Cabinet of Ministers is entitled to delegate natural persons for handling privatisation certificate accounts in instances and according to the procedure specified in laws and regulations. Starting from 1 January 2014, the state joint stock company “Latvijas Attīstības finanšu institūcija “Altum”” was delegated to

perform the task of handling privatisation certificate accounts, which includes opening and maintenance of privatisation certificate accounts, transfer of privatisation certificates into the account and other services related to the handling of privatisation certificate accounts and circulation of privatisation certificates. Until 1 June 2014, the above mentioned service was also provided by the insolvent joint stock company “Latvijas Krājbanka”, which is holding a part of the privatisation certificate accounts. As of 1 June 2014, *Latvijas Krājbanka* no longer handles privatisation certificate accounts, however, it has an obligation to maintain the privatisation certificate accounts it holds until the centralised transfer of these accounts to the Development Financial Institution. The persons who plan to perform transactions with privatisation certificates held in privatisation certificate accounts in *Latvijas Krājbanka* have to visit any of the nine branches of the Development Financial Institution and fill in an application for a transfer of privatisation certificate accounts to the Development Financial Institution. The persons who currently do not plan to perform transactions with privatisation certificates do not have to take the above mentioned measure, because privatisation certificate accounts held by *Latvijas Krājbanka* will be transferred to the Development Financial Institution centrally.

The Land Reform

The main goal of the land reform is to reorganize legal, social and economic relations for the use of land and property from command economy to market economy.

The process of the land reform includes requesting and granting the free land pertaining to the state, renewal of ownership and redemption (purchase) of land granted for use, as well as renewal of ownership of land intended for the completion of land reform, and these processes take place in relation to the land reform of rural areas and towns to be implemented in the state.

The option to request land in towns in compliance with Paragraph one of Section 2 of the *Law on Completion of the Land Reform in Cities* was terminated already on 1 March 1999, whereas the granting of land requested in compliance with Paragraph two Section 2 of this law had to be terminated on 1 July 1999, and in Riga and Daugavpils on 1 October 1999.

According to Paragraph two of Section 2 of the *Law on Completion of Land Reform in Rural Areas*, requesting of the free land pertaining to the state was terminated on 1 June 2006, whereas granting of the requested land for permanent use – on 1 September 2007.

Furthermore, transfer of land into ownership for a charge has ended in towns and rural areas. According to the *Privatisation Completion Law*, a land redemption (purchase) agreement with the state joint stock company “Latvijas Hipotēku un zemes banka” (Mortgage Bank) on urban or rural area land granted for use had to be concluded until 30 December 2011. According to

Paragraph twelve of Section 23 of the *Privatisation Completion Law*, this deadline does not apply to former land owners or their heirs for whom the total area of plot of land determined as a result of a cadastral survey is larger than the land area on which the ownership shall be renewed, and it exceeds the permissible error margin, during the land cadastral survey. Agreements with these persons are concluded by the Development Financial Institution, which has been delegated the state administration task of concluding agreements on redemption (purchase) of rural and urban land, control execution of these agreements and transfer unredeemed land into the ownership of local governments according to the *Procedure for Delegation of the State Administration Task – Conclusion of Agreements on Redemption (Purchase) of Land, Control of Execution of These Agreements and Transfer of Unredeemed Land into Ownership of Local Governments* of 14 April 2015.

During the land reform, in the period until 30 December 2011, the Mortgage Bank had signed 174,231 agreements on rural area land regarding 181,945 land units with the total area of more than 1.2 million hectares.

By adopting the last decision on the recognition of ownership of land intended for the completion of the land reform on 25 August 2014, the Central Land Commission (the CLC) has completed the last land reform completion task – the process of ownership renewal in rural areas for land intended for the completion of the land reform, implementation of which was stipulated in Paragraph one of Section 16 of the *Law on Completion of the Land Reform in Rural Areas*.

In total, the CLC approved the rights to be eligible for a renewal of ownership of land intended for completion of land reform for 1066 persons (claimants) regarding land with the total area of 12,982.64 ha.

Taking into consideration that for the corroboration of ownership in the land register, a land cadastral survey has to be done and a decision of the respective institution on the renewal of ownership has to be obtained, the CLC, the State Land Service and local governments continue adopting decisions on the renewal of ownership to former land owners or their heirs, as well as granting of land to the ownership for a charge in cases when the total area of land determined during the cadastral survey exceeds the area for which ownership to these persons is renewed.

Although, taking into consideration the above mentioned circumstances the land reform tasks can be considered as completed, pursuant to Section 5 of the *Law on Completion of the Land Reform in Rural Areas* and Section 7 of the *Law on Completion of the Land Reform in Cities*, the land reform will be deemed completed upon the adoption of a decree by the Cabinet of Ministers on the completion of the land reform in the territory of the respective local government.

With regard to towns, according to Section 6 of the *Law on Completion of the Land Reform in Cities*, by 30 November 2014, the respective local government had to prepare and coordinate with the State Land Service a report on the performance of works specified in laws and regulations governing the land reform, which must be submitted together with a declaration of completion of the land reform to the State Land Service for the preparation of the respective draft decree by the Cabinet of Ministers. Before the abovementioned deadline, out of 76 towns, the report had been coordinated and the decision for the completion of the land reform in the respective town had been adopted by 30 (39%) town local governments, out of which a decree of the Cabinet of Ministers has been adopted for territories of 5 towns (Olaïne, Ligatne, Ludza, Preili and Zilupe), and draft decrees of the Cabinet of Ministers concerning 25 towns have been announced at the meeting of State Secretaries. After this deadline, as of 12 May 2015, the report has been coordinated and the decision for the completion of the land reform in the respective town has been adopted by another 27 (36%) town local governments, for 15 of which the draft decrees of the Cabinet of Ministers have been announced at the meeting of State Secretaries.

With regard to the land of rural areas, pursuant to Paragraph four of Section 4 of the *Law on Completion of the Land Reform in Rural Areas*, the report on the land has to be prepared by the State Land Service and coordinated with the respective local government by

30 November 2014. It must be noted that the preparation of a report is possible only when the respective local government has adopted all decisions related to requesting land and examination of requests, and after the adoption of relevant decisions, reflected in the National Real Estate Cadastre Information System. Before the deadline, out of 110 territories of rural areas, the State Land Service managed to coordinate the report on land with four (4%) local governments (Adazi, Ludza, Olaïne and Zilupe), concerning three of which draft decrees of the Cabinet of Ministers have been announced at the meeting of State secretaries. After this deadline, as of 12 May 2015, the State Land Service has coordinated the report with another 45 (41%) town local governments, for 27 of which draft decrees of the Cabinet of Ministers have been announced at the meeting of State secretaries.

Thereby, it can be concluded that by 12 May 2015, the land reform has been completed (i.e. a decree by the Cabinet of Ministers has been adopted) for 6% of towns, the last stage of the land reform completion is near the end (i.e. decrees of the Cabinet of Ministers are in the process of adoption) in 53% of towns and 27% of rural territories, the last stage of the land reform completion is started (i.e. preparation of decrees of the Cabinet of Ministers has been initiated) in 16% of towns and 17% of rural territories, whereas work on the completion of the land reform continues in 25% of towns and 56% of rural territories.

6.16 Reform of Management of Commercial Activity and Capital Shares of Public Persons

The state of Latvia fully or partially owns a significant number of capital enterprises, which have a significant impact on the national economy, i.e. according to the financial data at the end of 2012, it amounted to 18.2% of the Latvian gross domestic product. The capital enterprises owned by the state hold considerable assets and the largest employers in the country are among these capital enterprises. Therefore, the state must follow the results of operation of capital enterprises owned by it in order to promote responsible, efficient and results-based management of capital enterprises, and to increase the value of these capital enterprises in the future. Furthermore, operation of individual local government capital enterprises has a significant role in providing certain services in the respective administrative territory.

According to the information available to the Ministry of Economics, by 1 May 2015, 100% participation of the state is observed in 66 capital enterprises, decisive influence in 5 capital enterprises, whereas in 46 capital enterprises the state participation constitutes 50% or less. The state has direct participation in 117 capital enterprises in total.

According to the information available to the Ministry of Economics, there were 323 capital enterprises in Latvia in 2011 with the local government being the sole participant (local government capital enterprises), 39 capital enterprises are under decisive influence of a local government and, in 243 instances, a local government owns 50% or less capital shares in a capital enterprise. 4 local governments do not participate in any capital enterprise.

At the meeting held on 15 May 2012, the Cabinet of Ministers approved the *Concept on Commercial Activity of Public Persons* and the *Concept on Management of State Capital Shares*, developed by the Ministry of Economics in compliance with the principles determined in the OECD guidelines for the management of state capital enterprises. The goal of the reform in the management of capital shares of public persons is to promote return on capital and to introduce good principles of corporate management in the management of capital enterprises, as well as to reassess the conditions for commercial activity of a public person. Through implementation of the reform of capital shares management it is expected to

achieve a higher return on capital (higher dividends), publicly available information about management of capital shares and capital enterprises owned by the state,

and about achievement of financial and non-financial goals determined for capital enterprises (see Box 6.33).

Box 6.33

Commercial Activity of Public Persons

Involvement of public persons in commercial activity creates a risk of market distortion. Therefore, commercial activity of public persons is permissible only in exceptional cases when there is a specific justification for such activity. The main economically justified goal for participation of a public person in capital enterprises is prevention of market shortcomings, consequently, improving the financial standing of the company. The restrictions of commercial activity laid down in Section 88 of the *State Administration Structure Law* are determined for achieving a legitimate goal, namely, that a public person, without causing market distortion, could operate as an equivalent partner to the private business only in cases when such activity is required for ensuring implementation of safety functions and the state policy in any area of the public life. However, in practice these restrictions are very often interpreted too broadly, consequently, the state and municipalities have business in sectors, which are, formally, in compliance with the conditions specified in Section 88 of the *State Administration Structure Law*, however, by their nature, they conflict with the purpose of this regulation, that is to limit commercial activity of a public person. On 26 March 2015, in the second reading, the Saeima adopted amendments to the *State Administration Structure Law*, stipulating changes in the conditions under which a public person is entitled to establish a capital enterprise or participate in an already existing capital enterprise. The draft law is being prepared for examination in the third reading.

The Reform of Commercial Activity of Public Persons provides for the following:

- to amend the conditions for commercial activity of a public person (amendments to the *State Administration Structure Law*);
- a public person must establish general strategic goals that it wants to achieve by participating in a capital enterprise and which arise from legal acts and documents of policy planning. Non-financial goals of the enterprise for a medium term are derived from the general strategic goals defined by the public person, which are integrated in the medium-term strategy of the capital enterprise (this is integrated in the *Law on Management of Capital Shares and Capital Enterprises of a Public Person*);
- an obligation of a public person to reassess its participation in capital enterprises and its compliance with the principles applied on commercial activity of a public person at least once in five years, adjusting the general strategic goals respectively, if necessary (this is provided in the *Law on Management of Capital Shares and Companies of a Public Person*);
- to establish that a capital enterprise of a public person must be transformed into an institution (a public agency), if it is established that the status of a capital enterprise is not the most adequate model of operation for achieving certain goals by participation of the public person in a capital enterprise (this is provided in the *Law on Management of Capital Shares and Capital Enterprises of a Public Person*).

Management of State Capital Shares

In Latvia, there is a decentralized model of management of state capital shares, and management of state capital shares is implemented through mediation of the holder of capital shares, i.e. the ministry of the respective sector, or any other institution. By analysing the practice of management of state capital shares, implemented in Latvia before the reform, several major problems were detected, for example, the holder of state capital shares simultaneously performs multiple roles (customer, owner and the sector policy-maker in one person), low return on capital, no transparently defined financial and non-financial goals to be achieved, and indicators of companies are not analysed and assessed in relation to these goals, uniform and transparent management of state capital shares is not provided, and, in addition, there is a lack of professionalism in the management of state capital shares (including attraction of professionals), there is no single monitoring system, which could promote improvement of the environment of commercial activity, there is fragmented and incomplete regulation of management of state capital shares, and politicisation of daily management decisions.

In order to introduce solutions, approved by the Cabinet of Ministers and suggested in the concepts, the Ministry of Economics has developed a package of draft laws, which was approved by the Cabinet of Ministers at the meeting held on 28 May 2013, and submitted for consideration to the Saeima. On 16 October 2014, in the third (final) reading, the Saeima adopted the *Law on Management of Capital Enterprises and Capital Shares of Public Persons*, which came into force on 1 January 2015. The improvements integrated in this law are applicable to the management of all capital enterprises (capital shares) owned by public persons.

The *Law on Management of Capital Shares and Capital Enterprises of a Public Person* provides that the Cabinet of Ministers shall assign an institution which will perform

tasks of the coordination institution for management of state capital shares, determined in the law (at the meeting held on 12 May 2015, the Cabinet of Ministers adopted a decision to assign the Cross-Sectoral Coordination Centre as the coordination institution), determination of goals for participation of a public person in capital enterprises, development of a medium-term operation strategy for a capital enterprise and regular assessment of results achieved by a capital enterprise, implementation of requirements for the information openness, preparation of annual reports on the management of capital shares owned by the state, rights of formation of a council of major capital enterprises, management of the procedure of nominating transparent applicants for positions of members of the board and council, etc.

6.17 National Economy Council

The National Economy Council (NEC) of the Ministry of Economics is an advisory body created by the founding organisations of the NEC (Ministry of Economics, Latvian Chamber of Commerce and Industry, Latvian Association of Local and Regional Governments, Free Trade Union Confederation of Latvia, Employers' Confederation of Latvia), and it participates in the resolution of matters related to business policies and acts according to Sub-paragraphs 6.11 and 7.2 of Regulations No. 271 of the Cabinet of Ministers of 23 March 2010 *Regulations of the*

Ministry of Economics, the Agreement on cooperation in the National Economy Council concluded on 17 February 1999 and Ministry of Economics' regulations of NEC No 1-7-33 of 29 August 2013.

To contribute to the professional representation of interests of sectors, as well as to improve co-operation between the Ministry of Economics and other state bodies, the NEC invites sectoral associations representing businessmen of their sectors and their interests, as well as independent experts – economists, education and science representatives.

Box 6.34

NEC's Staff and Work Organization

Based on the decision of the Management Committee, the NEC's staff is approved by the Minister of Economics.

By the order of the NEC, the Minister of Economics expresses the NEC's opinion in the Council for Coordination of Large and Strategically Important Investment Projects and the Council for Coordination of Foreign Economic Policies, as well as in other cross-sectoral forums.

The NEC Management Committee is an advisory and coordinating body, which participates in the resolution of business policy related matters and is in charge of the evaluation and approval of the NEC's plan of work and agendas of NEC's sessions, as well as the ensuring and improvement of NEC's work efficiency.

The staff of the Management Committee is approved by the Minister of Economics. The Management Committee consists of the Minister of Economics and four representatives of NEC's founders who are also members of the NEC:

- a representative from the Free Trade Union Confederation of Latvia;
- a representative from the Employers' Confederation of Latvia;
- a representative from the Latvian Association of Local and Regional Governments;
- a representative from the Latvian Chamber of Commerce and Industry.

The NEC Management Committee may invite representatives whose competence corresponds to the matters examined during sessions (such as the Foreign Investors' Council in Latvia, the Latvian Academy of Sciences, the Cooperation Council of Farmers' Organisations, relevant public bodies and community organisations).

The NEC consists of 28 experts proposed by the NEC Management Committee, including the Minister for Economics, the NEC's Chairperson and representatives of organisations of businessmen, public structures and other organisations.

Representatives from the Foreign Investors' Council in Latvia, the Riga Technical University, the Cooperation Council of Farmers' Organisations, the partnership "Association of Latvian Markets", the Latvian Academy of Sciences and the Latvian Chamber of Crafts participate in NEC's sessions as observers.

NEC's founders decide on changes in or extension of the composition of the NEC at sessions of the NEC Management Committee.

The NEC is managed by the chairperson of the council who is elected from the members of the NEC Management Committee on a rotating basis. The mandate period is one year.

NEC's sessions are held on average once a month.

The work of the NEC is ensured by the Secretariat of the National Economic Council, whose activity is ensured by the Ministry of Economics.

In between NEC's sessions, the NEC Management Committee takes recommending NEC's decisions.

To improve the model of cooperation between the Ministry of Economics and the non-governmental sector and to arrange the advisory mechanism, on 28 April 2012 the NEC Management Committee decided on the improvement of the NEC's structure by creating six sub-committees of the NEC, whose functions and tasks are to unite the advisory committees created by the order of the Ministry of Economics, to contribute to the dialogue about significant criteria of creating policies for a business-friendly environment in Latvia between the Ministry of Economics, the Minister, other ministries and non-governmental organisations, as well as to ensure the implementation of the sustainable national economy development principle and to promote the process of sustainable development of the country and public participation in this process.

The NEC Management Committees evaluated and developed this model for the NEC to ensure discussions about important and secondary matters with regard to a comprehensive economic policy and to review them within structured sectoral committees, which are acting directly or indirectly in co-operation with the non-governmental sector.

The NEC's structure includes six committees:

- Internal Market Committee;
- Competitiveness Committee;
- Energy Committee;
- Construction and Home Policy Committee;
- Tourism Committee;
- Micro, Small and Medium-Sized Enterprises Committee.

The purpose of operations of the NEC is to shape and implement policies for a business-friendly environment in Latvia, as well as to contribute to the implementation of the sustainable national economy development principle and public participation in it, to identify circumstances hindering business and to take all necessary actions to eliminate them, to participate in the development of laws, regulations and policy planning documents promoting business, to promote innovation and foreign trade.

The NEC reviews and traces the resolution of such matters and draft regulatory documents, economic development concepts, state budget and other documents, which are important for the development of Latvian economy. The NEC prepares proposals and takes recommending decisions on these matters. The NEC maintains a dialogue between businessmen and the Ministry of Economics, as well as other public bodies and community organisations.

The decisions taken by the NEC serve as a recommendation only.

The NEC co-operates with the Cabinet of Ministers and other public bodies to achieve the inclusion of proposals necessary for the improvement of business environment into the regulations prepared by the responsible authorities.

On 21 May 2009, the NEC, the Ministry of Economics and the Ministry of Finance signed a Memorandum of Co-operation for *Growth, Competitiveness and Employment*. The purpose of the Memorandum of Co-operation is co-operation between and coordinated

activities of the NEC, the Ministry of Economics and the Ministry of Finance to promote economic growth, employment and competitiveness of Latvia, and active participation in the development and implementation of a sustainable strategy in Latvia.

To professionally represent the interests of the sectors of the national economy in an efficient dialogue with the Ministry of Economics, the NEC and other organisations of businessmen and public authorities, the Ministry of Economics has created a co-operation model with the sectors of national economy.

The NEC reviews proposals of institutions and associations representing businessmen for the improvement of legislation. Sectoral associations evaluate and express their opinions on draft laws and regulations. The Ministry, in its turn, informs those who draft laws and regulations about the proposals for the improvement of legislations, which were submitted by the NEC, as well as takes other actions to implement programmes for the development of national economy and improvement of business environment within the framework of the government declaration.

Today, the National Economy Council represents associations of 15 sectors (chemistry and pharmaceuticals, finances, transport – transit, logistics, energy, information and communication technologies, IT clusters, trade, electric engineering, electronics, light industry, wood processing, machinery and metalworking, construction, tourism, hotels and restaurants, food, printing, education and science, agriculture).

Box 6.35

The NEC on the Priorities of the Economic Policy

The NEC believes that the work on ensuring a stable macroeconomic environment and general growth in the national economy of Latvia must be continued. To promote competition in Latvia, a balanced budget should be created, surveillance of competition should be strengthened and the development of competition in all sectors of national economy should be promoted in the interests of the society, by timely identifying risk sectors, where violations of competition rights are possible and by limiting administrative and other obstacles in the way of competition.

The NEC believes that tax policies and administration, education of workforce, macroeconomic stability and unforeseeability of changes in laws and regulations continue to be problem sectors.

Pending laws and regulations should also be evaluated to identify and prevent potential violations of competition rights, technical barriers to trade and discriminatory rules in the area of free movement of goods and services and business rights. Surveillance of state aid and procurements should be improved by achieving a high level of transparency for state aid projects.

The creation of an efficient and competitive structure of sectors should be promoted; research, development and innovation, especially in the private sector, should be stimulated, measures, which would promote co-operation between education, research and national economy sectors, should be developed and implemented, ensuring a transfer of knowledge and technologies.

Faster use of structural funds, and entering into new export markets, as well as reinforcement of positions in the existing markets should be promoted. An institutional framework to promote exports should be provided and its capacity should be increased, as well as the development of foreign economic representations, the availability of financial instruments and support for companies in export marketing should be provided.

By signing a memorandum of agreement, the parties agreed to combine resources for the development of programming documents, to take actions to implement national economy development and business environment improvement programmes, within the

framework of the government declaration; the parties also agreed that sectoral associations will evaluate and express their opinions on draft laws and regulations developed by ministries.

In the first half of 2015, 3 sessions of the National Economy Council took place, and the following important matters were reviewed:

- preparation and approval of a draft letter asking to restart the work of the Reform Management Group, which should review the matter of amendments to the Law *On Taxes and Fees* in relation to the application of responsibility of members of the board;
- tax discounts for social guarantees of employees included in the collective bargaining agreement;
- progress of the implementation of activities of existing EU funds, supervised by the Ministry of Economics in the 2014-2020 programming period;
- reduction of electrical energy costs for energy intensive companies in the manufacturing;
- proposals for the restoration of support to promote the use of renewable energy resources;
- *Energy Sector Development Guidelines 2014-2020*;
- the Energy Union and the latest news in the EU energy sector, latest news in energy policies within the framework of the Latvian Presidency of the Council of the European Union;
- development of electric energy connections, incl. within the context of the Programme for funds from the European Structural Funds developed by the Ministry of Environmental Protection and Regional Development;
- the need for the NEC Energy Committees to develop a list of standards, which would be approved by the Cabinet of Ministers for operation of electric energy sites;
- Sections 50 and 51 of the *Energy Law* – potential changes in the future.

7. RECOMMENDATIONS

In the post-crisis period, the economic advantages of Latvia were mainly based on low labour costs and sectors of low-technology industries, and it should be taken into account that in the coming years the increase of the labour costs is inevitable due to the growth and open labour market. It means that Latvia may lose its competitiveness in low-cost segments faster than it acquires any advantages in the production of products of higher added value. Thus, it is necessary to promote the structural changes of economy in favour of the production of goods and services with higher added value, including the increase of the role of industry, modernization of industry and services, and development of complexity of export. This is an essential prerequisite for the convergence of the Latvian economy with developed EU countries and for the growth of the population welfare that can be achieved by increasing the competitiveness of the Latvian economy that is based on innovation. It should be noted that such transformation of the economy requires not only strengthening of the innovation system, but also significant qualitative changes in the education system – formal education and further education of adults (lifelong learning system) to create the necessary prerequisites for structural changes.

At the same time, in order to ensure a stable economic growth, it is equally important to continue implementing measures to improve the business environment, especially those related to the institutional framework (legislation, tax policy and support institutions) and the improvement of infrastructure. It is also crucial to maintain a stable macroeconomic environment. A fair business environment should be promoted to prevent the restriction of competition on the market both by entrepreneurs and by public persons. The fight against tax evasion should be continued by supporting the authorities in charge and addressing the causes of the problem.

Taking into account the above mentioned, in our opinion, the immediate tasks of the economic policy are as follows:

- **for ensuring access to finance:**
 - to provide access to finance at all business development stages, particularly, at the business start-up stage;
 - to continue issuing loan guarantees. It is necessary to provide enterprises with a possibility to access credit resources for commercial activities in case of insufficient security for attracting the necessary amount of credit resources;
 - to develop venture capital instruments for stimulating investments in the development and expanding activities of enterprises; financing of venture capital funds requires the resources of private investors;
- **for developing a knowledge-intensive economy:**
 - to promote cooperation between scientists and entrepreneurs by supporting competence centres in order to promote co-operation between the research and manufacturing sectors in implementing industrial research, developing new products, and technologies, as well as to support the creation of a technology transfer system for promoting the increase in the income of scientific institutions from the commercialisation of state-funded research, and to promote the introduction of research results in production;
 - to support the development of new products and technologies, including those that contribute to energy efficiency, reduction of emissions, and lower consumption of resources and raw materials, by encouraging entrepreneurs to implement industrial research and introduce new products, services, and technologies in production;
 - to support the development of the potential of science more actively by concentrating it in the areas where Latvia has comparative advantages;
- **for promoting export:**
 - to continue supporting the participation of entrepreneurs and their unions in international exhibitions and trade missions, in order to foster the entering into new markets;
 - to develop and expand the network of the Latvian foreign economic representation offices, thus providing the Latvian entrepreneurs with a range of state export support services broadly and easily accessible on export markets;
 - to activate economic cooperation with the prior and potential export markets of Latvia, as well as to improve the economic contractual legal base between countries;
 - to continue ensuring access to export credit guarantees in order to increase access to higher risk markets and to promote the export of the Latvian goods and services;
 - to continue the work on the reduction of trade barriers the Latvian entrepreneurs face on both the EU internal market and external export markets, thus promoting the exportability of the Latvian enterprises;

- **for ensuring access to labour force and improving the supply:**
 - to timely identify a mismatch between the labour supply and demand according to the development trends of the labour market by providing information to education policy makers; to improve cooperation between various institutions in implementing proactive changes in the labour market;
 - to improve the lifelong learning system to prevent the current mismatch in the labour market and to reduce risks of structural unemployment;
 - to increase the attractiveness and quality of vocational education by matching it to the labour market demands;
 - introduce traineeships in the working environment as a method for implementation of vocational education, at the same time improving the professional competency of traineeship supervisors in educational institutions and companies;
 - to pay particular attention to the youth who are neither studying, nor working in order to return them to the education system for obtaining qualification and practice;
 - to encourage active involvement of employers in improving the quality of education – establishing traineeship positions, participating in the development and improvement of education programmes, as well as in the development and implementation of active labour market policy measures;
 - to develop interdisciplinary education/study programmes focusing on developing the business competence; to increase the role of hard sciences and natural sciences in basic and secondary education;
 - to develop 1st stage vocational higher education (college) studies;
 - to review the legal framework of employment relations, by enhancing flexibility opportunities between the employer and the employee;
 - to promote a match between training and the labour market demands by improving (changing) the current planning system of labour training, revising the current methodology for short-term forecasting of the labour market, and the procedure for defining training directions to take into account the medium-term forecast of the labour market, as well as the medium-term and long-term development objectives of the national economy;
- **for improving business environment and ensuring competitiveness:**
 - to develop an excellent business environment.
 - to ensure implementation of electronic registration of immovable property in Latvia. To draft a new *Annual Accounts Law* in the field of taxes and accounting. To continue the work on improving and streamlining legal proceedings by introducing an electronic document exchange system in courts. To promote the electronic registration of business start-ups with the Register of Enterprises;
 - to develop a mechanism for the establishment of industrial areas to ensure the coordinated and result-oriented development of industrial areas in regions to foster entrepreneurship and to attract new local and foreign investments;
 - to restructure the tax system, by making it more socially fair and business-friendly. It must be achieved that the tax burden on entrepreneurship and employment is reduced;
 - to reduce shadow economy by supporting fair and honest entrepreneurs and providing favourable conditions for a transition to official economy, to continue transforming the SRS into an institution that helps the entrepreneurs;
 - to revise the participation of a public person in business activities and implement a reform of capital shares management and business activities of public persons;
 - to promote the development of e-government and e-services. To reduce the risks of implementing projects of information systems and e-services by strengthening the administrative capacity and competence of customers and monitoring of project implementation. The functionality of the e-signature must be expanded, accessibility to e-services must be provided, and the usage of electronic procurements must be facilitated;
 - to ensure the introduction of the one-stop agency principle with regard to the availability of the state and local government services. To introduce a one-stop agency principle in the registration of real estate data, thus ensuring data exchange between the National Real Estate Cadastre Information System and the State Unified Computerised Land Register;
 - to develop an up-to-date legal framework of the construction process and new construction standards, including the adaptation of the Eurocode standards into the system of regulatory enactments governing the construction sector, and to improve the Construction Informative System, thus creating pre-conditions for the development of a sustainable and competitive construction sector;
 - to improve the mutual coordination of data and terms for entering data in the state registers and other information systems and to ensure a maximally complete and quick update of information stored in the registers in order to prevent discrepancy of information between the registers and the actual situation, as well as to

- avoid repeated requests of information from respondents;
- while prioritising, to actively address the most severe violations of the *Competition Law* – prohibited agreements and abuse of the dominant position in the market. As regards the above mentioned violations, particularly the identification of cartels, preventive measures are of high importance by performing inspections on the priority markets and implementation of a leniency programme promoting participation of market participants in the disclosure of violations of competition;
 - to improve the regulation of a merger report review to ensure a more qualitative public service. It is particularly important to foster the coordination of the regulation with neighbouring countries to reduce the amount of information to be provided, promote the awareness of market participants and develop explanatory guidelines, thus ensuring a faster and less-resource intense process for submission and review of reports;
 - to implement measures for promoting free and fair competition within the regulatory framework of the sectors (including the legislation drafting process), to reduce unjustified requirements, restrictions and other administrative impediments for companies to enter the market and operate there that negatively affect the competition and in the long-term – consumers;
 - to prevent deformation of competition done by public persons by involving in the commercial markets where the market shortage or particular interest of the state or public does not exist;
 - **for improving energy efficiency:**
 - to make energy efficiency a cross-industry policy objective, by including it not only in the industry and service policy areas, for example, energy, construction, industrial, domestic market, etc., but also in the area of natural resources, including renewable energy resources, agricultural manufacturing and processing policy areas (agricultural policy, forestry policy, fisheries policy), environmental, regional transport, and communication policy areas;
 - to promote and support energy efficiency in multi-apartment buildings, public buildings, industrial buildings by developing a sustainable financing model for improving energy efficiency;
 - to improve the criteria and define the objectives regarding the construction of low or nearly zero energy consumption buildings;
 - to promote public awareness of various methods and practices for improving energy efficiency of buildings, to promote the application of good practice of energy efficiency of buildings to public sector buildings;
 - to develop a framework of regulatory enactments for the implementation of energy efficient policy in Latvia and start a consistent implementation of such policy;
 - **for ensuring efficient, safe, and sustainable energy supply:**
 - to continue the integration of the Latvian electricity market in the common EU market and liberalisation of the Latvian market of natural gas by promoting the implementation of energy infrastructure development projects, particularly common interest projects;
 - to continue regional cooperation within the Baltic Sea strategy/BEMIP to improve the energy and gas markets, energy supply security, use of renewable resources and energy efficiency,
 - to develop an economically reasonable and flexible policy for the use of renewable energy resources in the energy production.

A consistently implemented structural policy will promote the recovery of the Latvian economy, which will form the basis for increasing the standard of living of the population. A successful development and economic growth of Latvia will depend not only on the work of public institutions, but also on the personal initiative of any person anywhere in Latvia under the conditions of mutual public understanding and dialogue.