

**MINISTRY OF ECONOMICS  
REPUBLIC OF LATVIA**

**ECONOMIC  
DEVELOPMENT  
OF LATVIA  
REPORT**

**December  
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**RIGA**



**Ministry of Economics  
Republic of Latvia**

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OF LATVIA  
  
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**Dear reader!**

We present the annual Report on Economic Development of Latvia prepared by experts of the Ministry of Economics for your evaluation. It has already become a tradition for us to assess the situation of the Latvian economy and give forecasts for the development perspectives of the economy in this document.

Over the recent years, the growth of our country has been among the fastest in the European Union. The average growth rate of the GDP was 4.7% during the period from 2011 until 2013. Similarly in 2014, despite the geopolitical instability and its consequences, the GDP of Latvia continued growing. As a result, we forecast that the GDP will have grown by 2.3% in 2014.

In 2015, the economic development of Latvia will be closely related to global tendencies in our geopolitical region. Latvia attributes the greatest importance to the economic situation on export markets – the EU is gradually recovering, yet at a slower pace than expected. Exporters who are mainly focused on Eastern markets, however, are influenced by the worsening situation in Russia. Unfortunately, consequences of geopolitical complications will hinder the economic growth of Latvia. Experts of the Ministry of Economics forecast that the GDP growth might be approximately 2% in 2015.

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 will be crucial to find the most effective ways to support the development of a knowledge-intensive economy, to increase the competitiveness of companies across sectors, to increase productivity and innovation capacity.

The economic policy supporting the development of regions of Latvia will be just as important. Our task is the creation of more new and well-paid job positions in the regions of Latvia.

Since 2013, over EUR 140 million from the EU structural funds have been invested in companies across Latvia, ensuring modernisation and competitiveness thereof. Within the framework of the previous programming period, significant financial resources are still available for the support of companies. For instance, EUR 82 million – for high added value projects. Hence, I am taking this opportunity to urge companies to take active part in the implementation of approved projects and increase their competitiveness.

The new programming period of EU funds gives us an opportunity to invest EUR 4.4 billion 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 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 and 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 EUR 800 million will be available for targeted investments in the modernisation and industrialisation of the Latvian economy.

The latest World Bank research *Doing Business 2015* has ranked Latvia 23<sup>rd</sup> among 189 countries. Latvia is ranked 9<sup>th</sup> among the EU Member States in the ease of doing business. The World Bank has recognised Latvia as one of the TOP 30 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 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 purposefully reduce the bureaucracy burden on tax administration and the time required for these procedures as soon as possible. The quality and speed of implementation of the reforms will determine further competitiveness of the Latvian business environment and economy.

The Ministry of Economics continues its work in developing the framework of regulatory enactments for improving the procedure for the settlement of consumer disputes and introducing an alternative dispute settlement mechanism. This will ensure a faster and more effective procedure for out-of-court settlement of consumer disputes and will increase the trust of parties in the decision on dispute resolution, as well as the number of cases that result in reconciliation.

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 establishing a modern and stricter regulation of the sector, which will ensure a better quality of construction at all stages.

At the same time, the State Construction Supervision Bureau has commenced its operations to improve the construction control mechanism. It carries out public supervision of construction of new public buildings and their operations.

In 2015, we will reform the management of commercial activities of public persons and capital shares. *The Law on the Management of Commercial Activities of Public Persons and Capital Shares* has already come into force. It has been developed to ensure the 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 these capital companies. *The Law on the Management of Commercial Activities of Public Persons and Capital Shares* is the basic law of this reform. Its implementation is vital for the acceptance of Latvia to the Organisation for Economic Co-operation and Development.

The integration of the Latvian energy market in Europe continues. The norms of the Electricity Market Law have already come into force, ensuring a 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.

The implementation of the second stage of gas market liberalisation is currently on the agenda as well.

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

To achieve the set aims, we are actively engaging in a dialogue with enterprises, 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, 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 experts of the Ministry of Economics.

I would like to express my gratitude to the authors of the Report!

December 2014



**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
BE	Belgium
BG	Bulgaria
CR	Croatia
CZ	Cyprus
CY	Czech Republic
DE	Germany
DK	Denmark
EE	Estonia
EL	Greece
ES	Spain
EU	European Union
FI	Finland
FR	France
HU	Hungary

IE	Ireland
IT	Italy
LT	Lithuania
LU	Luxembourg
LV	Latvia
MT	Malta
NL	The Netherlands
PL	Poland
PT	Portugal
RO	Romania
SE	Sweden
SI	Slovenia
SK	Slovakia
UK	United Kingdom



## 1. ECONOMIC SITUATION: BRIEF OVERVIEW

The extensive inflow of foreign capital from 2005 until 2007 fostered a significant increase in private consumption and investments in Latvia. The average annual growth rate of GDP exceeded 10%. In 2008 and 2009, the inflow of foreign capital halted due to the global financial crisis and the recession began. During the crisis, the GDP decreased by ¼, external debt almost doubled, the number of employed decreased by 16%, and the real wages dropped by 12 per cent.

**Since late 2009, the economic recession in Latvia has stopped and growth has resumed.** From 2011 until 2013, the GDP increased on average by 4.7% per

year, which was one of the highest growth rates in EU. Growth continued also in 2014, although the growth rate has slowed down due to tendencies in the external environment – slower growth in the EU than previously expected, as well as the weakening economic situation in Russia. Overall, in the nine months of 2014, the GDP has been by 2.5% higher than in the respective period of 2013, and **experts of the Ministry of Economics forecast that the GDP will increase by 2.3% in 2014.** Although the economy of Latvia has been growing in the recent years, the GDP still is by 5.3% lower than before the crisis in 2007.

Table 1.1

Latvia: Key Economic Development Indicators								
	2008	2009	2010	2011	2012	2013	2014e	2015f
Gross domestic product (current prices, billions EUR)	24.4	18.9	18.2	20.3	22.0	23.2	24.0	24.8
increase in comparison to the previous year, per cent								
Gross domestic product	-3.2	-14.2	-2.9	5.0	4.8	4.2	2.3	2.0
Private consumption	-8.0	-16.2	3.1	2.9	3.0	6.2	2.6	2.4
Public consumption	2.4	-10.7	-8.1	3.1	0.4	2.8	3.1	1.8
Gross fixed capital formation	-9.2	-33.3	-20.0	24.2	14.5	-5.2	0.1	-3.0
Exports	2.4	-12.9	13.4	12.0	9.8	1.5	1.7	0.7
Imports	-10.7	-31.7	12.4	22.0	5.4	0.3	0.3	-0.8
Consumer prices	15.4	3.5	-1.1	4.4	2.3	0.0	0.6	0.5
per cent of GDP unless indicated otherwise								
General government sector balance	-4.0	-8.9	-8.2	-3.4	-0.8	-0.9	-1.4	-1.0
General government debt	18.6	36.4	46.8	42.7	40.9	38.2	40.0	35.0
Export-import balance	-13.6	-1.5	-1.5	-5.0	-4.4	-3.2	-2.6	-1.7
Changes in the number of employed (aged 15–74 years, compared to the previous year, %)	-0.2	-13.9	-6.4	1.3	1.6	2.1	-1.1*	0.2
Employment rate	62.0	54.3	52.0	54.0	56.1	58.2	59.1	60.1
Unemployment rate (share of unemployed persons to the economically active population aged 15–74 years, %)	7.7	17.5	19.5	16.2	15.0	11.9	10.9	9.8
e – evaluation, f – forecast								
* As of 2014, changes in the methodology of workforce inspections have been introduced. To summarize data for quarter, the average number of population in private households is used (the number of population at the beginning of the year was used before)								

**Exports of Latvian goods and services have been growing very fast since 2010 and have become the driver of economic growth.** Export volumes have already exceeded the pre-crisis level by 20%. However, the low demand in external markets has affected the export dynamics, and it has become moderate. In 2013, export volumes increased by just 1.5%, but in the nine months of 2014, by 1.8%, compared to the respective period of 2013. During this period, export of services in

comparable prices decreased by 4.3%, while the export of goods increased by 4.3%. In 2014, export was positively influenced mainly by the increase in export volumes of wood and timber products, machinery production, as well as chemical industry. While export volumes of metals and its articles, light industry products, as well as agriculture and food industry have decreased, compared to the respective period of the previous year.

Further growth opportunities of exports will be affected not only by changes in external demand, but also by competitiveness of Latvian producers. It should be taken into account that the improvement of Latvian competitiveness so far has occurred mainly due to the cuts of labour costs, however, further improvement of competitiveness will depend on the ability to raise productivity.

Import volumes shrank rapidly along with the dropping domestic demand during the crisis. The gradual increase in economic activities on the domestic market has caused a gradual increase in demand for imports. However, since mid-2012, the import dynamics has become considerably more moderate, and import volumes have even decreased in 2014.

In 2013, the goods and services external trade balance was at 3.2% of GDP, i.e. slightly lower than a year ago. The improving export-import balance is expected also in 2014, having a positive influence on the current account of payment balance. The current account deficit in 2013 has been at 2.3% of GDP, while it has reached 3.8% of GDP in the nine months of 2014. It should be noted that **Latvia has maintained a low current account deficit since 2010, thus proving the external balance of Latvian economy.**

Along with a slowdown in exports, **a more considerable contribution to growth has been made by domestic demand.** An increase in employment and a gradual rise in wages foster an increase in private consumption. In 2013, private consumption has increased by 6.2%. However, since the 4<sup>th</sup> quarter of 2013, private consumption has been increasing at a slower pace. In the nine months of 2014, compared to the respective period of 2013, private consumption has increased by 2.1%. In 2014, a sharp growth in salaries has been observed, while the increase in employment is considerably slower than in 2013.

The improving budget situation fosters an increase in public consumption. In 2013, public consumption has increased by 2.8%, while in the nine months of 2014, by 3.3 per cent.

Over the past few years, dynamics of investments in Latvia has been changing rather frequently. During the crisis – in 2008–2009 – investments considerably decreased, while in 2011–2012, they increased. In 2013, the amount of investments in the Latvian national economy decreased once again – they were by 5.2% lower than a year ago and formed 23.3% of GDP. In the nine months of 2014, a slight increase in investments could be observed. Compared to the respective period of the previous year, investments increased by 2.1%. Overall, it is expected that investments in the Latvian national economy will increase at a moderate pace in 2014; however, they will still be by 30% lower than before crisis.

The low level of bank lending is still one of the factors hindering investments. It should be noted that the state plays a major role in the investment process – in the weak lending situation, the state provides a significant

support for private investments through the EU structural funds co-financing.

**The weak demand in export markets in the last two years hinders growth of manufacturing.** During the post-crisis period, manufacturing was the key driving force of the economic growth. From 2009 until the end of 2012, production volumes in manufacturing increased by 24%. In 2013, production volumes in manufacturing remained at the level of 2012. Production volumes of the industry were significantly affected by the termination of operations of JSC *Liepājas metalurģs* in 2013, which resulted in a considerable decrease in the metal production volumes.

In the eleven months of 2014, production volumes in manufacturing were by 0.3% lower than a year ago. Dynamics of the industry development is influenced by trends in external markets.

Development trends across sub-sectors of manufacturing are very different. Production volumes in the largest sector of manufacturing, namely, wood processing, continue increasing at a stable rate in 2014. In eleven months, these volumes were by 7.3% higher than a year ago; a stable increase in both export volumes and demand in domestic market in this sector may be observed. Furthermore, a sharp increase has been observed in the production of computers, electric and optical equipment. In the second largest industry, namely, food production, the volume of products manufactured in the eleven months of 2014 was by 0.3% higher than a year ago. While a decrease in the volume of production could be observed in manufacturing of clothes and textile, metals and chemical industry in the eleven months of 2014.

**The most considerable contribution to the increase of the GDP over the past two years has been made by industries focused on the domestic demand.** The considerable recession during the crisis was followed by a resumed increase in the construction sector, which is to a great extent fostered by public orders and projects funded by the EU. In 2013, construction volumes increased by 7.5%, which was to a great extent due to the increase in construction of engineering and technical structures. In the nine months of 2014, construction volumes continued to increase – by 9.8%. The increase to a great extent was boosted by the sharp increase in construction of buildings in the first half of the year.

In 2013, the volume of commercial service industries increased by 6%, and, considering the high proportion of the industries, formed almost half of the growth of national economy. In 2014, the volume of services provided in commercial service industries increased at a more moderate pace – in the three quarters, they were by 1.6% higher than a year ago. Increase in the volume in 2014 was mainly fostered by the growth in financial and insurance operations, as well as art, entertainment and recreational service industries. Moderate growth was



maintained in the information and communication service industry.

Along with an increase in government costs, a stable increase by 3.8% was observed also in the public service sector in 2013. In the nine months of 2014, the volume of services in this sector continued growing – by 3.3 per cent.

In other industries, production volumes decreased both in 2013 and in the nine months of 2014 by 3.3% and 5.3%, respectively. This was mainly related to weather conditions, since less electric power and thermal energy volumes were produced, compared to the previous periods.

In the trade sector (including accommodation and catering), the volume of services provided in 2013 increased by 4.8%. This increase was observed also in 2014, though, at a slower pace — an increase by 2.4% in nine months.

In the transport sector, the growth in 2013 reached 1.6%. This increase was mainly encouraged by an increase in volumes of the motor transport cargo. In the three quarters of 2014, the volume of services in this sector increased by 3.2%, compared to the period a year ago. This increase in 2014 was to a great extent fostered by successful operations of ports and an increase in volumes of the motor transport cargo.

**A moderate inflation has been observed in Latvia over the past few years.** In December 2014, compared to December 2013, prices increased by 0.2% (12-month inflation). The greatest increasing effect on consumer prices per year was caused by the growth in prices for services, which increased by 3.3% and raised the price level by 0.9 percentage points. Whereas the greatest decreasing effect per year was caused by the drop in fuel prices (by 12.3%), which lowered the total consumer price level by 0.8 percentage points. At the end of December, global oil prices had decreased to the lowest level within the last five and a half years with the decrease in global oil price by 50%. However, a sharper drop in fuel prices was prevented by the increase in the US dollar exchange rate in relation to euro.

The drop in food prices (by 0.8%) also had a significant impact lowering the overall consumer price level by 0.2 percentage points. Global food prices decreased by 8.5% within a year, which was due to the sharp drop in prices for dairy products. The drop in food prices in Latvia was influenced by the embargo for specific food products, imposed by Russia from August 2014. The average inflation in 2014 increased by 0.6% in comparison with 2013. **The Ministry of Economics forecasts that in 2015**, the average consumer price level could increase at the similar pace as in 2014. It will be influenced by various factors from the side of the offer, for example, opening the electricity market from 1 January 2015 will create a pressure on consumer prices. At the same time, inflation will be related to external factors – dynamics of global oil and food prices.

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 also been growing. The amount of credits with overdue payments in the total bank credit portfolios was 14.2% in the 3<sup>rd</sup> quarter of 2014, which is the lowest indicator since the end of 2008. Improvement of the quality of bank credit portfolios to a great extent is related to writing off bad credits.

The amount of resident deposits attracted by banks keeps growing. Along with the expected introduction of the euro, deposits experienced a sharp increase at the end of 2013. At the end of September 2014, compared to the respective period of 2013, the amount of deposits increased by 14 per cent.

However, the balance of credits still continues to decrease. This is mainly due to repayment of the previously granted credits and writing off of bad credits. At the end of September 2014, compared to the respective period of the previous year, they have decreased by 5.3%. Both the balances of commercial credits and industrial credits decreased during this period. Furthermore, the balance of consumer credits and mortgage credits continues decreasing.

**The fiscal condition of the state is stable. The overall government budget deficit for 2014** is expected to be 1.4% of GDP, which by 0.5% exceeds the value for 2014 established in the law *On the Framework of the Medium-term Budget for 2014, 2015, and 2016*. A deviation of 0.4% of GDP is formed due to changes to the possible true value of derived financial instruments reflected in the audited reports of the Privatization Agency. It shall be considered that it is a single measure and it has no impact on structural deficit. Other changes account for 0.1% of the deviation from the GDP.

The Saeima approved the state budget for 2015 with a deficit in the amount of 1% of GDP. As a priority, the state budget for 2015 states measures for fostering social and national security of the state, development of a sustainable economy of Latvia, which would improve the welfare of population, as well as measures for boosting competitiveness of business.

To ensure the stability of the tax policy and taking into account the former agreement to minimize the tax burden for labour force, the rate of the personal income tax will be decreased from 24% to 23% from 1 January 2015. Contributions at the second pension level will be increased from 4% to 5%. From 1 January 2015, the minimum salary is increased from 320 euro to 360 euro. This must be considered as one of the ways to implement the strategic development aim of the state – to reduce income inequality among the population. It is expected that the implementation of the differentiated non-taxable minimum will start in 2016.

**The increase in economic activities has a positive impact on the situation in the labour market –**

employment is increasing, unemployment is gradually decreasing. At the same time, certain population groups, especially people having a low level of education and qualification, elderly people, as well as the youth may perceive only slight improvement.

In 2013, the number of the employed increased by 2.1%, that is the biggest increase since 2008. The employment level among the population at the age of 15-74 increased to 58.2% in 2013, and around 894 thousand people were employed on average per year. At the same time, as a result of demographic trends, the number of economically active population decreased by 1.6% in 2013, which, along with the increase in employment, promoted also a sharper decrease of unemployment. The unemployment rate decreased by 3.2 percentage points – to 11.9% in 2013. The number of job seekers in 2013 was 120.4 thousand.

The situation in the labour market continued improving also in 2014, but at a slower pace. The unemployment rate in the 3<sup>rd</sup> quarter decreased to 10.6%, which was by 1.2 percentage point lower than in the 3<sup>rd</sup> quarter of 2013. Although, the employment rate continued increasing also in 2014, the number of employed people in the three quarters decreased by 0.7%, compared to the respective period of 2013. Overall, 885.7 thousand or 59.3% of population aged 15-74 were employed in the 3<sup>rd</sup> quarter.

The relatively high unemployment is still mainly related to cyclical factors; yet, the high risk of structural unemployment remains. Some unemployed people may be unable to find a job in a long-term, as the new work places are not the same, which have been lost during the crisis.

It is expected that similar trends will be preserved also in 2015 – **the number of the employed might increase by 0.2%, while the unemployment rate might drop close to 10 per cent.**

During the crisis, the adjustment of salaries was comparatively moderate; the bulk part of the economy volume drop has been recompensed by the decrease in the number of the employed. Along with the stabilising situation, **the increase in salaries has resumed since the end of 2010.**

Along with the demand for labour force, the average gross salary has gradually increased. In 2013, it increased

by 4.6%, reaching 716 euro. Comparatively sharp increase in salaries was observed also in 2014 – average gross salary in the 3<sup>rd</sup> quarter increased by 7.4%, compared to the 3<sup>rd</sup> quarter of 2013, reaching 775 euro.

Since 2010, salaries have grown both in the private and the public sector. It must be noted that the average gross salary in the public sector in the 3<sup>rd</sup> quarter of 2014 was at the level of the respective period of 2008, while in the private sector, it exceeded the level of 2008 by 18.6 per cent.

Further development of the economy of Latvia will be still closely related to the export possibilities, and therefore **the highest risk to the growth of Latvia is related to global economic development.** According to the forecasts of the Ministry of Economics, **the overall growth of Latvian economics in 2015 may reach 2 per cent.**

The growth of the national economy of Latvia in the medium-term will depend greatly on several factors. Growth of Latvia as a small open economy with a comparatively high degree of market liberalization is significantly influenced by the development of global economy and maintenance of stable competitiveness. Overall dynamics of development of the EU economic space, as well as improvement of the geopolitical situation caused by the crisis in Ukraine is of particular importance. Economic benefits of Latvia in the medium term are mainly based on the achieved macroeconomic stability, which has resulted in the improvement of credit ratings of Latvia, as well as on efficiency of the planned structural fund support programmes and improvements in the business environment.

The more rapid development scenario expects that growth in the key export markets of Latvia will be resumed, thus, benefits of competitiveness of the Latvian economy are mainly based on technological factors, improvement of production efficiency and innovations, but less on cheap labour force and low price of resources. **Latvia may reach an increase of 4% in the annual growth rate in the medium-term period.** The slower development scenario with weak growth in Europe and no improvements in the geopolitical situation caused by the crisis in Ukraine, the growth rate of the Latvian economy may be much slower.

## 2. GLOBAL ECONOMIC ENVIRONMENT<sup>1</sup>

The growth of global economy in 2014 was weaker than anticipated. The development is still weak and varies depending on the region. Growth perspectives are slowly improving in developed countries. In developing countries, however, the situation has slightly worsened, despite the fact that the growth rates there are still relatively high. The development of world economy is influenced by the geopolitical instability in Ukraine and the Middle East.

The global growth forecast of the European Commission for 2014 was reduced by 0.2 percentage points – down to 3.3%, whereas for 2015 it was preserved at the previously forecast level of 3.6 per cent.

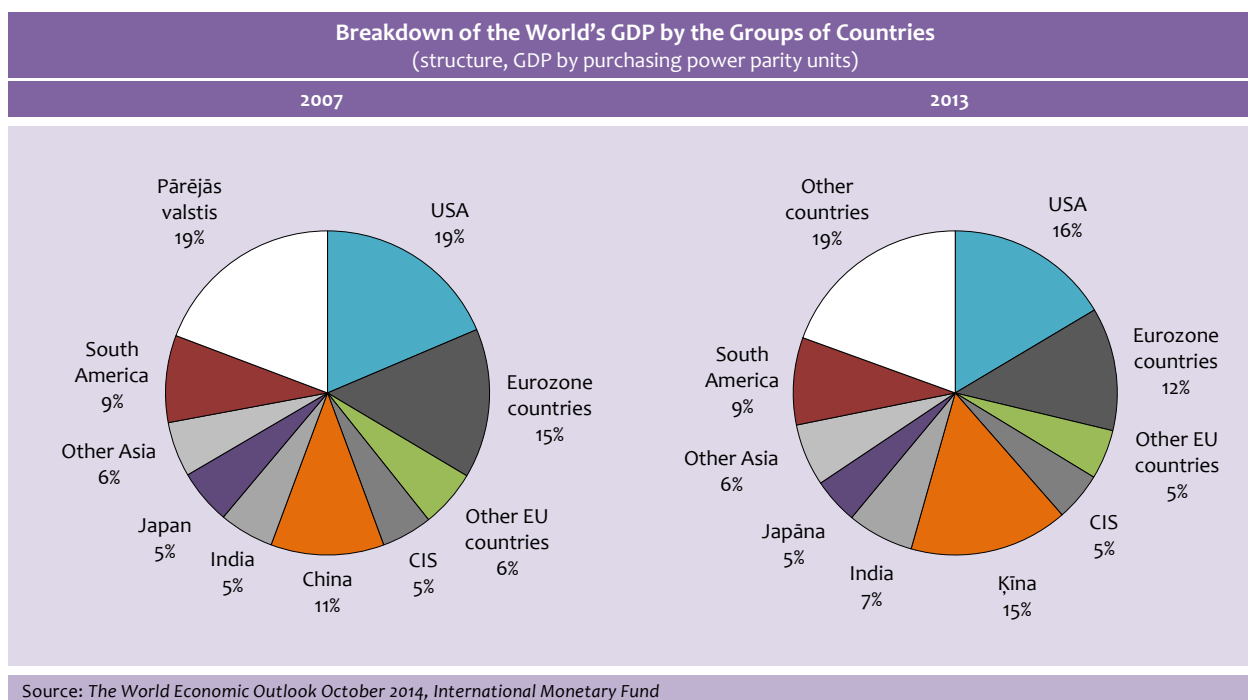
The US economy experienced a stable growth in 2014. Despite the fact that its growth rates decreased at the beginning of the year, which was mostly determined by the decrease in private investments, unfavourable weather conditions, and adjustments in inventories, the strong domestic demand, nonetheless, promoted the recovery of economy and in the second half of 2014, the US economy grew faster than expected. Overall, the growth might reach 2.4% in 2014.

Table 2.1

GDP growth (% in relation to the previous year)				
	2012	2013	2014f	2015f
<b>World including:</b>	<b>3.3</b>	<b>3.3</b>	<b>3.3</b>	<b>3.6</b>
USA	2.3	2.2	2.4	3.5
Japan	1.5	1.6	0.4	1.3
EU including:	-0.4	0.0	1.3	1.7
Eurozone countries	-0.7	-0.5	0.8	1.3
Russia	3.4	1.3	0.5	-3.5
China	7.8	7.6	7.4	7.1

Source: European Commission – European Economic Forecast, Winter 2015 f – forecast

Figure 2.1



<sup>1</sup> The preparation of the section is based on periodicals: *European Commission- European Economic Forecast, Autumn 2014, European Economic Forecast, Winter 2015; International Monetary Fund – World Economic Outlook, October 2014, World Economic Outlook Update, January 2015*

In 2015, the USA is expected to experience an even more rapid growth which will be slightly above the potential level. The improvement of the situation on the labour market, the improvement of the financial condition of households, as well as the low oil prices will promote an increase in private consumption. The risk of increase in the US economy is related to an increase in the value of the US Dollar, which may influence competitiveness and respectively limit export possibilities. External risks, in turn, include a sharper slowdown of the

growth on the markets of developing countries, including China.

**Asian countries** had overcome the global crisis more successfully than countries in other regions. However, over the recent years, a weak demand on external markets has been influencing the growth rates of Asian countries.

In Japan, the economic growth might reach 0.4% in 2014. The increase in public consumption and exports was insufficient to compensate for the decrease in private consumption due to the increase in the VAT rate.

Table 2.2

The Main Macroeconomic Indicators of the EU Member States (per cent)									
	GDP growth			Consumer prices			Unemployment		
	2013	2014f	2015f	2013	2014f	2015f	2013	2014f	2015f
<b>EU</b>	<b>0.0</b>	<b>1.3</b>	<b>1.7</b>	<b>1.5</b>	<b>0.6</b>	<b>0.2</b>	<b>10.8</b>	<b>10.2</b>	<b>9.8</b>
Austria	0.2	0.2	0.8	2.1	1.5	1.1	4.9	5.0	5.2
Belgium	0.3	1.0	1.1	1.2	0.5	0.1	8.4	8.5	8.3
Denmark	-0.5	0.8	1.7	0.5	0.3	0.4	7.0	6.6	6.5
France	0.3	0.4	1.0	1.0	0.6	0.0	10.3	10.3	10.4
Greece	-3.9	1.0	2.5	-0.9	-1.4	-0.3	27.5	26.6	25.0
Italy	-1.9	-0.5	0.6	1.3	0.2	-0.3	12.2	12.8	12.8
Ireland	0.2	4.8	3.5	0.5	0.3	0.3	13.1	11.1	9.6
United Kingdom	1.7	2.6	2.6	2.6	1.5	1.0	7.6	6.3	5.6
Luxembourg	2.0	3.0	2.6	1.7	0.7	0.6	5.9	6.3	6.4
Netherlands	-0.7	0.7	1.4	2.6	0.3	0.4	6.7	6.9	6.6
Portugal	-1.4	1.0	1.6	0.4	-0.2	0.1	16.4	14.2	13.4
Finland	-1.2	0.0	0.8	2.2	1.2	0.5	8.2	8.7	9.0
Spain	-1.2	1.4	2.3	1.5	-0.2	-1.0	26.1	24.3	22.5
Germany	0.1	1.5	1.5	1.6	0.8	0.1	5.2	5.0	4.9
Sweden	1.3	1.8	2.3	0.4	0.2	0.5	8.0	7.8	7.7
Bulgaria	1.1	1.4	0.8	0.4	-1.6	-0.5	13.0	11.7	10.9
Czech Republic	-0.7	2.3	2.5	1.4	0.4	0.8	7.0	6.1	6.0
Croatia	-0.9	-0.5	0.2	2.3	0.2	-0.3	17.3	17.0	16.8
Estonia	1.6	1.9	2.3	3.2	0.5	0.4	8.6	7.7	6.8
Cyprus	-5.4	-2.8	0.4	0.4	-0.3	0.7	15.9	16.2	15.8
Latvia	4.2	2.6	2.9	0.0	0.7	0.9	11.9	11.0	10.2
Lithuania	3.3	3.0	3.0	1.2	0.2	0.4	11.8	9.5	8.7
Malta	2.5	3.3	3.3	1.0	0.8	1.0	6.4	6.0	5.9
Poland	1.7	3.3	3.2	0.8	0.1	-0.2	10.3	9.1	8.8
Romania	3.4	3.0	2.7	3.2	1.4	1.2	7.1	7.0	6.9
Slovakia	1.4	2.4	2.5	1.5	-0.1	0.4	14.2	13.4	12.8
Slovenia	-1.0	2.6	1.8	1.9	0.4	-0.3	10.1	9.8	9.5
Hungary	1.5	3.3	2.4	1.7	0.0	0.8	10.2	7.7	7.4
Source: European Commission — European Economic Forecast, Winter 2015 f – forecast									

In China, the weak growth on external markets was compensated by various measures stimulating economic activities on the internal market. In the 3<sup>rd</sup> quarter of 2014, the GDP of China grew by 7.3%, experiencing the slowest growth since 2009. The slowdown of economic growth was determined by low investments, the slowdown of crediting growth rates, as well as a weaker industry growth.

In India, however, the growth rates of economy are becoming higher – the growth by 5.8% is expected in 2014. In India, confidence indicators have improved, stable growth is observed in the manufacturing industry and various services sectors.

Further growth in the region will be related to the recovery of global economy. Low oil prices, increasing domestic demand, favourable conditions of financial and labour markets are named among the factors promoting the growth.

Growth in the **CIS countries** significantly decreased in 2014. Due to the geopolitical tension, Russia experienced a significant drop in investments, which was determined by the sharp decrease in entrepreneurs' trust. As the crisis in Ukraine is escalating, production output and exports are decreasing. In certain Caucasian and Central Asian countries, the growth was negatively affected by the decrease in the amount of cash transfers and trade with Russia. The further economic

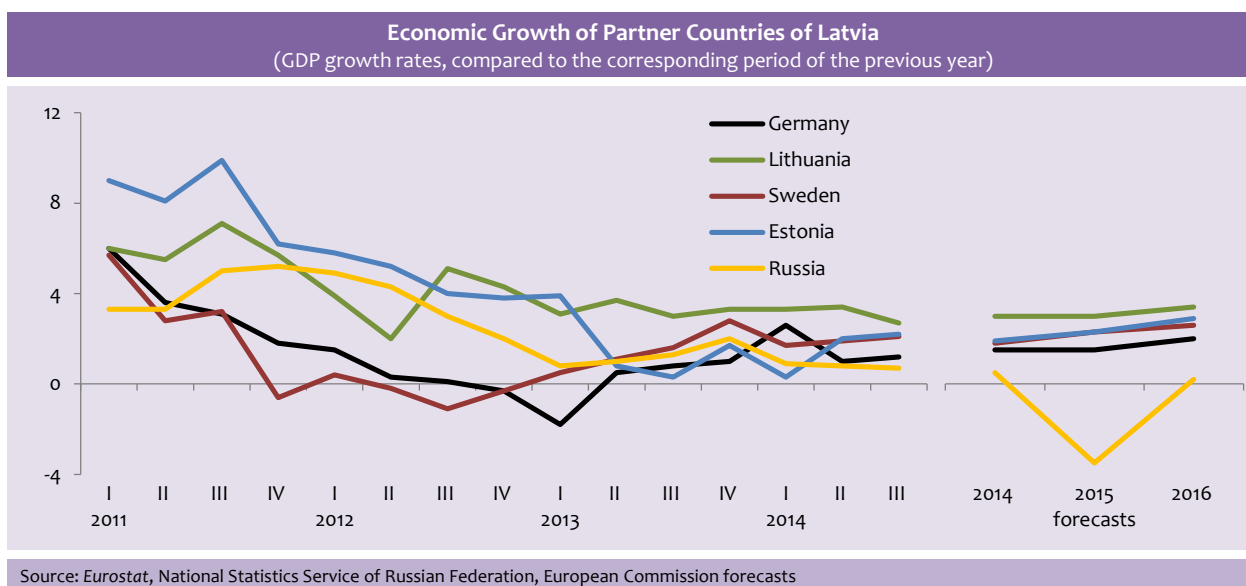
development of the CIS countries is assessed cautiously. There are several risks that restrict the development; however, the main risk is related to the geopolitical tension in the region.

As exports are getting weaker and investments are decreasing, the economic growth of **Russia** continues to slowdown. These tendencies are closely related to the geopolitical tension, including sanctions that restrict trade and financial flows, reduce investors' trust, and promote the outflow of investments.

In the 1<sup>st</sup> quarter of 2014, economic activities in Russia were at a rather high level, which was promoted by the increase in exports. However in the 2<sup>nd</sup> quarter, as the geopolitical tension, as well as political and economic uncertainty increased, significant capital outflow was observed, influencing the drop in the value of the rouble, increase in inflation, and decrease in private consumption. Overall, the economy of Russia is experiencing stagnation in 2014. In 2015, the economy of Russia will be significantly affected by the aforementioned factors as well, and GDP might decrease by 3.5 per cent.

Economic activities in the **European Union** remain moderate. This is due to the weak global growth and internal factors of the EU, such as slow recovery of the bank sector, long-overdue economic reforms, and the debt crisis of countries.

Figure 2.2



In 2014, the economic recovery in the EU and the eurozone continued, but the GDP growth rates were slower than previously expected, which was determined by the weak demand, as well as a high debt and unemployment rate. The manufacturing and investments were still below the pre-crisis level.

It is expected that the growth will gradually strengthen from now on. Despite the fact that the consequences of the crisis will still be observed during the next two years, the situation on the labour market and

financing terms will start to improve gradually due to the structural reforms carried out previously and the supportive policy. The growth will be mostly supported by the domestic demand, as inflation will remain at a low level. The EU growth will be positively affected by the sharp drop in oil prices in late 2014, as a result of which the expenditures of both households and entrepreneurs have decreased. The weak Euro exchange rate will strengthen the price competitiveness of the eurozone

companies on external markets, thus improving export possibilities.

The risks affecting the growth are mostly related to the uncertainty of global environment. However, internal risk factors that may pose a threat to the economic recovery of the region are related to the delay in the implementation of structural, fiscal, and institutional reforms in the EU Member States.

Over the recent years, the **Baltic States** were among the countries that experienced the most rapid economic growth in the EU. However, as the increase in exports slowed down, economic growth rates slowed down as well.

In 2014, **Lithuania** continued to experience growth driven by a strong domestic demand. Private consumption increased, which was determined by the increasing employment rate and the increase in actual wages. Private investments increased faster than during the previous years. Nevertheless, the geopolitical tension between Russia and Ukraine negatively affects the mood of consumers and enterprises, as well as exports, which resulted in a more moderate GDP growth in the second half of the year.

Despite the fact that the Russian-Ukrainian crisis will still have a negative impact in early 2015, Lithuania is expected to experience a stable growth over the next two years. The increase in wages and the decrease in inflation will have a positive impact on private consumption. Due to the high level of capacity use and favourable lending conditions, investments will continue growing.

Due to the geopolitical uncertainty and still weak external demand, the growth of GDP in **Estonia** was slightly weaker than the previously forecast level in 2014. The domestic demand remains the main factor

promoting the growth, whereas the growth of exports has practically stopped. Private consumption was promoted by the relatively rapid increase in wages, higher pensions, and low inflation. The increase in investments was mostly influenced by large investments in the housing market and the improvement of public transport.

In the near future, the increase in consumption is expected to be stable, supporting the increase in actual income and decrease in the unemployment rate. Due to the Russian-Ukrainian crisis, exports will remain weak. As the situation in the global environment gradually improves, the growth will become more rapid as well.

After a strong increase in early 2014 due to the rapid increase in construction volumes, the economic growth of **Germany** slowed down slightly in Q2 of 2014. It was largely influenced by the weak dynamics of private investments and net exports. It is expected that the overall growth will remain moderate in 2014, which will mostly depend on the domestic demand.

The further improvement of the situation on the labour market and favourable financing conditions will promote the increase in both domestic demand and exports. Low oil prices will positively affect the growth as well.

The economic growth of **Sweden** is slightly weaker in 2014 than it was previously expected. It was determined by the weaker dynamics of exports and the decrease in private investments. On the contrary, the domestic demand and construction volumes were rather high. Confidence indicators remained at a high level as well.

As the external demand will normalise, the growth rates of Sweden will gradually increase over the next two years.



## 3. GROWTH

### 3.1 Gross Domestic Product and Aggregate Demand

#### 3.1.1 Development Trends

Since 2011, the economic growth in Latvia has been one of the fastest in the EU. The growth of the GDP exceeded 5% per year in 2011 and 2012. The rapid growth was based on exports, which were fostered by competitiveness of Latvian companies, restored during the crisis. Although uncertainty in foreign markets increased and export opportunities weakened in 2013, the Latvian economy grew steadily. In 2013, the GDP increased by 4.2%. The growth in 2013 was mainly due to the increase in private consumption, which was fostered by the increase in employment and wages. Despite the fact that Latvia has been the fastest growing economy in the EU over the past few years, in 2013, the GDP was by 7.4% lower than before crisis.

In 2014, the economic growth rate slowed down, which was due to tendencies in external environment – slower growth in the EU than expected before, as well as the economic problems in Russia. Overall, in the three quarters of 2014, the GDP was by 2.5% higher than in the respective period of 2013.

Figure 3.1

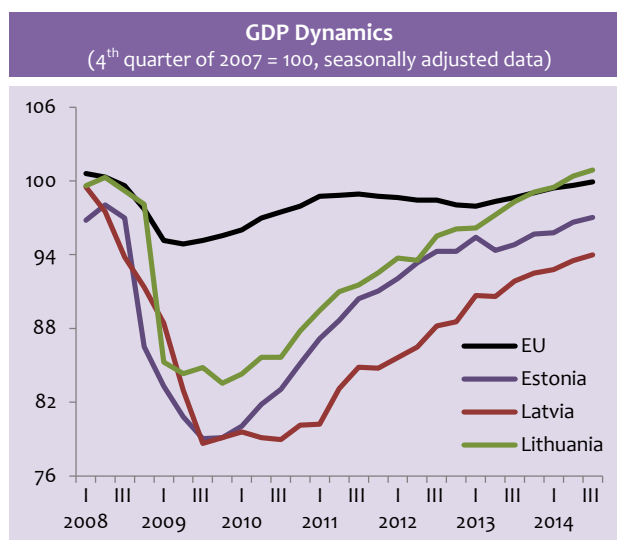


Table 3.1

GDP by Expenditure Items (changes compared to the previous year, percentage)						
	2008	2009	2010	2011	2012	2013
<b>GDP</b>	-3.2	-14.2	-2.9	5.0	4.8	4.2
Private consumption	-8.0	-16.2	3.1	2.9	3.0	6.2
Public consumption	2.4	-10.7	-8.1	3.1	0.4	2.9
Gross fixed capital formation	-9.2	-33.3	-20.0	24.2	14.5	-5.2
Exports	2.4	-12.9	13.4	12.0	9.8	1.5
Imports	-10.7	-31.7	12.4	22.0	5.4	0.3

In 2013, exports of goods and services reached the highest level in history and exceeded the pre-crisis level by 23.4%. Compared to the first year after the crisis, dynamics of exports of goods and services became more moderate – exports of goods and services increased only by 1.5% in 2013, which was due to the weak demand in the largest trade partner states of Latvia.

Dynamics of exports of goods and services was moderate also in 2014, and export volumes in the three quarters increased by 1.8 %, compared to the respective period of 2013.

In 2013, with the slower exports growth, the domestic demand contributed most to the growth. In 2013, the domestic demand increased by 2.9%. Although, the domestic demand in 2013 was by 15.7% higher than at the lowest point of the crisis of 2010, it was still by 17.2% lower than in the pre-crisis level in 2007.

In 2014, domestic demand continued increasing. In the three quarters of 2014, compared to the respective period of the previous year, it has increased by 2.5 per cent.

Along with the gradual increase in economic activities in the domestic market after the crisis, the demand for import of goods and services increased rapidly. Since

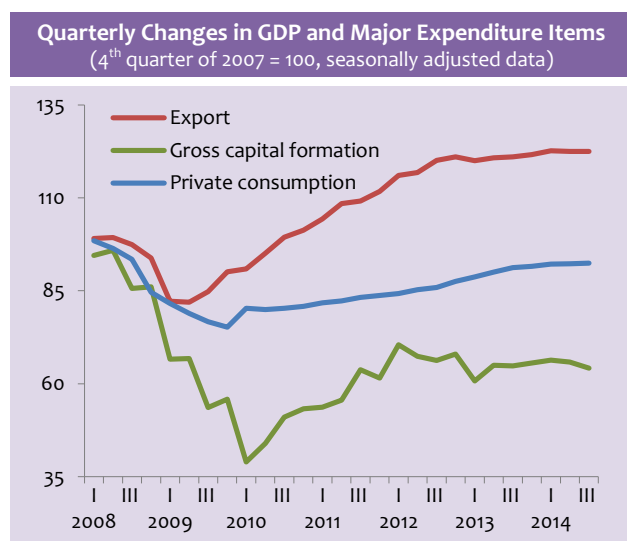
2013, the dynamics of imports was very moderate mainly due to the dynamics of investments. In 2013, import of goods and services increased by 0.3 per cent.

Table 3.2

GDP by Expenditure Items by Quarters (changes compared to the respective period of the previous year, per cent)											
	2012				2013				2014		
	I	II	III	IV	I	II	III	IV	I	II	III
GDP	8.8	4.3	3.7	3.4	3.1	4.6	4.6	4.4	2.8	2.3	2.4
Private consumption	3.0	4.6	2.7	1.8	5.9	8.2	8.4	2.3	2.7	2.3	2.1
Public consumption	-8.8	5.5	0.2	3.7	6.2	1.2	3.7	1.4	4.1	3.9	2.3
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
Exports	12.4	5.9	10.6	10.3	3.4	2.2	-0.4	1.0	3.4	1.7	0.3
Imports	11.7	7.0	0.9	3.4	2.6	-1.2	0.8	-0.9	0.5	2.4	-1.2

In the three quarters of 2014, imports of goods and services have increased by 0.5%, compared to the respective period of 2013. The decrease was to a great extent caused by the dynamics of investments, as well as by the drop in volumes of certain product groups, for example, mineral products and vehicles.

Figure 3.2



During the crisis the export-import balance of Latvia improved significantly. In 2007, the export-import balance still exceeded -20% of GDP, but since 2009 the export-import balance continued to improve. In 2013, the export-import balance was -3.2% of GDP.

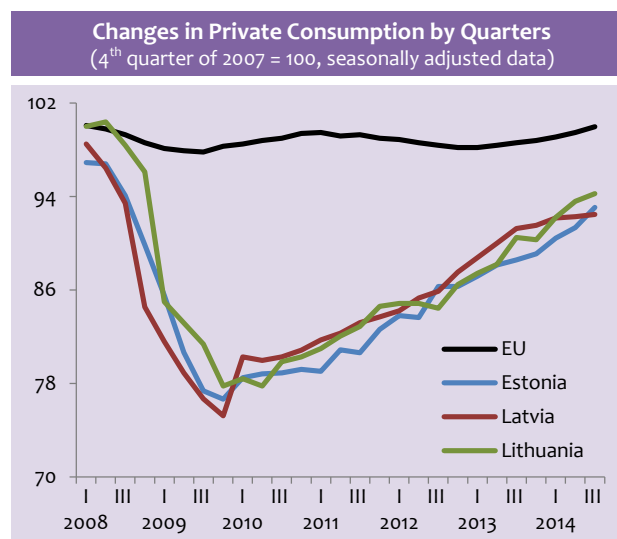
The export-import balance was -3.4% of GDP in the three quarters of 2014.

### 3.1.2 Private and Public Consumption

The growth of private consumption was fostered by a gradual increase in employment and wages during the recent years. In 2012, private consumption increased by 3%, whereas in 2013, by 6.2 per cent.

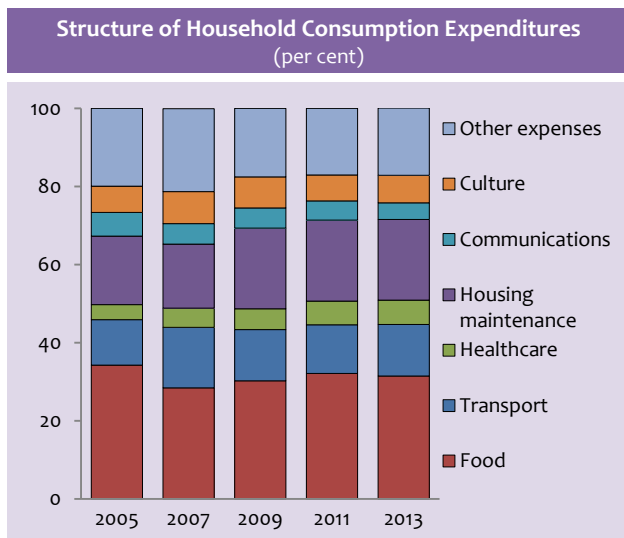
In 2013, expenditures for housing maintenance in the structure of household consumption constituted 23% of total expenditures, 19% for food and 14% for transport. Compared to 2012, the highest increase was observed in food – by 7.8%. Expenditures for transport and housing maintenance increased by 4% and 3.3 % respectively.

Figure 3.3



In 2014, private consumption contributed the most to the growth. However, it increased at a slower pace than in 2013: in the three quarters, the private consumption was by 2.4% higher than in the respective period of the previous year. In 2014, a sharp increase was observed in salaries, while the increase in employment was slow.

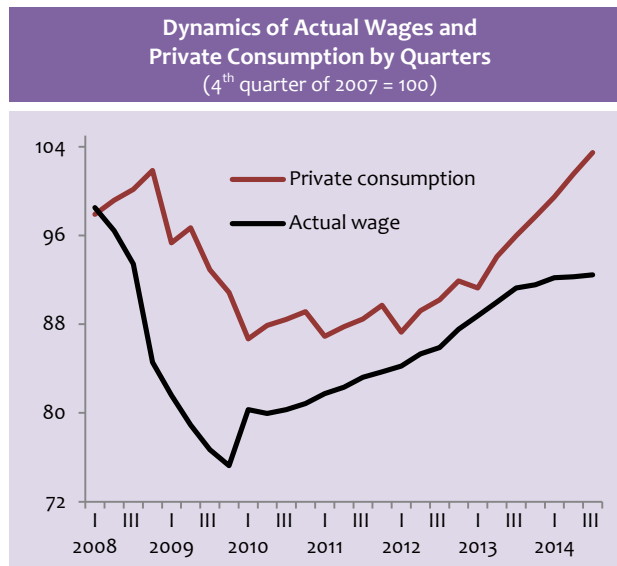
Figure 3.4



In 2013 consumer confidence has not experienced significant changes. Consumer confidence in 2013 was mainly based on optimistic consumer reviews regarding the overall economic situation in the country in the

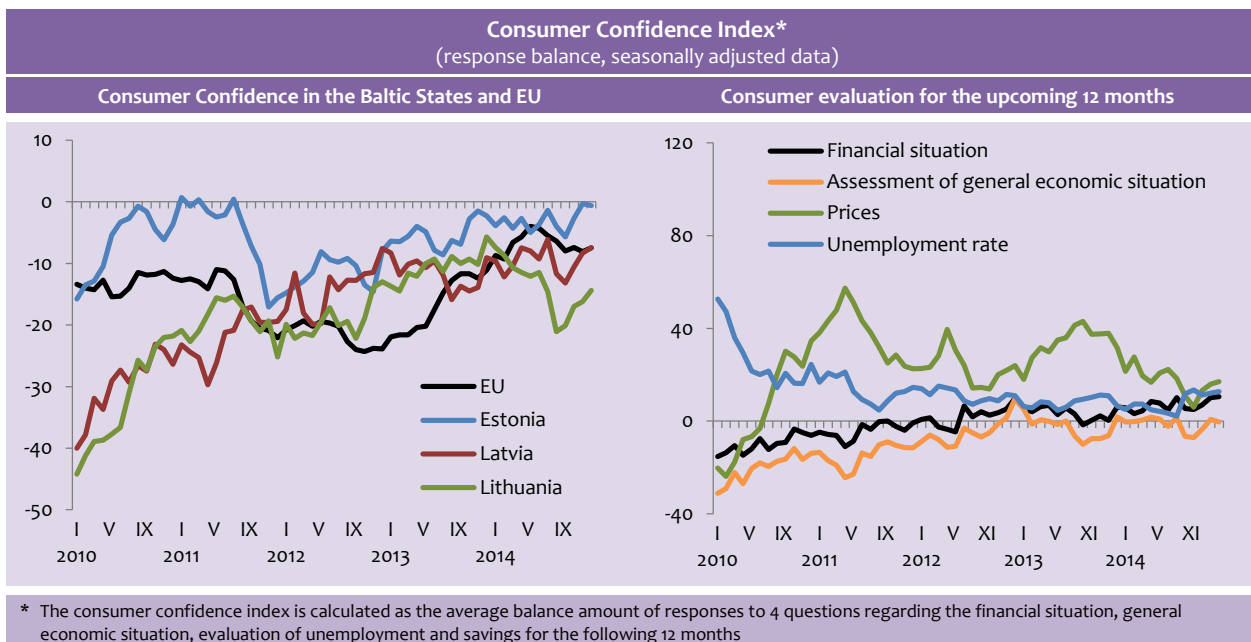
coming months, the financial situation in their families and unemployment, as well as the expected inflation in 2013 due to the planned introduction of the euro.

Figure 3.5



In 2014, consumer confidence has improved. Such improvement was mainly based on optimistic consumer reviews regarding the financial situation in their families. Meanwhile, the assessment of the consumers' inflation expectations shows that they decrease in 2014 after an increase in 2013 due to moderate dynamics of prices.

Figure 3.6

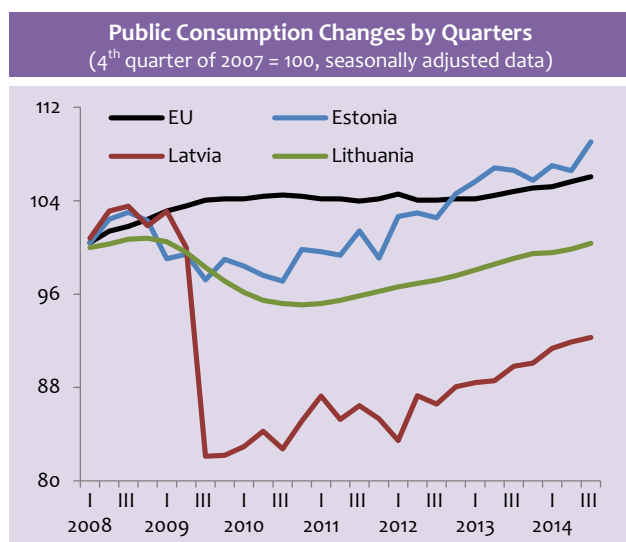


The volumes of **public consumption** or public services shrunk fast during the crisis. In 2011, public consumption was by 13.3% lower than in 2007. The drop was due to the introduction of state budget consolidation measures. It resulted in a reduced share of public consumption in the GDP. In 2008, public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

In 2013, compared to 2012, the volumes of public expenditures increased by 3.6 per cent.

With the increase in budget revenues, a stable growth in public consumption was observed in 2014 – by 3.4 per cent in the three quarters.

Figure 3.7



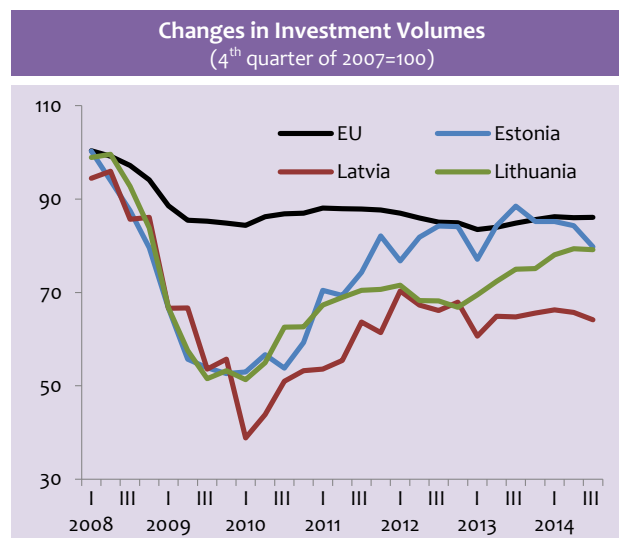
### 3.1.3 Investments

Investment activities are rather moderate and investment volumes still have not reached the pre-crisis level.

Investment dynamics in Latvia as well as in other EU Member States shows that investors are cautious in relation to the implementation of investment plans. It is determined by the economic and political uncertainty, limited access to financial resources, as well as a comparatively high level of debt commitments in the public and private sector. In 2013, as compared to 2007, overall investment volumes in the EU were by almost 15% lower. In several EU Member States, the decrease in investment volumes was even sharper, for instance, by 66% in Greece, 47% in Cyprus, 40% in Ireland. At the same time, it should be noted that investment volumes in Germany, Poland, and Luxembourg in 2013 exceeded the level of 2007 by 1.5%, 7.7%, and 15% respectively. In the Baltic States, the decrease in investment volumes during

the crisis was almost four times greater than the average EU indicator and in 2010, it was by 63% lower than before the crisis. As the economic situation stabilised, investment volumes increased, as a result of which the investment gap decreased by a half. In 2013, investment volumes in the Baltic States were by 30% less than the pre-crisis level.

Figure 3.8



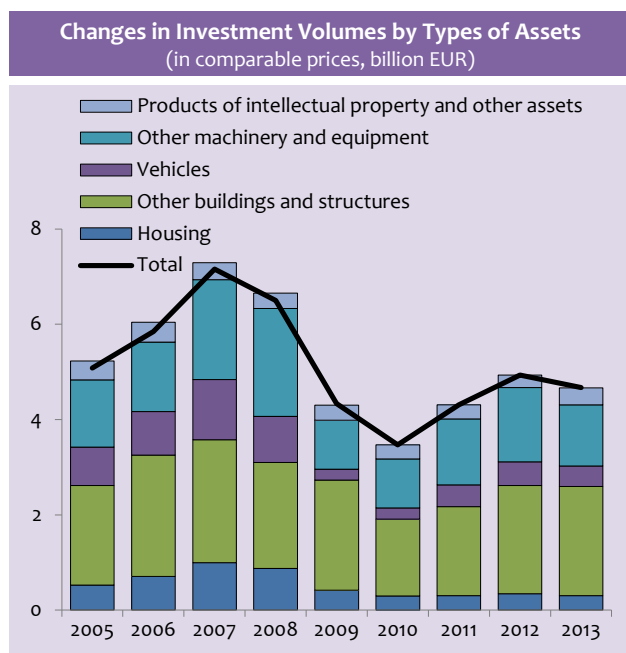
Investments in Latvia since 2008 have been rather unstable. During the years of sharp decline, they decreased by almost a half. Since late 2010, the positive dynamics of investments has been restored. In 2011, investment volumes were by 24.2% higher than in 2010, whereas in 2012, they increased by 14.5%, i.e. at nearly half the pace. The slowdown of investment dynamics was already expected, since the rapid increase in investment volumes, which was observed in 2011 and in early 2012, was related to the low base effect. In 2013, investments in the national economy of Latvia decreased by 5.2% and were by 35% less than before the crisis.

In the first half of 2014, investment dynamics was positive. Investments in the national economy of Latvia increased by 9.3% in the 1st quarter and by 2.1% in the 2nd quarter. However, in the 3rd quarter, the investment volume was by 1.9% lower than a year before. Overall, during the nine months of 2014, as compared to the respective period of the previous year, investment volumes increased by 2.1% and amounted to 22.3% of GDP. It is expected that growth of investments in the national economy of Latvia will remain moderate. A faster growth of investment volumes is mainly hindered by the slow recovery of lending.

The structure of invested assets has changed since 2007. It was mostly determined by the crucial decrease in investments in housing, as well as machinery and equipment during the rapid economic decline. In 2010, as compared to 2007, investments in housing decreased by 70.3%, in machinery and equipment – by 62.4%, including in vehicles – by 81.3%. Over the following

years, investments in machinery and equipment increased, yet their volumes in 2013 were only a half of that in 2007. Investments in housing, however, almost did not increase and amounted to just 30% of the pre-crisis level.

Figure 3.9



During the crisis, investments made in other buildings and structures were more stable. In 2010, as compared to 2007, they decreased by 37.5%. Over the following three years, investments in these assets increased rather rapidly – by 42.3%, mainly due to significant state investments in infrastructure projects. In 2013, the volumes of investments in buildings and structures were almost at the pre-crisis level and amounted to 48.5% of the total investments in the national economy of Latvia.

During the nine months of 2014, as compared to the respective period of the previous year, the sharpest increase was observed in investments in housing and vehicles, by 34.1% and 31% respectively, while investments in production equipment decreased by 17 per cent.

The state has been playing an important role in the investment process over the past few years. Under weak lending conditions the state provides a significant support to private investments through the EU structural funds co-financing.

Although the amount of public investments decreased during the economic recession, its share in the total investments in the national economy of Latvia increased, reaching 24% in 2010, i.e. by 8 percentage points more than in 2007. In 2011, public investments increased by 16%, contributing 4 percentage points to the total increase in investments. In 2012, public investments remained at the level of the previous year, while in 2013, they decreased by 3% and amounted to 17% of total investments in the national economy of Latvia (4% of GDP). During the nine months of 2014, the volume of public investments was by 8.8% lower than a year before, whereas the volume of private investments increased by 2 per cent.

Table 3.3

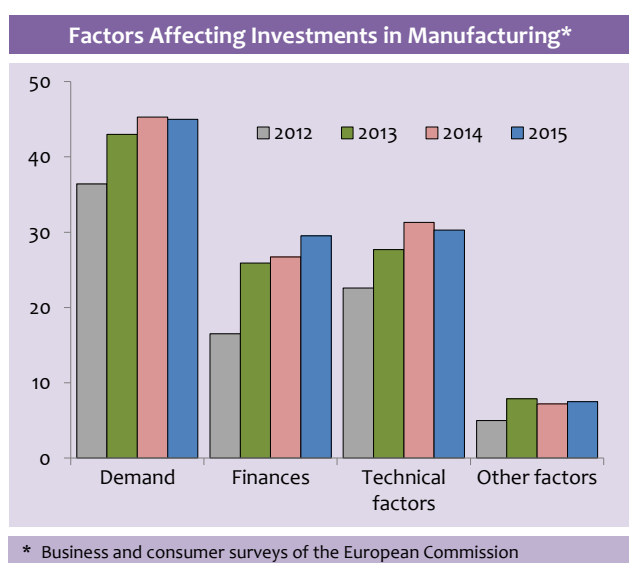
Gross Capital Formation (per cent)						
	2008	2009	2010	2011	2012	2013
Current increase, %						
GDP	-3.2	-14.2	-2.9	5.0	4.8	4.2
Gross Capital Formation	-14.5	-41.2	-16.2	42.1	2.6	1.7
– gross fixed capital formation	-9.2	-33.3	-20.0	24.2	14.5	-5.2
% of GDP						
Gross Capital Formation	34.0	21.4	19.4	24.3	26.0	25.0
– gross fixed capital formation	32.0	22.5	19.1	22.1	25.2	23.3
– changes in inventories	2.1	-1.1	0.3	2.1	0.8	1.7

The increase in investments is prevented by the still weak lending, low demand, as well as the awaiting behaviour of entrepreneurs, considering the uncertain external situation. The survey results of enterprise managers show that the increase in demand is the main factor promoting investments. The role of “access to finance” factors in promoting investments has significantly increased since 2013. Also in 2015, financial

factors are estimated as an important element promoting investments, which is equal to technical factors, such as technology development, accessibility of qualified labour force, etc. It should be noted that technical factors have been the main drivers for investments followed by demand factors in the EU countries over the past few years.

The capacity load level in the manufacturing industry has been gradually increasing since early 2010. In late 2014, it reached 74.1%, which is by 0.4 percentage points more than in late 2007. Low investment activities at high capacity load contribute to the reserved behaviour of investors. The 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 tendencies in the investment process are largely expected to depend on access to credit resources and other external financing sources, as well as on the will to strengthen the positions on foreign and domestic markets including by technologically renewing the existing capacity loads.

Figure 3.10



**Structure of investments by sectors.<sup>1</sup>** Investments decreased in all sectors due to the financial crisis. A particularly sharp decrease in investment volumes was observed in the field of construction. In 2010, the volume of investments in construction was by 78% lower than in 2008. An almost equal decrease in investments was observed in the trade sector and the sector of accommodation and catering services. Whereas, investments in such sectors as information and communications services, health and social care, mining industry and energy decreased at a rather moderate pace.

As of late 2010, positive investment dynamics was restored in several sectors, and in 2011, it progressed rather rapidly. In 2011, investments in goods production sectors were by 49.4% higher than a year before. It was mainly due to the substantial investments in the energy sector and manufacturing industry. Investments in services sectors increased by 12% and amounted to almost 60% of total investments in the national economy of Latvia.

In 2012, the overall investment activities were slightly more moderate than a year before. Investments in services sectors increased by 19%, which was mainly determined by the substantial investments in the transport and storage sector, as well as real estate activities. In 2012, investments in goods production sectors increased by 6.6%, amounting to 38% of the total investment volume in the national economy of Latvia. In 2012, considerable investments were made in the electricity, gas supply, heating and air conditioning sector. Investments in this sector amounted to 10.3% of the total investment volume in the national economy of Latvia. Investments in water supply, sewerage, waste management and recovery activities increased nearly by one and a half time.

Table 3.4

Dynamics and Structure of Investments by Sectors* (per cent)								
	Growth rates				Structure			
	2011	2012	2013	2014 I-IX	2011	2012	2013	2014 I-IX
Agriculture and forestry	56.2	7.0	2.2	-14.9	7.4	7.0	7.5	5.1
Manufacturing industry	37.5	7.6	-31.2	35.2	14.1	13.4	9.7	14.4
Construction	58.6	-29.1	5.3	-3.6	4.7	3.0	3.3	2.5
Trade and accommodation	24.8	19.9	-5.6	19.6	8.1	8.5	8.5	7.3
Transport and storage	43.1	31.1	-5.9	6.2	13.6	15.7	15.6	16.1
Other commercial services	-14.2	34.1	6.4	0.6	17.6	20.7	23.2	15.2
Public services	21.7	-3.9	4.3	-6.3	19.3	16.3	17.9	24.3
Other industry	55.7	16.6	-12.0	-15.8	15.0	15.4	14.3	15.1
<b>Total</b>	<b>24.9</b>	<b>13.8</b>	<b>-5.1</b>	<b>2.1</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
* 2013 – provisional data; 2014 – estimated based on quarterly data								

<sup>1</sup> Investments by sectors are considered according to the non-financial investment statistics.



According to provisional data, in 2013, investment volumes in services sectors remained at the level of 2012. The slowdown of investments in these sectors was largely due to the decrease in investments in trade, transport, and storage sectors. Whereas, the volume of investments in food production sectors was by 14.7% lower than in 2012, which was determined by the decrease in investments in the manufacturing industry (by 31.2%) and energy sector (by 21%). It was partially compensated by the decrease in investments in construction, as well as waste water, waste management and recovery.

During the nine months of 2014, overall investments in the sectors of the national economy of Latvia remained at the level of the previous year. However, the dynamics of investments in certain sectors varied significantly. According to provisional data, during the nine months of 2014, the volume of investments in the manufacturing industry was by 35.2% greater than a year before and amounted to almost 15% of the total investments in the national economy of Latvia. The overall volumes of investments in services sectors increased as well, which was largely determined by the crucial increase in investments in information and telecommunications services – by 42.6%, in trade – by 23.6%. During the three quarters of 2014, however, investment volumes in energy were by 22.8% lower than a year before, which was mainly determined by the completion of the large investment projects implemented last year.

Investment processes in the manufacturing industry are unsteady, with explicitly high fluctuations over the

recent years. During the sharp economic decline, the volumes of investments in the sector decreased almost three times, reaching the lowest level in 2009. It was largely determined by the decrease in investments in the production of consumer goods (including the food industry – by 44%), as well as the production of intermediate consumer goods (including wood processing – by 88% and production of chemical substances and their products – by 77%).

Since 2010, the positive dynamics has restored in the sector. Overall in 2010, investments in the manufacturing industry 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 the production of pharmaceuticals had the largest contribution to the increase in investments in manufacturing sectors.

In 2011, investment activities in the manufacturing industry increased rapidly. As compared to 2010, investment volumes increased by 37.5%. More than a half of the investments in the manufacturing industry were made in wood processing and production of metals. In 2012, investments in the manufacturing industry increased as well, yet at a slower pace than a year before. It was largely determined by the lower level of investments in wood processing and metal production sectors. In 2012, overall investments in the manufacturing industry amounted to 13.4% of the total investment volume in the national economy of Latvia, which was by 7.6% more than in 2011.

Table 3.5

Dynamics and Structure of Investments in the Manufacturing Industry* (per cent)								
	Growth rates				Structure			
	2011	2012	2013	2014 I-IX	2011	2012	2013	2014 I-IX
Food industry	66.1	46.7	-39.6	3.5	17.7	27.9	25.1	20.0
Light industry	83.0	-19.2	-7.6	112.5	1.6	1.4	1.9	2.1
Wood processing	147.0	-28.2	-26.9	81.6	31.0	23.9	26.0	34.8
Paper industry and publishing	44.6	0.3	16.4	-26.3	3.0	3.2	5.5	3.8
Chemical industry and related industries	-7.6	-33.6	-19.1	51.6	10.5	7.5	9.0	8.6
Production of other non-metallic mineral products**	-82.5	43.2	-18.6	48.4	4.9	7.5	9.0	9.2
Production of metals and metal articles**	191.1	-33.4	-68.7	12.8	19.9	14.2	6.6	5.8
Production of machinery and equipment	173.7	5.1	-35.8	35.6	1.4	1.5	1.5	1.9
Production of electrical and optical equipment	107.0	66.6	-30.8	51.1	1.8	3.3	3.3	3.8
Production of vehicles	141.5	22.1	-40.7	63.3	4.3	5.7	5.0	5.5
Other industries	212.9	-6.6	18.8	-10.8	4.0	4.0	7.1	4.6

\* 2013 – provisional data; 2014 – estimated based on quarterly data  
 \*\* estimation of the Ministry of Economics

According to provisional data, in 2013, investments in the manufacturing industry were by 31.2% lower than a year before. The lower investment volume in the manufacturing sector, as compared to the previous year, was mainly related to weaker investment activities in the food industry and wood processing, as well as considerable decrease in investments in the metal manufacturing sector in the first half of 2013. It should be noted that investment volumes in wood processing in 2011, as compared to 2009, increased nearly five times, while investments in the food industry nearly doubled during this period. In early 2013, investment activities in the rest of manufacturing industries were slightly weaker than a year before. It should be noted that investment activities tended to grow in some industries in the 2<sup>nd</sup> half of 2013. For instance, investments in the production of chemical substances in the 2<sup>nd</sup> half of 2013 were by 50% higher than a year before, while investments in wood processing increased by 42%. Positive tendencies were observed in 2014 as well. During the nine months of 2014, as compared to the respective period of 2013, investment volumes in the manufacturing industry increased by 35.1% and amounted to 15% of the total investments in the national economy of Latvia. The increase in investments was largely determined by substantial investments in the wood processing sector and the production of non-metal mineral articles. Investments in these sectors amounted to 44% of the total investments in the manufacturing industry. It should be noted that the dynamics of investments in all sub-sectors of the manufacturing industry was positive.

Investor survey results showed that the investment structure in the manufacturing mostly remained unchanged. In 2014, investments in the manufacturing sector were mainly related to the replacement of worn-out equipment and machinery and the expansion of production capacities – respectively 41% and 24% of the total investments in the manufacturing. Over the recent years, investments made with the aim to rationalise the production process have had a tendency to increase. In 2014, they amounted to 21% of the total investments in manufacturing sectors.

In the nearest future, investment volumes in the national economy of Latvia are likely to increase at a moderate pace. However, the dynamics of investment processes will be largely determined by accessibility to financial resources, as well as by the improvement of the external situation.

### 3.1.4 Export and Import

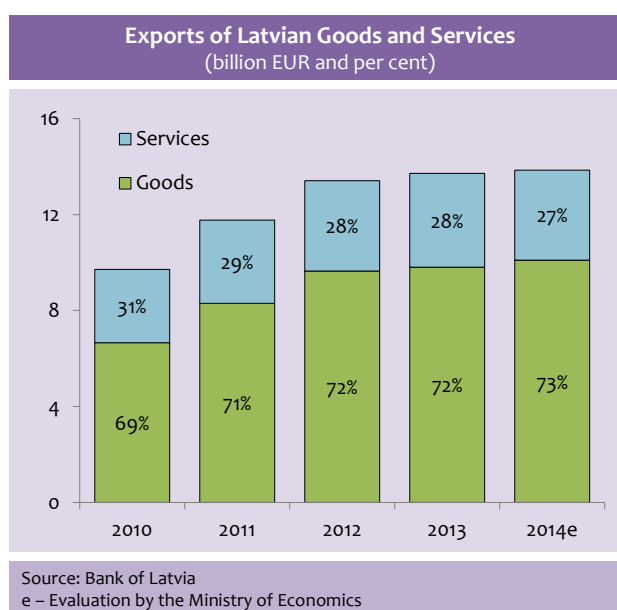
#### Export and import of goods

Latvian exports have been growing very fast from 2010 until 2012. In 2011, exports of Latvian goods in current prices increased by 27.8% whereas in 2012, by 15.7% (in comparable prices – by 13.9% and 11.5% respectively).

Due to the considerable decrease in foreign demand, the pace of exports of goods is slow in 2013, however, it still remains positive. In 2013, exports in current prices have increased by 1.5%, while in comparable prices it remained at the level of the previous year. In January–November 2014, exports of goods increased by 2.2 % compared to the eleven months of 2013.

In 2011, imports of Latvian goods in current prices increased slightly faster than exports, namely, by 30.6%, whereas in 2012, by 13.9% (by 23.2% and 5.6% respectively in comparable prices). Like exports in 2013, the import of Latvian goods in current prices increased only by 1 %, whereas in comparable prices, by 0.5%. In January–November 2014, the import of goods in current prices has decreased slightly by 1.3 per cent.

Figure 3.11



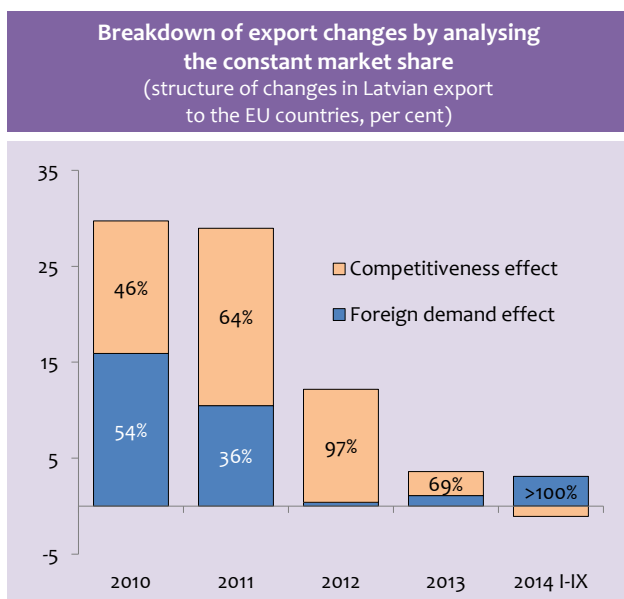
As exports increased faster than imports in 2012–2013, the external trade deficit was decreasing as well. In 2013, it amounted to 11.5% of foreign trade, whereas in the eleven months of 2014, only 10%. Yet, during the period of rapid growth (in 2007–2008), it amounted to over ¼ of total foreign trade.

Figure 3.12



In the post-crisis period – 2010-2011 – the growth of Latvian exports to the EU was determined equally by the improving competitiveness of Latvian enterprises and the steady foreign demand. In the period from 2012 until 2013, the deteriorating growth in the EU led to a significant drop in foreign demand, and thus the growth of exports was mainly achieved due to the improving competitiveness. The improving competitiveness of the Latvian producers in the post-crisis years was mainly achieved due to the decrease in labour costs. An analysis of exports to the EU shows that the growth of exports in 2014 has been mainly determined by foreign demand. Meanwhile, the role of competitiveness in the growth of exports decreased gradually.

Figure 3.13



Over the past few years, the level of diversification of Latvian goods exports has considerably improved. During the years of rapid growth, certain largest product groups, like timber and timber articles 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 drop in volumes, which led to an improvement of the diversification index. As the growth resumed in the post-crisis period, the increase in the volumes of exports in the group of goods was similar, which is a sign of a higher level of diversification of exports. It should be noted that recently this index in Latvia has levelled with the average level of the EU-15 countries.

The total exports of Latvian goods in 2013 were fostered by the slight improvement of trade conditions, the export unit value index increased by 1.6%, while the import value increased by 0.5 per cent.

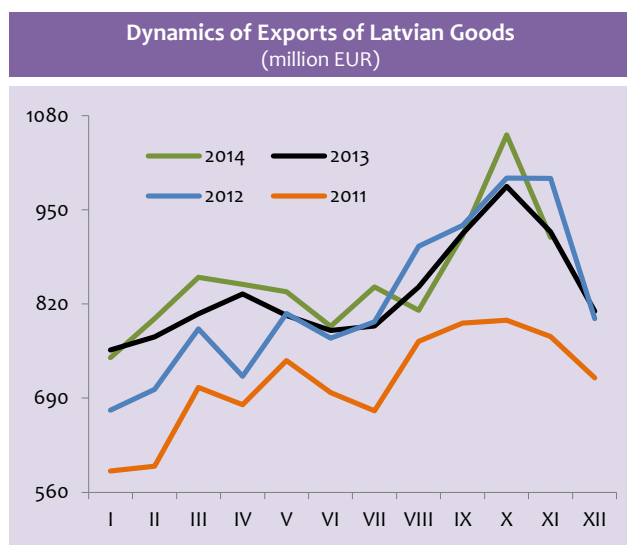
While in eleven months of 2014, along with more sharp decrease in export prices than in import prices (by 1.3% and 0.3% respectively), trade conditions have slightly deteriorated.

Figure 3.14



In 2013, the rate of export growth was affected by the significant decrease in the volume of metal and metal products group, as well as transport vehicles. While the increase in the export volume of mechanical manufacturing, as well as timber and timber product group had a positive effect on the development of export. The increase in the export volumes of chemical and light industry goods was moderate.

Figure 3.15



In January-November 2014, the export growth is still influenced by the increase in the export volume of wood and wood products, mechanical manufacturing and chemical industry products. The decrease in the export volumes of metal and metal products, however, had a negative effect.

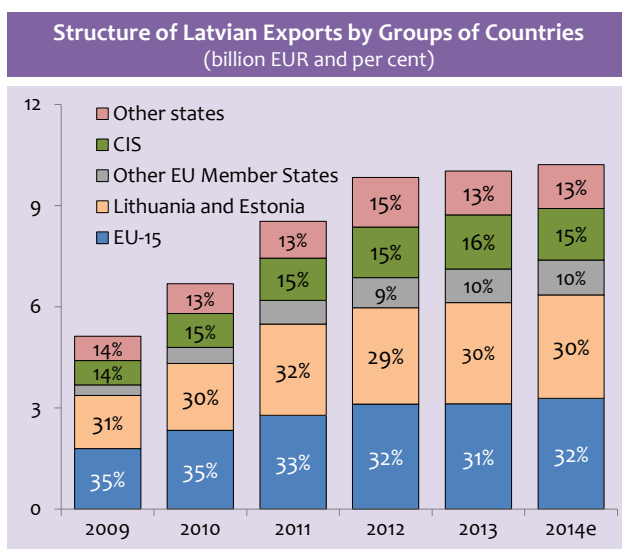
Table 3.6

Exports of Latvian Goods by the Main Commodity Groups (%, in current CIF prices)				
	2013		2014 I-XI	
	structure	changes compared to the previous year	changes compared to the respective period of the previous year	contribution to changes in volumes
<b>Total</b>	<b>100</b>	<b>1.5</b>	<b>2.2</b>	<b>2.2</b>
including:				
agriculture and food products	20.4	1.1	-0.9	-0.2
wood and wood products	15.9	8.7	9.1	1.5
machinery products	15.6	15.4	5.6	0.9
metal and metal articles	10.5	-23.8	-9.0	-1.0
products of chemical industry and related industries, plastics	9.8	4.4	7.0	0.7
minerals	8.7	1.7	-1.4	-0.1
light industry products	4.9	6.9	-4.7	-0.2
vehicles	4.5	-15.3	1.0	0.0
other goods	9.7	13.6	6.3	0.6

Export of goods to EU Member States in 2013 increased by 3.8%. A large part of the increase was constituted by the growth in the mechanical manufacturing, as well as mineral product export groups. However, in January-November 2014, the export to EU Member States increased by 3.3%. During this period, the most intensive growth was observed in the export of timber and timber product group.

In 2013, exports to the CIS countries increased by 5.3%. In January-November 2014, it decreased by 3.1%. A positive impact on exports was achieved by export groups of agricultural and food product, as well as chemical products. A more considerable decrease, however, was observed in transport vehicles and mechanical manufacturing product import.

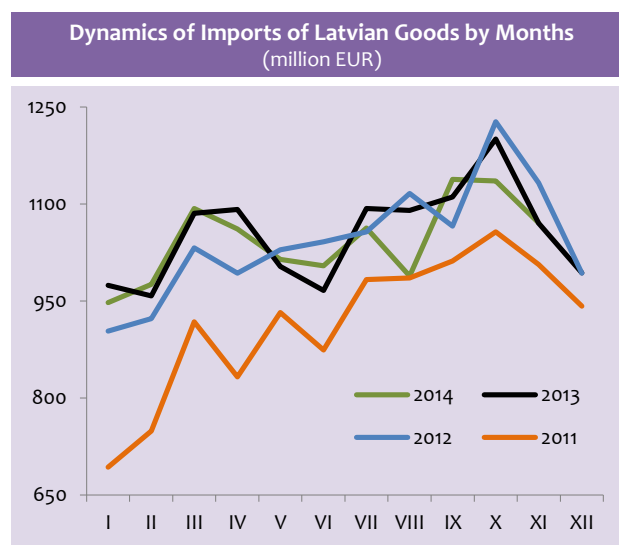
Figure 3.16



e – Evaluation by the Ministry of Economics

The increase in imports of goods in 2013 was mainly influenced by the increase in the volume of imports of chemical products, light industry products, as well as agricultural and food products. In January-November 2014, the increase in imports of mechanical manufacturing products, timber and timber products, as well as chemical industry product group had a positive impact on the growth of imports of goods. The import volume of mineral products, however, decreased considerably.

Figure 3.19



Import from the EU Member States in 2013 increased slightly faster than the total growth of imports (increase by 4.1%), whereas in January-November 2014, it decreased by 1.3 per cent.

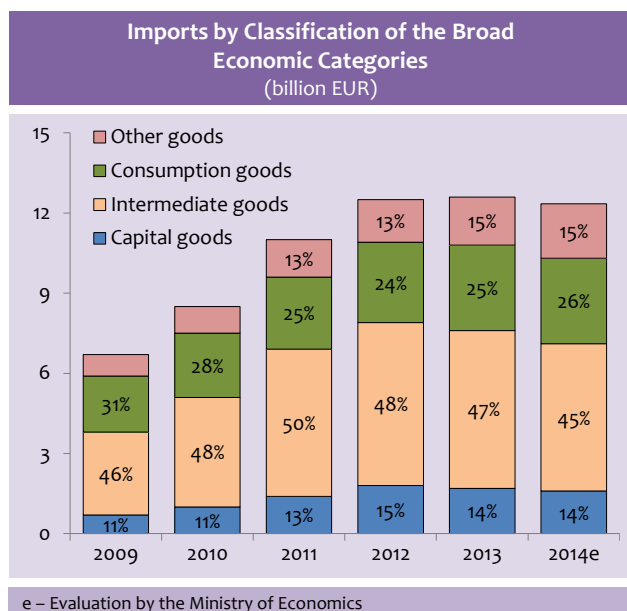
In 2013, along with the considerable decrease in the import volume of mineral product group, as well as metal and metal product group, the import from CIS countries decreased considerably (by 17.3%). A similar trend could be observed also in the eleven months of 2014, when the import volume of goods from CIS countries decreased by 3.9 per cent.

Table 3.7

Imports of Latvian Goods by the Main Commodity Groups (%, in current CIF prices)				
	2013		2014 I-XI	
	structure	changes compared to the previous year	changes compared to the respective period of the previous year	contribution to changes in volumes
<b>Total including:</b>	<b>100</b>	<b>1.0</b>	<b>-1.3</b>	<b>-1.3</b>
machinery products	18.4	1.9	4.5	0.8
agriculture and food products	15.9	3.8	-1.7	-0.3
products of chemical industry and related industries, plastics	14.9	7.5	3.6	0.5
mineral products	17.2	-1.8	-15.3	-2.7
metal and metal articles	8.7	-16.1	-3.9	-0.3
light industry products	6.1	12.1	-1.3	-0.1
vehicles	7.7	-10.2	-7.6	-0.6
wood and wood products	2.0	24.8	33.8	0.7
other goods	9.3	9.6	6.6	0.6

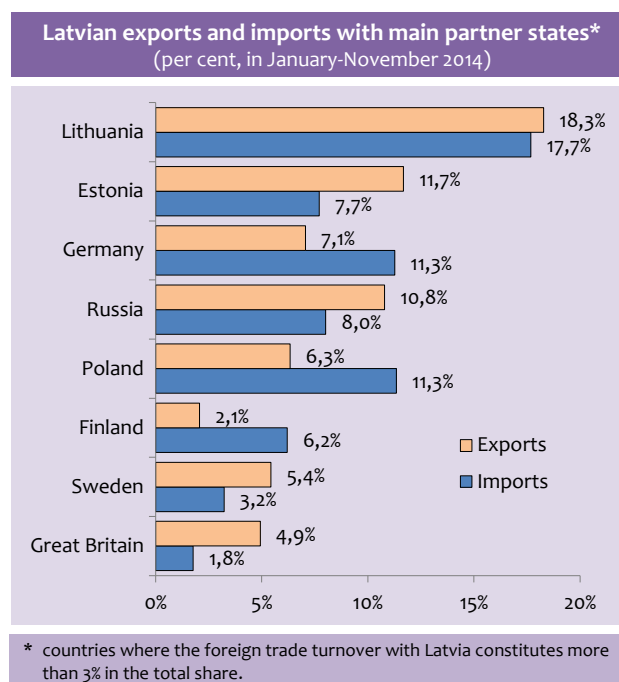
Up until 2009, the share of import of capital goods shrank along with the decreasing investments, whereas in 2009-2011, the share of import of consumer goods shrank. Over the recent years, the structure of import by application has undergone insignificant changes.

Figure 3.18



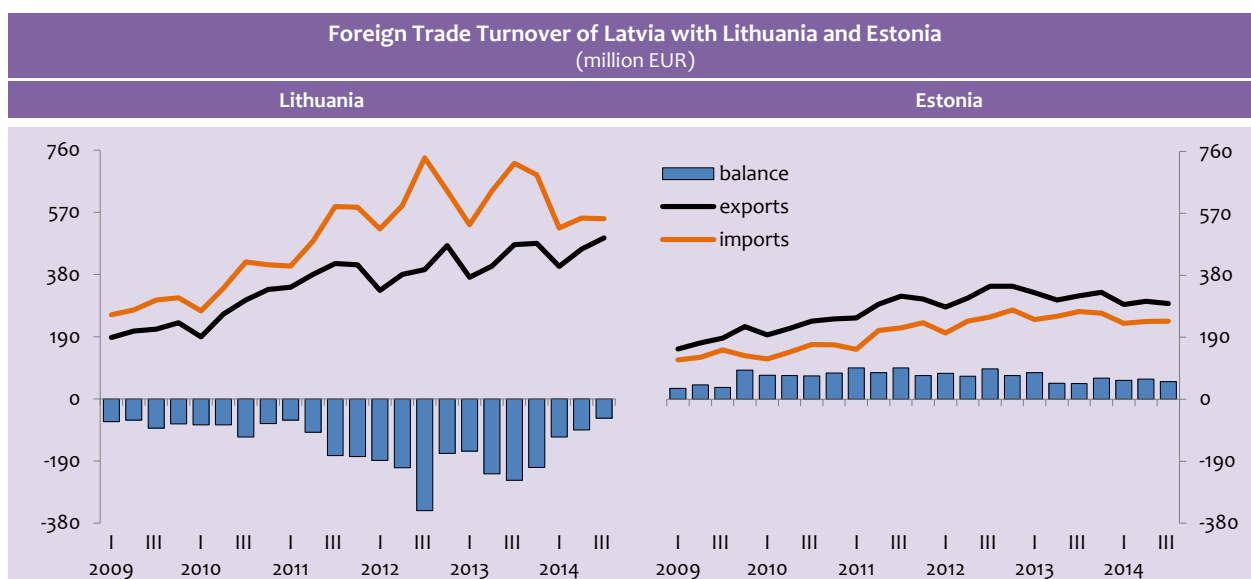
The biggest **trade partners** of Latvia in January-November 2014 have been Lithuania with the total foreign trade turnover of 18%, Estonia, Germany, Russia and Poland with 9% each, Finland and Sweden with 4% each, and Great Britain with 3 per cent.

Figure 3.19



Latvian neighbours **Lithuania and Estonia** traditionally have been the largest trade partners of Latvia. As imports considerably increased during the rapid growth period, a manifest deterioration of the Latvian trade balance with both countries was observed. In the second half of 2008, the balance with Lithuania and Estonia started improving gradually.

Figure 3.18





Recently, the foreign trade balance with Estonia has remained steadily above 10% of the total trade turnover, while the balance with Lithuania slightly deteriorated mainly due to the more intensive imports of mineral products and agricultural and food products in 2012-2013. In January-November 2014, the negative trade balance with Lithuania decreased sharply. This was mainly due to the sharp decrease in the import of mineral products.

In January-November 2014, the main groups of products exported to both Baltic States still are agricultural and food products, as well as machinery products, however, the largest share in imports from Lithuania and Estonia consists of agricultural, food products and mineral products.

#### **Exports and imports of services**

The decrease in exports of services during the crisis was considerably smaller than that of exports of goods. In 2011-2012, exports of services – similarly to exports of goods – grew steadily. The positive balance of services in 2012 covered approximately 64% of the negative trade balance of goods. However, taking into account the improvement in the trade balance of goods, the positive balance of services in 2013 covered 70% of the negative trade balance of goods. Furthermore, in the three quarters of 2014, a similar trend was preserved.

Traditionally, over a half of exports of services is constituted by income from transit (transportation). The year 2013 was not a successful year for transit services – volumes of this group decreased by 6%, furthermore, the shipping volumes in all kinds of transport decreased. A similar trend was observed also in the three quarters of 2014.

Income from foreign tourists increased steadily both in 2013 and in January-September 2014.

A half of the total service export of Latvia is related to the EU Member States. In 2013, the export volume to the EU Member States increased by 2.5%, while in the three quarters of 2014 – by 2.3%. The biggest proportion in the export to the EU Member States is related to land transport and travelling.

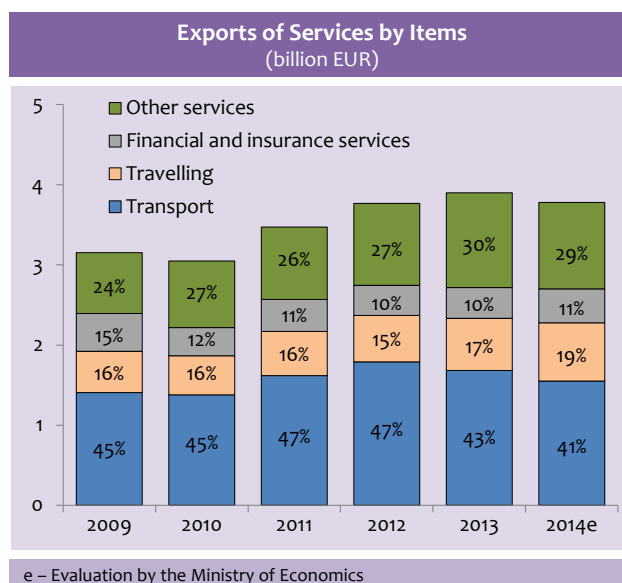
The export volume of services to the CIS countries accounts for over 10% of the total export of services. In 2013, the export volume of services to the CIS countries increased very rapidly (by 25%) mainly due to travelling and road transport. In January-September 2014, along with the decrease in export volume of transit, the total export of services slightly decreased. In turn, the decrease in the export of services was partially compensated by the increase in revenues from tourists from the CIS countries.

Table 3.8

Exports and Imports of Services (per cent)								
2013					2014 I-IX			
	structure		changes compared to the previous year		structure		changes compared to the respective period of the previous year	
	exports	imports	exports	imports	exports	imports	exports	imports
<b>Services – total, including:</b>	<b>100</b>	<b>100</b>	<b>3.5</b>	<b>-0.8</b>	<b>100</b>	<b>100</b>	<b>-1.6</b>	<b>-1.1</b>
<b>Transport services</b>	<b>43.1</b>	<b>30.7</b>	<b>-6.0</b>	<b>-2.2</b>	<b>42.1</b>	<b>32.7</b>	<b>-6.0</b>	<b>3.7</b>
– sea transport	11.0	7.0	-9.3	-0.2	10.6	7.4	-8.3	1.4
– air transport	6.8	10.4	-2.2	-1.9	6.5	11.2	-11.0	2.8
– rail transport	10.7	3.9	-10.5	-16.3	11.0	4.2	-0.4	9.8
– road transport	13.5	9.0	-0.4	3.7	12.5	9.5	-7.3	4.2
– other transport	1.2	0.5	-11.6	-9.4	1.4	0.5	9.1	3.6
<b>Travel</b>	<b>16.7</b>	<b>25.3</b>	<b>11.9</b>	<b>1.8</b>	<b>18.8</b>	<b>26.1</b>	<b>10.7</b>	<b>0.8</b>
<b>Other services</b>	<b>40.2</b>	<b>44.0</b>	<b>12.3</b>	<b>-1.3</b>	<b>39.2</b>	<b>41.1</b>	<b>-1.9</b>	<b>-5.8</b>
– construction services	3.1	3.1	23.9	-22.9	3.2	2.3	14.9	-13.6
– insurance and financial services	9.9	9.8	3.3	9.9	10.6	8.1	6.9	-17.3
– communication services	2.5	3.4	11.1	-20.8	2.4	3.2	-5.2	-8.8
– information and computer services	4.7	4.8	21.8	12.0	5.0	4.5	8.9	-3.7
– other commercial services	18.7	21.3	13.0	-1.3	16.7	21.5	-11.5	0.0
– other services	1.2	1.5	21.5	9.8	1.3	1.5	2.3	0.7

In 2013, a significant increase was observed in the export of services to Estonia and Lithuania (by 10% and 13% respectively). In the three quarters of 2014, the export of services to Lithuania increased considerably (by 26%) thanks to the rapid growth of construction services and travelling. The export of services to Estonia, however, remained at the level of the previous year. The most significant services exported to the both neighbouring states are related to tourism, transport, trade brokerage, as well as construction.

Figure 3.19



## 3.2 Contribution of Sectors

### 3.2.1 Structure of the National Economy and Development Tendencies of Sectors

Following a considerable decrease in volumes during the crisis, and thanks to improved competitiveness and export opportunities, tradable sectors were the first sectors to recover. In 2013, production volumes in the key export industry – manufacturing – exceeded the level of 2009 by 24%. The growth of tradable sectors and an increase in revenues from exports fostered growth of domestic market-oriented industries.

An increasingly higher contribution to growth is ensured by domestic market-oriented industries –

commercial services, trade and construction during the past years.

The share of manufacturing and commercial services has increased, while the share of construction sector and public services in the total value added has decreased, compared to 2008.

The improvement of the situation on the labour market, namely the increase in the level of employment and in wages promote the increase in private consumption, which, in turn, positively affects the growth of services sectors that are mainly oriented to the internal market. The retail trade turnover is rising and the commercial services sector is growing steadily. Meanwhile, narrowing export possibilities in 2013 affected the growth of tradable sectors.

Table 3.9

Structure of the National Economy (by value added, per cent)								
	2000	2005	2008	2010	2011	2012	2013	2014e
Agriculture, forestry, and fishery	5.2	4.3	3.3	4.5	3.9	3.7	3.6	3.4
Manufacturing	15.7	13.2	10.9	13.5	13.1	12.9	12.6	12.2
Other industries	4.3	3.2	3.7	5.5	5.0	4.7	4.4	4.1
Construction	6.4	6.4	9.6	4.7	5.4	6.1	6.4	6.6
Trade, accommodation, and catering	15.2	17.8	15.4	16.9	16.3	15.7	15.8	15.7
Transport and storage	11.8	12.3	9.2	10.2	10.2	10.3	9.7	9.5
Other commercial services	24.0	27.5	30.9	28.6	30.4	31.3	32.7	33.4
Public services	17.4	15.2	17.0	16.2	15.6	15.2	14.8	15.0
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

e – Evaluation of the Ministry of Economics

In 2013, production volumes of **agriculture and forestry** slightly decreased. This was due to several factors. Despite the fact that the production volume of meat and dairy products in 2013 was respectively by 5.5% and 2.5% higher than in 2012, a decrease in the volume was observed in other subsections. In 2013, the yield of the main agricultural crops was lower than in the

previous year. Production volumes in the forestry sector also decreased, which was evidenced by the decrease of 0.6% in the volume of wood cut in forests in 2013. The forestry sector was affected also by the low demand in foreign markets, which was evidenced by the decrease in export of unprocessed wood.

Table 3.10

Dynamics of GDP (per cent)										
Changes						Investment in volume changes				
	2009	2010	2011	2012	2013	2009	2010	2011	2012	2013
Agriculture, forestry, and fishery	12.7	-3.9	-1.8	7.5	-0.4	0.5	-0.1	-0.1	0.4	0.0
Manufacturing	-22.4	14.0	4.0	4.6	0.0	-2.9	1.0	0.4	0.7	0.0
Other industries	6.8	-1.7	-5.2	-5.5	-3.3	0.3	-0.1	-0.2	-0.3	-0.2
Construction	-38.0	-35.4	27.1	14.5	7.5	-4.4	-1.7	1.0	1.0	0.5
Trade, accommodation	-16.5	-1.9	4.1	1.7	4.8	-3.0	-0.2	0.5	0.3	0.9
Transport and storage	-23.3	-5.5	18.5	6.9	1.6	-2.5	-0.4	1.5	0.9	0.2
Other commercial services	-6.8	-4.1	6.2	5.2	6.0	-2.5	-0.8	1.4	2.0	2.2
Public services	-9.9	-6.9	3.1	0.1	3.8	-2.0	-0.8	0.4	0.0	0.7
<b>GDP</b>	<b>-14.2</b>	<b>-2.9</b>	<b>5.0</b>	<b>4.8</b>	<b>4.2</b>	<b>-14.2</b>	<b>-2.9</b>	<b>5.0</b>	<b>4.8</b>	<b>4.2</b>

The beginning of 2014 was successful for the agriculture and forestry sectors: in the 1<sup>st</sup> half of the year, production volumes were almost by 6% higher than a year ago, whereas in the 2<sup>nd</sup> half of 2014, the agriculture sector was considerably affected by the food production import embargo established by Russia. In the 3<sup>rd</sup> quarter of 2014, production volumes in the agriculture and forestry sectors were by 5.9% lower than a year ago.

Weak demand in foreign markets affected the performance of **manufacturing**, and in 2013 production

volumes remained at the level of 2012. The termination of operations of AS "Liepājas metalurģs", which resulted in considerable a drop in metal production volumes, also had a significant impact on the industry in 2013.

The situation in the external environment considerably affected the industry also in 2014 – production volumes of the manufacturing industry in the three quarters were only by 0.2% higher than a year ago. It must be noted that development trends in subsections of manufacturing differ considerably.

Table 3.11

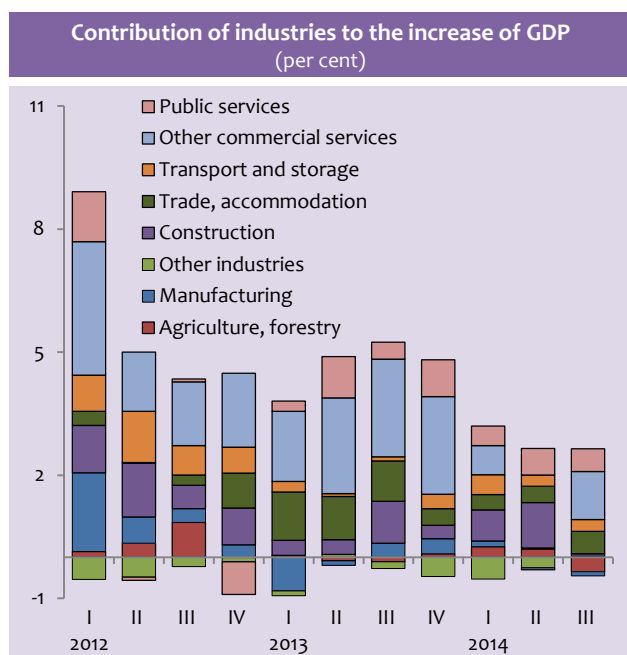
GDP by quarters (changes compared to the corresponding period of the previous year, %)											
2012				2013				2014			
I	II	III	IV	I	II	III	IV	I	II	III	IV
Agriculture, forestry, and fishery	3.4	6.6	15.9	-0.2	1.2	-1.7	-2.0	2.8	8.8	4.0	-5.9
Manufacturing	11.9	4.0	2.4	1.5	-4.8	-0.6	2.5	2.6	1.2	0.1	-0.6
Other industries	-6.5	-9.3	-5.4	-1.3	-1.4	1.4	-4.1	-8.3	-9.2	-5.4	0.5
Construction	37.9	25.8	7.3	8.3	9.8	5.3	11.6	3.9	24.6	15.8	0.6
Trade, accommodation	1.7	0.1	1.3	3.4	6.2	5.8	5.2	2.2	2.6	2.2	2.4
Transport and storage	6.7	10.5	6.8	4.0	2.0	0.5	0.8	3.3	5.1	2.2	2.3
Other commercial services	8.0	4.1	5.2	3.7	4.1	6.1	7.2	6.5	2.2	-0.1	2.9
Public services	6.0	-0.4	0.5	-3.2	1.3	5.0	2.7	5.1	3.3	3.4	3.2
<b>GDP</b>	<b>8.8</b>	<b>4.3</b>	<b>3.7</b>	<b>3.4</b>	<b>3.1</b>	<b>4.6</b>	<b>4.6</b>	<b>4.4</b>	<b>2.8</b>	<b>2.3</b>	<b>2.4</b>

In 2013, production volumes **in other industries** (electricity, gas supply and heat supply) were by 3.3% lower than in 2012. The volumes of the sector were

dropping also in the three quarters of 2014 – they were by 5.3% lower than in the corresponding period of the previous year. It was greatly related to weather

conditions, since lower volumes of electricity and heat energy were produced.

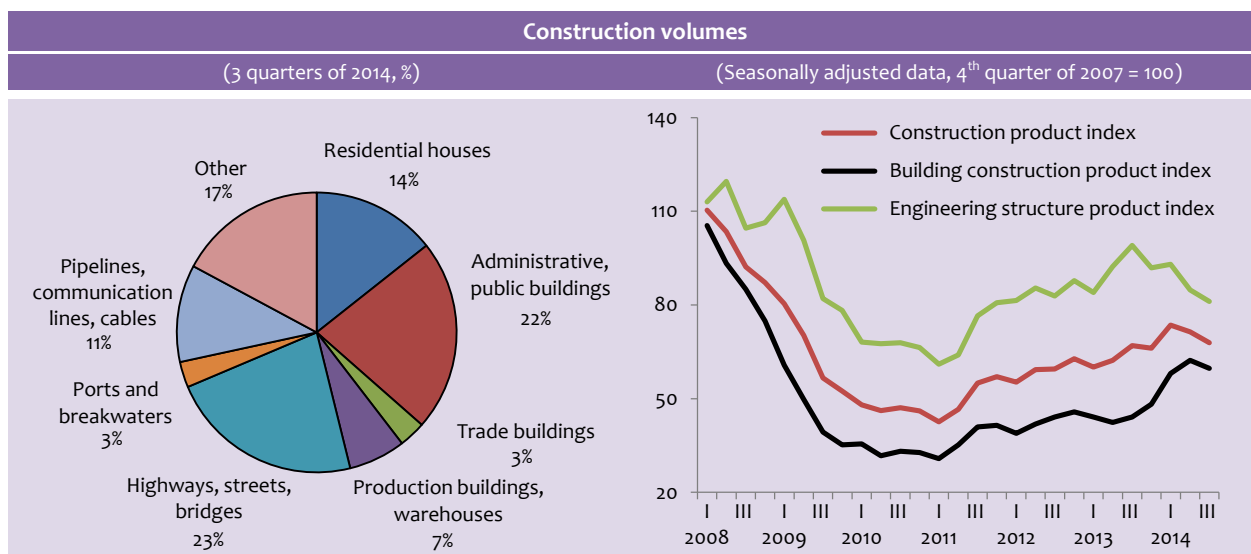
Figure 3.22



**The construction sector** experienced a rapid growth after the sharp decrease during the crisis. In 2013, construction volumes increased by 7.5%. Recovery of the construction sector is mainly fostered by public procurements and EU funds. In 2013, construction volumes of engineering structures have contributed the most to the growth of construction (by 10.5%). At the same time, construction volumes of buildings have grown at a rather moderate pace – by 3.1% in 2013.

In the three quarters of 2014, construction volumes were by 9.8% higher than a year ago, which was due to the rapid increase in the construction volumes in the first half of the year. Meanwhile the construction of engineering structures decreased by 11.7%, compared to the three quarters of the previous year. It was due to the decrease in construction of local pipelines and cables, as well as ports. Although, the construction volumes increased rapidly over the past few years, they, however, are considerably behind the highest level of the pre-crisis period.

Figure 3.23

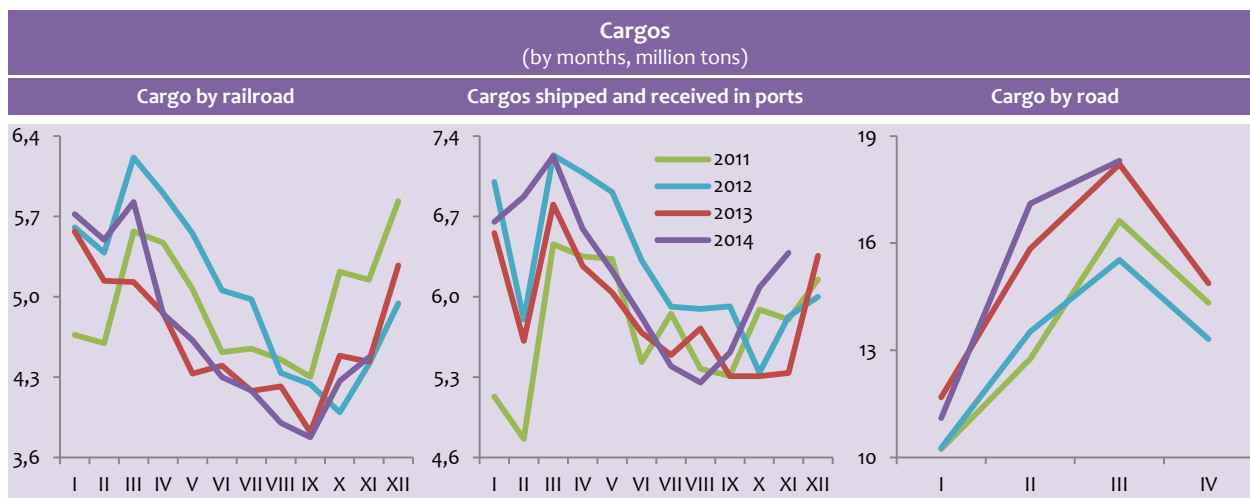


In 2013, the volumes of services provided in **the transport and storage** sector were by 1.6% higher than in 2012. Unlike the trends of 2012, the growth in 2013 was to a great extent fostered by the increase in the freight turnover of motor vehicles (by 15.2%). Yet, the volumes of freight by railroad and in ports in 2013 dropped by 7.9% and 6.3%, respectively.

The growth in the transport and storage sector continued also in 2014 – the volume of services provided

in the three quarters was by 3.2% higher than a year ago. The increase in the transport and storage industry is mainly fostered by the successful operation of ports. The volume of cargos dispatched and received in ports in the eleven months of 2014 was by 6.1% higher than a year ago. During the same period, the volume of cargos by railroad increased by 1.7%. The volume of cargos by road also increased in 2014.

Figure 3.24



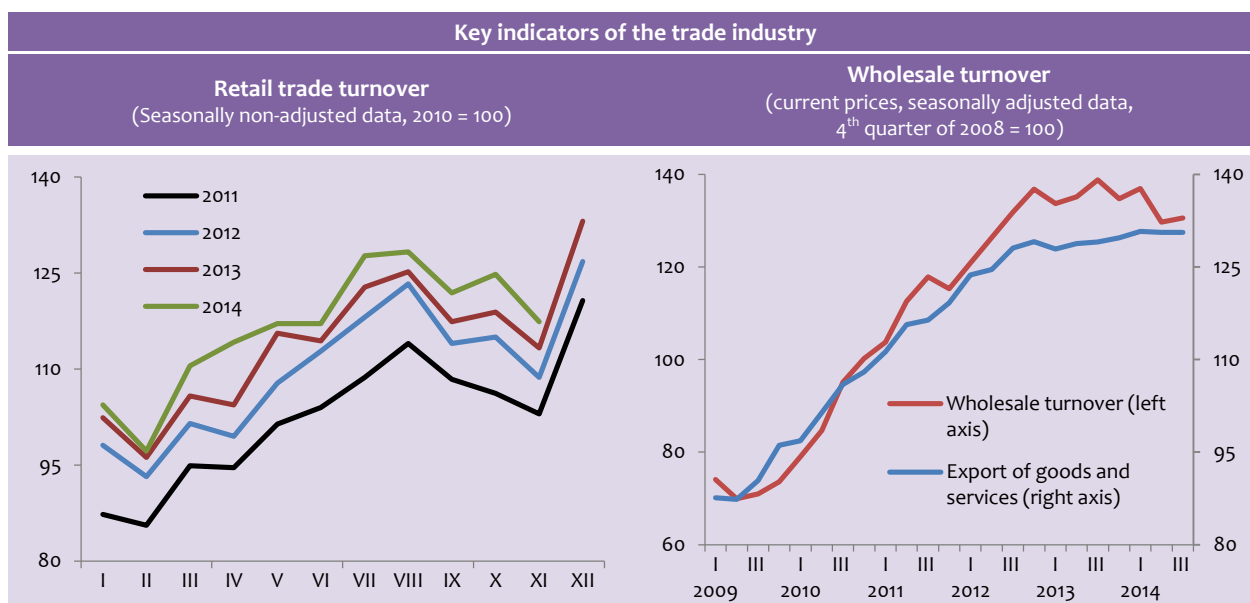
In 2013, the volumes of services (including accommodation and catering services) provided in the **trade sector** increased by 4.8%. The growth of the sector ensured approximately 1/5 of the overall growth of national economy in 2013. The growth of the trade sector continued also in 2014 – the volumes of services provided in the trade sector in the three quarters were by 2.4% higher than a year ago.

The growth of the trade sector is fostered by the increase in turnover of retail trade. In 2013, turnover of retail trade increased at a slower pace than in 2012 (increase by 3.8%). Non-food retail trade turnover contributed the most to the growth in retail trade in 2013 (increase by 5.4%). Yet, retail trade turnover of food

products in 2013 have increased by 4.4%, while fuel retail trade decreased by 1.3 per cent.

Retail trade turnover increased also in 2014. However, in the first months of the year, the increase in retail volumes was very moderate, since consumers were cautious due to the introduction of the euro. Overall, in the eleven months, retail sales volumes were by 3.6% higher than a year ago. Non-food retail turnover at this point was by 2.7% higher than a year ago. The largest contribution was made by the increase in retail sale volumes of clothing, footwear and household electric appliances, as well as the increase in retail sale volumes of goods ordered by post and in online shops.

Figure 3.25



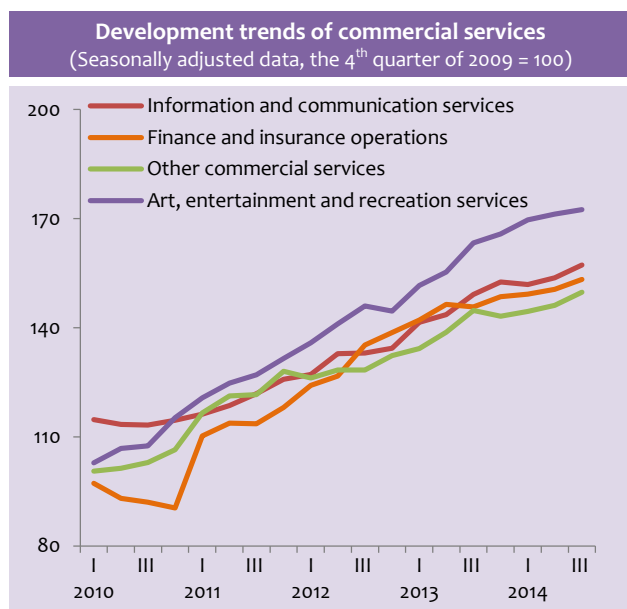
Retail trade of food products constitutes over one third of the total retail trade turnover. In the eleven months of 2014, retail trade turnover of food products was by 3.9% higher than a year ago.

Retail trade turnover of motor fuel increased in 2014, after the decrease in 2013. In the eleven months of 2014, it was by 5.3% higher than a year ago. The increase in retail trade turnover of motor fuel was boosted by the decrease in fuel prices resulting from the drop in global oil prices in the second half of 2014.

Growth trends of the wholesale trade sector to a great extent depend on foreign trade activities. In 2013, along with the slowdown of the export and import growth rate, the increase in the turnover of wholesale companies was moderate – it increased by 5% (in current prices). In the three quarters of 2014, the wholesale turnover was by 2.7% lower than in the respective quarter of the previous year.

Stable growth over the recent years can be observed in the field of **commercial services**. The amount of services provided in this sector increased by 5% in 2012, whereas in 2013, by 6%. In 2013, growth in the field of commercial services ensured over a half of the growth of the overall national economy. The year 2013 was successful for the information and communications sector where the volume of provided services increased by 7.5%. A rapid growth was observed in the field of art, entertainment and recreation services in 2013 (an increase by 13.1%). In the field of operations with real property, service volumes in 2013 increased by 5.7 per cent.

Figure 3.26



In 2014, stable growth was maintained in the sector of commercial services, although the growth rate was slower than in 2013. In the three quarters of 2014, commercial service volumes were by 1.6% higher than a year ago. The most rapid growth in 2014 was observed in financial and insurance operations, as well as in the field

of arts, entertainment and recreation. A moderate growth was maintained in the field of information and communication services.

The growth of **public services** sectors is closely linked to the capacity of the government budget.

With an increase in government expenditure, a stable growth of 3.8% was observed in the public service sectors in 2013. Furthermore, in 2014, an increase in the volume of public services can be observed – in the three quarters it was by 3.3% higher than a year ago.

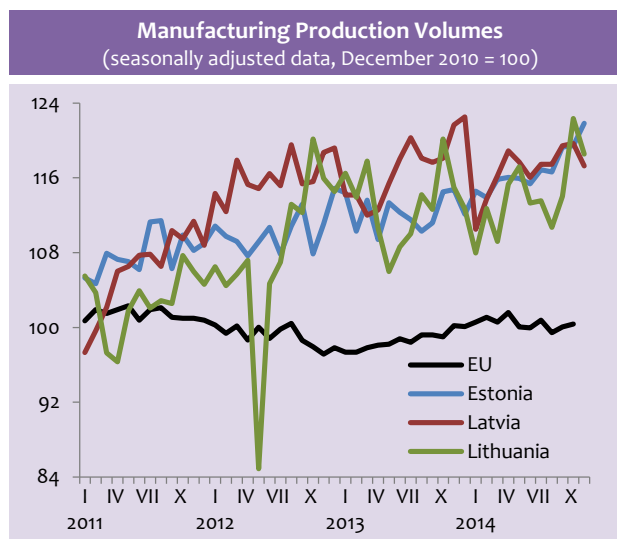
### 3.2.2 Manufacturing

Along with cutting the costs during the crisis, competitiveness of Latvian producers improved. It boosted the growth of manufacturing. From 2010 until the end of 2012, production volumes of manufacturing increased rapidly.

The weak demand on export markets, mainly the EU and CIS countries, slowed down the growth of manufacturing in 2013. In 2013, production volumes in manufacturing were by 0.1% higher than a year ago.

Apart from the weak demand in foreign markets, the output of manufacturing was significantly affected also by the termination of AS “Liepājas metalurģs” operations. The volumes of manufactured products shrank by a half in the sector. At the same time, a slight growth was observed in the manufacture of fabricated metal products in 2013. Overall, production volumes of metal processing in 2013 were by 17.6% lower than a year ago.

Figure 3.27



The year 2013 has not been as successful for the chemical industry as the year 2012. Although the situation in the sector has been improving and production volumes have been growing over the past few months of the year, the total volumes in 2013 were by 8.7% lower than a year ago. Manufacture of chemical substances and chemical products and the pharmacy



sector have been significantly influenced by the weak demand on the CIS markets where nearly 30% of all products manufactured are sold.

Table 3.12

Structure of manufacturing in 2014* (per cent)			
	By output	By number of filled jobs	Share of exports in the sale of the sector
<b>Manufacturing – total</b>	<b>100</b>	<b>100</b>	<b>61.9</b>
Food industry	25.3	21.8	35.8
Light industry	4.2	10.7	86.3
Wood processing	25.9	20.3	72.9
Paper industry and publishing	4.4	4.0	60.3
Chemical industry and related industries	7.6	6.6	76.5
Production of other non-metallic minerals	6.7	4.5	46.6
Production of metals and metal articles	9.1	10.0	59.9
Production of electrical and optical equipment	5.9	3.9	90.6
Production of machinery and equipment	2.1	3.0	81.7
Production of vehicles	3.5	3.2	86.7
Other manufacturing industries	5.3	12.1	57.3
* Estimated by the Ministry of Economics			

Other significant manufacturing industries continued to grow also in 2013. The major manufacturing industries of Latvia – food production and wood processing, which form almost a half of all production volumes of manufacturing in Latvia, produced by 6% and by 2.7% more production than in 2012.

A very rapid growth of production volumes in 2013 was observed in the production of electric and optical equipment, exceeding production volumes of 2012 by 18%. In 2013, stable export potential remained in this sector, as well as an increased demand in the domestic market was observed. Production volumes in 2013 increased in the production of non-metal minerals, paper production and publishing industry, as well as in the production of vehicles. Slower growth was observed in the light industry, as well as in the production of machinery and equipment.

In the eleven months of 2014, production volumes in manufacturing were by 0.3% lower than a year ago. The growth of the industry is affected by tendencies in foreign markets – a slower than expected economic growth in the EU, as well as the weak situation in Russia. Development tendencies in the sub-sectors of manufacturing are very diverse.

Stable growth continues in 2014 in one of the major manufacturing industries, i.e. wood processing. Production output of the industry in the eleven months was by 7.3% higher than a year ago. A stable increase in the export volumes and demand in the domestic market was observed.

The fastest growth of production volumes in the eleven months of 2014 was observed in the production of electric and optical equipment. A moderate growth in 2014 was observed in the production of non-metallic minerals, as well as in the production of machinery and equipment.

Production volumes in the largest manufacturing industry – food and beverage production – in the eleven months of 2014 were by 0.3% higher than a year ago. After a successful beginning of the year, the food production industry was affected by the food production embargo imposed by Russia in the last months of the year. A decrease in production volumes was observed in the eleven months of 2014 in the light industry, as well as in metal processing, which was due to the downtime of AS “Liepājas metalurģis”.

In the eleven months of 2014, compared to January–November of 2013, production volumes decreased also in the chemical industry and production of vehicles.



Table 3.13

Changes of Production Volumes in Manufacturing (% compared to the corresponding period of the previous year)						
	2009	2010	2011	2012	2013	2014 I-XI
<b>Manufacturing – total</b>	<b>-20.2</b>	<b>16.5</b>	<b>11.7</b>	<b>9.3</b>	<b>0.1</b>	<b>-0.3</b>
Food industry	-16.1	-0.1	-0.2	2.5	6.0	0.3
Light industry	-38.6	19.4	19.4	3.0	1.4	-12.9
Wood processing	1.6	33.0	12.6	5.4	2.7	7.3
Paper industry and publishing	-17.1	19.8	-0.5	10.1	5.6	-0.7
Chemical industry and related industries	-18.5	5.2	4.4	8.3	-8.7	-1.3
Production of other non-metallic minerals	-40.1	17.6	24.2	8.6	4.6	0.7
Production of metals and metal articles	-27.1	24.2	28.3	16.3	-17.6	-11.3
Production of electrical and optical equipment	-34.8	33.2	29.6	19.9	18.4	30.5
Production of machinery and equipment	-35.5	17.8	37.1	8.7	1.4	0.4
Production of vehicles	-49.7	59.0	37.0	15.8	3.0	-14.7
Other manufacturing industries	-20.1	-4.9	9.5	26.1	-7.6	-11.5

In 2013, production volumes in manufacturing, as well as production output remained at the level of 2012. Changes in turnover had an impact also on producer prices, which grew at a considerably slower pace in 2013, compared to the previous years. At the end of 2013, producer prices were only by 1.4% higher than a year ago, and producer prices for exported production increased by 1.5%, while those of the production sold in the local market – by 1.3 per cent.

In 2013, sale of production in export markets decreased by 2.7%. At the same time, the turnover of manufacturing production in the domestic market increased by 4.9%. The largest positive contribution to the growth of total turnover of manufacturing in 2013 was made by the food industry and wood processing. The most considerable decrease in turnover, however, was observed in the chemical industry and metal processing.

In the eleven months of 2014, the turnover of manufacturing was by 1.2% lower than a year ago. The turnover of production sold in the domestic market decreased by 1.3%, while for the exported production, by 1.1%. Overall, the turnover of manufacturing was positively influenced by the rapid increase in the turnover in the wood processing sector (by 10.2%). A slight increase in the turnover in eleven months was observed in food and beverage production, chemical industry and non-metallic mineral production.

In other industries, the turnover in the eleven months of 2014 was lower than a year ago. Total turnover in manufacturing was significantly affected by the drop in metal processing (by 2.1 percentage points).

In the eleven months of 2014, 61.9% of all production of the manufacturing industry was exported. Almost 1/3 was exported to the EU-15 markets.

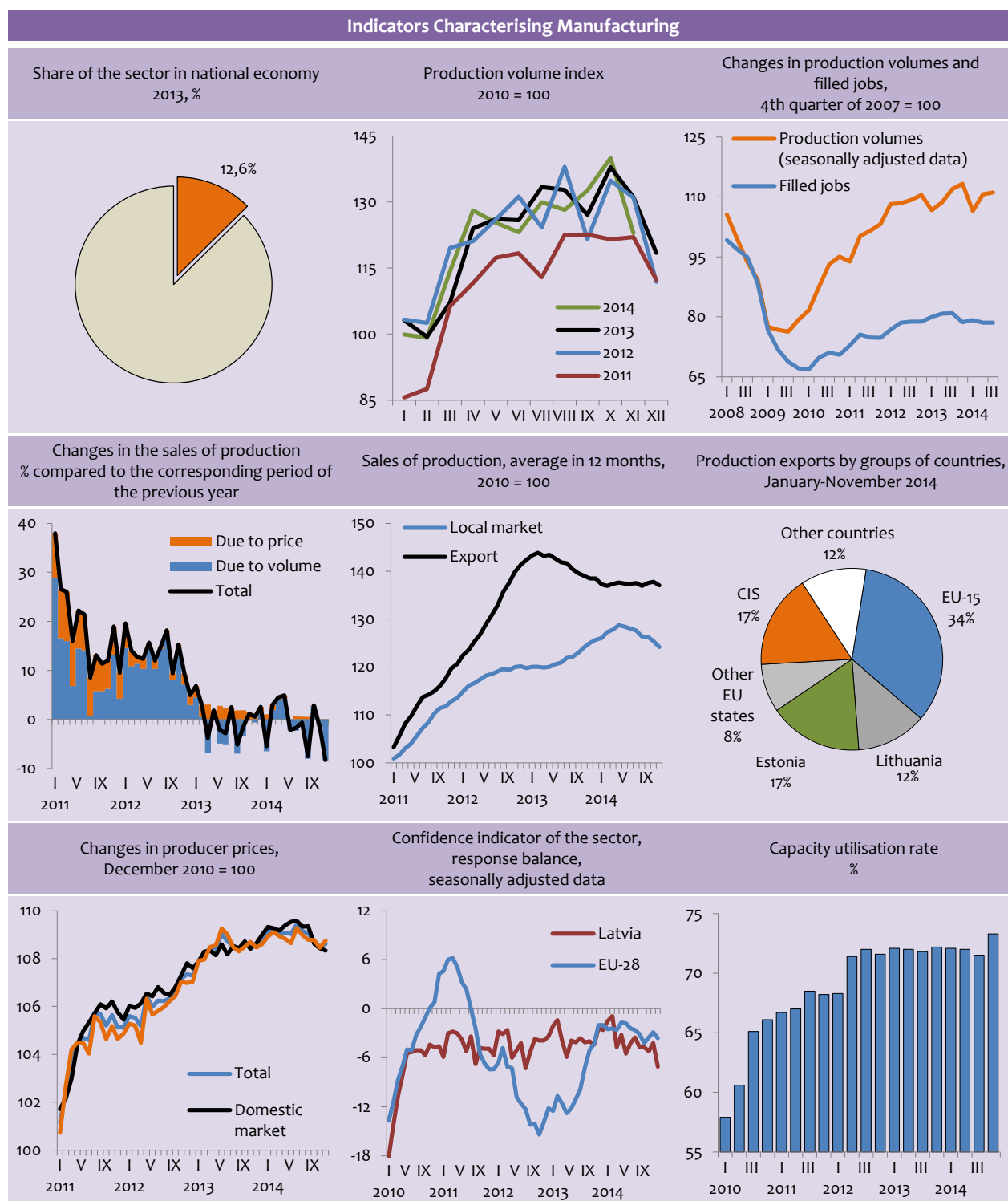
Whereas 30% of the exported products were sold in the neighbouring countries Lithuania and Estonia. Exports to the CIS countries constituted 17 per cent.

The growth of manufacturing in the past few years has fostered labour demand. Manufacturing has also contributed the most to the creation of new jobs in the national economy during the post-crisis period – in 2011 and 2012, the sector has ensured almost one fifth of all new jobs. Furthermore, the number of the employed in manufacturing has been growing considerably slower than the output, which proves that productivity is increasing.

Although the growth of manufacturing was moderate in 2013, the number of jobs kept growing. In 2013, the number of filled positions was by 2.4% or 2.7 thousand more than a year ago. In 2014, employment in manufacturing decreased – the number of jobs filled in the three quarters was by 2.3% lower than a year ago. This was mainly due to the decrease in jobs resulting from the terminated operations of AS “Liepājas Metalurģs”. The decrease in the number of jobs in 2014 was observed also in such sectors as the light industry and production of food and beverages. Meanwhile, an increase in the number of jobs in 2014 was observed in wood processing, the chemical industry, as well as in the production of non-metallic minerals.

Since the mid-2012, the level of production capacity in manufacturing remained at 71–72%. In late 2014, the level of production capacity increased to 73.3%. While the evaluation of confidence of Latvian producers after a period of certain stability over the past few years has deteriorated since March 2014. This is mainly due to the situation in Ukraine and the aggravated economic situation in Russia.

Figure 3.28



**The food and beverage industry** accounts for over ¼ of all output and almost 22% of all jobs in the manufacturing. The sector is mainly focused on the domestic market. At the same time, the share of export in the output of industry has increased over the recent years – in 2014, it reached 36% of the total production. The largest export markets are Lithuania, Estonia and Russia.

The production volumes in the food and beverage industry have been growing at a slower pace than the average in manufacturing during the post-crisis period. In 2010 and 2011, the production output remained at the level of 2009. In 2012 and 2013, the production volumes in the sector increased along with the increase in domestic demand and acquisition of new export markets. In 2013, production volumes were by 6% higher than in 2012. Although the domestic demand continued growing in 2014, the sector was considerably affected by the

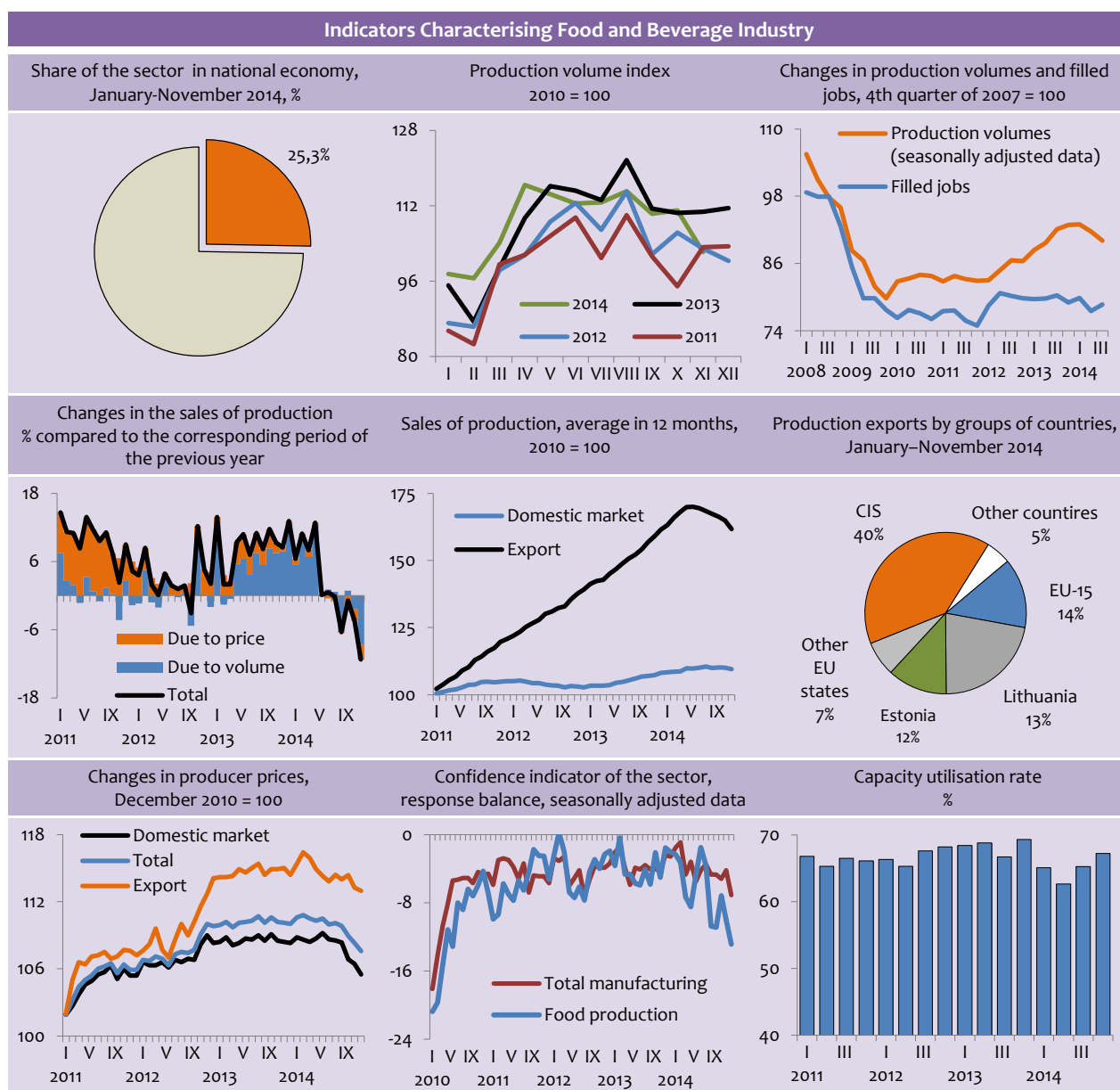
situation in export markets.

In January–November 2014, production volumes of the food and beverage industry were by 0.3% higher than a year ago. At this time, production volumes in the beverage production sector decreased by 13%, whereas in food production, increased by 2.3%. The growth in food production was achieved at the beginning of the year, however, the sector was affected by the embargo of food import imposed by Russia in August.

In the eleven months of 2014, net turnover of the industry was only by 1% higher than a year ago. Export production volumes during this period increased by 0.1%, and by 1.4% exceeded production volumes for the products sold in the local market.

In 2013, the number of jobs remained at the level of 2012. While in three quarters of 2014, the number of filled jobs was by 1.5% lower than a year ago.

Figure 3.29



The **light industry** sector is mainly focused to foreign markets. 86% of the production is exported, mainly to the EU, and therefore the growth of the sector is closely linked to changes in demand and competitiveness in foreign markets.

Although a comparatively rapid increase was observed in the sector in 2010 and 2011, production volumes still were behind the pre-crisis level of 2007.

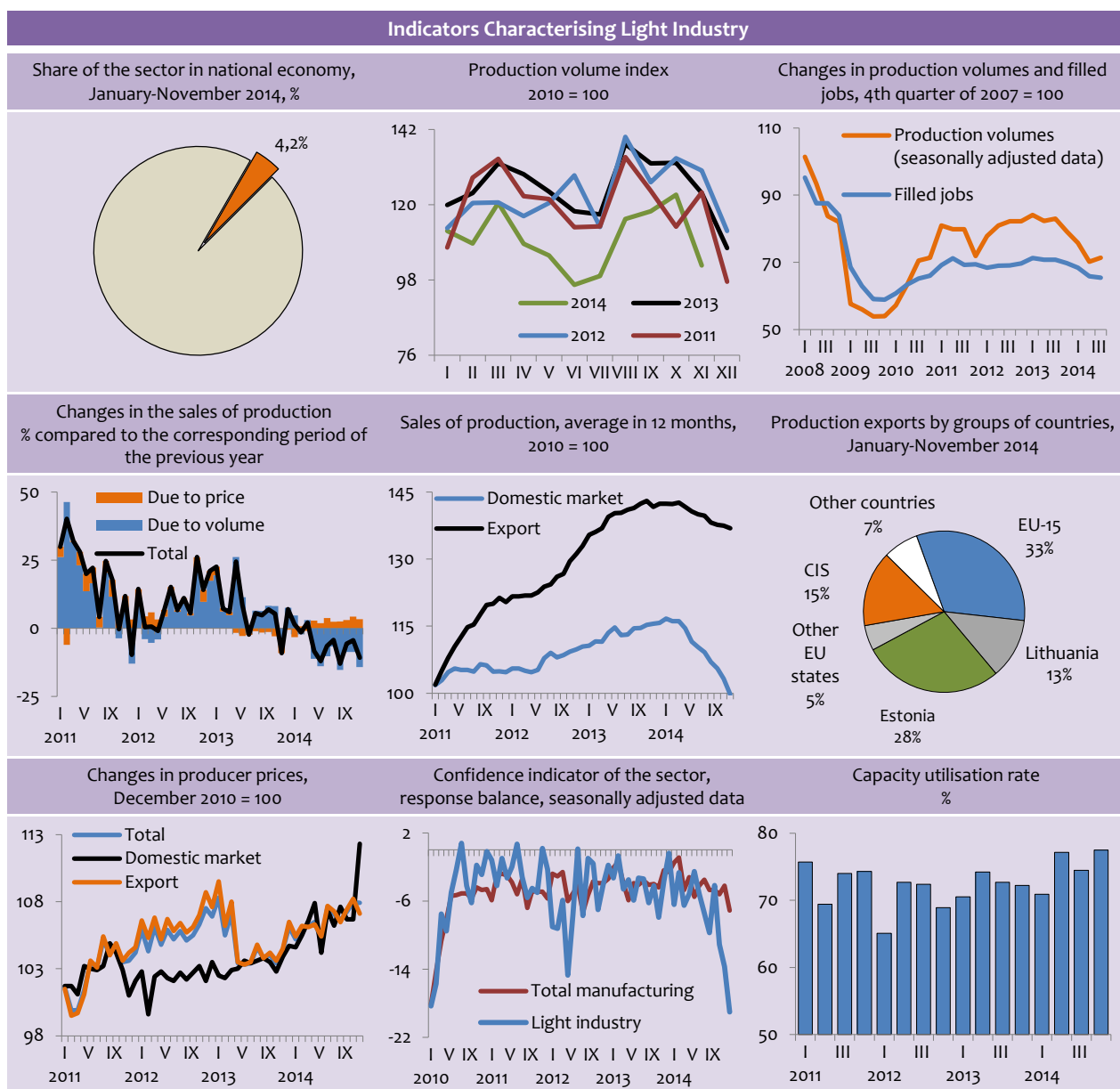
The deteriorating economic situation in the biggest sales market in the EU over the past few years has affected growth of the industry. In 2013, production volumes in the light industry increased only by 1.4%. In January–November 2014, production volumes were by 12.9% lower than a year ago. Production volumes decreased in manufacturing of clothing and fabric alike.

In 2013, the turnover of the light industry increased by 6.8%. Dynamics of the turnover of the sector was

affected by the increase in producer prices. Revenues from export sales were still growing faster – by 7.1%, whereas income from the products sold in the domestic market by 4.9%. In January–November of 2014, the turnover of the light industry sector was by 5.8% lower than a year ago. The turnover of export production decreased by 4.1%, and by 14.8% – for products sold in the domestic market.

The growth of the sector has been mainly related to the increase in productivity in the post-crisis period, while the number of jobs has been growing at a moderate pace. In 2013, the number of filled jobs in the sector increased by 2.3%. Along with the considerable decrease in production volumes, the number of filled jobs in the sector in the three quarters of 2014 decreased by 6.2%, compared to the respective period of the previous year.

Figure 3.30



**Wood processing** is one of the largest manufacturing sectors, and it accounts for 26% of the total output and provides over 20% of all jobs in manufacturing in 2014. Three quarters of the total production in the sector are exported, and the EU-15 countries are the largest export market.

Wood processing was one of the first sectors to resume growth after the significant drop in manufacturing. In 2012, production volumes of the wood processing sector exceeded the level of 2007 by more than 40%.

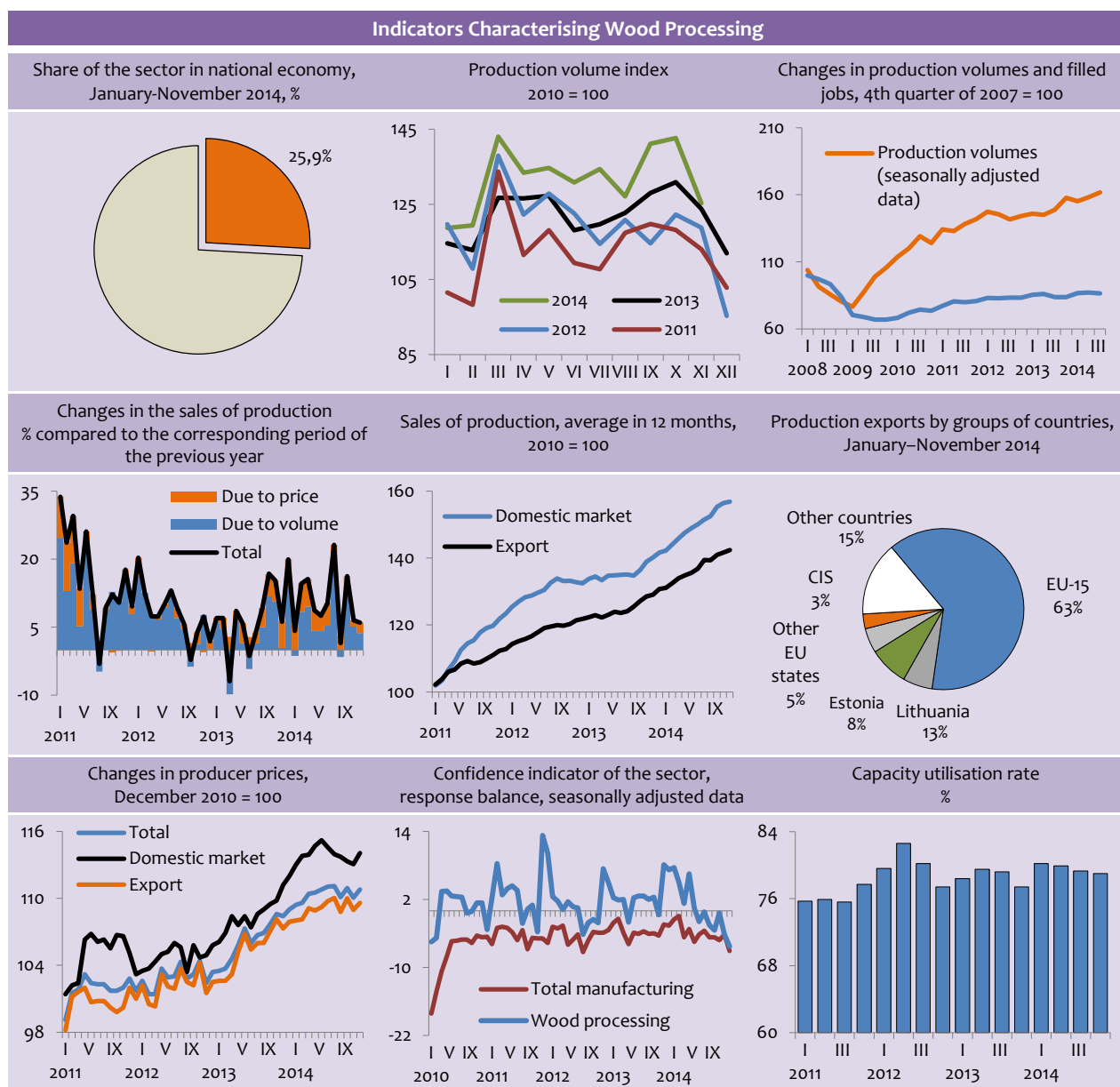
In late 2012 and in the first half of 2013, there was a weak demand in the largest trade partner countries. It was observed also in the wood processing output indicators – in the 1<sup>st</sup> half of 2013, the production volumes were behind the level of the 1<sup>st</sup> half of 2012, the situation in the sector tended to improve gradually in 2013, and thus

the production volumes increased by 2.7%. In 2014, growth of the sector continued – in January-November, production volumes were by 7.3% higher than a year ago.

The significant increase in the turnover of the sector over the past few years was based on the increase both in output and producer prices. In 2013, the turnover increased by 7.2%. Sales volumes in the domestic market and exports increased at a similar pace. In the eleven months of 2014, the turnover was by 10.2% higher than a year ago. Apart from the stable increase in exports, the growth of the turnover was fostered also by the increase in revenues from products sold in the domestic market.

Compared to the increase in production volumes, the number of jobs in the industry grew at a slower pace – in 2013, it increased only by 2%. The number of jobs increased by 2 % also in the three quarters of 2014.

Figure 3.31



Before the crisis, *the paper production and publishing industry* was mainly focused on the domestic market. During the crisis, the improved competitiveness and the weak domestic demand called for re-focusing of the industry to foreign markets. Over the past few years, export opportunities were considered as the grounds for growth of the industry. In 2013, nearly 60% of the production manufactured was exported.

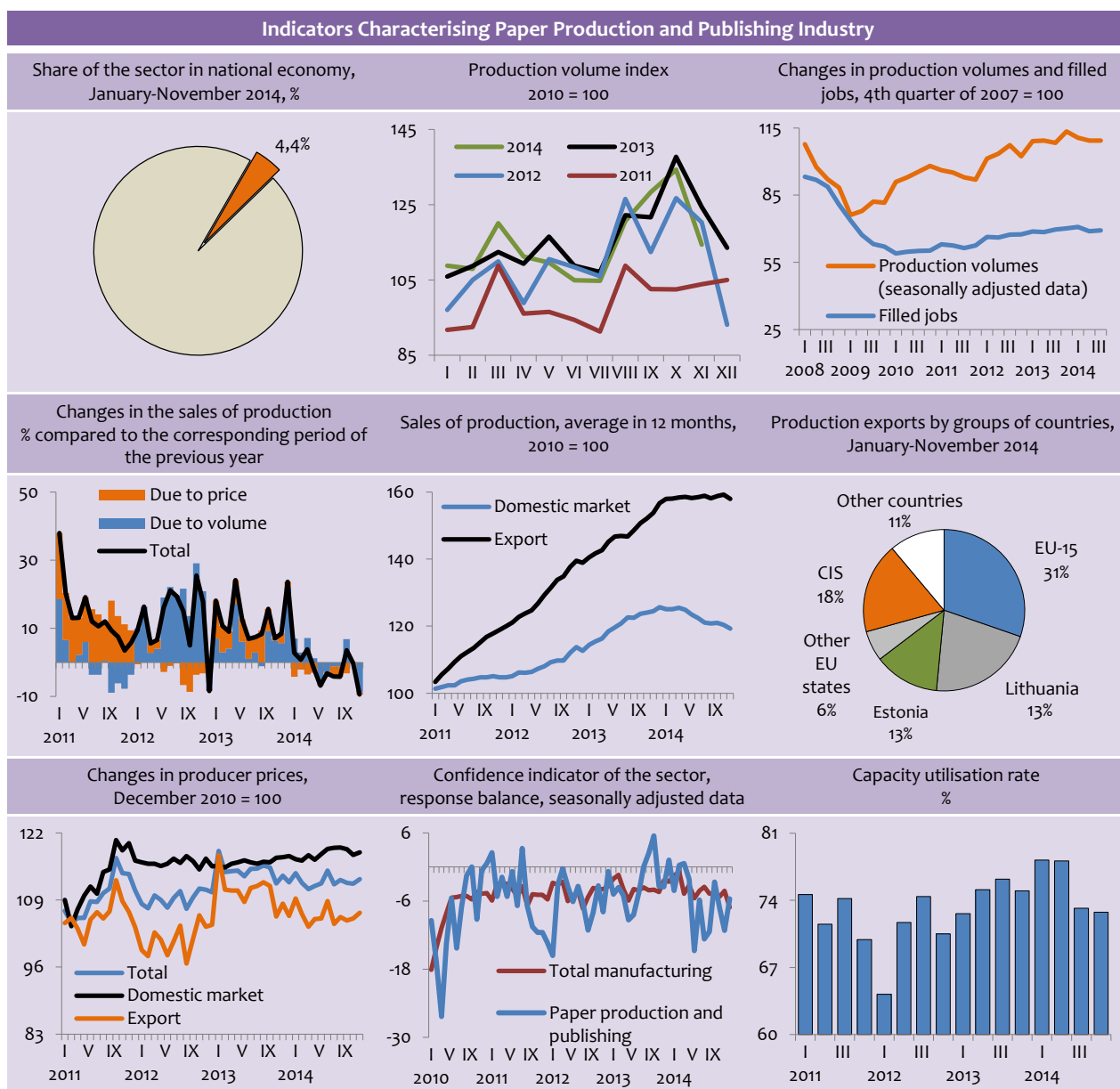
The production volumes in the industry in 2012 reached the pre-crisis level, and in 2013, the industry kept growing at a steady pace and the production volumes were by 5.6% higher than a year ago.

In 2014, production volumes was lower than in 2013 – in the eleven months, the output in the industry was by 0.7% lower than a year ago. Paper production volumes decreased by 4.8%, while production volumes in the publishing industry increased by 2 per cent.

Since 2011, the increase in the turnover of the paper production and publishing industry has exceeded 12% every year. The rise in revenues was based on both exports and the domestic market. While in the eleven months of 2014, the turnover of the industry decreased by 1.8%. During this time, the turnover of exports increased by 0.8%, while income from the products sold in the domestic market shrank by 5.5%.

The industry ensures nearly 4% of the total number of jobs in manufacturing. In 2013, the number of filled jobs in the paper production and publishing industry increased by 3.6%, which was higher than the average rate in manufacturing. In the three quarters of 2014, the number of jobs was by 1.1% higher than a year ago. Growth was observed in the publishing industry (by 4.8%), whereas the number of jobs in the paper industry decreased by 6.6 per cent.

Figure 3.32





The **chemical industry** and related industries form 8% of all manufacturing output and ensure more than 6% of jobs. Nearly ¾ of production of the chemical industry are exported, thus, the growth of the sector is closely related to foreign market trends.

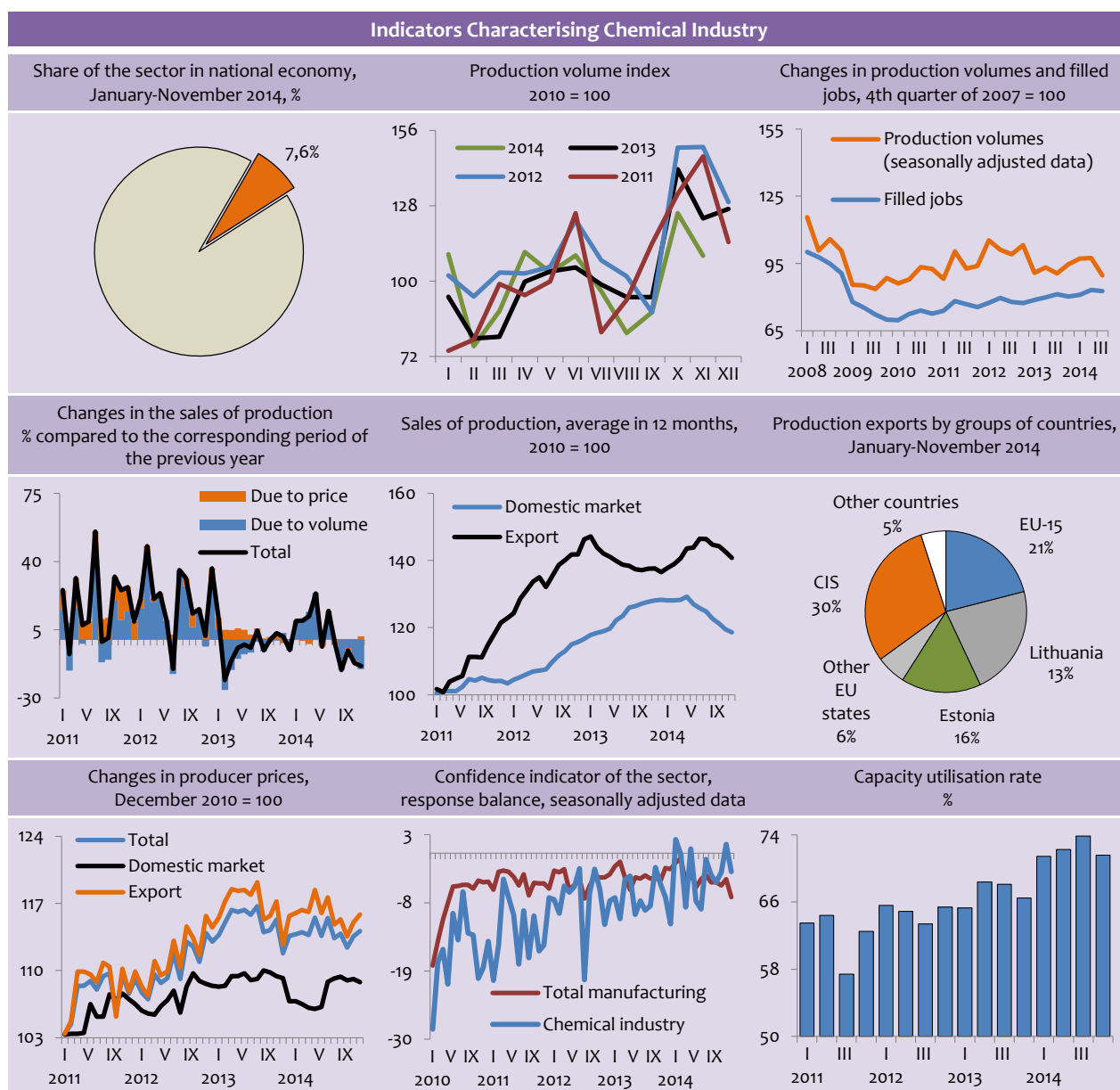
In 2013, the development of the industry was affected by the slowdown in growth rates of the largest export markets. In 2013, the production volumes of the chemical industry decreased by 8.7%. Narrowing output was observed in manufacture of chemical substances and products and pharmacy, while the manufacture of rubber products kept growing at a moderate pace. At the beginning of 2014, positive tendencies were observed in the sector. While in the second half of the year, the sector was affected by the weakening economic situation in Russia, which was one of the key markets, and production volumes decreased. Overall, in the eleven

months of 2014, production volumes of the chemical industry was by 1.3% lower than a year ago.

Along with narrowing output volumes, the turnover of the chemical industry decreased in 2013 (by 2.9%). Including the turnover of exported production decreased by 6.6%, yet, the volumes of production sold in the domestic market were by 10.1% higher than a year ago. In 2014, the turnover of the chemical industry remained at the same level as in the previous year. In the eleven months of 2014, the turnover of sales was by 3.4% higher than a year ago, which was mainly determined by the increase in export prices. In turn, revenues from products sold in the domestic market decreased by 8%.

Despite the challenges, the number of filled jobs kept growing in the industry – in 2013, the number of filled jobs increased by 2.5%, while in the three quarters of 2014, by 2.9%, compared to the three quarters of 2013.

Figure 3.33



The crisis affected *the production of other non-metallic minerals* more severely than other sectors of manufacturing – the production of non-metallic minerals decreased almost by a half along with the significant drop in the construction volumes.

The recovery of the sector after the crisis is mainly related to the ability to focus on foreign markets – mainly on the old EU countries and the gradually resuming activities in the construction sector in the domestic market. Proportion of the export production has increased from 18% to 46%, compared to 2007.

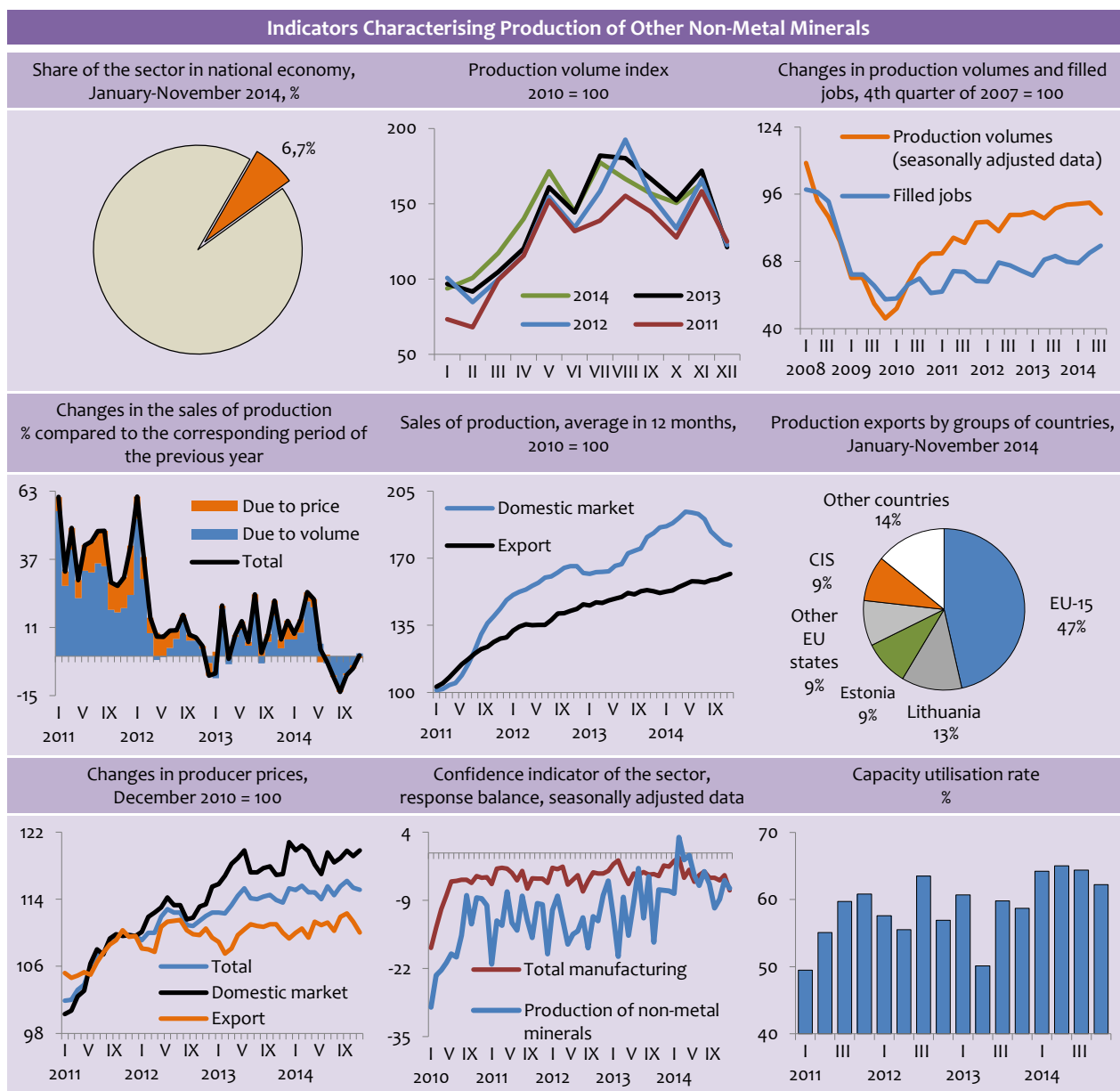
In 2013, the production volumes of the sector increased by 4.6%. Turnover in this period increased almost by 10%, including for export production – by 4.1%, while for products sold in the domestic market – by 14.7 per cent.

In the first half of 2014, production volumes of non-metallic mineral products increased with the rapid growth in the construction sector. Since mid-2014, production volumes lagged behind the indicators of the previous year. In the eleven months of 2014, the industry produced only by 0.7% more products than a year ago.

In the eleven months of 2014, the turnover of the sector remained at the level of the previous year. Although, the turnover of export production increased by almost 7% during this period, the turnover of products sold in the domestic market decreased (by 5.3%).

In previous years, the number of jobs increased with the growth of production volumes. In 2013, the number of filled jobs in the sector increased by 4.4%, while in the three quarters of 2014, by 6.1 per cent.

Figure 3.34



### Production of metal and metal articles

significantly contributed to the overall growth of the manufacturing during the post-crisis period. In 2012, production volumes of the sector were nearly by 40% higher than in 2007. Majority of products were exported.

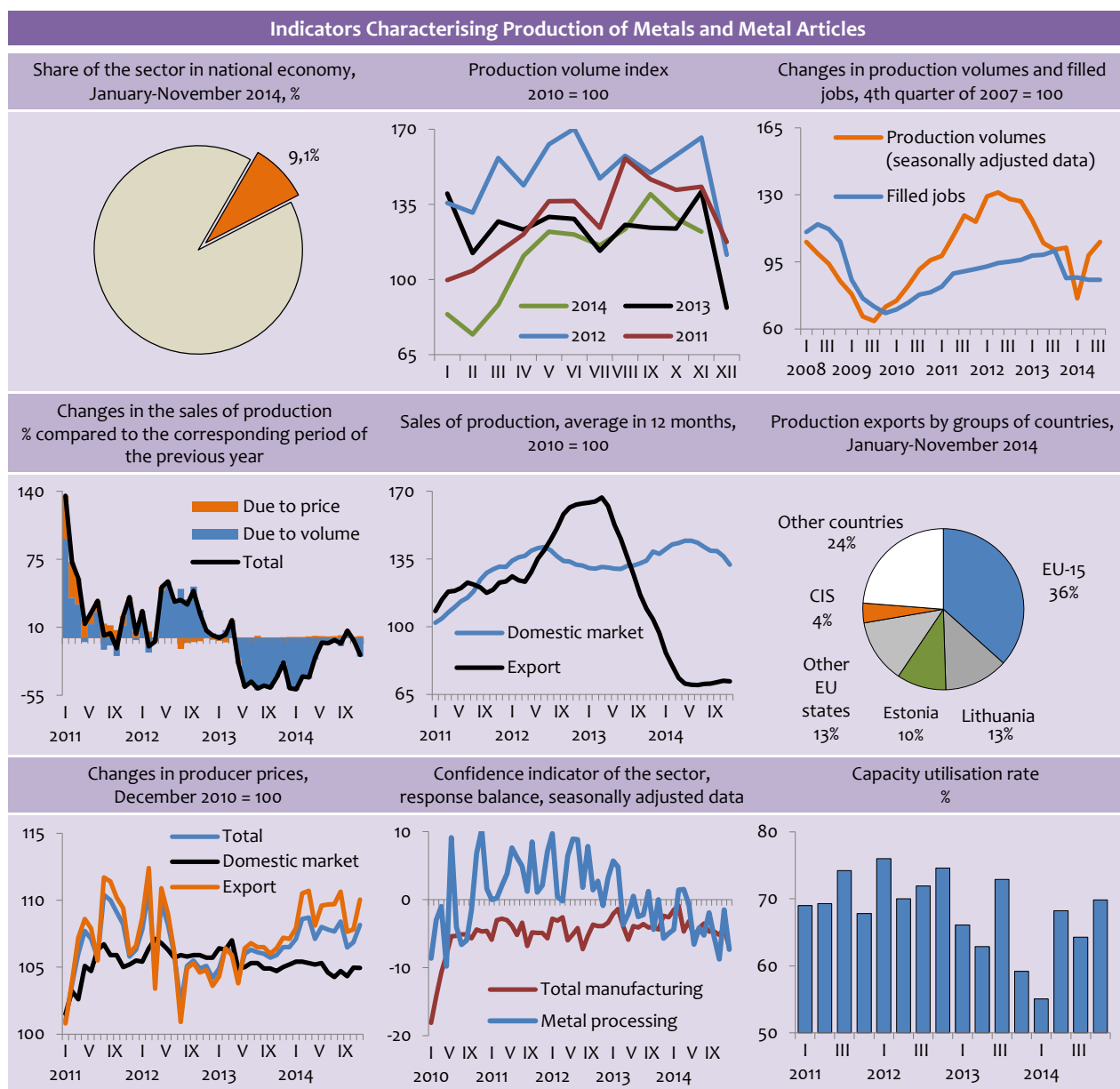
In 2013, the sector was significantly affected by the termination of activities of one of the largest manufacturing company AS "Liepājas metalurģs". The volumes of production shrank by a half in the sector in 2013. Although a slight growth was observed in the manufacture of fabricated metal products, overall, production volumes in metal processing shrank by 17.6% in 2013. In 2014, the termination of activities of AS "Liepājas metalurģs" considerably affected overall indices of the manufacturing. In the 11 months of 2014, metal production volume was by 11.3% lower than a year ago.

The significant drop in the production volumes led to

a decrease in the turnover of the sector. In 2013, it was by 30% lower than a year ago, while the volume of production sold for export shrank by nearly 40 % in this period. In January-November 2014, the turnover was by 19% lower than a year ago.

The number of jobs has grown over the past few years along with the relatively rapid growth of the sector. However, termination of AS "Liepājas Metalurģs" activities at the end of 2013 resulted in dismissal of employees of the company, which constituted approximately 1/10 of the total number of people employed in the sector. The number of people employed in the sector in the three quarters of 2014 was by 13.3% lower than a year ago. It must be noted that the new owner AS "KVV Liepājas metalurģs" has taken over the assets of the insolvent company and plans to resume operations in 2015.

Figure 3.35



**Production of electrical and optical equipment** has been one of the fastest growing sectors since 2010. Its share in the total manufacturing volume has increased from 3.7% in 2009 to 6% 2014. About 90% of production manufactured in the industry is exported.

In 2013, the production volumes have increased by 18.4% exceeding the level of 2007 nearly twice. The increase in production volumes of computer, electronic, and optical equipment have contributed the most to the growth of the industry (an increase of 27%), while the production volumes of electric equipment have increased slower (by 9%). Similar trends were observed in the sector in 2014 – in January–November, the production volumes exceeded the level of the corresponding period of the previous year by 30.5%.

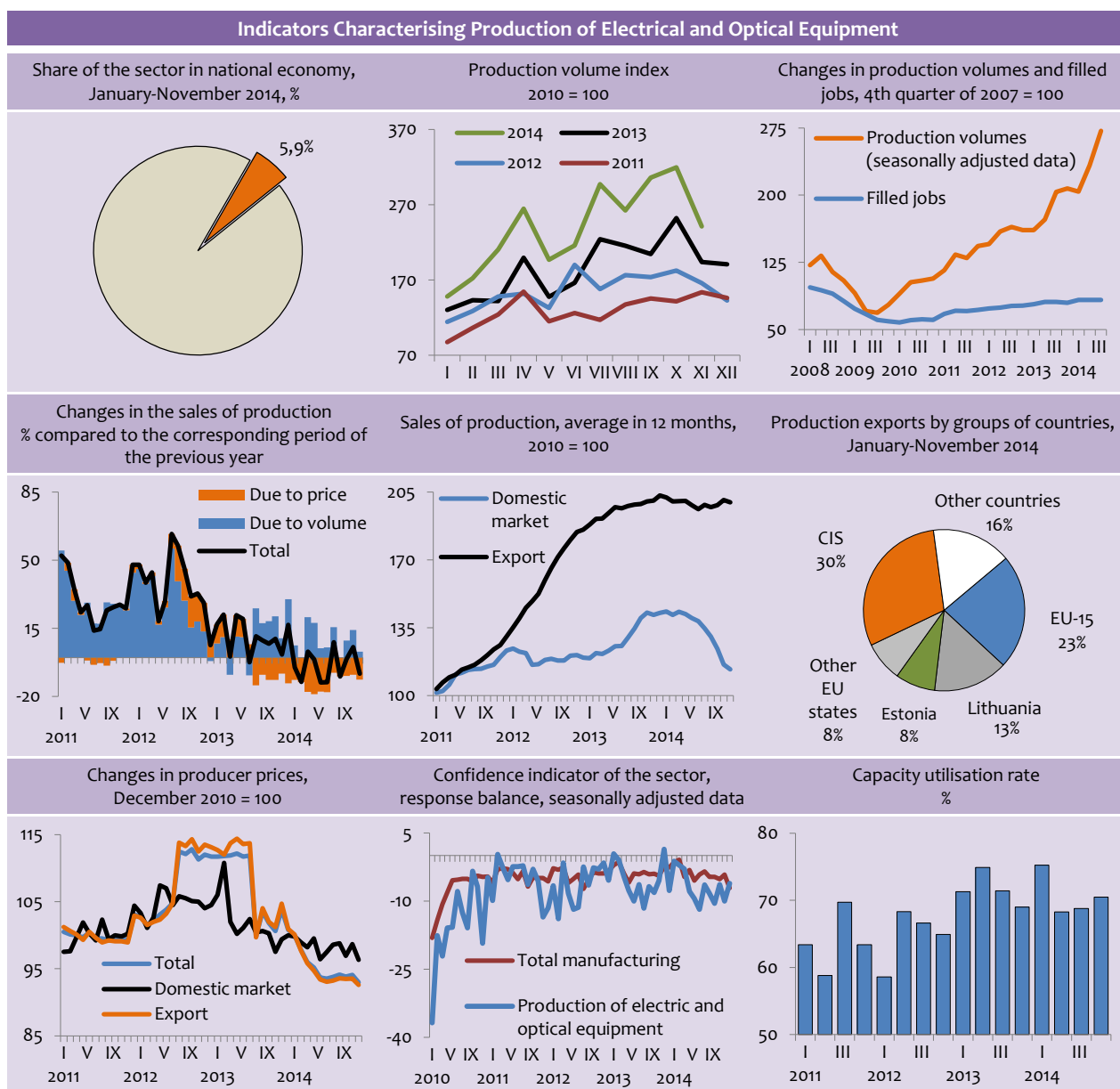
In 2013, the turnover of the sector increased by 10.5%. The turnover of exported production increased at

a slower pace than in the previous years (by 9.5%). While a rapid increase in the turnover – by almost 20%, was observed in the domestic market in 2013.

Despite the considerable growth in manufacturing volumes in 2014, turnover of the industry in the eleven months was by 4.2% lower than a year ago. Turnover of exported products decreased by 2%, while in the domestic market, by 22.2%. The decrease was affected by the considerable drop in producer prices – in November 2014, they were by 11.5% lower than a year ago.

The number of jobs in the sector has grown at a considerably slower pace than the increase in production volumes – for the most part, the growth has been ensured by growth in productivity. In 2013, the number of jobs in production of electric and optical equipment increased by 6.2%, while in the three quarters of 2014, by 3.8 per cent.

Figure 3.36



**The industry of production of machinery and equipment** is the supplier of means of production and technologies to other industries, thus, its development is closely related to the growth of other industries. Overall, 80% of all production of industry is exported – mainly to Lithuania, Estonia, and other EU Member States.

In early 2013, the growth of the industry was affected by the deteriorating economic situation in trade partner countries. The total production volumes in the industry or production of machinery and equipment were only by 1.4% higher than in 2012. While in 2014, production volumes were by 0.4% higher than in the respective period of the previous year.

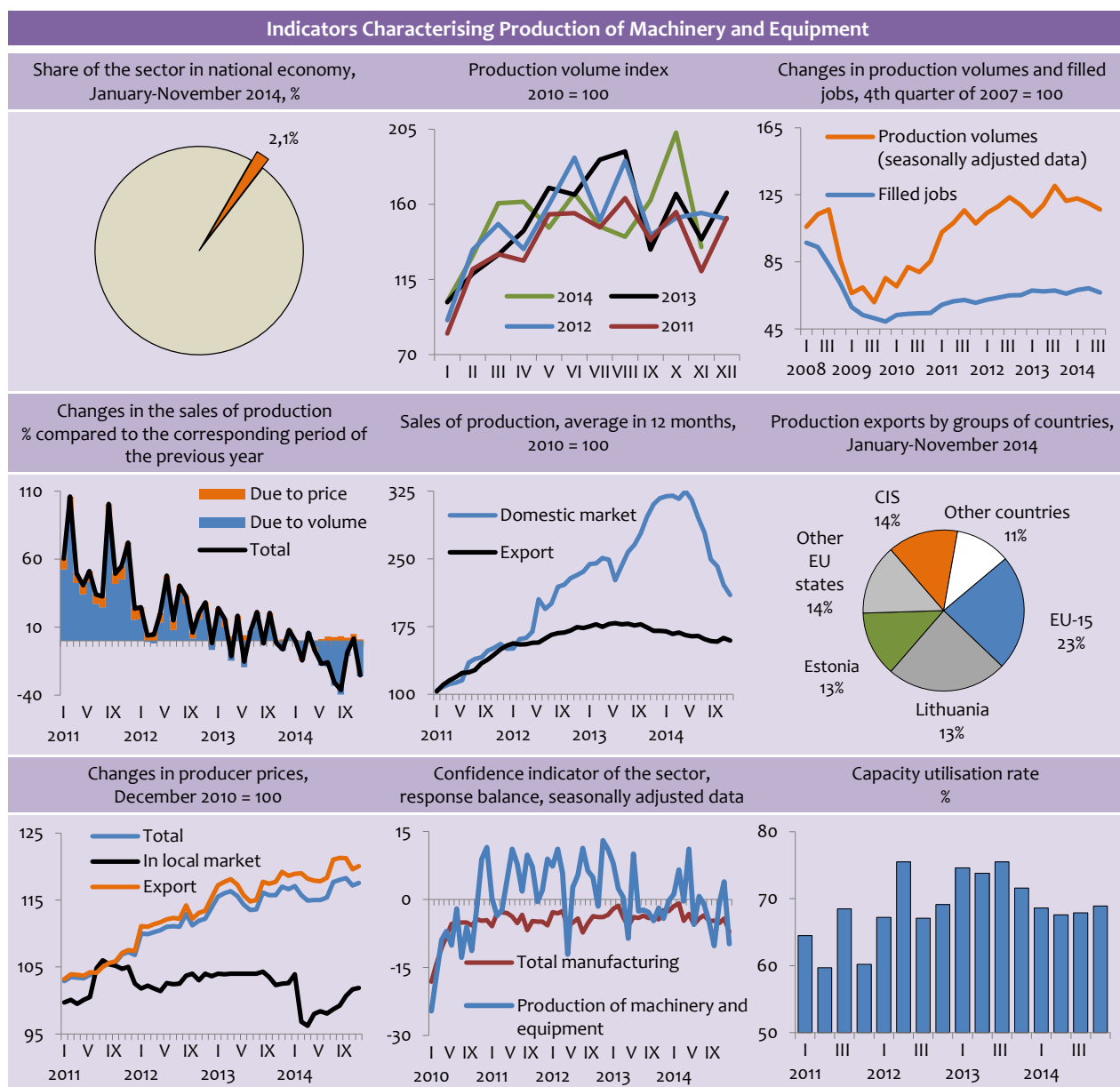
Since 2009, the turnover has significantly increased for both exported production and the production sold in the domestic market, which has been mainly fostered by the rise in producer prices for exported production. In

2013, the turnover of the industry increased by 5.3%. In 2013, the amount of productions sold in the domestic market increased by 35%, compared to 2012, while sales volumes of exports were by 1.9% lower than a year ago, which was both due to slower increase in production volumes and more moderate producer price dynamics.

In the eleven months of 2014, the turnover was by 14.3% lower than a year ago. During this period, the volume of exported production decreased by 6.8%, while in the domestic market, by 37 per cent.

Since 2010, the number of jobs in the industry has been gradually increasing. Even in 2013, despite the slower growth, the number of people employed in the industry continued to increase and was by 5% higher than in 2012. The number of jobs filled in the three quarters of 2014 was only by 0.4% higher than a year ago.

Figure 3.37



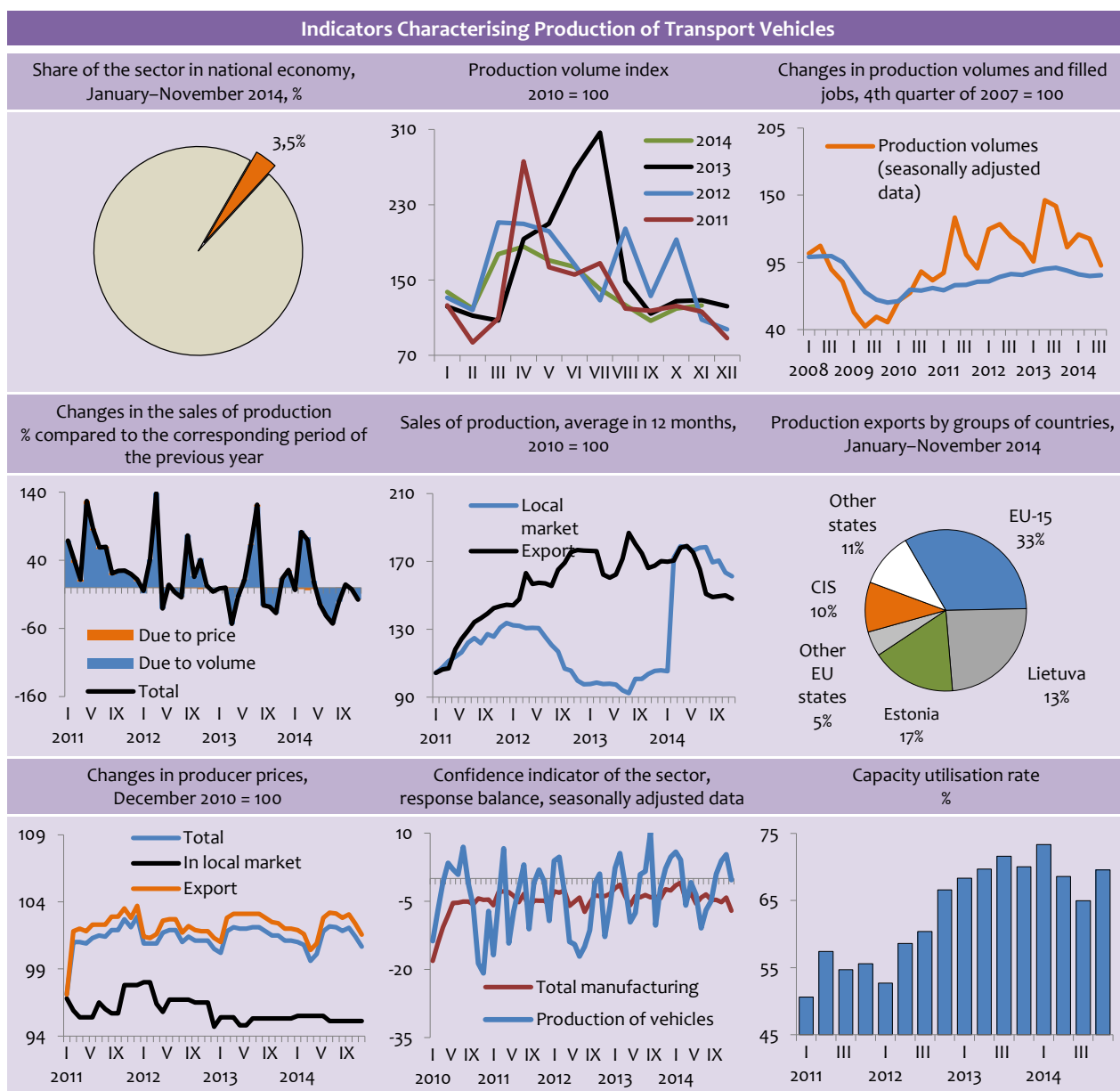
**Production of transport vehicles** constitutes 3.5% of the total output of manufacturing. The volumes of new orders in domestic and foreign markets and production volumes increased rapidly in the post-crisis period. The industry is characterised by explicit fluctuations of production volumes. In the past few years, approximately 90% of production has been exported.

In 2012, the production volumes were by 1/3 higher than in 2007. The orders finished in the previous years and the weak demand in foreign markets affected the development of the industry. In 2013, growth of production volumes in the industry was considerably slower – production volumes increased by 3%. In the eleven months of 2014, production volumes were by 14.7% lower than in the respective period of 2013 due to the weak demand.

In 2013, as the demand in foreign markets dropped, the production turnover of the industry decreased by 2.7%. At the same time, the turnover of production sold in the domestic market increased by 8.4%. Whereas in the 11 months of 2014, the turnover in the industry was by 8.4% lower than a year ago. A considerable growth was observed in revenues from sales of products in the local market, which increased by 60% during the period. Export turnover in the 11 months of 2014 was by 14% lower than a year ago.

Fluctuations in production volumes in the sector affect also the number of those employed in the industry. In 2013, the number of filled jobs in the industry increased by almost 7%, while the number of jobs filled in the three quarters of 2014 was by 5.2% lower than a year ago.

Figure 3.38





### 3.3 Forecasts

The latest forecasts of the European Commission and of the International Monetary Fund have been used for developing the forecasts of the Ministry of Economics in the analysis of external markets and evaluation of global economic development tendencies (see Chapter 2).

#### **Economic Development in 2015**

According to the preliminary assessment of the GDP in 4<sup>th</sup> quarter of 2014, the overall growth rate of the Latvian economy reached 2.3% in 2014.

Further development of the national economy of Latvia will be still closely related to export possibilities and, therefore, the highest risk to the growth of Latvia is related to global economic development.

The volumes of goods and services export in 2015 will be close to the level of 2014. The increase in the exports will be influenced by the food import restrictions imposed by Russia, at least during the first half of the year. Export possibilities of Latvia will be influenced even more significantly by the factors related to the economic problems of Russia – the drop in the currency exchange rate, investors losing trust in the region, weaker demand.

The latest forecasts of international institutions show that the Russian economy is expected to experience a decline in 2015. It will, furthermore, negatively affect the growth rate of EU Member States. Over 70% of Latvian exports are to EU; hence, a weaker demand on these markets will most likely slow down the increase in the exports of Latvia. It should be taken into account that the competitive advantages achieved after the crisis, based on the decrease in labour force costs, are gradually disappearing. Therefore, growth of the national economy of Latvia will not exceed the growth rate of 2014.

Private consumption in 2015 might increase a little bit faster than GDP. The dynamics of private consumption will be mostly determined by wage increases, while the increase in employment will be slow. In 2015, investments will be still influenced by the awaiting behaviour of entrepreneurs regarding future perspectives, as well as by the cautious lending policy of commercial banks. Private consumption will promote growth in the services sectors focused on the domestic market.

Most of the production of manufacturing sector has been exported, thus the growth of this sector in 2015 will be closely related to tendencies in external markets – slow economic growth in EU and economic downturn in Russia. At the same time it is expected that in subsectors which experienced growth in 2014, it will remain also in 2015. JSC “KVV Liepājas metalurģs” will resume its operation in 2015, which will positively affect total indicators of manufacturing.

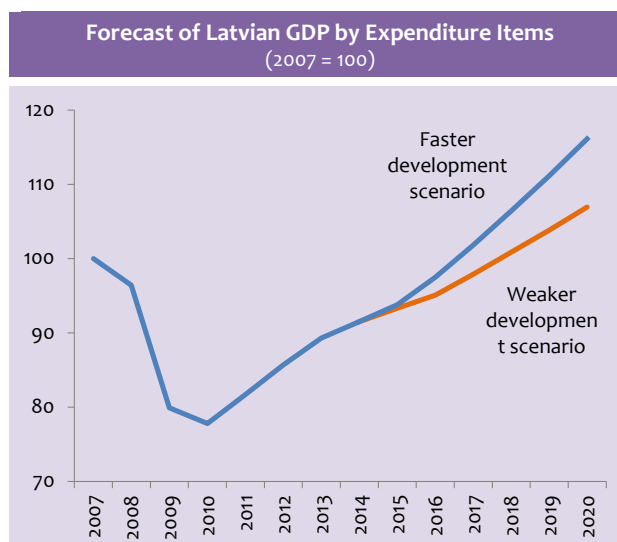
The Ministry of Economics forecasts that the overall increase in GDP may reach 2% in 2015.

#### **Development Perspective for 2016-2020**

The more rapid and slower development medium-term scenarios have been developed until 2020. The basic

assumptions of development scenarios are based on different global economy development tendencies in the medium-term.

Figure 3.39



For Latvia, as a small and open economy with the relatively high degree of market liberalisation, the growth is significantly influenced by global economic development and maintenance of stable competitiveness. The dynamics of development of the EU single economic area as well as the improvement of geopolitical situation caused by the Ukrainian crisis are particularly important.

The economic advantages of Latvia in the medium-term will be mainly based on the achieved macroeconomic stability, as a result of which the credit rating of Latvia has been improved, as well as on the effectiveness of the planned structural fund aid programmes and improvements in the business environment.

Labour force costs in Latvia are considerably lower than in the old EU Member States. The cheap labour force and comparatively high productivity are a weak stimulus for changes in the entrepreneurial model and the creation of other competitive advantages. Nevertheless, the increase in labour force costs is inevitable due to growth and open labour market. It means that unless appropriate structural policy measures are carried out, Latvia may lose the competitiveness in low cost segments faster than the advantages are acquired in production of higher value added products.

The weaker development scenario is based on an assumption that the global economic development is uneven, the EU recovers slowly from the crisis, and the geopolitical situation caused by the Ukrainian crisis shows no improvement. It means that the export growth rate in

the weaker development scenario does not exceed 2% per year. Private consumption and investments grow

slowly. However, the GDP growth rate on average will not exceed 2.6% during the period from 2016 until 2020.

Table 3.14

Forecast of Latvian GDP by Expenditure Items					
	2012	2013	2014	2015	2016-2020 annual average*
	Fact	Forecasts			
growth rates, % over the previous year					
Gross domestic product	4.8	4.2	2.3	2.0	2.6.. 4.0
Private consumption	3.0	6.2	2.6	2.4	2.4.. 4.0
Public consumption	0.4	2.9	3.1	1.8	2.4.. 3.0
Gross fixed capital formation	14.5	-5.2	0.1	-3.0	0.5.. 4.5
Exports	9.8	1.5	1.7	-0.7	1.8.. 3.6
Imports	5.4	0.3	0.3	-0.8	0.8.. 3.4
structure, %					
Gross domestic product	100	100	100	100	100
Private consumption	61.2	61.9	61.7	62.0	61.3.. 61.8
Public consumption	17.2	17.6	17.6	17.7	10.0.. 17.4
Gross fixed capital formation	25.2	23.3	22.8	21.6	19.0.. 21.7
Changes in inventories	0.8	0.4	0.4	0.5	1.4.. 1.0
Exports	60.9	59.4	57.9	56.6	53.5.. 54.3
Imports	65.3	62.6	60.6	58.3	53.3.. 56.2
Export-import balance	-4.4	-3.2	-2.6	-1.7	0.2.. -1.9
* structure at the end of the period					

The more rapid development scenario provides for that the growth will resume on the main export markets of Latvia and competitive advantages of Latvian economy are to a greater extent based on technological factors, improvements of production efficiency, and innovations, and to a lesser extent – on cheap labour and low prices for resources. The more rapid development

medium-term scenario provides for that the growth rates of exports and manufacturing industry will remain comparatively high, based mainly on both the increased competitiveness of Latvian producers and on the growing external demand. In this scenario, the GDP medium-term growth rate may reach 4% a year.

Table 3.15

Forecast of Latvian GDP by Sectors (real growth, % in comparison with the previous year)					
	2012	2013	2014	2015	2016-2020 annual average
	Fact	Forecasts			
<b>Gross domestic product</b>	<b>4.8</b>	<b>4.2</b>	<b>2.3</b>	<b>2.0</b>	<b>2.6.. 4.0</b>
Agriculture, forestry	7.5	-0.4	0.0	-0.6	2.0.. 2.5
Manufacturing industry	4.6	0.0	-0.3	0.5	3.0.. 4.5
Other industry	-5.5	-3.3	-3.4	2.2	1.5.. 2.0
Construction	14.5	7.5	7.6	-0.5	1.5.. 5.5
Trade, lodging	1.7	4.8	2.3	2.2	3.0.. 4.5
Transport and storage	6.9	1.6	2.5	-0.7	1.5.. 3.0
Other commercial services	5.2	6.0	1.8	3.4	3.0.. 4.5
Public services	0.1	3.8	3.1	3.2	2.5.. 3.0

## 4. MACROECONOMIC DEVELOPMENT

### 4.1 Public Finances

#### 4.1.1 Fiscal Policy and Public Debt

Table 4.1

General Government Budget				
	2010	2011	2012	2013
Revenues (mln EUR)	6540.2	7204.5	7886.7	8089.8
(% of GDP)	36.0	35.5	35.8	34.8
Expenditures (mln EUR)	8036.4	7900.5	8072.5	8289.5
(% of GDP)	44.2	38.9	36.6	35.7
Balance (mln EUR)	-1496.2	-696.0	-185.8	-199.6
(% of GDP)	-8.2	-3.4	-0.8	-0.9

The deterioration of the economic situation in 2008 and 2009 affected by the global financial crisis has considerably worsened the Latvian fiscal position. In order to prevent the situation in the financial sector from going out of control, Latvia has carried out comprehensive budget consolidation. Overall, from 2008 until 2012, fiscal consolidation measures with fiscal impact of 16.9% of GDP have been carried out, out of which about 6.7% of GDP are measures on the revenue side, whereas measures on the expenditure side constitute about 10.2% of GDP. On average, Latvia has carried out annual fiscal consolidation measures in the amount of 3.4% of GDP from 2008 until 2012.

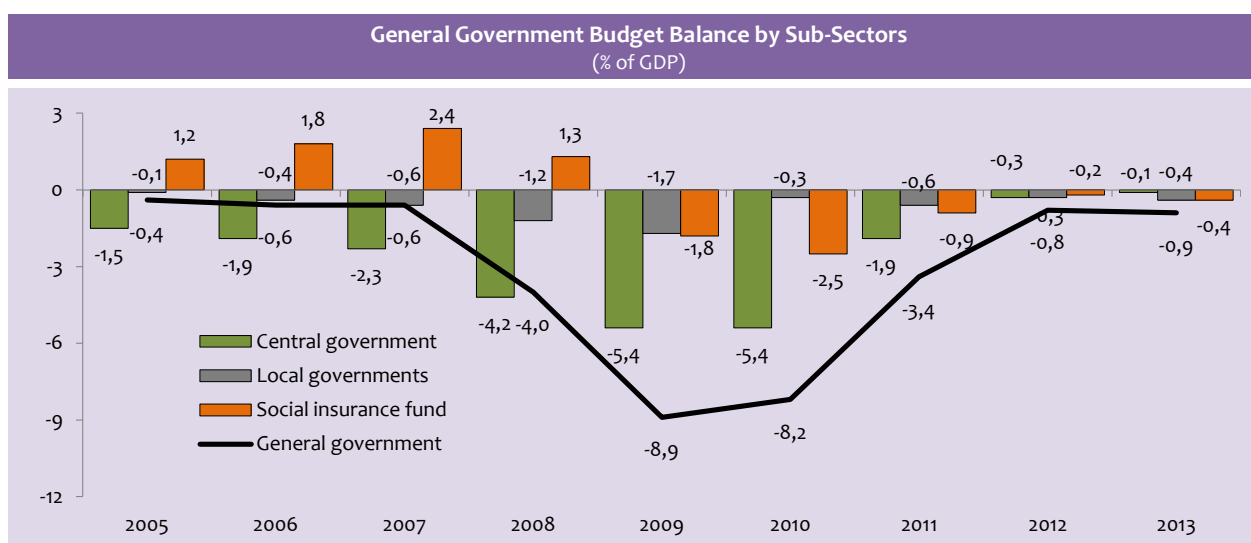
As a result of budget consolidation measures implemented by the government, the budget deficit decreased and in 2013, it was only 0.9% of GDP.

In 2014, the deficit of the general government debt is forecasted to be in the amount of 1.4% of GDP, which is by 0.5% more than the value forecast for 2014 in the law *On the Framework of the Medium-term Budget for 2014, 2015 and 2016*. The deviation of 0.4% of GDP is formed by changes to the possible fair value of derivatives reflected in reports audited by the Privatisation Agency. It must be noted that it is a one-time event and it has no effect on the structural deficit. Other changes form the deviation of 0.1% of GDP.

Over the past few years, the general government budget deficit is composed of the deficit in the central government budget and the local government budget, as well as the Social Security Fund.

The level of the average budget deficit of the EU in 2013 was 3.2% of GDP (in 2012, 4.2% of GDP, in 2011, 4.5% of GDP). In 10 EU Member States, the government budget deficit in 2013 exceeded the Maastricht criterion of 3% of GDP (in 2012, 17). Slovenia, Greece, and Spain had the highest general government budget deficit in relation to GDP in 2013. The budget deficit in these countries exceeded 6% of GDP. Only Luxembourg and Germany had a budget surplus.

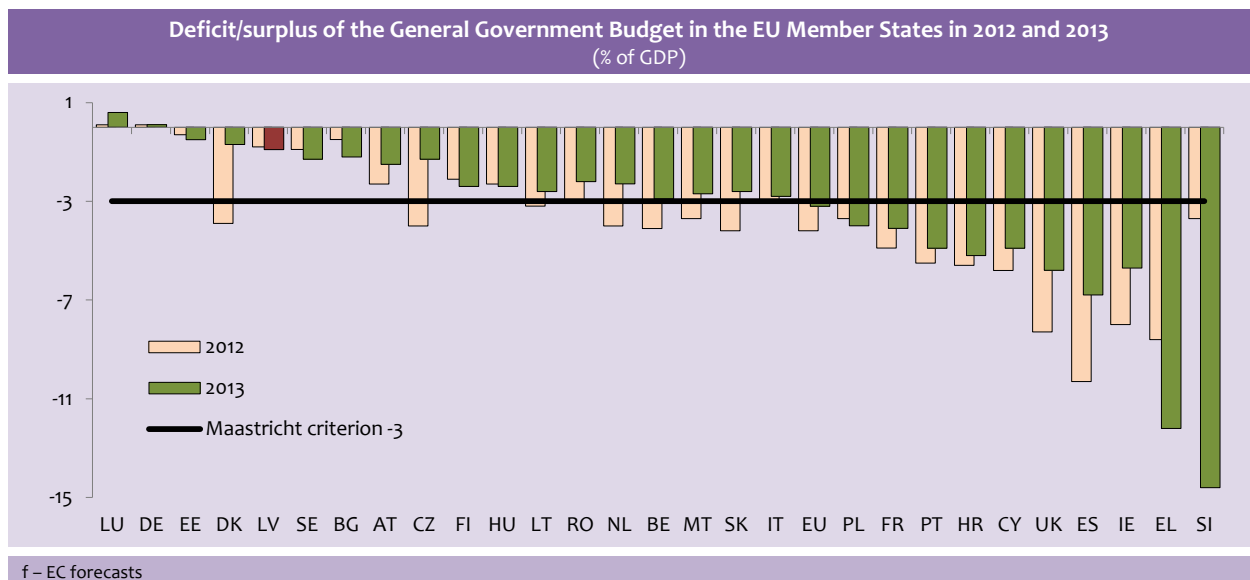
Figure 4.1



According to EC forecasts published in the autumn 2014, the budget situation in the EU Member States is expected to continue improving both in 2014 and 2015. In 2014, the level of the average budget deficit of the EU Member States is forecast to be in the amount of 3% of

GDP, whereas in 2015, in the amount of 2.7% of GDP. In 2014, the highest budget deficit that could exceed 5% of GDP, is expected in Spain, Croatia, and the United Kingdom.

Figure 4.2



The government budget for 2015 was approved with a deficit of 1% of GDP. The priorities of the government budget for 2015 are specific measures to strengthen State social and national security, to develop sustainable economy of Latvia, which would improve public welfare, as well as to promote the competitiveness of entrepreneurship.

To ensure the stability of fiscal policy and complying with the previous undertaking to reduce the fiscal load of labour force, the personal income tax rate will be reduced from 24% to 23% as of 1 January 2015. The contribution to the second pillar pensions will be increased from 4% to 5%. As of 1 January 2015, the minimum wage will be increased from EUR 320 to EUR 360. It is one of the ways of achieving the strategic development aim of the State – to reduce the inequality of population income. The differentiated tax-exempt minimum is planned to be introduced as of 2016.

Along with the approval of the *Law on Fiscal Discipline* (FDL) on 6 March 2013, the state fiscal policy is based on the concept providing for that the economic cycle ensures a balanced budget, i.e. the amount of the general government budget structural balance not exceeding -0.5% of GDP, as provided for by the FDL. Latvia reached the structural deficit in the amount of 0.5% of GDP in 2012. Thus, the mission in the upcoming year is no longer the reduction of structural deficit; it is now to maintain the MTO at the level, allowing deviations that comply with those prescribed in EU regulations (*Stability and Growth Pact*).

The permissible aim of the structural deficit for 2015 was set on the basis of the national middle-term objective

(-0.5% of GDP) and using possible deviations for the increase in contributions to the second pillar pensions in compliance with the Regulation (EU) No. 1175/2011 of the European Parliament and of the Council. In accordance with the conditions referred to Regulation, the target of the structural deficit for 2015 was set at 1% of GDP. Latvia will fully eliminate derogations and return to the medium-term objective in 2019.

The Ministry of Finance plans that the deficit of general government debt for 2015-2017 will not exceed the permissible amount of the deficit arising from the aim of the structural budget balance: in 2015 – 1% of GDP, in 2016 – 0.9% of GDP and in 2017 – 0.7% of GDP.

**The level of the general government debt** in Latvia is still among the lowest in the EU (see Figure 4.3).

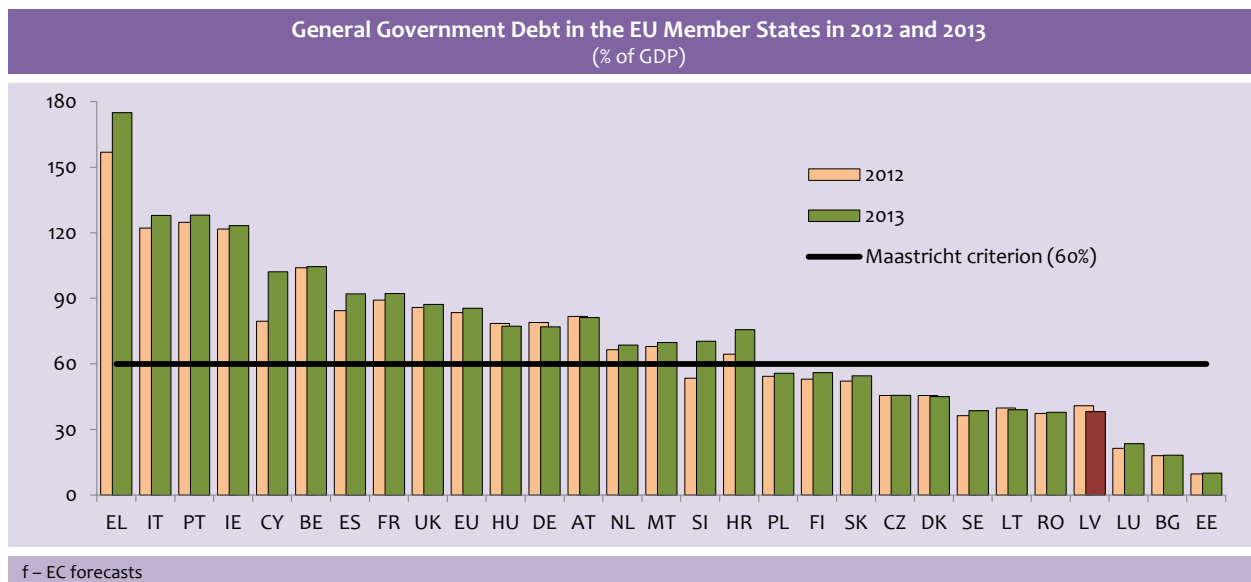
In 2013, the EU average public debt level was 85.4% of GDP (83.5% of GDP in 2012, 80.8% of GDP in 2011). The public debt exceeded the Maastricht criterion that is 60% of GDP in 16 EU Member States in 2013 (in 2012-14). In 2012, the highest public debt in relation to GDP was observed in Greece, Portugal, Italy, and Ireland, while the lowest general government debt in relation to GDP was registered in Estonia, Bulgaria, and Luxembourg. According to EC forecasts published in the autumn 2014, the average level of the general public debt in the EU continued growing in 2014.

The general government debt in Latvia was gradually increasing until 2007. Since 2008, it has been growing rapidly to meet the financial commitments of the government and reached EUR 8496 million or 46.8% of GDP at the end of 2010. At the end of 2011, it was EUR 8659 million or 42.7% of GDP, but at the end of

2012, it was EUR 9013 million or 40.9% of GDP. At the end of 2013, it decreased slightly and was EUR 8876 million or 38.2% of GDP. In 3<sup>rd</sup> quarter of 2014, however, it amounted to EUR 9629 million. The level of the general government debt is mainly influenced by the central government debt, constituting EUR 8629.2 million at the end of 2013.

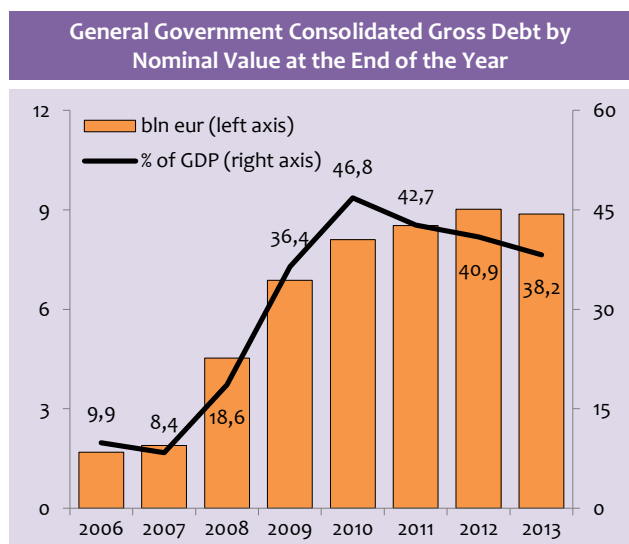
It should be noted that the three-year international loan programme has been successfully completed at the end of 2011. The programme earmarked a loan of EUR 7.5 billion to Latvia. Taking into account that the economic situation and the financial condition of Latvia had improved, Latvia did not need the full amount of the available financing. Latvia used EUR 4.4 billion.

Figure 4.3



After successfully completing the international loan programme, Latvia has, on several occasions, proved its ability to attract funding on global financial markets on favourable conditions by organising a public issue of government debt securities.

Figure 4.4



In 2015, it is planned to repay the loan of EUR 1.2 billion from the EC principal amount, as well as the principal amount of the first loan disbursed by the

World Bank in the amount of EUR 60.05 million. Hence, in 2015, it is planned to reduce the public debt by 5.1%.

By carrying out timely borrowing measures under the medium-term strategy and continuing the implementation of a sustainable fiscal policy, it is possible to refinance the currently assumed central government debt commitments on more favourable conditions in terms of rates and deadlines, as well as to achieve the reduction and stabilisation of the general government debt at a sustainable level in the long-term, by strictly complying with the criterion for the general government debt under the Maastricht Treaty.

#### 4.1.2 Budget Revenues<sup>1</sup>

After the decrease in revenues of the general government consolidated budget during the economic downturn in 2009 and 2010, budget revenues restarted increasing as the economic activities gradually resumed in 2011.

The **revenues of the general government consolidated budget** increased in 2014 along with the gradually growing economy, amounting to EUR 8535.9 million in 2014, which is by 1.9% higher than in 2013.

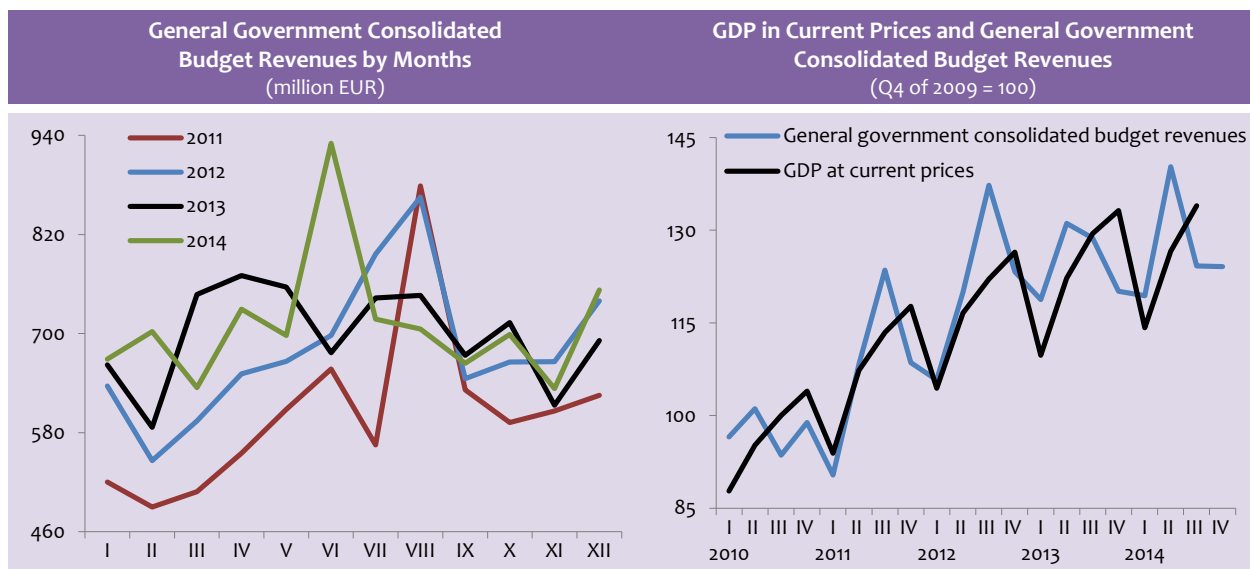
<sup>1</sup> According to the official data of monthly reports of the Treasury

Almost  $\frac{3}{4}$  of all budget revenues consist of tax revenues. The rest of budget revenues largely consisted of income from non-taxable income and foreign financial assistance.

In 2014, tax revenues constituted EUR 6675.9 million, which is by EUR 249.6 million or 3.9%

more than in 2013. The most crucial contribution in 2014 was ensured by the increase in the value added tax revenues, which was promoted by the increase in private consumption and retail trade turnover. The increase in the employment level and salaries promoted the increase in the collection of employment taxes.

Figure 4.5



In 2014, **employment tax** revenues increased by 1.4% along with the increasing salaries, as compared to 2013.

Employment taxes constitute a half of all tax revenues.

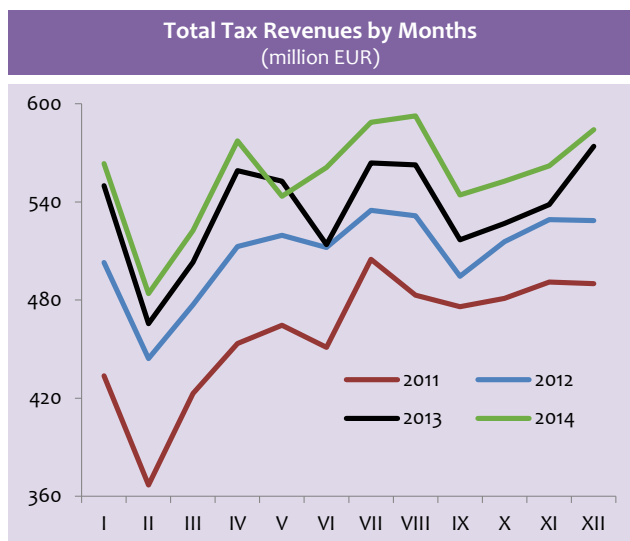
In 2014, revenues from the personal income tax amounted to EUR 1385.2 million, which was by 3.9% more than in 2013.

Table 4.2

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



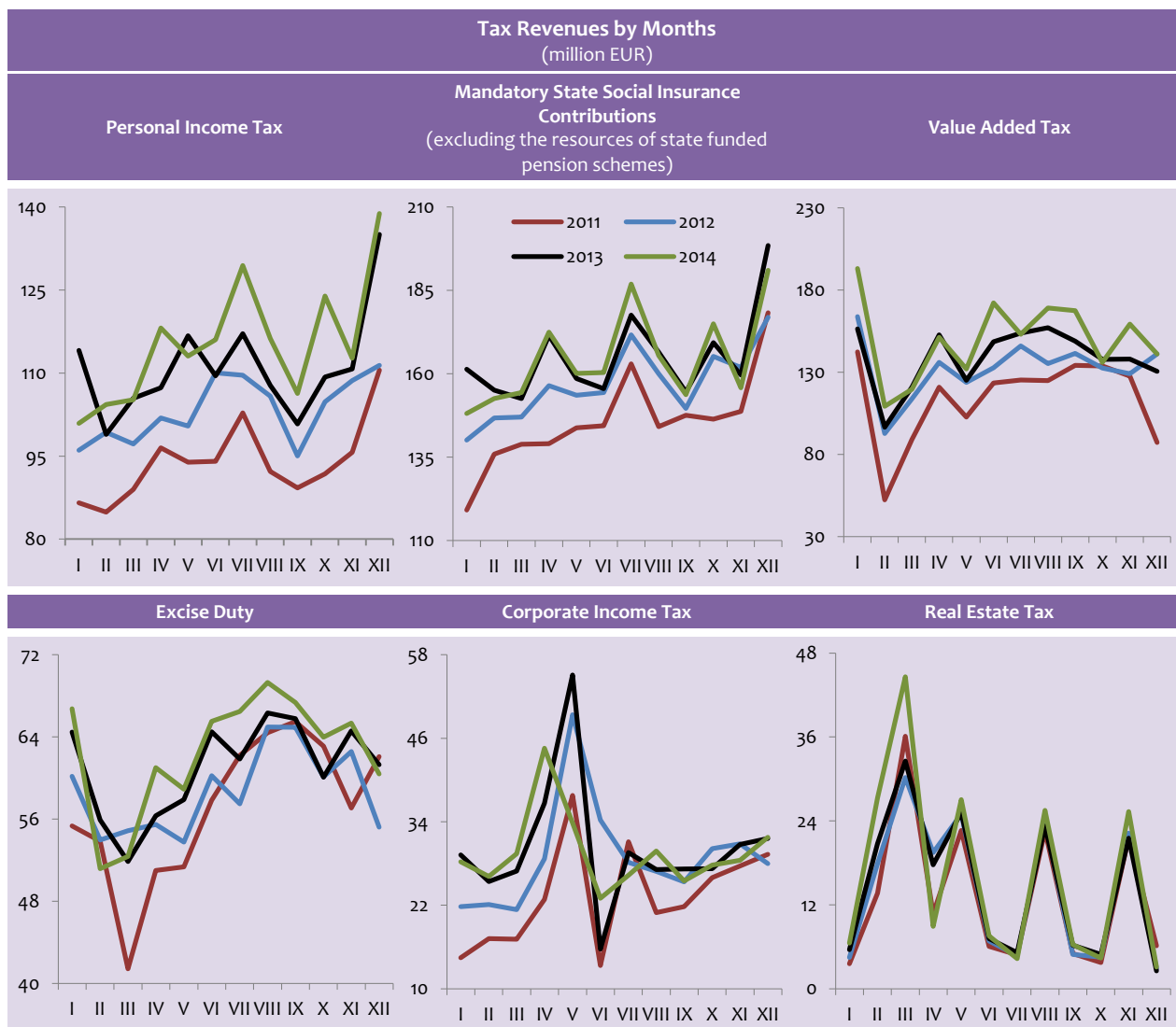
Figure 4.6



As of 1 January 2014, the established tax rate reduction model was changed. It was established that the personal income tax rate in 2014 would be 24%, in 2015, 23%, and from 2016, 22%. The non-taxable minimum was increased from EUR 64.03 to EUR 75, the tax relief for dependants was increased from EUR 113.83 to EUR 165, and the established minimum wage was increased from EUR 284.57 to EUR 320.

Moreover, several changes are planned to be introduced in the field of personal income tax as of 1 January 2015 – the minimum wage will be increased from EUR 320 to EUR 360, the personal income tax rate will be reduced, tax inequality will be eliminated in relation to persons due to the general tax-exempt minimum, measures will be taken to minimise the administrative burden for families with children by motivating school-age children to work during summer holidays, etc.

Figure 4.7

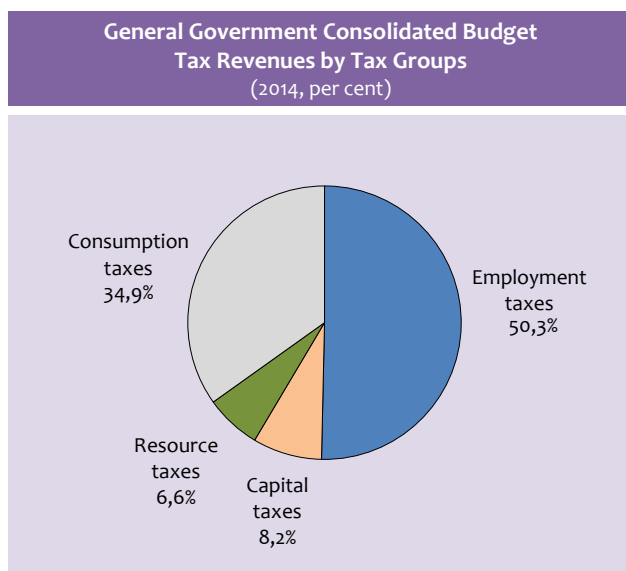


The employment tax reform is aimed at reaching employment tax rates equal to those in Estonia and Lithuania in terms of costs to keep Latvia competitive among the Baltic States with regard to investments and jobs. The reduced overall tax burden will also reduce the risk of poverty and structural unemployment, as well as shadow economy and motivation to avoid paying taxes.

In 2014, revenues from mandatory state social insurance contributions amounted to EUR 1976.1 million or 0.2% less than in 2013.

As of 1 January 2014, the rate of the mandatory state social insurance contributions was reduced to 35.09%, out of which 23.59% shall be paid by employer and 10.5% – by employee. The rate of mandatory state social insurance contributions decreased due to changes in the tax rate.

Figure 4.8



**Revenues from consumption taxes** constitute 1/3 of all tax revenues. The increase in private consumption and thus the increase in retail trade turnover in 2014 allowed collecting by 8.6% more taxes than in 2013.

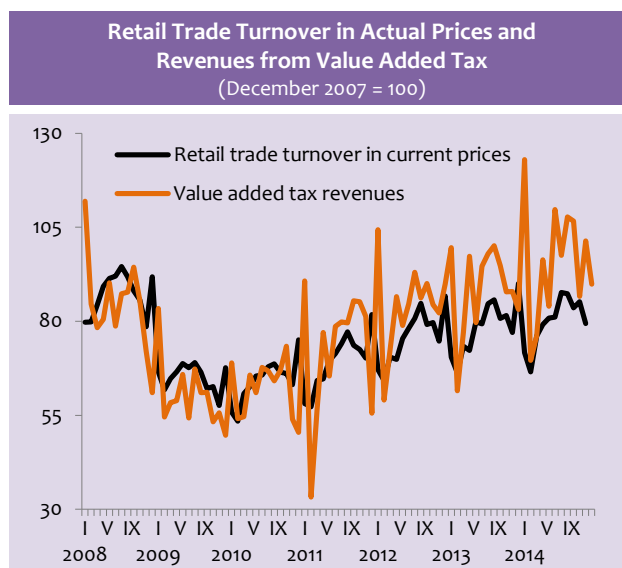
In 2014, revenues from the value added tax amounted to EUR 1803.7 million and increased by 8.2% as compared to 2013.

As of 1 January 2014, a number of VAT pre-tax deduction limitations were removed, changes to the VAT application to real estate transaction were carried out, VAT guarantees in oil product transactions were introduced, etc.

As of 1 January 2015, several changes are planned to be introduced in the field of value added tax – special regimens for calculating and paying the value added tax will be introduced for electronic communications, broadcasting and electronic services, changes will be introduced in the procedure for applying the *Value Added Tax Law*, etc.

The excise duty revenues from consumption were growing at a slower pace in 2014 (alcoholic beverages, tobacco, and other excise goods). In 2014, the excise duty revenues amounted to EUR 330 million, which was by 3.8% more than in 2013.

Figure 4.9



As of 1 January 2014, changes to the excise duty on tobacco products were carried out, by increasing the tax on cigarettes, cigars, and smoking tobacco. The excise duty on these product groups is expected to be increased annually until 2018.

As of 1 January 2015, the excise duty will be determined for tobacco leaves with the tax rate equal to the tax rate determined for smoking tobacco.

**The share of capital taxes** in the total tax revenues in 2014 amounted to 8.2%. Overall, in 2014, the capital tax revenues were by 2% higher than in 2013.

In 2014, corporate income tax revenues decreased by 2.1%, as compared to 2013. It was mainly due to the increase in the repaid amount. Real estate tax revenues, on the other hand, increased by 10.5% and amounted to EUR 190.9 million in 2014, as compared to 2013.

As of 1 January 2014, a number of changes were introduced in the field of corporate income tax, aiming to promote investments and contributions to research and development, for example, to extend the opportunity to apply a tax relief to new technological equipment for manufacturing, to extend the application period of tax rebates for investments in supported projects, etc.

To preserve a diversified tax policy for business start-ups and micro-enterprises, simultaneously reducing the risk of increase in the share of shadow economy, in 2015, the Parliament (the Saeima) will examine the amendments proposed by the Ministry of Economics to the *Micro-enterprise Tax Law* that provide for keeping the micro-enterprise tax rate of 9% during the first three years of activity.

As of 1 January 2014, a number of changes were introduced in the field of real estate tax, for example, tax exemption from State protected cultural monuments was removed, the procedure for determining a taxpayer as a real estate unit owned by and belonging to state or local government was amended, etc.

As of 1 January 2015, in the field of real estate tax it will be determined that the tax exemption from the real estate tax for 12 months after the building is commissioned will no longer be applied to the newly-constructed or reconstructed buildings intended for carrying out economic activities.

The group of **resource taxes** in 2014 amounted to 6.6% of all tax revenues. In 2014, as compared to 2013, revenues from the resource taxes increased by 1.5 per cent.

In 2014, as compared to 2013, natural resource tax revenues increased by 5 per cent.

As of 1 January 2014, several changes were made in the field of natural resource tax, for example, new natural resources tax objects were introduced and the natural resources tax rates were increased (for the extraction of natural resources, disposal of waste, air and water pollution, for goods harmful to environment, etc.).

In 2014, revenues from the excise duty for oil products and natural gas were EUR 418.6 million – by 1.3% more than in 2013.

As of 1 January 2014, the excise duty rate for natural gas used in industrial manufacturing was reduced in the field of the excise duty for oil products and natural gas, while the excise duty for petroleum gas and other gaseous hydrocarbons was increased.

As of 1 January 2015, several changes will be introduced in the field of the excise duty, as a result of which the excise duty rates will be removed for certain fuel types, norms regarding the application of the excise duty exemption will be specified for natural gas used for the heat supply of greenhouses, changes will be determined in relation to the application of the excise duty exemption for diesel fuel used for agricultural needs.

### 4.1.3 Budget Expenditures

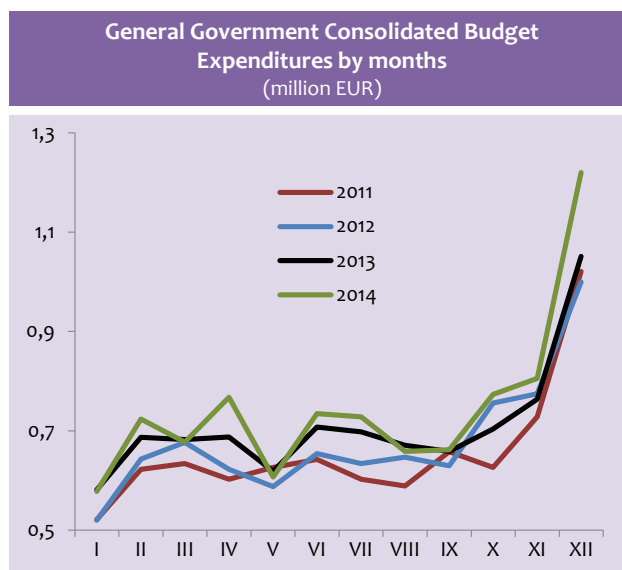
After the sharp cuts in expenditures during the economic crisis, the **government consolidated budget expenditures** resumed their growth. It was mainly based on the increased capital expenditures in both government and local government budgets in relation to the active use of EU funds.

In 2014, the total government consolidated budget expenditures amounted to EUR 8934.9 million, which is by EUR 426 million or 5% more than in 2013.

In 2014, the **expenditures for subsidies and grants** increased by 7.4%, as compared to the respective period of 2013. It should be noted that expenditures for subsidies and grants increased also during the economic crisis. Generally, it was linked to the increasing

unemployment and the paid unemployment benefits, severance pay to employees dismissed from the public sector, as well as social benefits.

Figure 4.10

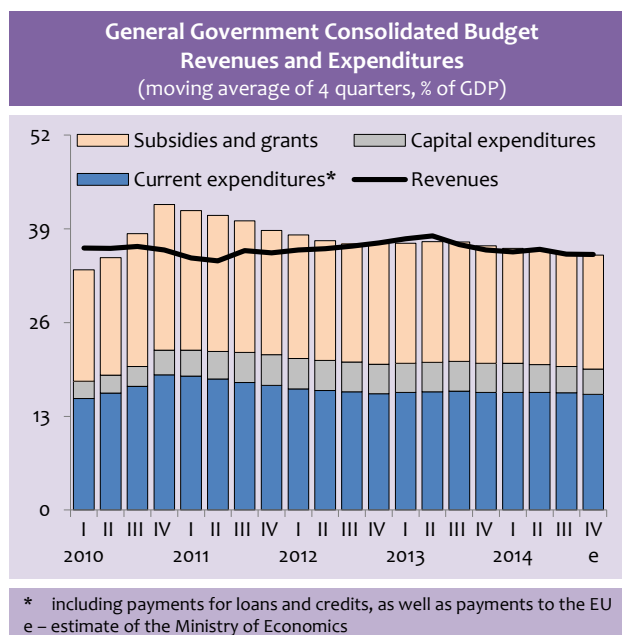


In 2014, the expenditures for subsidies and grants amounted to 44.7% of all budget expenditures.

**Capital expenditures** were the first to be cut during the crisis. Already in 2008, capital expenditures were lower than a year ago and were significantly cut in 2009 and 2010 as well. Since 2011, capital expenditures have been increasing due to the active use of the EU funds.

After the increase during the post-crisis years, capital expenditures decreased in 2014 – they were by 4% lower than a year ago.

Figure 4.11



Despite the increase over the past few years, the share of capital expenditures in the total expenditures has not considerably changed, as compared to 2008 – in 2014

they amounted to average 10% of the total government budget expenditures.

Table 4.3

Expenditures of the General Government Consolidated Budget by Functions (per cent)								
	Structure				Against GDP			
	2011	2012	2013	2014	2011	2012	2013	2014e
<b>Expenditures – total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>38.8</b>	<b>36.9</b>	<b>36.6</b>	<b>37.1</b>
General public services	12.1	13.3	12.8	13.2	4.7	4.9	4.7	4.9
Defence	2.3	2.1	2.2	2.1	0.9	0.8	0.8	0.8
Public order and safety	4.4	4.5	4.8	4.9	1.7	1.7	1.8	1.8
Economic affairs	19.0	18.6	18.7	18.1	7.4	6.9	6.9	6.7
Environmental protection	2.5	2.3	2.4	2.4	1.0	0.9	0.9	0.9
Management of municipal territories and housing	3.0	3.0	3.0	2.6	1.2	1.1	1.1	1.0
Health	7.8	7.8	7.6	7.4	3.0	2.9	2.8	2.8
Recreation, culture and religion	3.2	3.5	3.6	3.4	1.3	1.3	1.3	1.3
Education	17.1	16.6	16.4	16.7	6.6	6.1	6.0	6.2
Social security	28.5	28.2	28.4	29.1	11.0	10.4	10.4	10.8
e – estimate of the Ministry of Economics								

**Current expenditures** were cut the most during the crisis. In order to cut the government consolidated budget expenditures, public administration and certain sectors went through optimisation by reducing the number of employees in ministries, along with a number of public agencies and hospitals. In 2008, current expenditures constituted more than a half of all budget expenditures, while in 2014 the share thereof constituted just 45.4 per cent.

In 2014, as compared to previous year, current expenditures in the private sector increased by 8.7%. Such a rapid increase was mainly due to the gradual rise in the government expenditures since current expenditures faced the sharpest cutting during the crisis.

According to the expenditures by functional categories, the highest share in 2014 was in social protection, economic affairs, education and expenditures for general government services. The lowest share of all expenditures, however, was in defence, environmental protection and expenditures for managing local government territory.

**Public demand** consists of public consumption or public services, the value of which is determined by the volume of the provided public services, as well as of public investments, i.e. capital investments using the budget resources.

Table 4.4

Public demand (per cent)										
	Against GDP					Changes				
	2009	2010	2011	2012	2013	2009	2010	2011	2012	2013
<b>Public demand</b>	<b>23.8</b>	<b>22.8</b>	<b>23.2</b>	<b>22.0</b>	<b>20.2</b>	<b>-10.5</b>	<b>-8.4</b>	<b>5.6</b>	<b>-0.4</b>	<b>-7.0</b>
Public consumption	18.9	18.1	18.2	17.2	16.3	-10.7	-8.1	3.1	0.4	-4.7
– central government*	10.1	10.4	10.2	9.2	8.6	-11.2	-1.6	0.4	-3.1	-6.1
– local governments	8.8	7.8	8.1	8.0	7.7	-10.1	-15.6	6.7	4.9	-3.1
Gross fixed capital formation	4.8	4.6	5.0	4.8	4.0	-9.9	-9.6	15.5	-3.4	-15.4
– central government*	2.0	1.8	2.2	2.3	1.7	-2.4	-15.8	34.9	2.6	-23.5
– local governments	2.8	2.9	2.8	2.5	2.3	-14.5	-5.3	3.5	-8.2	-8.1
* including Social Security Fund										

The public demand decreased rapidly during the crisis. The average public demand has shrunk by 14.9% from 2008 to 2013.

## 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 restarted increasing. The 12-month inflation of consumer prices was 4% in 2011 and 1.6% in 2012, whereas, in 2013, consumer prices decreased by 0.4%. In 2013, despite the growth in Latvia that had been the fastest among the EU Member States, consumer prices remained growing at a moderate pace. Price changes in 2013 were mainly determined by the drop in prices for transport, heat energy and food products, as well as by the rise in costs of services. The dynamics of global prices for food products and fuel had a major impact as well.

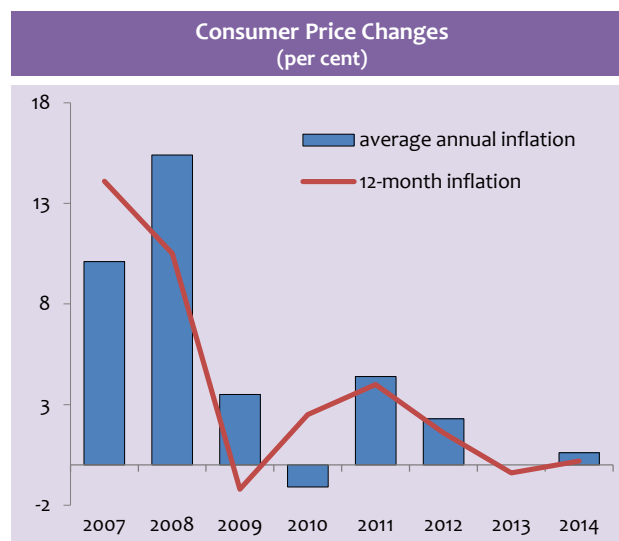
In 2014, a moderate increase in prices was observed and it was bigger than in the respective period of the previous year; however, price changes were lower than the traditional level of seasonal fluctuations.

Table 4.5

Consumer Price Changes by Months (per cent)				
		Compared to the previous month	Compared to the respective month of the previous year	Average during the year
2013	August	-0.8	-0.2	0.6
	September	0.3	-0.4	0.4
	October	0.3	0.0	0.3
	November	-0.5	-0.4	0.1
	December	0.0	-0.4	0.0
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

In December 2014, consumer prices increased by 0.2% (12-month inflation), while the average annual price level increased by 0.6%.

Figure 4.12



The main factors influencing prices in 2014 were the following:

- prices for services increased by 3.3%, thus increasing the total price level by 0.9 percentage points. The rise in prices in the group of services was mainly affected by the increase in the prices for services related to housing maintenance, mostly water supply, which is related to the increase in tariffs as of 1 July 2014. The prices for services related to health care, as well as catering, recreation and cultural services increased.
- the drop in prices for oil products since July, as the prices decreased on average by 50% within a year and reached its lowest index over the last five and a half years. In Latvia, the drop in fuel prices had the greatest impact on the decrease in prices within this year, despite that the drop in fuel prices was not as sharp as in world oil prices. A faster drop in fuel prices is delayed by the increase in the exchange rate of US Dollar in relation to euro. Within a year, fuel prices in Latvia decreased by 12.3% and reduced the total price level by 0.8 percentage points. Overall, prices in the transport group decreased by 5.2%, thus reducing the total level of consumer prices by 0.7 percentage points;

- the increase in prices for tobacco due to the increase in excise duty since early 2014. Within a year, the prices for tobacco increased by 8.7%, thus raising the total price level by 0.24 percentage points.
- prices for food products decreased by 0.8%, thus reducing the total price level by 0.2 percentage points. Changes in prices for food products depend mainly on global price fluctuations. It should be noted that the world prices for food products experienced a drop, which was affected by the sharp decrease in the prices for dairy products as of April by over 30%, as well as the drop in the prices for vegetable oils, sugar, and cereals, with prices increasing only for meat. In December 2014, the world prices for food products were by 8.5% lower than in December 2013. In Latvia, the drop in prices for dairy products had the greatest impact; the prices for meat, sugar, vegetables, and potatoes decreased as well. The drop in prices for food products in Latvia was affected by the embargo imposed by Russia on certain food products as of August 2014. The increase in prices for coffee and

tea (by 8%) had a great impact on the group of food products as well. The world prices for coffee increased on average by 40%; the prices for tea, however, increased by 10 per cent.

Figure 4.13

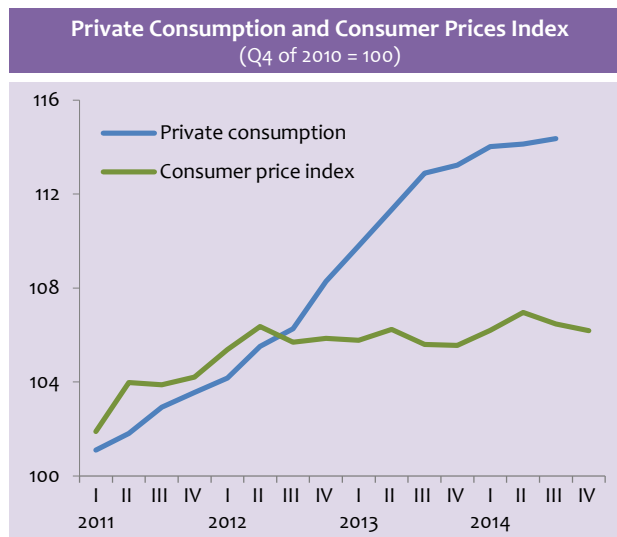


Figure 4.14

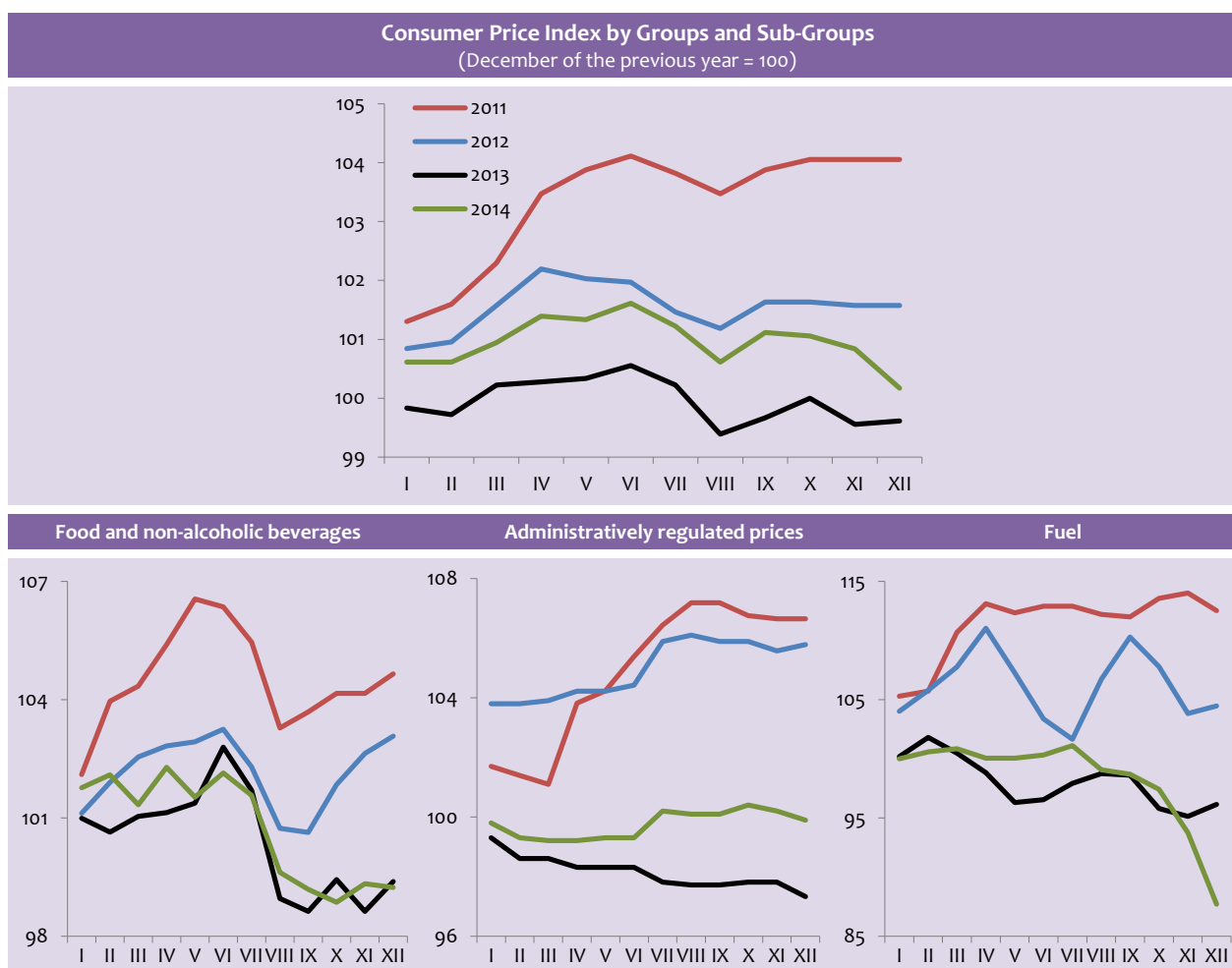
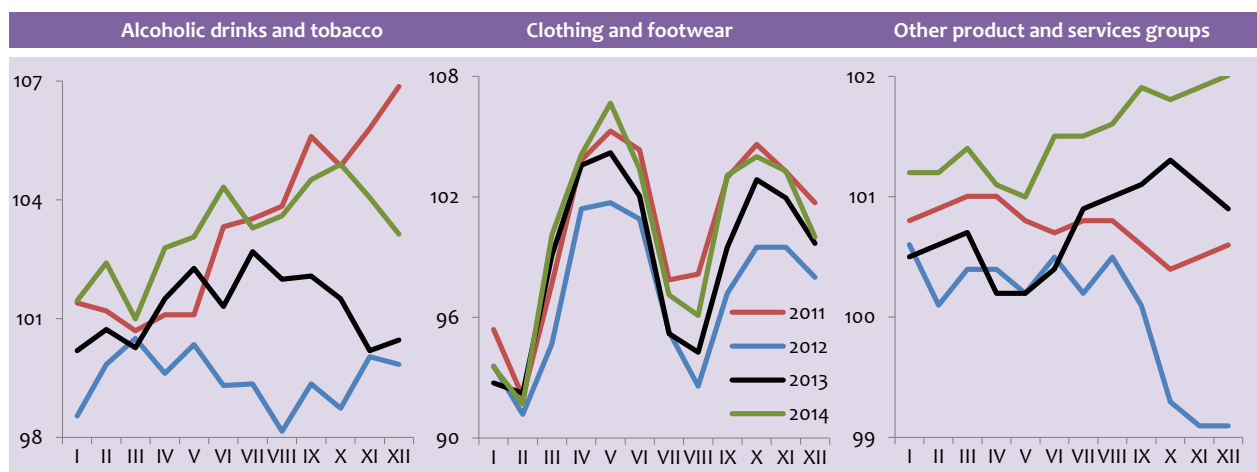




Figure 4.14 continued

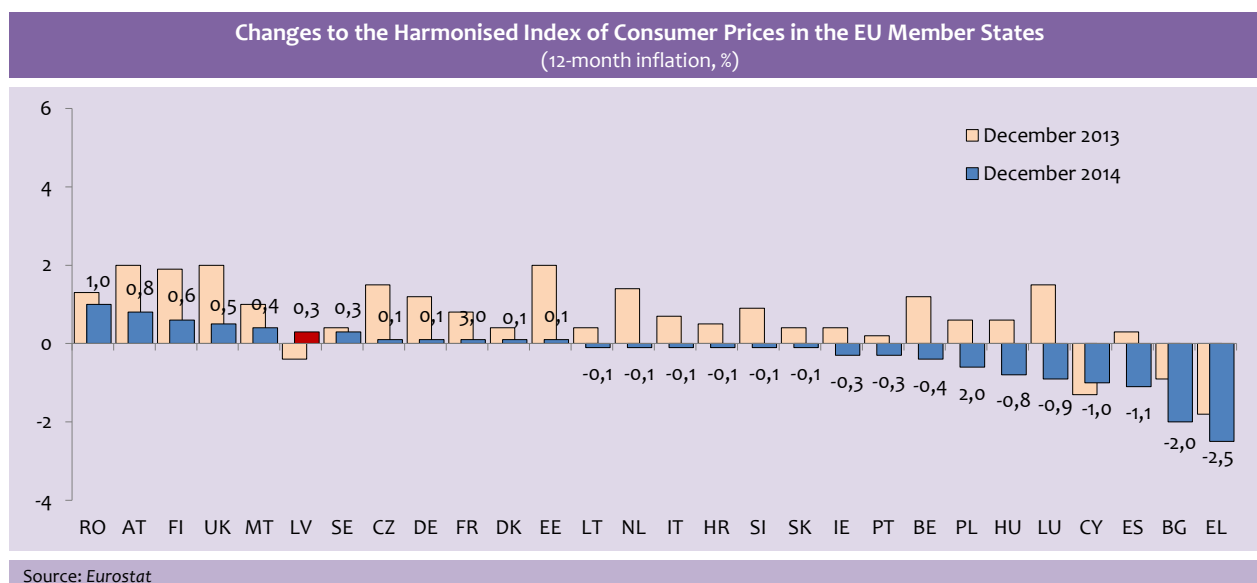


In 2015, the increase of average level of consumer prices will be lower than in 2014. Inflation will be related to external factors – global oil and food price dynamics. At the same time it will be affected by various supply factors (the opening of the electricity market on 1 January 2015, increase of prices for transportation services).

In 2013, as compared to 2012, the average price level in the EU increased by 1%. It was determined by the rise in prices for food products and services.

In December 2014, as compared to December 2013, the price level in the EU Member States decreased by 0.1% (in eurozone, it decreased by 0.2%). The biggest increase in 12-month inflation was observed in Latvia and Cyprus, while the sharpest decrease was observed in Luxembourg, Estonia, and Belgium. The highest inflation in December 2014 was observed in Romania and Austria, while deflation, in Greece and Bulgaria.

Figure 4.15



In a comparison of the Baltic States, the highest rise in the harmonised index of consumer prices in December 2014, as compared to December 2013, was observed in Latvia (by 0.3%). In Estonia, consumer prices increased by 0.1%. In Lithuania, however, prices decreased by 0.1%. In December 2014, as compared to December 2013, the consumer prices for food products, alcohol, and tobacco products experienced a slight increase in all Baltic States, as the prices mostly increased

for alcohol and tobacco, while the prices in the energy group decreased in all countries.

The prices in the group of food products, alcohol, and tobacco products among the Baltic States increased by 1.2% in Lithuania, by 1% in Estonia, and by 0.2% in Latvia. Energy prices dropped more sharply in Lithuania – by 7.6%; in Estonia, they decreased by 5.2%, whereas the lowest drop in energy prices was observed in Latvia – by 4.9%. Administratively regulated prices

increased in Estonia and Latvia – by 0.1% in every country, while in Lithuania, these prices decreased by 1.6 per cent.

It should be noted that in December 2014, as compared to December a year ago, the prices in Latvia for the service group increased faster than in Lithuania and Estonia – by 3.1% (in Lithuania and Estonia, they increased by 2.7% and 2.1% respectively). In December 2014, prices in Latvia were mostly affected by the increase in prices for the group of services, since apart from this group, a slight drop in prices was observed for the rest of the groups.

Figure 4.16

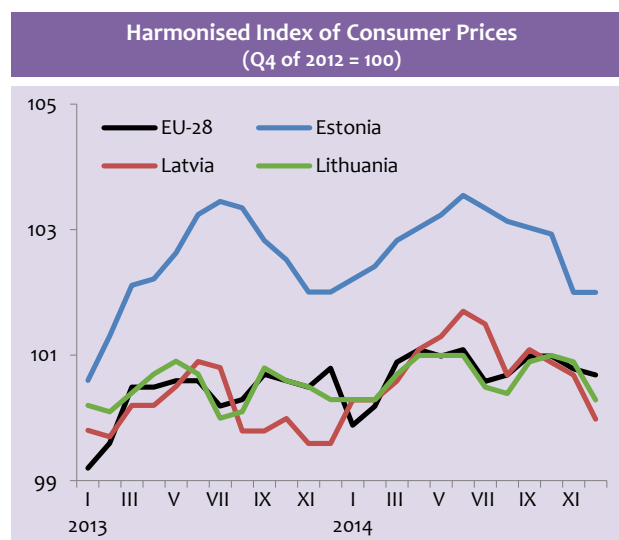
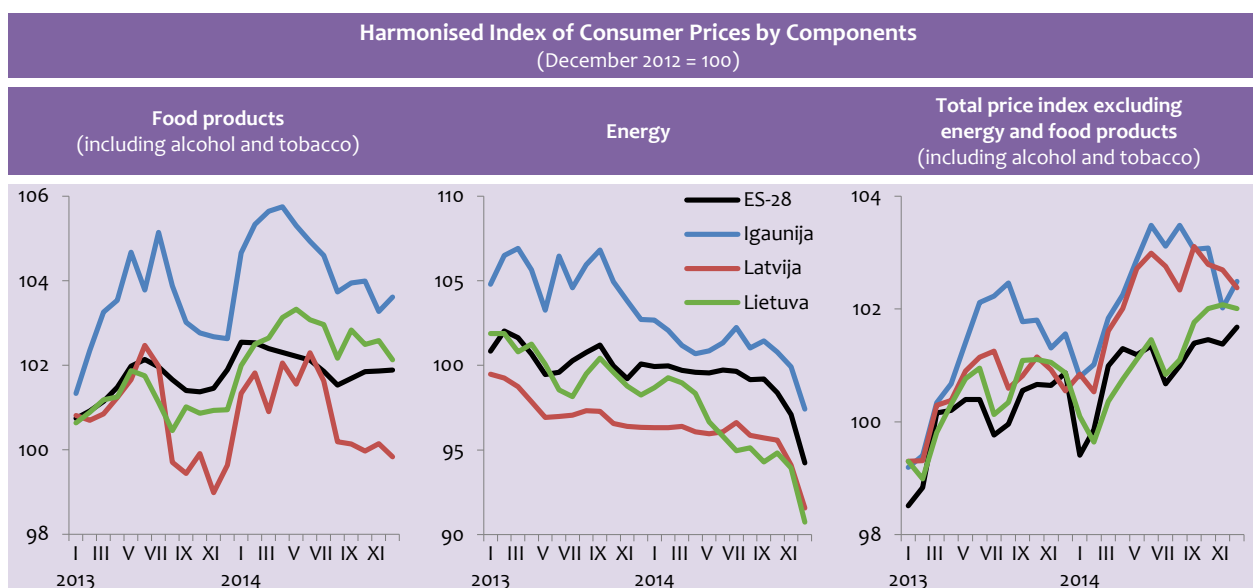


Figure 4.17



## 4.2.2 Producer Prices

After the 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%, as compared to 2012. The prices for products sold on the domestic market decreased by 0.6% within a year, and the prices for exported products increased by 1.3 per cent.

In December 2014, as compared to December 2013, the average level of producer prices increased by 0.4%. Prices for products sold on the domestic market increased by 0.2% within a year, and for exported products, by 0.6%. Fluctuations of producer prices without changes in the manufacturing industry sectors

were mostly affected by a rise in prices in the field of water production, treatment and supply, waste water collection and treatment.

Slightly over 60% of manufacturing products are exported, therefore the overall dynamics of producer prices is largely affected by the fluctuations of producer prices for exported products. Prices for exported products are mainly determined by the dynamics of prices for the main export goods of Latvia, including wood and timber materials, metal articles, and food products, on the world markets. The rise in prices for products sold on the domestic market was affected by the stabilising domestic demand.

The overall level of producer prices in the manufacturing industry of Latvia in December 2014 decreased by 0.6%. In the manufacturing industry,

producer prices for exported products decreased by 0.4%, while prices for products sold on the domestic market decreased by 0.8%. In the manufacturing industry, producer prices were affected by the Russian embargo on food products, as well as the economic situation in the EU and Russia and the drop in the world prices for raw materials. It should be noted that in December 2014, as compared to December a year ago, a drop was observed in the prices for energy, industrial and agricultural raw materials.

Figure 4.18

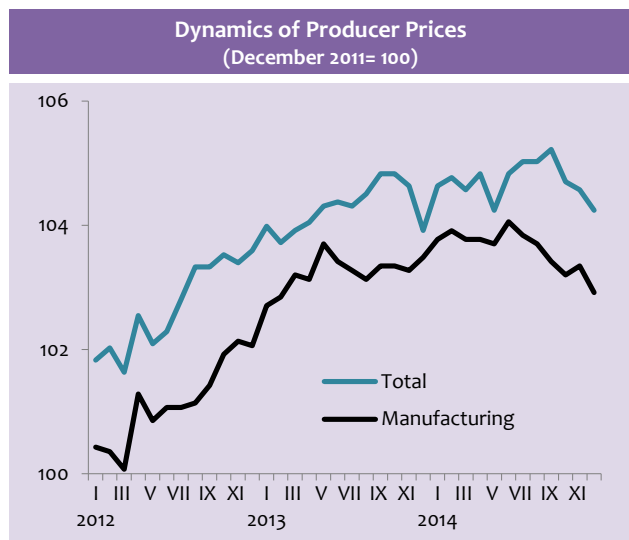
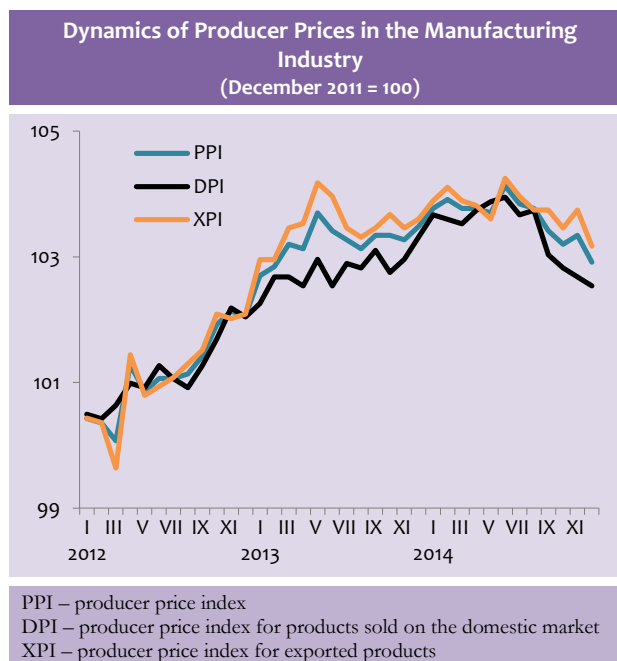
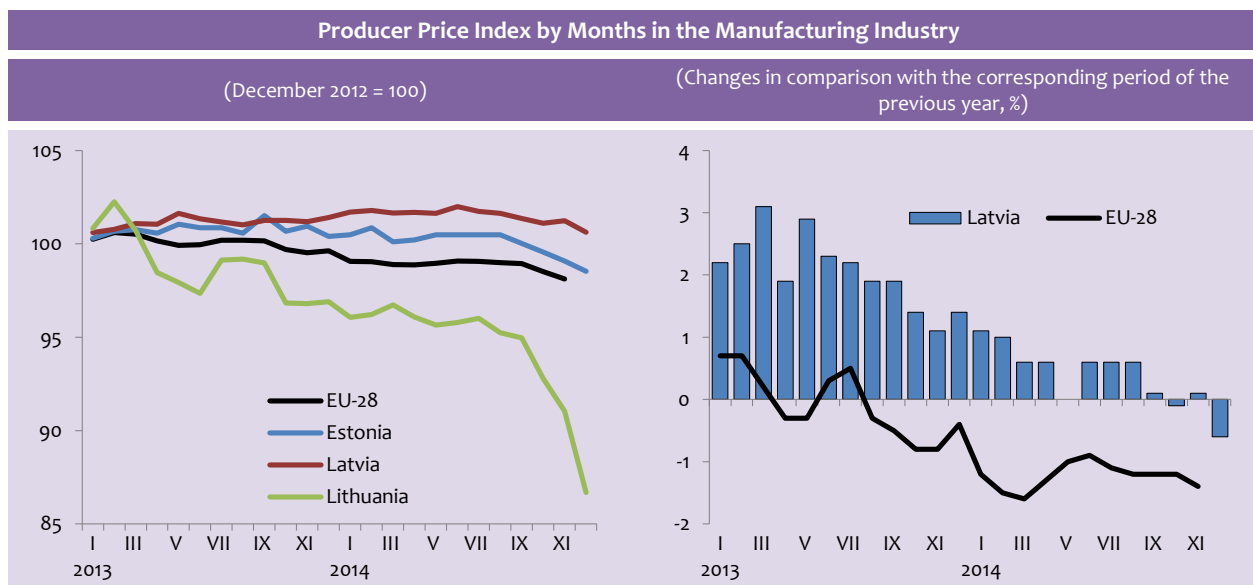


Figure 4.19



The fastest rise in producer prices in the manufacturing industry by sectors within the year was observed for the production of wood and wood articles (by 1.4%). The rise in producer prices in the production of wood articles was determined by the rise in prices for products sold on the domestic market and exported products alike. It should be noted that the prices for hardwood and softwood materials have increased worldwide within a year as well.

Figure 4.20



In the manufacturing industry, however, producer prices decreased for food production (by 2.9%), which

was mostly affected by the drop in prices specifically in September through December. Prices decreased for the

production of computer, electronic, and optical equipment as well (by 17.7%). The rise in producer prices for food production was determined by the rise in prices for products sold on the domestic market and exported products alike, whereas for the production of computer, electronic, and optical equipment, by the rise in prices for exported products.

Producer prices in the EU have been decreasing since mid-2011. It is mainly caused by the drop in food prices and in prices for agricultural and industrial raw materials, which, to a certain extent, was due to the decreasing demand worldwide in response to the escalating debt crisis in the eurozone, 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.

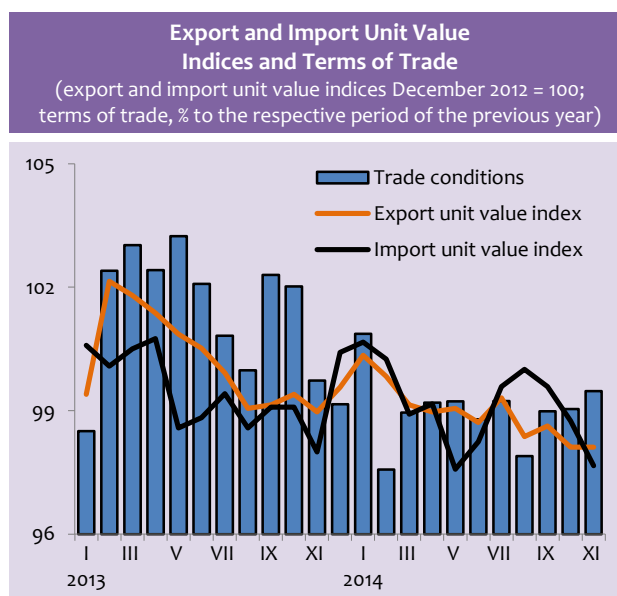
In 2014, the rise in EU producer prices continued to decrease, which was determined by the economic situation between the EU and Russia due to the Ukrainian crisis and the drop in the world prices for raw materials. When comparing the Baltic States, producer prices in the manufacturing industry decreased in all Baltic States in December 2014, as compared to December 2013. They experienced the sharpest drop in Lithuania due to the drop in the oil refining industry – by 10.4%, whereas in Estonia and Latvia, producer prices decreased by 1.6% and 0.6% respectively.

### 4.2.3 Foreign Trade Unit Value Indices

Taking into account a faster increase in the export unit value, the conditions of trade improved at the beginning of 2013; however, they worsened at the end of the year and in December 2013, as compared to December 2012, the unit value decreased by 0.4% for exported goods and increased by 0.4% for imported goods.

In November 2014, the terms of trade practically remained unchanged, as compared to the respective period of the previous year. Within a year, the unit value has decreased by 0.9% for exported goods and by 0.3% for imported goods. The average level of the export unit value in November 2014, as compared to November 2013, was mostly affected by the drop in the unit value for computers, electronic and optical devices, coke and oil refining products, food products, as well as by the increase in prices for wood and wood products, pharmaceutical products and water supply, waste water and waste management and treatment services. The average level of the import unit value was mostly affected by the drop in the unit value for coke and oil refining products, computers, electronic, and optical devices, as well as food products the increasing impact was caused by the rise in the value for agricultural and pharmaceutical products, clothing, electrical equipment, and automotive vehicles.

Figure 4.21



## 4.3. Balance of Payments

### 4.1.3 Current Account

The external stability of Latvia has significantly improved since the crisis. The deficit of the current account of the balance of payments decreased from 20.8% in 2008 to 2.3% in 2013. During nine months of 2014, the deficit of the current account reached 3.6% of GDP (1<sup>st</sup> quarter – 3.5%, 2<sup>nd</sup> quarter – 3.8%, and 3<sup>rd</sup> quarter – 4%). Despite the fact that the current negative balance of the current account has been steadily increasing every quarter in 2014, the average level of the current account over three years has not exceeded the

threshold determined in the EU early warning mechanism and is to be considered as sustainable.

Similar tendencies were observed also in the dynamics of the current account of our neighbouring countries. As the economic situation stabilised, insignificant fluctuations were observed in all three Baltic States. During the nine months of 2014, the balance of the current account was at a moderate deficit in Latvia and Estonia, while in Lithuania, there was a slight surplus in the current account balance.

Current account fluctuations are mainly determined by changes in the foreign trade balance. Latvia has a foreign trade deficit, which increased during the years of sharp growth, but decreased considerably during the

recession mainly in relation to the considerable decrease in the volume of imports. As the economy stabilised, exports grew faster than imports, though, the export and import dynamics has been slowing down over the recent years.

Over the last three years, the foreign trade deficit remained at an average annual level of 11.5% of GDP. Despite the slow pace, the foreign trade deficit has been annually decreasing as of 2011, which is mostly determined by the faster increase in exports than in imports. Imports in current prices increased by 1.2% in 2013, as compared to the previous year, while exports increased by 1.7%, and the foreign trade deficit reached 10.9% of GDP, which was almost by 1 percentage point higher than a year before, though considerably lower than before the crisis (in 2007 – 22.9%).

In 2014, similarly to two previous years, exports of goods grew faster than imports. Exports were positively influenced by the increase in the export volumes of wood and its products, mechanisms and machinery production, as well as goods of the chemical industry. However, in comparison with the respective period of the previous year, export volumes of metals and their products, mineral products, as well as products of the light industry decreased. During the three quarters of the year, import

volumes grew at a slower pace than exports and the foreign trade deficit, as compared to the nine months of 2013, decreased by almost 1 percentage point and reached 10.8% of GDP.

Figure 4.22

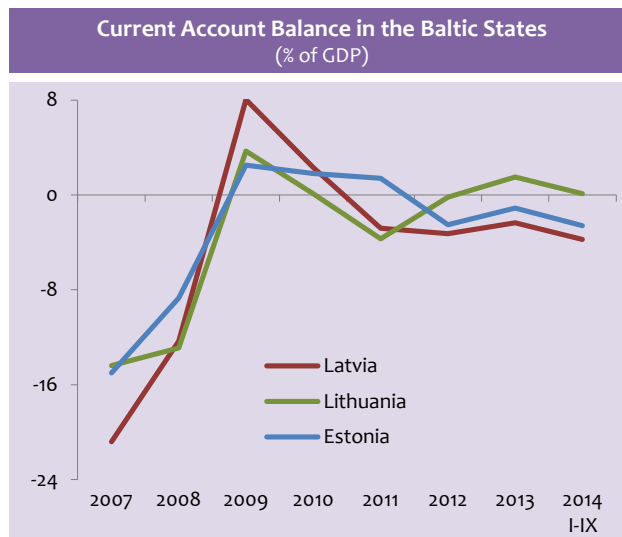


Table 4.6

Balance of Payments of Latvia (% of GDP)						
	2010	2011	2012	2013	2013 I-IX	2014 I-IX
<b>A. Current Account</b>	2.3	-2.8	-3.3	-2.3	-2.9	-3.8
Trade balance	-8.2	-12.0	-11.6	-10.9	-11.7	-10.8
Exports	36.6	40.9	43.8	42.2	42.1	41.8
Imports	-44.8	-52.9	-55.4	-53.2	-53.9	-52.6
Balance of services	7.2	7.3	7.4	7.6	7.8	7.4
Initial revenues	1.0	0.0	-0.6	-0.3	-0.3	-0.7
Secondary revenues	2.3	1.9	1.6	1.3	1.3	0.3
<b>B. Capital account</b>	1.9	2.1	3.0	2.5	2.5	3.3
<b>C. Financial account*</b>	-2.1	-4.0	2.9	0.7	0.9	-6.0
Direct investments	1.5	4.9	3.2	1.6	1.0	0.7
Abroad	-0.1	-0.2	-0.7	-1.3	-1.1	0.2
In Latvia	1.6	5.2	3.9	2.9	2.1	0.5
Portfolio investments**	-2.8	-1.8	4.7	0.1	0.1	0.0
Assets	-0.1	-1.0	-1.8	0.0	0.0	-7.7
Liabilities	-2.7	-0.8	6.5	0.1	0.1	7.7
Other investments	-0.7	-7.2	-5.1	-1.0	-0.3	-6.7
Assets	-3.3	-1.5	-1.2	0.0	-0.3	-11.8
Liabilities	2.5	-5.7	-3.8	-1.0	0.0	5.1
<b>D. Net errors and omissions</b>	1.8	0.3	1.0	0.8	1.1	5.8
<b>E. Reserve assets</b>	-4.0	4.5	-3.6	-1.7	-1.7	0.6

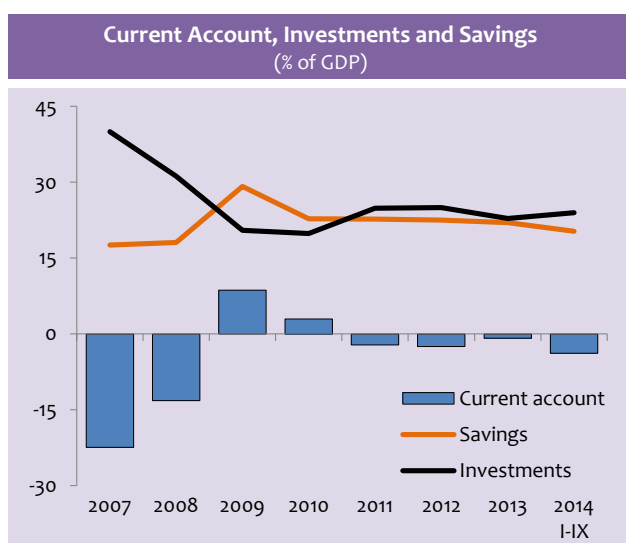
\* excluding reserve assets  
 \*\* portfolio investments and derivative financial instruments

The positive balance of services has been increasing annually since 2011. In 2013, the surplus of the balance of services reached 7.6% of GDP, thus covering almost 70% of the negative foreign trade balance. During the three quarters of 2014, the export volume of services in current prices was by 1.6% lower than a year before, whereas import volumes decreased by 1.1%; as a result, the surplus of the balance of services decreased to 7.4% of GDP (during the nine months of 2013, 7.8% of GDP). The positive balance of services covers the foreign trade deficit of goods to an extent of almost 80%.

The balance of initial revenues has been negative since 2011 and its fluctuations are mostly determined by changes in the deposit revenues of non-residents. In 2013, the deficit of initial revenues amounted to 0.3% of GDP. During the nine months of 2014, the negative balance of initial revenues increased to 0.7% of GDP, which mostly influenced the decrease in the loan flow, including the subsidies of EU funds received by Latvia.

Changes in secondary revenues and capital accounts are mainly influenced by the flow of the EU funds. In 2013 and during the nine months of 2014, the total balance of secondary revenues and capital accounts had a surplus of 3.8% and 3.6 % of GDP respectively.

Figure 4.23



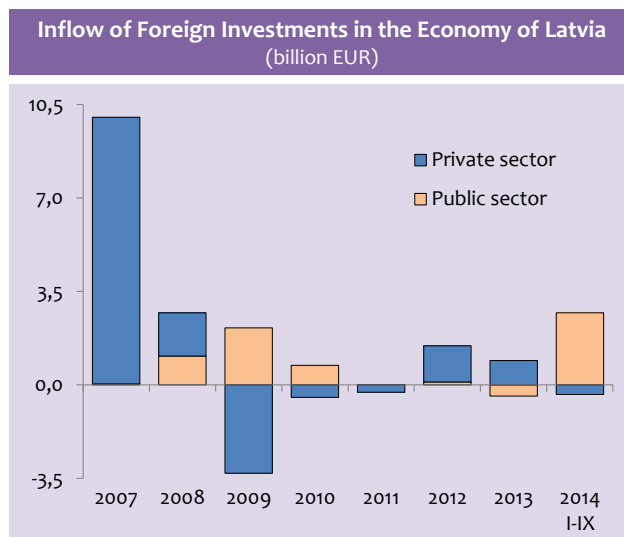
The considerable current account deficit during the pre-crisis period reflected a significant imbalance between domestic investments and savings. The level of national savings has been increasing gradually since 2007, reaching 21.5% of GDP during the three quarters of 2013 (in 2007, 19.2% of GDP), while the investment level in the national economy of Latvia dropped from 40% of GDP in 2007 to 23.8% of GDP in 2013. During the nine months of 2014, savings and investments remained at the level of the previous year. A moderate current account deficit is a proof of a balance between savings and domestic investments.

### 4.3.2 Financial Flows

The global financial crisis had a severe impact on cross-border financial and capital flows causing major adjustments to the financial account of the balance of payments. In 2007, the surplus of the financial account (excluding reserve assets) amounted to 24.7% of GDP, while in 2009, the financial account deficit was negative at close to 7% of GDP. The financial account deficit has been dropping since 2010. At the same time, the financial flows are stabilising.

Over the last years, the financial account balance has been mainly determined by measures to stabilise the financial sector, as well as the policy for restructuring debts and reducing debt commitments of the public sector.

Figure 4.24



Overall, during the period from 2009 until 2011, the financial account was negative, 6.1%, 2.1%, and 4% of GDP respectively. In 2012, however, the balance of the financial account was positive – 2.9% of GDP, with explicitly high quarterly fluctuations. In 2013, the financial account had a slight surplus – 0.7% of GDP. The positive balance of the financial account remained during all four quarters, with rather moderate fluctuations.

During nine months of 2014, the deficit of the financial account amounted to 6% of GDP (1<sup>st</sup> quarter – 5.1%, 2<sup>nd</sup> quarter – 6.7%, and 3<sup>rd</sup> quarter – 6.1%). If compared to the respective period of the previous year, the negative balance of the financial account increased by almost 7 percentage points, which was determined by the increase in the deficit of the account of other investments in 1<sup>st</sup> and 2<sup>nd</sup> quarter of 2014, and by the increase in the deficit of portfolio investment account in 3<sup>rd</sup> quarter.

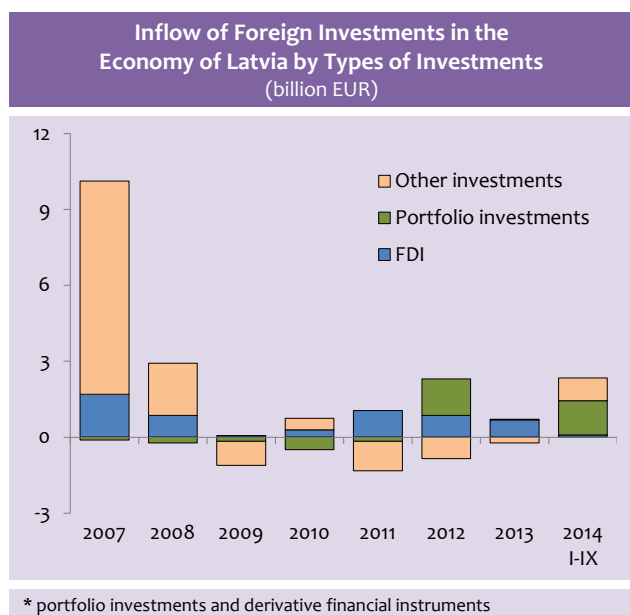


During the pre-crisis years, foreign investments were mainly attracted by the private sector. Unfavourable conditions on the global financial markets weakened the intensity of the flow of foreign investments and the volumes of private capital flow have been rapidly increasing since 2008. Since 2007, the structure of the attracted foreign capital flows has changed as well.

The balance of direct investments has remained positive for several years. FDI flows have been moderate over the recent years, which suggests the caution of foreign investors. In 2011, the attracted FDI amounted to 5.1% of GDP. In 2012, they decreased to 3.9% of GDP, while in 2013, they reached 2.6% of GDP. The decrease in the intensity of FDI flows is largely influenced by weak economic activities in the EU Member States.

During the nine months of 2014, the attracted FDI amounted to 26.3% of flows during the respective period of the previous year. It was mostly determined by the decrease in investments in the equity of companies, which was partially compensated by the increase in the re-invested profit.

Figure 4.25



The share of portfolio investments has been continuously changing over the last three years. Fluctuations of portfolio investment flows are considerably influenced by the activities aimed at balancing the banking sector, as well as restructuring the external debt. In 2012, the balance of portfolio investments had a surplus (4.5% of GDP), whereas in 2013, a small deficit (0.8% of GDP). During the nine months of 2014, the balance of portfolio investment account was positive – 0.6% of GDP.

Significant fluctuations were observed regarding other investments that formed a large part of the total foreign

investments until 2008. These include trade loans, loans and borrowings, money and deposits, etc.

The account of other investments of the payment balance is negative with clear quarterly fluctuations since 2009, which was mostly influenced by the decrease in deposits in the banking sector.

In 2012, just as in 2013, the negative balance of the account of other investments was 5.1% and 1% of GDP respectively. During the nine months of 2014, however, the deficit of the account of other investments increased up to 6.7% of GDP. Fluctuations of the balance of other investments, like those of portfolio investments, are mainly related to the measures to stabilise the financial sector and the restructuring policy of public sector debts.

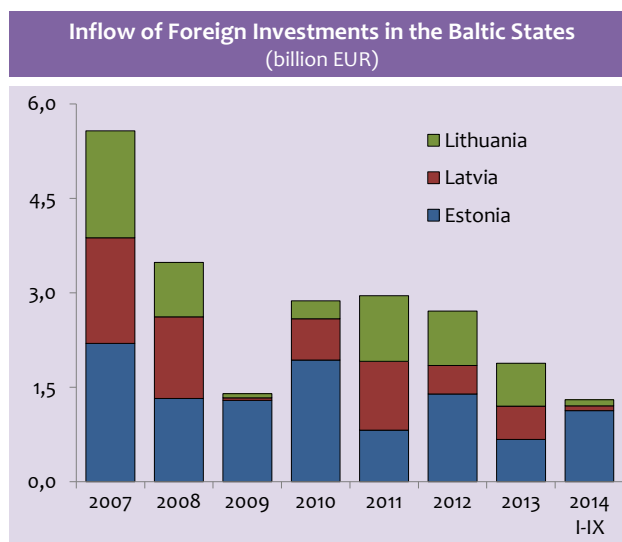
In general, incoming foreign investment flows are gradually stabilising, though they are considerably lower than they were before the crisis.

The gross external debt of Latvia remained at a comparatively high level. As the data of the balance of international investments of Latvia suggest, at the end of September 2014, the government gross external debt amounted to 141.6% of GDP. The government gross external debt reached EUR 7904.7 million (33.1% of GDP).

### 4.3.3 Foreign Direct Investments

The intensity of FDI flows has become more moderate over the recent years. Similar tendencies were observed in our neighbouring countries as well.

Figure 4.26



In 2013, the total amount of incoming FDI in the Baltic States was by 33.4% less than during the previous year. Latvia attracted 35.3% of all FDI in the Baltic States region in 2013.

During the nine months of 2014, the total amount of incoming FDI in the Baltic States amounted to EUR 1,300.9 million, i.e. by 7% less than during the previous year. Latvia attracted approximately 7% of all FDI in the Baltic States.

Activity of Latvian investors abroad has been increasing since 2010. In 2013, direct investments of Latvian entrepreneurs abroad were almost twice as high as the year before, amounting to 1.3% of GDP.

The structure of the incoming FDI by types of investments shows that direct investment enterprises have been operating with losses from 4<sup>th</sup> quarter of 2008 until 2<sup>nd</sup> quarter of 2010. Losses of foreign direct investment enterprises were fully compensated by great investments in equity capital and other capital, and therefore the incoming FDI flows were positive.

FDI flows experienced a rapid increase along with the economic recovery and the increase in economic activities. The volume of incoming FDI in 2010 was four times greater than in 2009. In 2011, the volume of attracted FDI amounted to 5.1% of GDP, whereas in 2012 and 2013, their volume decreased and reached 3.9% and 2.6% of GDP respectively. Net flows of attracted FDI during the nine months of 2014 amounted to 26.3% of the flows of the respective period of the previous year. It was mostly determined by the decrease in the equity capital of enterprises, which was partially compensated by the increase in the re-invested profit.

According to the international investment balance of Latvia, the FDI stock in the economy of Latvia reached EUR 11'735.6 million at the end of September 2014 and amounted to almost 28% in the structure of the accrued foreign capital. If compared to the respective period of the previous year, the level of accrued FDI increased by 3%, which was influenced by the increase in volumes of

direct investments accrued by German, Hungarian, and Russian enterprises. Investments in bank intermediation, transactions involving real estate, and manufacturing industry have the largest share of accrued FDI in the structure of sectors.

The global financial crisis did not affect the geopolitical structure of foreign capital stock of Latvia. Mainly, these are investments of the EU Member States. At the end of September 2014, the FDI of the EU Member States amounted to 70% of all FDI stock, and almost a half of them are investments of eurozone countries.

Figure 4.27

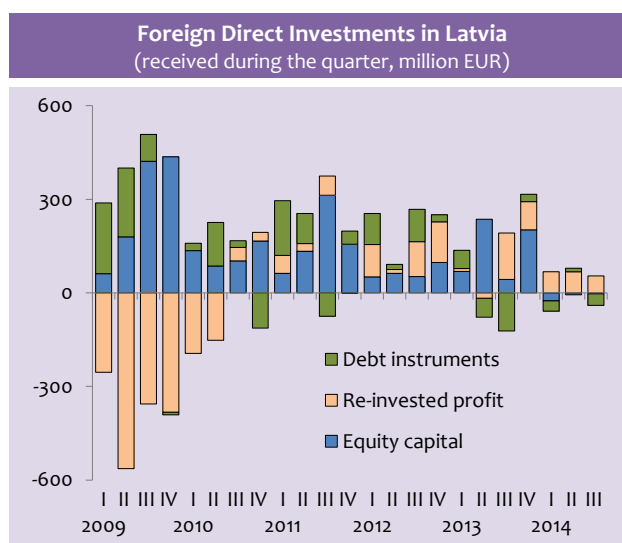
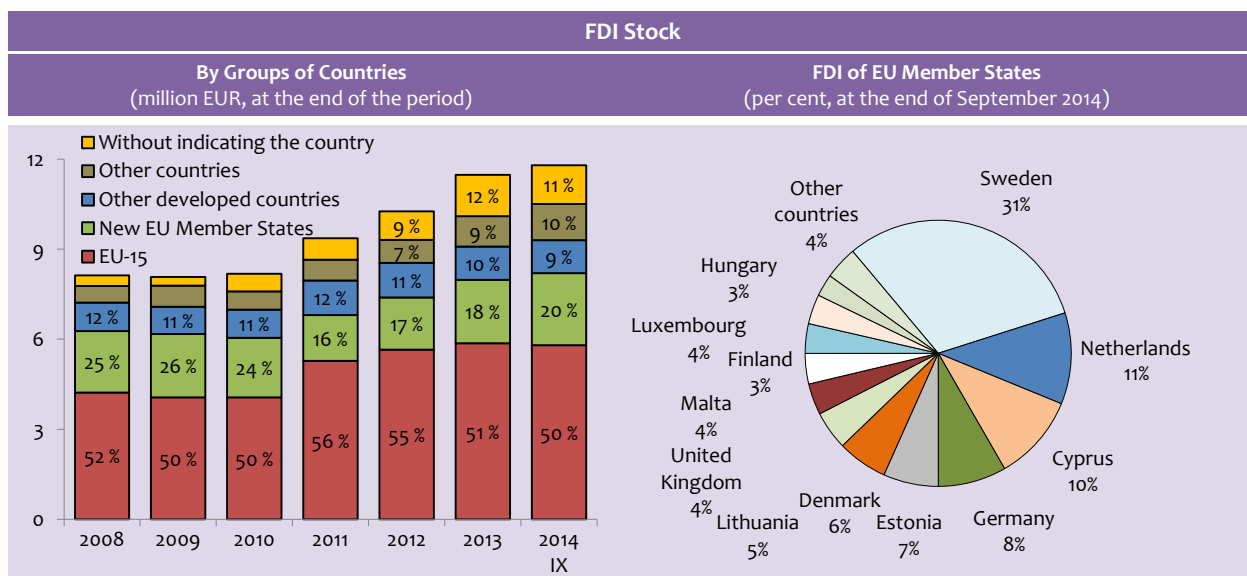


Figure 4.28



Sweden is the largest investor in the economy of Latvia. At the end of September 2014, investments of Swedish entrepreneurs constituted almost 22% of the total FDI stock. Mainly, they are investments in financial intermediation. Since the end of 2008, direct investments of Sweden have increased 2 times, which is mainly related to mutual transactions in the banking sector between Estonia and Sweden. Therefore, the FDI stock of Estonian entrepreneurs in Latvia decreased by almost a half amounting to 4.7% of the total FDI stock at the end of September 2014 (at the end of 2008 – 16.1%).

Extensive investments were also made by entrepreneurs from the Netherlands, Cyprus, Germany, Norway, Russia, Estonia, Lithuania, Denmark, and the United Kingdom. The investment volumes of these countries at the end of September 2014 amounted to almost 70% of the total FDI stock in the economy of Latvia. It must be noted that the activity of investors from Asia has increased in Latvia over the recent years.

At the end of September 2014, the FDI stock of Asian countries amounted to 2.5% of total FDI in the economy of Latvia and, as compared to late 2008, they increased almost 3 times. At the same time, investments of entrepreneurs from Finland and Ireland into the economy of Latvia decreased considerably.

The FDI are focused mainly in services sectors.

During the period of rapid growth, investments in the financial intermediation sector explicitly dominated in the structure of incoming FDI flows. The average annual amount of FDI in the services sector was almost four times higher than in the manufacturing sector.

Since 2010, the structure of incoming FDI flows has levelled out, without any explicit dominance of the financial sector. It should be noted that average annual investments in service sectors have been exceeding the investments in manufacturing industries nearly five times over the last three years.

Table 4.7

FDI by Sectors (at the end of the period)						
	Balance (million EUR)			Structure (%)		
	2005	2007	2014 IX	2005	2007	2014 IX
Agriculture	64.6	130.3	308.5	1.6	1.7	2.6
Manufacturing industry	490.2	695.4	1432.1	11.8	9.3	12.2
Other industry	544.8	439	508.7	13.1	5.9	4.3
Construction	175	513.6	505.1	4.2	6.9	4.3
Trade and accommodation	577.8	1002.9	1413.4	13.9	13.4	12.0
Transport and storage	257.4	282.1	386.1	6.2	3.8	3.3
Financial intermediation	1063	2492.2	2915.4	25.6	33.4	24.8
Real estate activities	283.8	662.4	1473.3	6.8	8.9	12.6
Other services	702.5	1247.3	2793.0	16.9	16.7	23.8
<b>Total</b>	<b>4159.1</b>	<b>7465.2</b>	<b>11735.6</b>	<b>100</b>	<b>100</b>	<b>100</b>

The accrued FDI in the services sector at the end of September 2014 amounted to almost 76.5% of the total FDI stock in the national economy of Latvia. If compared to the end of 2007, they have increased by 58%. Financial intermediation and real estate sectors constitute almost a half of the FDI stock in services sectors.

The accrued FDI in manufacturing sectors at the end of September 2014 amounted to almost 23.5% of the total FDI stock in the national economy of Latvia. If compared to the end of 2007, they have increased by 55 per cent.

A particularly rapid increase in the FDI stock in industry was observed in the manufacturing industry from the end of 2007 until the end of September 2014 – by 106%. The increase in the FDI stock in the manufacturing industry was largely influenced by

substantial investments in the production of construction materials and food production.

Overall, structural changes of FDI stock in the manufacturing industry from the qualitative aspect suggest that the share of low technology industries decreases in favour of medium low and medium high technology sectors.

Although FDI flows in Latvian manufacturing industry have been relatively stable even during the rapid downturn, it should be noted that Latvia is behind Lithuania and Estonia in terms of attracting FDI to this sector.

**The Investment and Development Agency of Latvia (IDAL)** plays a significant role in attracting foreign investments. The investment attraction strategy of the IDAL is focused on the proper maintenance of incoming investment projects and active operations

related to the attraction of investment projects, by addressing the potential investors.

During the nine months of 2014, processing of incoming investment projects was rather extensive – 334 investment information requests were processed and 73 investment offers were prepared. The IDAL representations organised meetings with 72 potential investors and visits of 114 potential investors to Latvia. Overall, work has been carried out on 192 potential investment projects, while continuing the work on both the investment projects accrued during previous periods and projects commenced in 2014, as well as on projects for which post-maintenance was carried out.

In 2014, 16% of all projects submitted by foreign investors were in the metal processing and machinery sectors, whereas, if the projects of the electronics sector are also taken into account, then they amounted to one fifth. Service centres are the next most popular sector (12%) among projects, followed by life sciences (9%) and information technologies (7%). It should be noted that the number of projects in the information technologies sector doubled and reached 7%, as compared to 2013. The number of projects in other service and manufacturing sectors is increasing as well, for instance, in education, engineering and technical services, extraction of useful minerals, peat processing, production of polymer pipes, light industry, etc.

Overall, 56% of potential investors that were cooperating with the IDAL in 2014 came from European countries. The largest number of potential investment projects, on which work was carried out during the nine months of 2014, came from countries, in which IDAL representations are located (exceptions – the USA and Italy). Overall, 69% of all investments projects came from countries, in which IDAL representations are operating. Currently, Latvia is mainly considered by potential investors from the Russia (10%), Sweden (8%), the USA (8%), Norway (7%), and France (7%). During the nine months of 2014, 15 investors made positive decisions regarding the implementation of new investment projects and 13 investors – regarding current projects. As a result of the complete implementation of projects, the anticipated amount of investments is EUR 117.43 million, creating 1100 new jobs. For instance, a chocolate manufacturer – the family company *Pobeda Confectionery* made a decision to construct a production unit in Latvia, investing over EUR 10 million in total and creating 60 new jobs; an IT service centre already operating in Latvia doubled its number of employees (from 250 to 500) within the period from 2014 to 2015, supplementing its duties with new functions; the company *Lanos*, which manufactures specialised metal doors for ships, is expanding its operation in Latvia, currently investing EUR 0.5 million and creating 100 new jobs; the electronics company *Schneider Electric* will expand its activities by constructing a completely new production line in Latvia with a higher added value (microcircuits), investing EUR 10 million and creating 270 new jobs, etc.

To improve the attraction of investments significant for Latvia, the IDAL continues the POLARIS process of the investment attraction methodology, which is aimed at the attraction of investments into the export with high added value. Within the framework of the POLARIS project, a strategically significant role is attributed to the promotion of partnership and cooperation between the public and private sector. One of the priorities in this regard is the work with local governments, taking into account the important role of qualitative work of local governments in arranging the business environment and attracting investments. To ensure a close co-operation, 4 new co-operation agreements were entered into with local governments (Gulbene, Mārupe, Limbaži, and Stopiņi Regional Councils) on more active co-operation in the field of attracting investments since early 2014.

In 2014, the IDAL along with the Latvian Association of Local and Regional Governments co-organised a discussion cycle aimed at addressing the issues of investment attraction in the regions. In 2015, it is planned to continue co-operation in the organisation of joint discussions. Likewise, in 2014, the IDAL started participating in the training programme “Knowledge Angels” organised by the Ministry of Environmental Protection and Regional Development (hereinafter – the MEPRD) for local governments employees involved in promoting business and planning development. The IDAL will continue its participation in this programme throughout 2015.

The IDAL closely co-operates with the Council of Foreign Investors in Latvia and annually co-organises meetings with the Cabinet of Ministers to examine the developed recommendations on the improvement of Latvian business and legal environment.

Regular work is continued on the elimination of established investment impediments within the framework of the Council for the Coordination of Large and Strategically Significant Investment Projects. The issue in the field of employment should be mentioned as a positive result of the work of the Council for the Coordination of Large and Strategically Significant Investment Projects in eliminating investment impediments. In late 2013, the IDAL received a letter from outsourcing centres regarding problems they faced in Latvia. A problem in the framework of the Labour Law was established, which did not motivate employers to invest in the training of employees. The IDAL pointed to this problem during the discussion of the IT and global business services sector, in communication with the Ministry of Education and Science and the Ministry of Welfare, as well as at the 13<sup>th</sup> session of the Council. A year after the letter of outsourcing centres was received, amendments were adopted by the Saeima (23.10.2014) and came into force on 1 January 2015.

The development of the project of MEPRD concept on the improvement of legal framework regulating the use of natural resources for attracting potential investments should be assessed positively as well. The development of this project is currently transferred for

discussion and it was initiated within the framework of the issue examined within the framework of the Council for the Coordination of Large and Strategically Significant Investment Projects. The work on these issues is continued.

In assessing global tendencies in attracting investments, in 2015, it is planned to continue emphasising the role of post-maintenance in making new investment decisions. It promotes the improvement of

satisfaction of foreign investors already investing in Latvia and, hence promotes new investment decisions.

Global trends suggest the gradual return to the pre-crisis investing format (investments in greenfield projects), which had proportionally and numerically reduced during the crisis. It provides for a need to focus the support instruments on the needs of projects, which might promote making decisions in favour of Latvia (for instance, support to investments in infrastructure, construction, acquisition of equipment).

## 4.4 Financial and Capital Markets

### 4.4.1 Monetary Policy

The main goal of the Bank of Latvia is to ensure price stability that boosts long-term economic growth. Its principal tasks are as follows:

- To participate in the development and implementation of the monetary policy of the Eurozone;
- To manage financial investments;
- To ensure cash turnover in Latvia and to participate in ensuring cash turnover in the eurozone;
- To participate in facilitating expedient operation of the payment system of the *Eurosystem*;
- To prepare and publish statistical information in accordance with requirements of laws of the European Union.

Latvia has been a member of the European Central Bank (ECB) since joining the EU. Until the introduction of the euro, Latvia has coordinated monetary policy instruments and procedures for monetary operations and the management system of foreign currency reserves has been adapted to ECB requirements. The Bank of Latvia is already using the same indirect monetary policy instruments based on free market principles as the ECB. For Latvia, being a member of the *European Monetary System (EMU)* means:

- A single currency with other EMU member states – the euro;
- A single monetary policy in the entire eurozone implemented by the ECB with central banks of the eurozone;
- Coordination of economic and fiscal policy among the member states.

As of 1 January 2014, along with introduction of the euro, the Bank of Latvia has become a member of the *Eurosystem*.

#### Box 4.1

##### Eurosystem

As a member of the *Eurosystem*, the Bank of Latvia, in its relations with co-operation partners (credit institutions registered in the Republic of Latvia or branches registered in the Republic of Latvia of credit institutions registered abroad) is implementing the monetary policy of the ECB. Monetary policy decisions in the *Eurosystem* fall within the competence of the ECB Governing Council. The Governing Council consists of governors of the national central banks of all eurozone countries and the six members of the ECB Executive Board. Latvia in this Council is represented by the President of the Bank of Latvia. Members of the ECB Governing Council are independent in their stances and voting. The primary goal of the ECB Governing Council is to act for the eurozone as a whole. Responsibilities of the ECB are:

- to adopt guidelines and take decisions necessary to ensure the performance of the tasks entrusted to the *Eurosystem*;
- to formulate the monetary policy for the eurozone. This includes decisions relating to monetary objectives, key interest rates, the supply of reserves, and the establishment of guidelines for the implementation of these decisions.

The decision-making on interest rates takes place once a month; however, the ECB Governing Council is entitled to pass a related decision at any time, outside the regular meeting schedule.

The main goal of the *Eurosystem* is to maintain price stability. It must support the general EU economy policy. *Eurosystem* will operate according to the open market economy principle envisaging a free competition under an effective distribution of resources. To successfully implement the set monetary policy goals, independence of central banks from governmental authorities and their decisions will be determined as a significant pre-condition. Institutional independence is required since the implementation of the monetary policy must be carried out in accordance with the medium-term and long-term perspective, and the implementers of the monetary policy may not submit to any short-term interests. The institutional independence also means a prohibition for the central bank of the state to fund any expenses of the government or its institutions.



To implement the monetary policy of the *Eurosystem* and to ensure liquidity of credit institutions, the Bank of Latvia offers market participants the following monetary policy operations:

- Open market operations;
- Overnight marginal lending facility;
- Overnight deposit facility;
- List of marketable assets eligible for *Eurosystem* monetary policy operations.

#### 4.4.2 Market Structure and Development

At the end of the 3<sup>rd</sup> quarter of 2014, 17 **banks** operated and 9 branches of the EU member states were registered in Latvia. There are 6 branches of Latvian banks operating abroad. Banking services in Latvia can also be provided by credit institutions or their branches, which are registered in the European Economic Area countries and have submitted an application to the Financial and Capital Market Commission (FCMC).

In 2014, the banking sector underwent several significant changes:

- Commercial activity of VAS “Mortgage and Land Bank of Latvia” to be phased-out, and as of 1 January 2014, it has been reorganized into a development financial institution with a new name – VAS *Latvijas Attīstības finanšu institūcija Altum*;
- An agreement on the sale of 75% of AS “Citadele banka” shares to an international group of investors, represented by a US investment company and 12 investors, has been signed.<sup>1</sup> ERDB will maintain its ownership of 25% of shares of the bank. It is planned to conclude the transaction in the 1<sup>st</sup> quarter of 2015;
- The sale of five corporate and mortgage loan portfolios of AS “Latvijas Krājbanka” has been successfully completed. The sale has been commenced after initiating a liquidation process of AS “Latvijas Krājbanka” in the spring of 2012. Despite the sale of credit portfolios of AS “Latvijas Krājbanka”, the procedure of bankruptcy of the bank continues. Furthermore, litigation for the recovery of various assets is continued in Latvia and abroad to be able to settle the accounts with the creditors of the bank;
- On 1 January 2014, the licence for performing activities of a credit institution issued to SJC “UniCredit Bank” was cancelled.

The single supervisory mechanism (SSM) of the European banks has entered into force on 4 November 2014, to implement a single monitoring approach and prevent issues in any of the states. It is aimed at moving towards an integrated supervisory mechanism to restore

confidence in the banking industry and to minimize the costs of bank bankruptcies. The SSM will be composed of the ECB and national supervisory authorities. In Latvia, the ECB will take over the supervision of three largest banks (Swedbank, SEB bank and ABLV Bank). In relation to other banks, these tasks will remain within the competence of FCMC. Furthermore, the FCMC will co-operate with the ECB, by providing information about significant supervision decisions and other credit institutions of Latvia.<sup>2</sup>

In the 3<sup>rd</sup> quarter of 2014, performance indices of all Latvian banks complied with the regulatory requirements. The liquidity ratio of banks was high – 63.5% that was two times higher the prescribed minimum requirement (minimum regulatory requirement was 30%). In 2013, the FCMC set higher individual liquidity ratio requirements for banks depending on the amount of non-resident deposits in the total bank assets.

The banking sector capitalisation level continued to increase. In the 3<sup>rd</sup> quarter of 2014, the average banking sector capital adequacy ratio reached 20.8% (the minimum regulatory requirement is 8%), which is the highest result over the past few years. The return on assets (ROA)<sup>3</sup> has increased to 1.17%, which is the highest result since the end of 2008. The return on equity (ROE)<sup>4</sup> has slightly decreased and was 11.8 per cent.

Bank profitability is still positive, and in the three quarters of 2014, the profit in the bank sector increased by 26% and was EUR 240 million, compared to the respective period of the previous year.

The **insurance market** kept growing at a stable pace. In 2014, compared to 2013, the number of insurance companies in Latvia has remained unchanged: in the three quarters of 2014, 7 insurance companies, 2 of which offered life insurance and 5 offered non-life insurance, operated in Latvia. Furthermore, there were also 14 branches of foreign insurance companies, which is by one more than in 2013.

In the three quarters of 2014, compared to the respective period of 2013, the amount of gross premiums signed by insurance companies has increased by 3.7% reaching EUR 271.1 million. The greatest increase in three quarters was observed in premiums signed for life insurance. The amount of paid gross compensations has increased by 5.8%, reaching EUR 152.2 million. In the three quarters of 2014, insurance companies operated with a profit of EUR 11.7 million: non-life insurance companies, with EUR 8.7 million profit, whereas life insurance companies, with EUR 3 million profit.

Since the end of 2011 until 2013, the situation in the **Latvian securities market** significantly improved, while the situation slightly deteriorated at the beginning of 2014, and the value of OMX Baltic Benchmark index slightly decreased. The value of NASDAQ OMX Riga

<sup>1</sup> 75% 75% of bank shares are owned by the state of Latvia represented by the Privatization Agency, while the proprietor of 25% and one share is the European Bank for Reconstruction and Development.

<sup>2</sup> Out of all 6000 banks in the eurozone, about 200 will be subject to direct supervision of the ECB according to approved criteria.

<sup>3</sup> ROA – ratio of profit/loss to assets.

<sup>4</sup> ROE – ratio of profit/loss to capital and reserves.



and NASDAQ OMX Tallinn index also decreased, however, over a longer period of time (3 years), the Baltic market indexes have considerably increased. As of 1 October 2014, the Baltic exchanges will use also the new brands Nasdaq Riga, Nasdaq Tallinn and Nasdaq Vilnius.

A decrease in the amount of loans triggered an increase in investments into securities. In the 3<sup>rd</sup> quarter of 2014, compared to the 3<sup>rd</sup> quarter of 2013, the amount of central government debt securities in bank assets has considerably increased (by 54%) mainly due to the increase in the amount of foreign central government securities. Out of other securities, the amount of non-government bonds and fixed income securities had fastest annual increase (by 60%), whereas the amount of shares and other variable-yield securities experienced a decrease (by 14%).

#### 4.4.3 Assets, Deposits and Loans

A rapid increase in **bank assets** of Latvia was observed at the end of 2013, which was determined by the expected introduction of euro – cash accruals of the population were deposited into bank accounts. Thus, the amount of the currency outside MFI decreased significantly, and use of non-cash assets increased. However, when the euro replaced the lats, the amount of the currency outside MFI increased significantly from 667.8 million euro at the end of 2013 to EUR 3615.3 million at the end of the 3<sup>rd</sup> quarter of 2014.

Although at the end of the 1<sup>st</sup> quarter of 2014 a decrease in the bank assets was observed, bank assets increased in the subsequent two quarters, reaching EUR 29.8 billion in the 3<sup>rd</sup> quarter, which is by 3.6% more than a year ago. The share of loans granted to non-banking institutions has decreased to 50.3% of total assets (compared to the 3<sup>rd</sup> quarter of 2010, when bank credits formed 70% of bank assets), whereas the amount of securities has increased.

Table 4.8

Monetary Indicators of the Latvian Banking System								
	2007	2008	2009	2010	2011	2012	2013	2014 IX
At the end of the period, billion EUR								
Net foreign assets	-6.4	-8.4	-4.3	-1.7	-0.3	0.9	1.2	-0.3
Net domestic assets	15.2	16.9	12.6	10.8	9.5	8.8	8.6	9.3
Domestic loans	18.5	20.3	17.4	16.0	15.7	13.7	13.5	12.6
to the government (net)	-0.1	-0.5	-2.1	-2.0	-0.9	-1.3	-0.7	-0.8
to companies and individuals	18.6	20.8	19.5	18.0	16.7	14.9	14.1	13.5
Other assets (net)	-3.4	-3.5	-4.8	-5.1	-6.2	-4.9	-4.8	-3.3
Broad money M2X	8.8	8.4	8.3	9.1	9.2	9.6	9.8	8.9
Cash in circulation (without vault cash balance)	1.3	1.2	0.9	1.1	1.5	1.5	0.7	3.6
Deposits of individuals and companies, including	7.5	7.2	7.3	7.9	7.7	8.1	9.2	8.9
overnight deposits	4.1	3.3	3.1	4.0	4.4	5.1	6.6	6.5
time deposits	3.4	3.9	4.2	4.0	3.3	3.0	2.6	2.5
Changes in % compared to the respective period of the previous year								
Domestic loans, including:	31.8	9.7	-14.5	-8.1	-1.5	-13.1	-1.4	-2.2
to companies and individuals	34.0	11.8	-6.6	-7.6	-7.4	-10.4	-5.3	-5.6
Broad money M2X	12.6	-3.9	-1.9	9.8	1.5	4.5	2.0	-3.7
Cash in circulation (without vault cash balance)	-7.1	-3.8	-22.9	21.0	28.8	4.1	-56.6	197.7
Deposits of individuals and companies	16.9	-3.9	1.7	8.3	-2.4	4.5	13.2	-3.7
GDP (at current prices)	32.3	9.3	-18.7	-2.2	11.7	8.7	5.6	3.7

Along with the expected introduction of the euro, the **balance of deposits** attracted by banks increased considerably, reaching EUR 19.5 billion at the end of

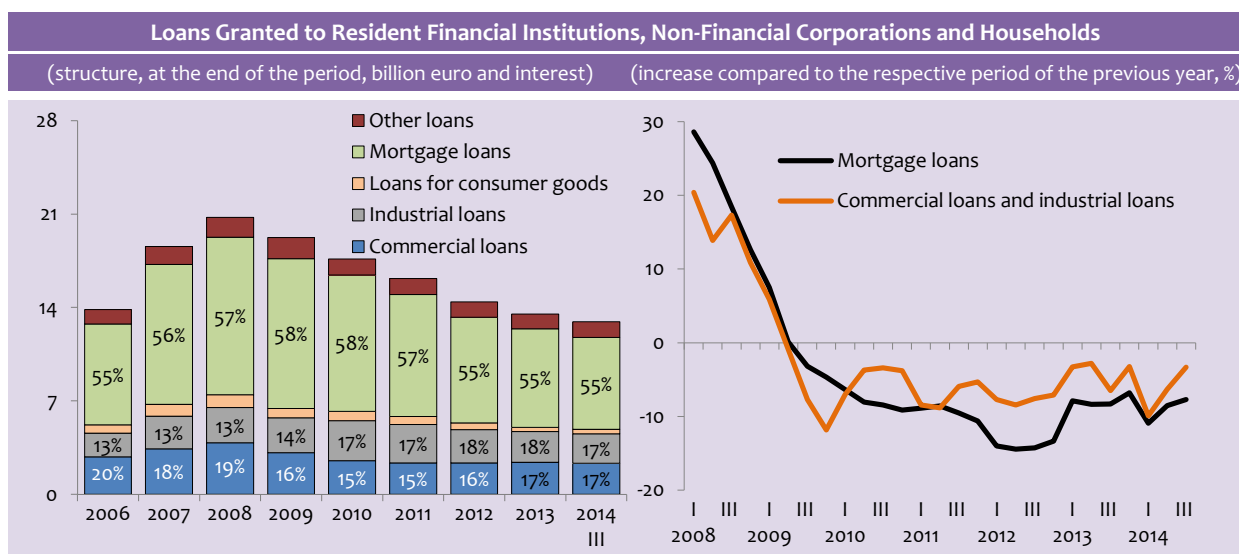
2013. At the beginning of 2014, the rate of the increase in deposits slowed down slightly, though, in the 3<sup>rd</sup> quarter, the amount of deposits increased by 14%, compared to

the respective period of the previous year, which was the biggest increase since the end of 2010. Resident and non-resident deposits constituted almost an equal share in the total amount of deposits. The structure of non-resident deposits has not changed considerably during the past years – out of non-resident deposits 15% are deposits from the CIS countries and 33% are deposits of the rest of the European Economic Area (EEA) countries, whereas deposits of other countries constitute the largest part (52%). Since the end of 2010, the share of deposits of the CIS countries has almost doubled. Higher requirements for liquidity and capital adequacy are applied to the banks working with non-resident deposits.

Along with the introduction of euro, the structure of deposit currencies has undergone considerable changes. Most deposits of residents are made in euros (91.7%), whereas most deposits by non-residents are still made in USD (64.1%).

The **balance of granted bank loans** still continues decreasing. It is mainly related to payment of previously granted loans and write-off of bad loans. The balance of loans granted to residents' financial institutions, non-financial corporations and households decreased by 5.3% at the end of the 3<sup>rd</sup> quarter of 2014 in comparison with the corresponding period of the previous year.

Figure 4.31



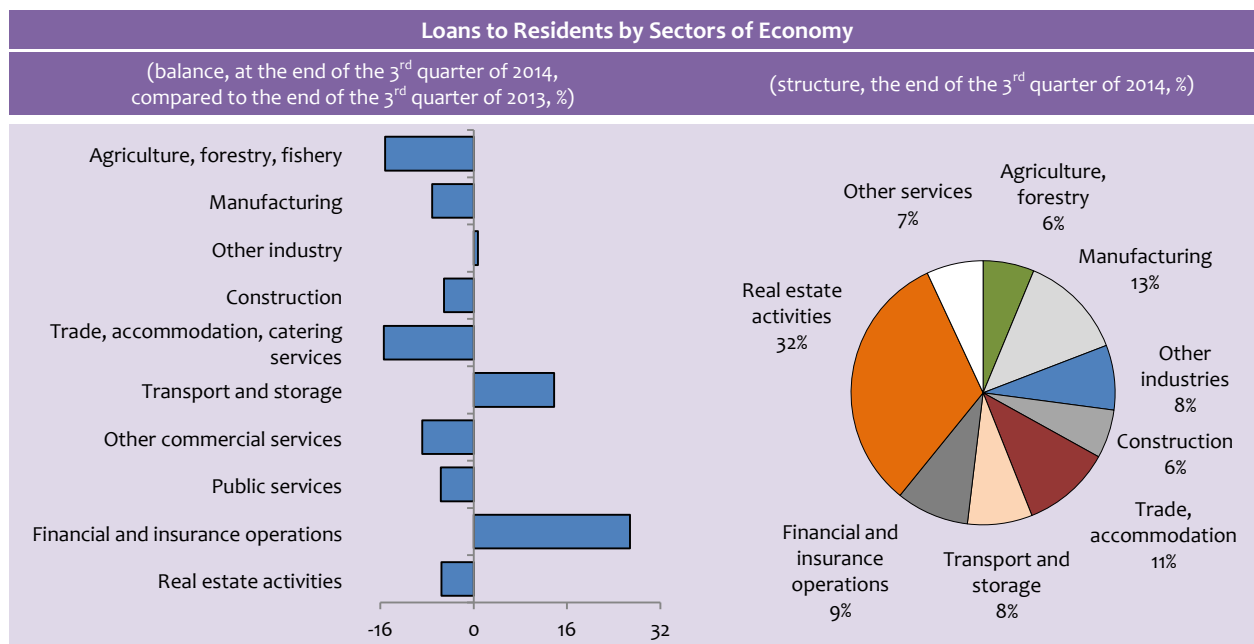
The following trends have been observed in the lending sector:

- the amount of new loans issued decreased considerably in 2014: in the 3<sup>rd</sup> quarter of 2014, the banking sector issued new loans in the amount of EUR 673 million, which is by almost 22% less than a year ago. Out of the new loans, almost a half was issued to non-residents. The share of loans issued to non-residents has slightly increased in 2014, it constitutes just 12.4% in the total loan portfolio of the banking sector, and this indicator has remained almost unchanged for at least past ten years;
- the overall dynamics of household loan portfolio remains negative, and household lending is still at a low level. In the 3<sup>rd</sup> quarter of 2014, the amount of new household loans increased slightly, though, it still remained low. In terms of amount, most new loans have been granted for the purchase of housing. The lack of first instalment or borrower's self-financing is still a significant obstacle for households to receive a loan;

- moreover, business lending is still weak. In the 3<sup>rd</sup> quarter of 2014, compared to the respective period of 2013, the amount of new credits issued to companies decreased by 36%. The amount of new credits decreased in almost all largest sectors of national economy, except construction and real estate activities. Overall, in the 3<sup>rd</sup> quarter of 2014, the amount of credits issued to residents was by 5.9% lower than in the respective period of 2013.

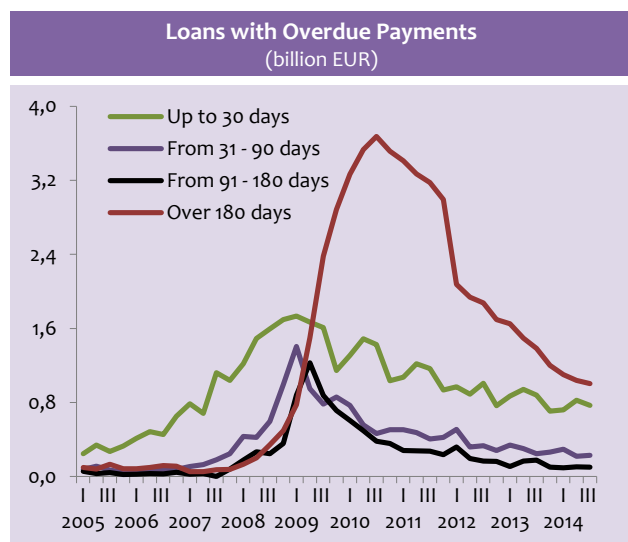
No significant changes in the structure of loans have been observed. Mortgages still dominate in the structure of loans granted to domestic companies and individuals; the share of mortgages in the overall loan structure has shrunk to 53.2% in the 3<sup>rd</sup> quarter of 2014. The share of commercial credits and industrial credits in the total loan structure has slightly increased, and it is 35.2%. The share of consumer credits in the overall loan structure is 2.6%. In the 3<sup>rd</sup> quarter of 2014, the sharpest decrease was observed in the balance of industrial loans (by 7.7%) and in the balance of mortgage loans (by 7.7%). Commercial lending (for increasing the working capital) also experienced a slight increase. A similar situation can be observed with consumer credits.

Figure 4.32



When distributed by sectors of national economy, the largest share of loan balances is still related to real estate activities (32% of the total loans granted). A relatively high share of granted loans is also observed in manufacturing (13%), trade, accommodation and catering sectors (11%), as well as the transport and storage (8%).

Figure 4.33

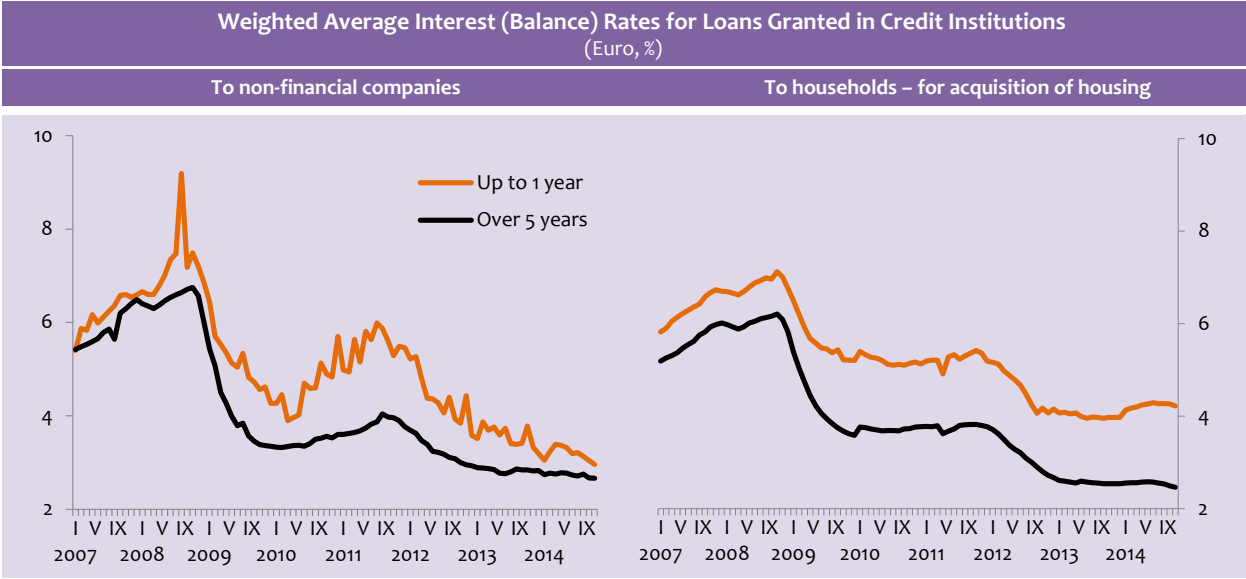


The quality of loans continues improving, and the amount of loans with overdue payments is decreasing. The amount of loans with overdue payments in the total loan portfolio was 14.2% in the 3<sup>rd</sup> quarter of 2014, which is the lowest indicator since the end of 2008. The improving quality of banks' loan portfolio is mainly related to writing-off bad debts, which is an increasing tendency.

Banks continue co-operating with the clients facing difficulties to repay the loans. The share of restructured loans and loans currently being recovered in the total banks' loan portfolio is decreasing. At the end of the 3<sup>rd</sup> quarter of 2014, restructured loans and loans currently being recovered constituted 14.8% of the total loan portfolio. The share of restructured loans in the total banks' loan portfolio dropped to 7.8%, whereas the share of loans currently being recovered – to 7 per cent.

The interest (balance) rates on short-term and long-term loans granted to non-financial institutions have decreased in the past three years and are almost equal. The interest (balance) rate for credits granted to households for the acquisition of housing has decreased since 2012; however, in 2014, it has slightly increased again.

Figure 4.34

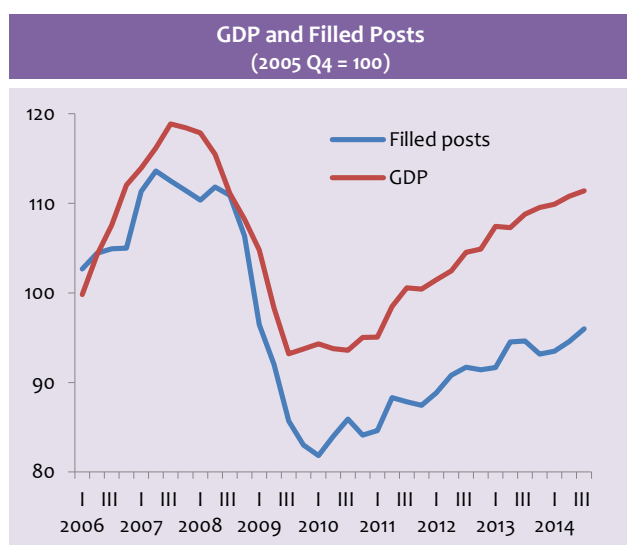


## 5. LABOUR MARKET

### 5.1 Employment and Unemployment

The gradual improvement of the economic situation also positively affects the situation on the labour market – unemployment is decreasing and employment is increasing. At the same time, certain population groups, especially people having a low level of education and qualifications, older people, as well as the youth barely feel the improvement.

Figure 5.1



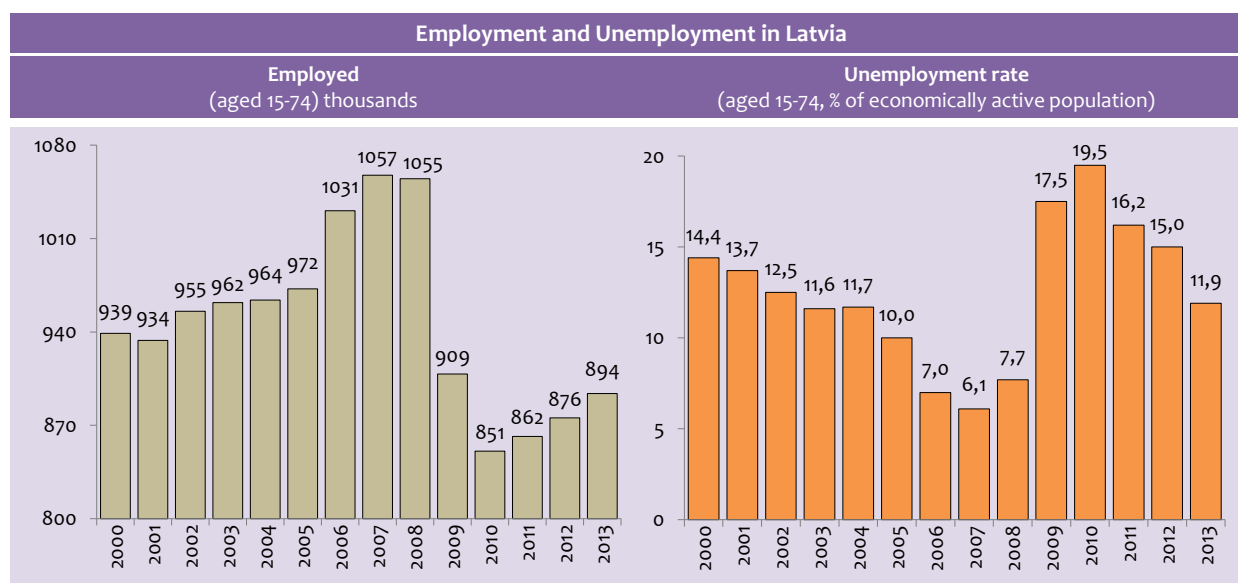
Since the middle of 2010, the number of employed has been increasing gradually. According to the Labour Force Survey data, the number of employed has increased by 43.2 thousand or on average by 14.4 thousand a year from 2011 until 2013. Overall, the increase in employment is due to the recovery of economy – the GDP has increased by one fifth since late 2009. At the same time, the increase in employment has promoted a considerable decrease in unemployment. The unemployment rate over 4 years has decreased by almost a half.

Since 2007, the most rapid increase in the level of 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 employment rate increased to 58.2% and was by 2.1 percentage points higher than in the previous year.

At the same time, the number of economically active population has decreased in 2013; it was mainly affected by the negative demographic trends – the decrease in the number of working age population. In general, the number of economically active people has decreased by 16.5 thousands or 1.6% in 2013 as compared to 2012. The number of economically active people was 1014.2 thousand or 66% of the inhabitants aged 15–74 in 2013.

Unemployment rate decreased by 3.2 percentage points reaching 11.9% in 2013 as compared to 2012. The total number of job seekers was 120.4 thousand in 2013.

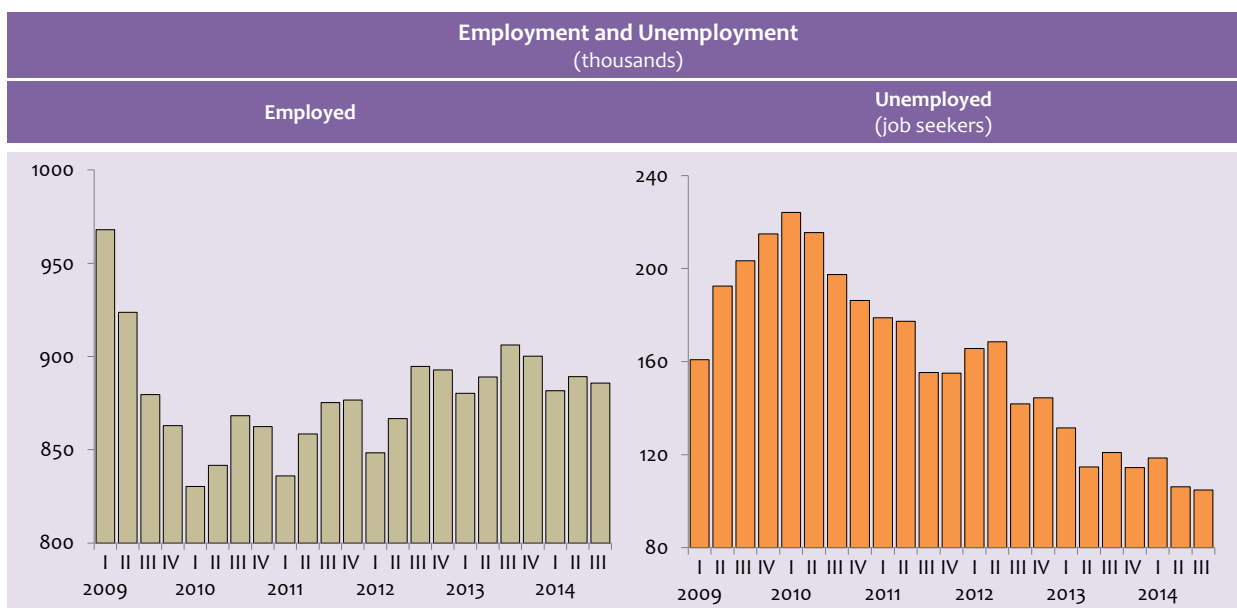
Figure 5.2



The situation in the labour market continued to improve in 2014 as well, though at a slower rate than before. In the 3<sup>rd</sup> quarter of 2014, unemployment rate decreased to 10.6% which was by 1.2 percentage points less than in the 3<sup>rd</sup> quarter of 2013. Overall, the number of job seekers was 104.9 thousand, which is by 16 thousand fewer than a year before.

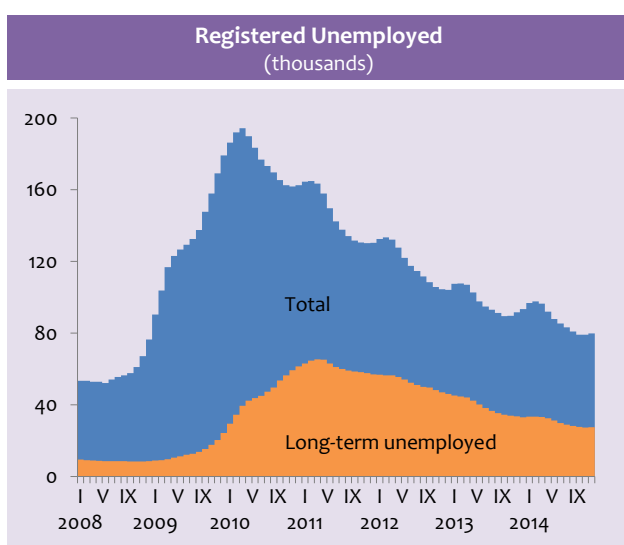
Along with the overall decrease in unemployment, registered unemployment has decreased as well. Registered unemployment rate at the end of November 2014 decreased to 8.3% – 79.9 thousand unemployed persons were registered, which is by 11.8 thousand fewer than in November 2013. The highest registered unemployment rate remains in the Latgale region (17.6%), whereas the lowest is in Riga (4.9%).

Figure 5.3



At the same time, the employment rate reached 59.3% in the 3<sup>rd</sup> quarter of 2014 and was by 0.3 percentage points higher than during the respective period in 2013. Overall, 885.7 thousand inhabitants were employed in the 3<sup>rd</sup> quarter.

Figure 5.4



Despite the fact that the unemployment rate continued to increase in 2014, the number of employed decreased by 0.7% during the three quarters of the year as compared to the respective period in 2013. 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.

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 fosters an increase in the labour demand and employment growth. At the same time, there is a risk that some of the currently unemployed 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 neither the ones that were offering vacancies before the crisis nor those 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.

The number of long-term unemployed increased along with the overall unemployment rate during the crisis. The number of long-term unemployed has a tendency to drop along with the growing economic activity since early 2011. At the end of November 2014,

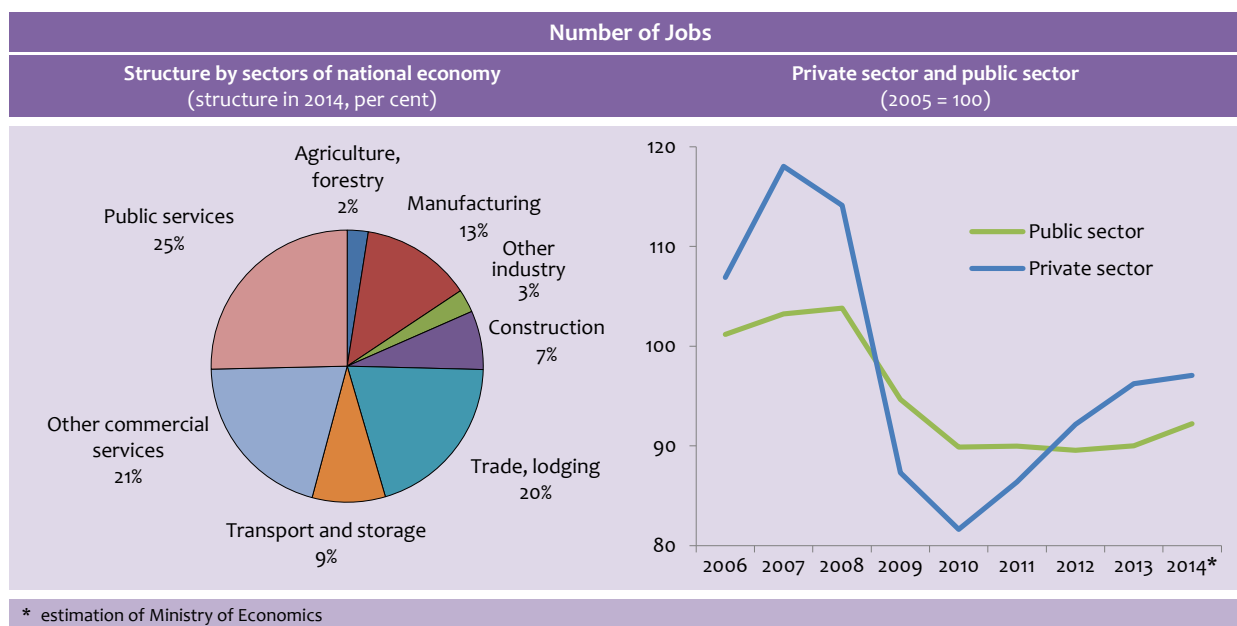


there were 27.5 thousand long-term unemployed registered at the SEA, which was by 6 thousand or 18% fewer than at the end of November 2013. Although the situation is improving gradually, the share of long-term unemployed is still high – approximately 34.5% of the total number of registered unemployed. It should be taken into account that the high level of long-term unemployment can cause the growth of structural

unemployment, i.e., 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.

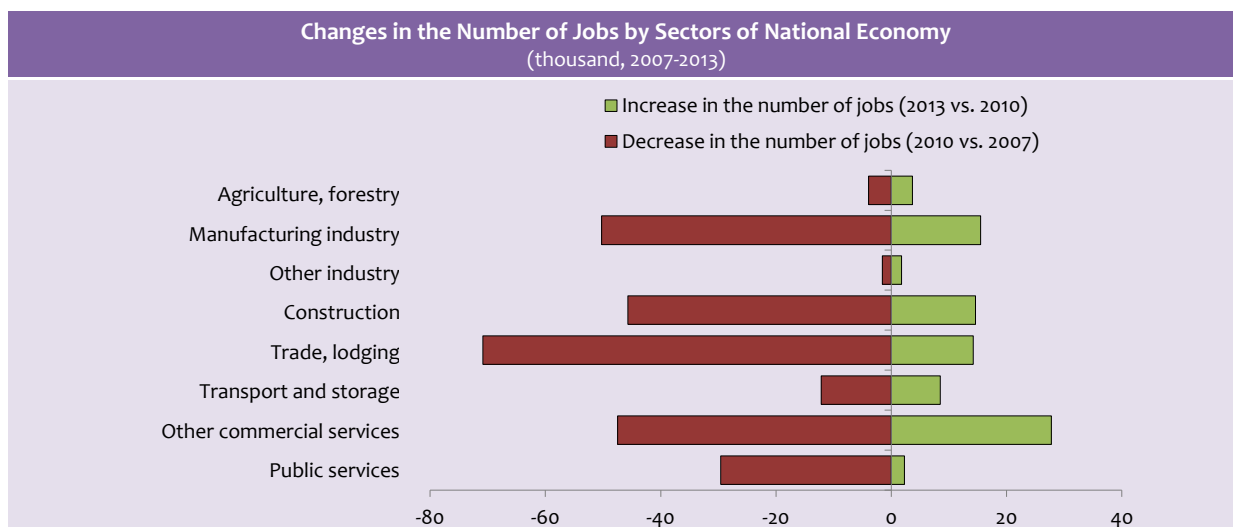
Figure 5.5



The number of jobs has been growing at a steady pace since mid-2010 along with the improving economic situation. According to the CSB data, the total number of filled posts has increased by 26 thousand or 3.1% in 2013 as compared to 2012. At the same time, the number of vacancies increased by 17.4% or approximately 0.6 thousand jobs.

The number of filled positions in almost all sectors kept growing also in 2013. The sharpest increase in the number of jobs in 2013, compared to 2012, was in construction (by 8.9%) and in the field of commercial services (by 4.6%).

Figure 5.6



Despite the termination of operations of *Liepājas metalurģs* and the considerable decrease in the number of jobs in the metal production sector, overall, the number of filled positions in manufacturing kept increasing in 2013 – the number of jobs increased by 2.4% as compared to 2012.

At the same time, a relatively moderate increase in the number of jobs was observed in the field of trade and public services in 2013.

The number of jobs continued to increase in 2014 as well – the number of jobs increased on average by 9.8 thousand or 1.1% during the three quarters of 2014 as compared to the respective period in 2013.

In 2014, the sharpest increase in the number of jobs was observed in the field of information and communications services – the number of filled posts increased by 10.3% during the three quarters of the year as compared to the respective period a year before. A

considerable decrease in the number of job was observed in the field of public services – the number of filled posts on average increased by 2.7% or 5.8 thousand.

Over the past few years, the number of jobs in the private sector has increased significantly. After the drop in the number of jobs by 30% during the crisis from 2010 to 2013, the number of jobs in the private sector increased almost by 18%.

At the same time, the number of jobs in the public sector increased at a relatively slow pace – the number of filled posts increased only by 0.1% within the period from 2010 to 2013.

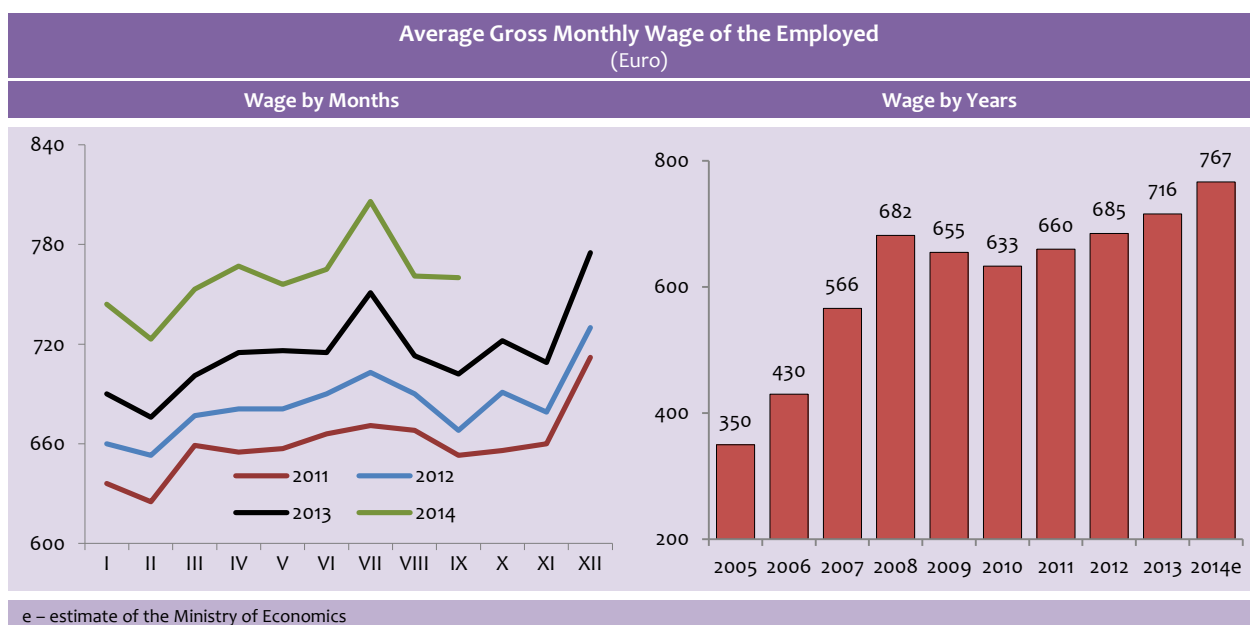
A sharper increase in the number of filled posts in the public sector was observed in 2014 – the number of filled posts increased by 1.7% during the three quarters as compared to the respective period in 2013. The number of filled posts in the private sector, however, increased only by 0.8% over this period.

## 5.2 Labour Force Costs and Productivity

The dynamics of labour force costs and productivity during the sharp economic decline was largely determined by the differences in the adjustment of labour and goods markets to the cyclic fluctuations of conjuncture. Significant adjustments on the labour

market since 2008 affected both the number of the employed and the dynamics of wages. As the economic situation stabilised, wages and employment started to improve since 2011.

Figure 5.7



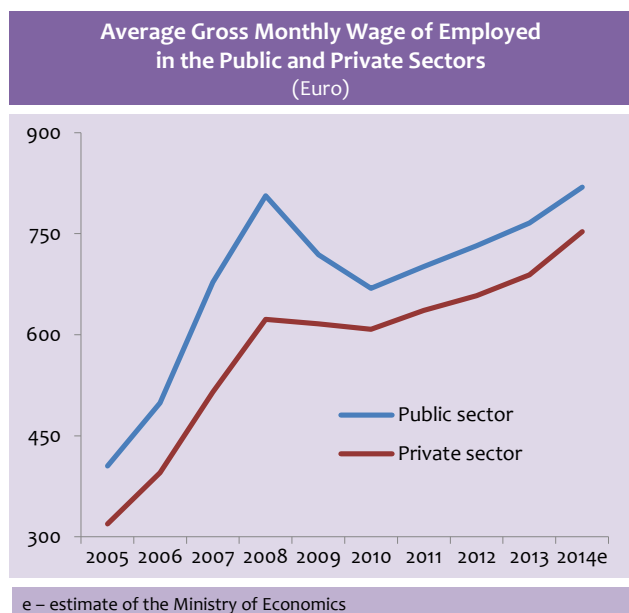
The average gross wage grew by 4.6% in 2013, as compared to the previous year, reaching EUR 716. In 2013, it was by 5% higher than before the crisis in 2008. The average gross wage in the public sector was EUR 766 in 2013, which was by 4.6% more than in 2012, while still by 5% less than in 2008. The average gross wage in the private sector was EUR 689 in 2013 or by

4.7% more than a year before and by 10.7% more than in 2008.

During the three quarters of 2014, compared to the according period of 2013, the gross wage increased by 7.1%, incl. by 7.9% in the private sector and by 5.9% in the public sector.

The difference in wages across sectors has considerably decreased over the recent years. In 2008, the average gross wage in the private sector was by 22.8% lower than that in the public sector, while in 2013, this difference was only 10 per cent.

Figure 5.8



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,

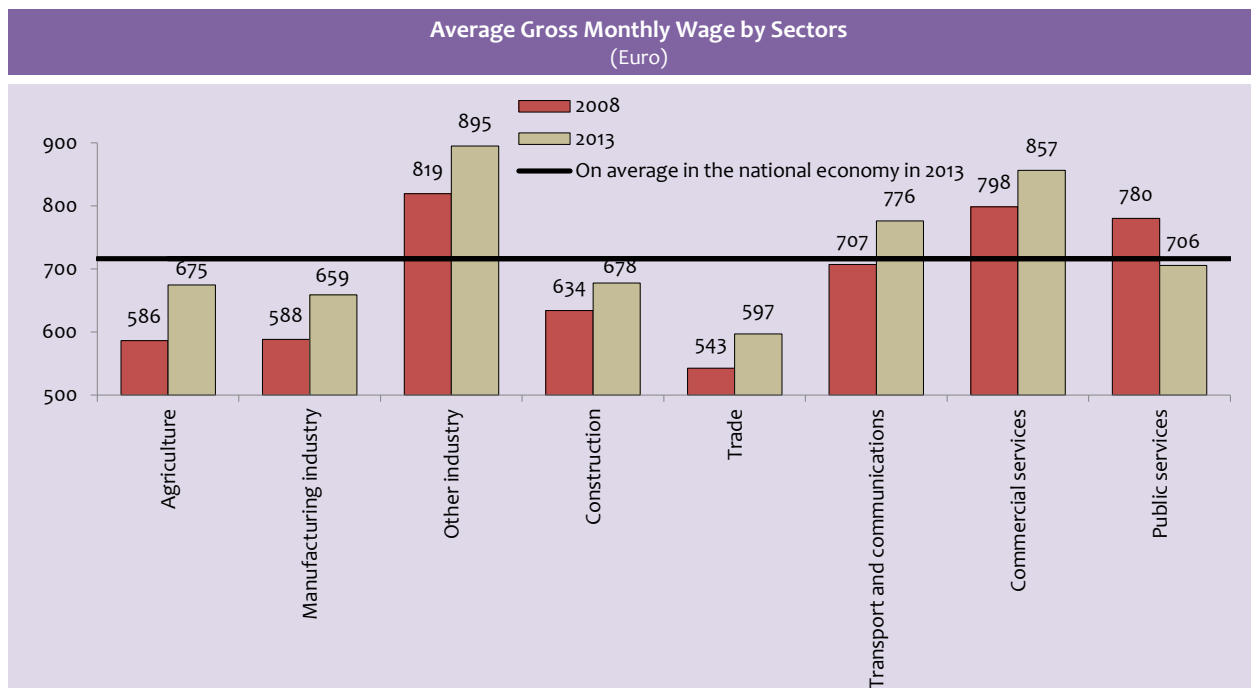
the employment rate decreased considerably in the private sector, while the decrease in the wages of employees was relatively moderate. However, the decrease in the number of people employed in the public sector amounted to almost a half of that in the private sector. The wages of employees were reduced 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 is steady.

Over the last five years, the average gross wage has increased faster in the manufacturing, agriculture, and trade sectors.

In 2013, as compared to 2012, the most rapid increase in the average gross wage was observed in construction, trade, and public service sector. The wages in the transport and communications sectors basically remained the same as last year.

In 2013, the increase in the wages in the key exports sector of Latvia – the manufacturing – was slightly slower than in the national economy on average. In comparison with 2012, wages grew by 4%, thus exceeding the level of 2008 by 12%. Over the last five years, the most significant increase in wages in the manufacturing industry has been experienced in the following sectors: production of electrical and optical equipment, wood-processing, paper production and polygraphy, as well as chemical manufacturing. The comparatively more intense increase in wages in these sectors is largely related to the more rapid growth of production volume and productivity.

Figure 5.9

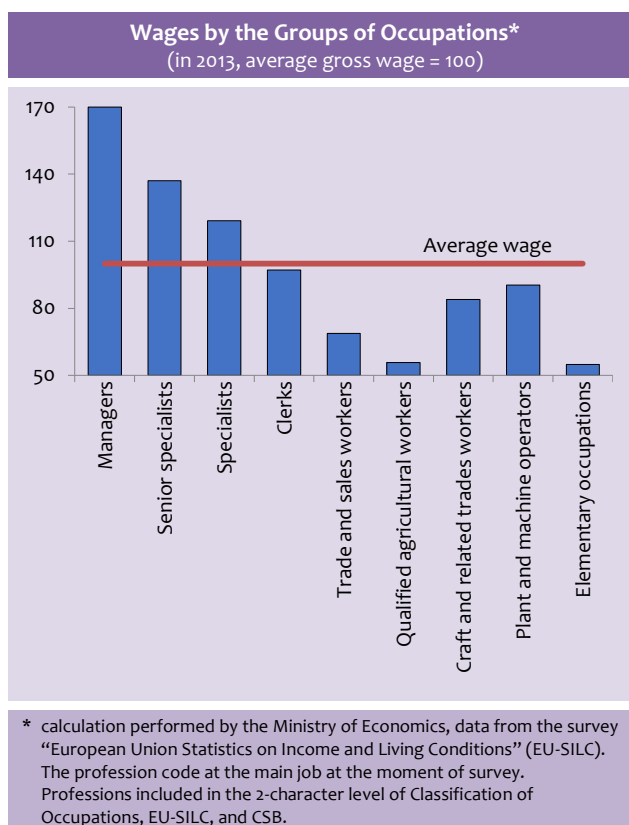


In 2014, wages continued to grow in all sectors of the national economy. During the three quarters of 2014, the most rapid increase in the average gross wage was observed in the field of financial and insurance activities, real estate activities, as well as in the field of activities of administrative and maintenance services.

During the three quarters of 2014, wages of persons employed in the manufacturing industry increased by 7.2% and was practically at the level of the average gross wage in the national economy. The most significant increase in wages in the manufacturing industry during the three quarters of the year was observed in furniture production, wood processing, and food production.

Since the Latvian economy is gradually changing towards producing goods and services with a high added value, the demand for specialists with medium and high qualifications is growing. Wages for employees in highly-qualified occupations increased by 7% in 2013, as compared to 2012, in medium qualification occupations grew by 9.4 %, however in low-qualification occupations wages increased by 7.2 per cent. Wages in various groups of occupations still differed greatly. For example, wages in elementary occupations is 2.5 times lower than in high qualification occupations and 1.5 times lower than in average qualification occupations.

Figure 5.10



It should be noted that wages in high qualification occupations are by more than one-third higher than the national average, while wages in average qualification occupation groups are by almost one-fifth lower than the national average, and wages for employees working in elementary occupations are by nearly a half lower than the national average.

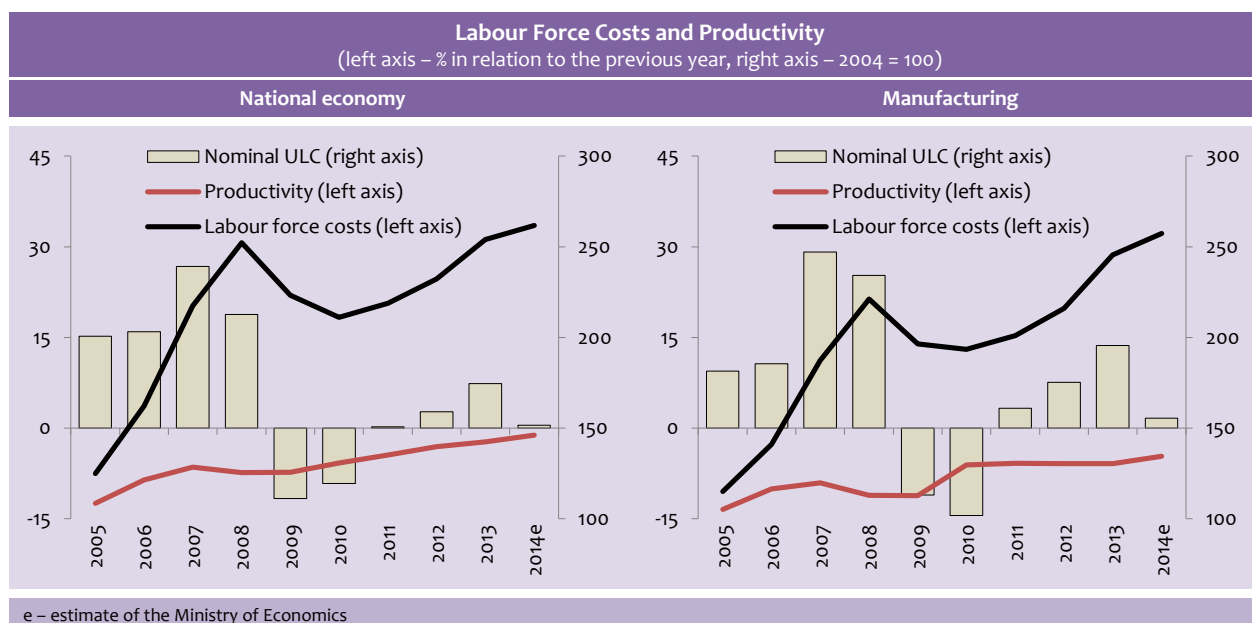
Wages are a considerable factor of cost competitiveness, thus, the increase in wages must be balanced with the increase in productivity. Otherwise, competitiveness in the respective trade sectors will be lost, which, as a result, ensures no stable increase in the total revenue (welfare).

Within the period from 2004 until 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)<sup>1</sup>. Adjustments in goods and labour markets caused by the crisis eliminated the gap between productivity and labour force costs resulting in a gradual improvement of Latvia's competitiveness on foreign markets.

The ULC dynamics is largely related to the cyclical factors or crisis consequences since 2008. It should be noted that the markets of goods 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 2008, as compared to 2007, productivity in the national economy of Latvia decreased by 2.3% 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 industry. Since 2011, productivity and dynamics of labour force costs have been positive. Within the period from 2011 to 2013, productivity increased on average by 3% a year, while labour force costs increased almost two times faster – by 6.4%, affecting the increase in ULC. In 2014, labour force costs grew faster than productivity and the nominal ULC continued increasing. It should be noted that the overall gap between the growth rates of labour force costs and productivity, as compared to pre-crisis years, has decreased and the increase in ULC has been rather moderate. However, the dynamics of ULC and productivity of the last two years show that production unit labour costs will continue growing as the economic activity rises.

<sup>1</sup> 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 state costs increases and vice versa.

Figure 5.11

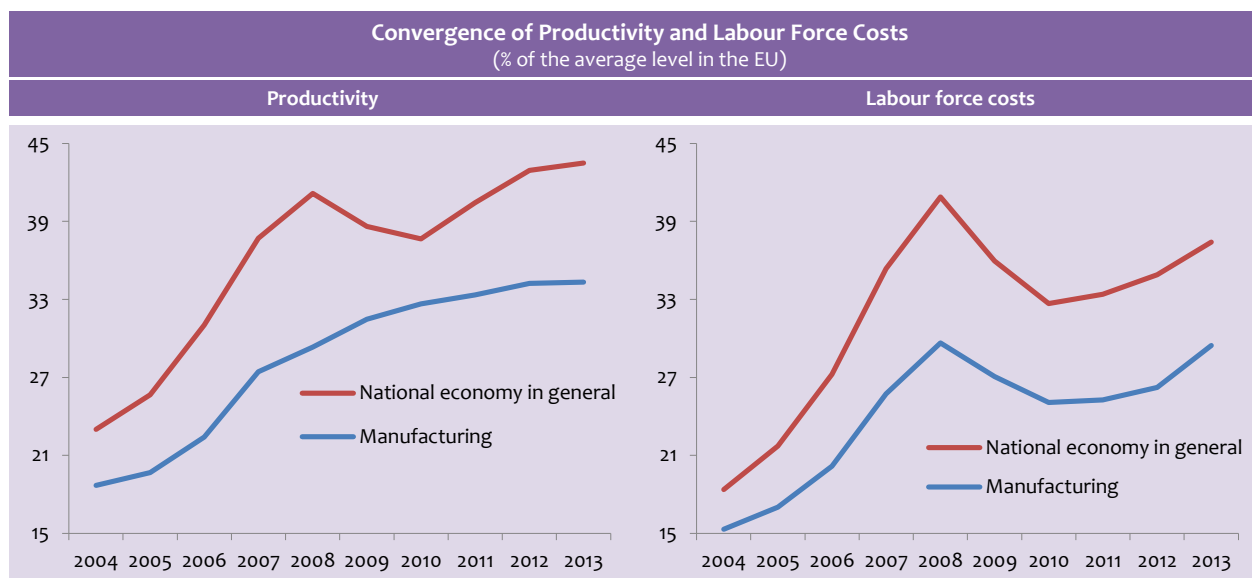


The dynamics of nominal ULC in the medium-term will be mainly affected by structural factors, while the influence of cyclical factors (for example, economic fluctuations in foreign trade countries) is expected to be lower. One of the most significant factors for the increase in ULC is the increase in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

Labour force costs in Latvia are among the lowest in the EU. In 2013, labour force costs per one employee in Latvia were 38% of the EU average. Thus, the

equalisation of wages (convergence) is an objective process, which must be taken into account in the future, and the gap between productivity and wage dynamics most probably will be preserved in the near future. The more rapid increase in wages may be related to the increase in the minimum 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 increase the productivity of production resources, though, affecting competitiveness.

Figure 5.12



## 5.3 Labour Market Forecasts

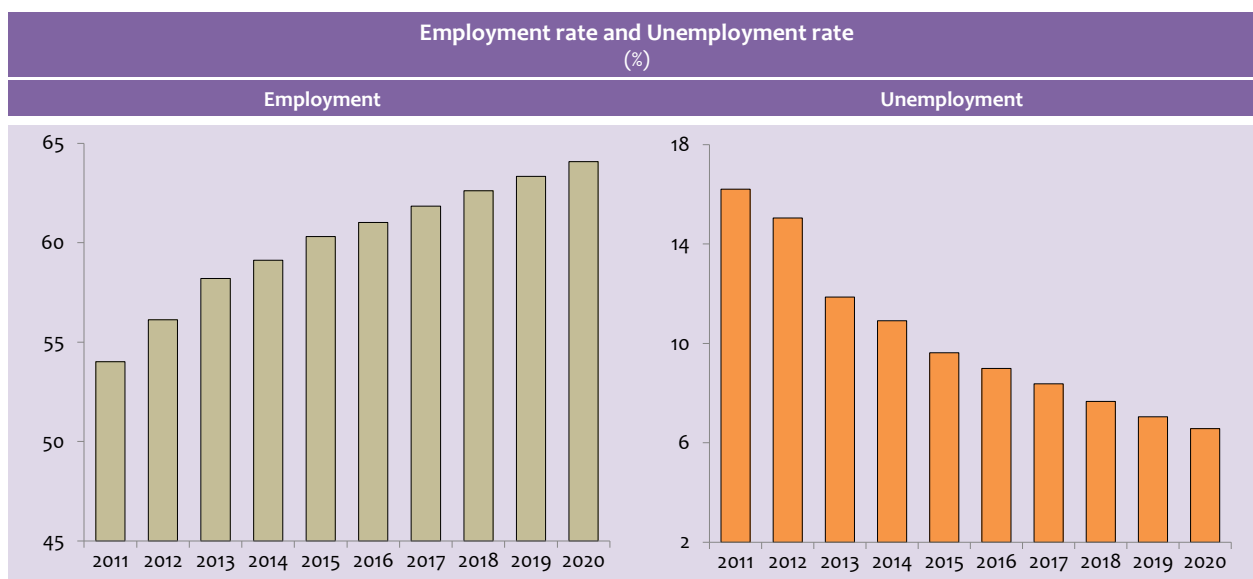
Labour market forecasts for the period until 2020 have been developed in line with the economic development scenarios (see Chapter 3.3).

It is expected that the situation on the labour market in upcoming years will continue improving, while improvements will become more moderate, which will be influenced by a greater base effect on the labour market, lower growth rates. Moreover, the situation will be affected by negative demography tendencies, which will

be manifested in labour market indicators and labour force accessibility alike.

According to the assessment performed by the Ministry of Economics, in 2014, the number of the employed amounted to 884 thousand on average, while the employment rate increased to 59.1%, which was by 0.9 percentage points higher than in 2013. The unemployment rate in 2014 reached 10.9% and the number of job seekers amounted to 108.3 thousand persons.

Figure 5.13



The overall slow increase in employment is expected in 2015 – the number of the employed will increase by only 0.2% or 4.8 thousand, as compared to 2014. The employment rate will be slightly above 60%. The overall number of the employed might reach 889 thousand in 2015.

The unemployment rate will continue decreasing – it will reach 9.8% in 2015. The number of job seekers, as compared to 2014, will decrease by almost 14 thousand – up to 95 thousand on average.

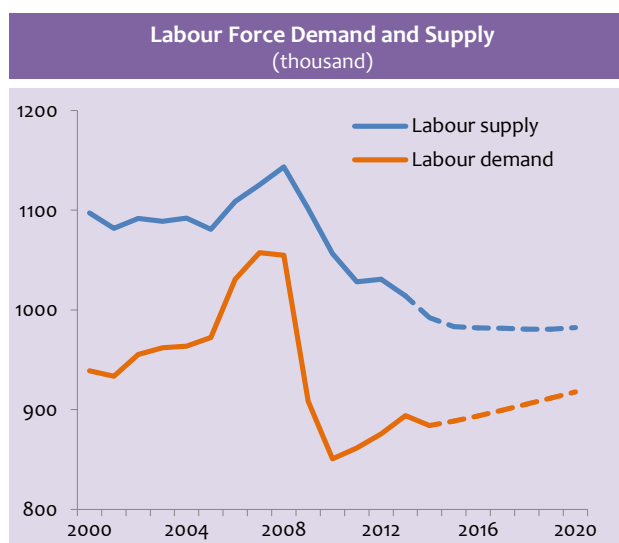
The labour demand will continue growing also in medium-term. At the same time, employment is likely to increase slower than the growth, as the output will be mostly based on the increase in productivity.

The number of the employed is expected to increase on average by 3.8% or 34 thousand until 2020, as compared to 2014. Hence, the number of the employed in 2020 might amount to approximately 918 thousand, while the share of the employed among inhabitants aged 15-74 years might increase up to 64 per cent.

Unemployment will also continue decreasing in the medium-term. Until 2017, the unemployment rate will decrease to 8.4% and labour force shortage will become a

topical issue. Overall, the unemployment rate might decrease to approximately 6-7% by 2020.

Figure 5.14





In 2014, the growth rates of economy slowed down in the majority of national economy sectors, which respectively influenced the increase in sector employment. Similar tendencies will be observed in 2015 as well – the majority of national economy sectors will experience a weak increase in employment.

The most considerable increase in the number of the employed in 2015, as compared to 2014, is expected in commercial services sectors (by 1.6 thousand or 1%) and construction (by 0.9 thousand or 1.2%). The situation will slightly improve in the manufacturing industry as well. The most rapid increase in employment in the manufacturing industry is expected in metal production, which will be mostly influenced by the resumed operations of the JSC “KVV Liepājas metalurģs”.

The role of domestic demand-oriented sectors on the labour market will also increase. The growth of tradable sectors will be mainly based on the increase in productivity which is crucial for competitiveness, and therefore the employment might grow relatively slower in these sectors.

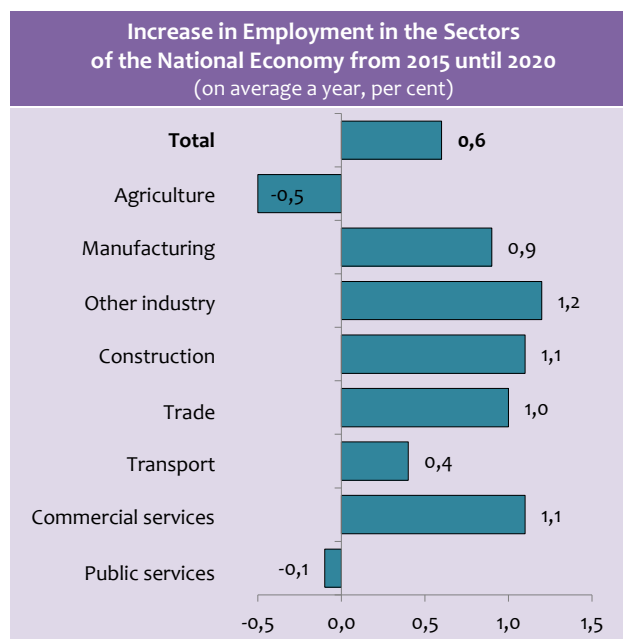
The number of the employed will increase in most sectors by 2020. The most significant increase in the number of the employed will be observed in the sector of commercial services, trade, construction, as well as manufacturing industry.

At the same time, the number of the employed is expected to drop in primary sectors – mainly agriculture and forestry, as well as public services sectors. The drop in the labour demand in agriculture is mainly related to the improvement of the agriculture sector – formation of farmers’ cooperatives and large farms, introduction of systematised production organisation, introduction of complex technological solutions in the production process.

Overall, the medium-term and long-term situation on the labour market will be determined by several important factors. The greatest uncertainty is related to further development of the global economic environment – stagnating external demand might affect a successful recovery of the labour market. Although the situation in the eurozone and Europe as a whole has stabilised, Europe is unlikely to return to the pre-crisis economic growth rates. At the same time, further developments in the geopolitical situation due to recent

events in Ukraine, as well as a weaker growth and intensifying protectionism in Russia cause additional risks as it is the second largest market for Latvian products after the EU.

Figure 5.15



Internal challenges in Latvia, however, are mainly related to a gradual population decrease (particularly, working-age population), as well as general labour force ageing tendencies.

According to the forecasts of the Ministry of Economics, the number of the working-age population (aged 15-62 years) will drop by almost 10% until 2030, as compared to 2014. At the same time, the demographic burden will increase by approximately 18%. Significant changes are expected also in the structure of the population age – the share of elderly people in the total number of population will increase in the future.

Overall, these tendencies will escalate the problem of labour force shortage until 2030 that might cause various disproportions on 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 Chapter 6.1) by 2020 in the age group of 20-64. To reach this target, policy directions are planned on both the labour supply and labour demand side.

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 measures, consultations on business start-ups, etc.;

- fostering correspondence 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 access to labour force** (see also Section 5.3) will become urgent 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 specialist shortages. The future labour force shortage might become a factor affecting the growth. It may give rise to the need for attracting foreign workers. The objective of Latvia is to fill in the vacant positions with 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 example, to start own business (re-emigration policy).

In August 2012, a working group was created for the development of a **re-emigration** support plan by the initiative of the Minister for Economics aimed at covering a wide range of return migration issues and promoting the co-operation between 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 Latvians 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 on-line discussion platform [www.musuvalsts.lv](http://www.musuvalsts.lv).

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

#### Box 5.1

##### **Re-emigration support measure plan**

The Plan is aimed at supporting and assisting those 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.

The measures have been incorporated in the Plan according to the following eight directions of support measures:

- ensuring the one-stop agency principle – providing information and consultations, also remotely, about moving to and living in Latvia, helping to navigate 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 and Vacancies database* of the State Employment Agency; the *CV and 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), including to promote the return of highly skilled youth having 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 Latvian nationals, developed Latvian language learning materials, including electronic learning materials;
- 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.; surveyed entrepreneurs and professionals of Latvian diaspora abroad and promoted their involvement in the development of national economy of Latvia; collecting and sharing 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 capital companies – promoting transparent personnel selection procedures, including assessing the justification of requirements (for example, 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 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, expected result-based indicators, deadlines for the implementation of measures, as well as responsible and involved institutions.

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* (approved at the CoM meeting on 30 July 2013) (see Box 5.1).

The main factors that motivate the 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.

The re-emigration support measure plan does not propose solutions to all issues neglected for years, but rather provides for ensuring support to nationals who are willing to or have already decided to return to Latvia.

The plan has been developed for 2013–2016, comprising measures that encompass various areas, therefore a wide range of institutions is involved in its implementation. Support measures included in the plan primarily provide for the following:

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

Since the approval of the plan, mainly measures to improve the availability of information on living, work and entrepreneurship opportunities in Latvia, as well as state and local government services to those living abroad are implemented. In 2014, a thematic section “Returning to Latvia” was created on the unified state and local government service portal [www.Latvija.lv](http://www.Latvija.lv). This section provides information and instructions in matters topical for nationals residing abroad prior to their return to Latvia. The linking of information provided on the portal to the e-services provided by the state and local governments has been commenced in the fields important within the context of re-emigration.

Special attention has been paid to the availability of information on employment opportunities in Latvia. A job in Latvia is one of the preconditions for successful return to Latvia. The State Employment Agency has improved the CV/vacancy portal. Currently, job seekers have access to information about vacancies at the Agency, including the amount of remuneration, and open job competitions published in “Latvijas Vēstnesis”. The services provided by the Agency and the possibilities offered by the CV/vacancy portal are promoted within the Latvian diaspora. Within the framework of the EURES activities, the experts of the State Employment Agency ensure consultations on work and living conditions in Latvia for those living abroad (including the nationals of Latvia). In 2014, the consultants of the

Agency participated in 9 international labour fairs, as well as provided topical information and consultations to the nationals of Latvia during the informative event organised by the Latvian Society of Ireland and Latvian Embassy in Ireland, in Tullow.

In order to strengthen the ties of Latvians residing abroad with Latvia and to promote the participation of Latvians residing abroad in the economic growth process of Latvia, meetings with representatives of the diaspora are held within the framework of visits of officials and other events on a regular basis. Within the framework of these events, the current issues in Latvia, including employment and business opportunities, available support instruments etc., are discussed.

A successful example for the establishment of business contacts is the first *World Latvian Economic and Innovation Forum* by the World Free Latvian Association, the Latvian Chamber of Commerce and Industry, and the Ministry of Foreign Affairs held in Riga in 2013. The forum was aimed at promoting the co-operation between Latvian entrepreneurs and professionals with Latvia, encouraging involvement and investments into the economy of Latvia. The next forum is planned in the spring of 2015.

State-supported measures, including camps, are organised on a regular basis to maintain the link with the new generation of the diaspora, to strengthen the Latvian identity and encourage willingness to co-operate with Latvia (for instance, in 2014, 450 children participated in summer camps organised by the Society Integration Foundation for Latvian and diaspora children; 230 of them were diaspora children from 24 countries). In 2014, the *Youth Forum* organised by the Ministry of Foreign Affairs and Youth Competence Centre in Riga gathered participants from Latvia and the diaspora. The forum emphasised several topics important for the youth, paying particular attention to the employment of the youth.

The Latvian Language Agency constantly develops and improves Latvian language learning materials, including electronic learning materials available for the public from the agency's website [www.valoda.lv](http://www.valoda.lv). Thus, any person interested has an opportunity to learn the Latvian language while staying in their home country and in Latvia alike. In 2014, the website was visited over 824 thousand times.

In Latvia, free Latvian language courses are provided to various target audiences, including repatriates and their families, who move to Latvia together with repatriates, as of the second half of 2014. By the end of 2014, 121 participants have commenced training within the framework of these courses organised by the Society Integration Foundation.

The Ministry of Education and Science has recognised that significant improvements and an extension of the existing support mechanism for school children is required, upon returning to/integrating in the education system of Latvia, as well as to deepen the skills and knowledge of teachers in Latvian schools so that they

can work successfully with children, who have returned from abroad after a longer absence, and children who are foreign nationals. In 2014, the State Service of Education Quality carried out analytical research regarding the integration of students of secondary education institutions, who had returned or arrived in Latvia after a period of studies abroad, in the education system of Latvia. Following a research carried out, in October 2014, a report was prepared with recommendations to the Ministry of Education and Science to improve support measures, including a range of proposals for amendments to regulatory enactments, further education of teachers, organisation of the study process, information accessibility.

As of 2013, the Latvian Language Agency has been organising courses for improving professional qualification for teachers working with students who have returned from studies abroad (36 teachers were trained in 2014 and 19 teachers were trained in 2013).

In order to encourage Latvian nationals living abroad to apply for a job in public administration, the State Chancellery and the Ministry of Economics have addressed public administration authorities, encouraging them to ensure remote job interviews with job applicants, for example, through Skype. Moreover, to promote the attraction of new specialists in public administration, the State Chancellery has developed a programme *Re-emigration of Youth to Public Administration*, within the framework of which 10 young people, who have obtained a higher education degree in a foreign university, will be offered a possibility of practical training in one of the public administration institutions in 2015.

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*. Within the framework of this project, a poll or monitoring of Latvians and nationals of Latvia residing abroad was carried out, involving over 14 thousand respondents. The aim of the project is to analyse the diversity of migration processes and provide substantiated information regarding policy makers to strengthen the Latvian diaspora, as well as to provide support to nationals willing to return to Latvia. At the end of the project (in August, 2015), the results will be reflected in the report, which will be presented to the institutions in charge.

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

The key target audience of the employment measures implemented by the SEA are the unemployed registered at 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 corresponds with the economic development rates in the country. The number of the unemployed registered at the SEA and the registered unemployment rate has been dropping steadily over the past few years (see Section 5.1).

The total funding for active labour policy measures has been increasing rapidly over the past few years. A total of EUR 15.7 million was used for these measures in 2008, EUR 45.5 million in 2009, EUR 91.1 million in 2010. Along with the dropping number of the unemployed, the same trends have been observed also in relation to the funding for labour market measures. The utilised funding reached EUR 71.1 million in 2011, EUR 44.4 million in 2012, and EUR 45.7 million in 2013, and most of it – about 4/5 – was financing from the European Social Fund.

Considering the recent situation on the labour market, the employment policy is now focused on training-oriented measures instead of socially-oriented measures. Most of the financing is granted for the measures to improve skills, which involve professional training, retraining, and increasing the qualification, measures to promote competitiveness and career consultations. In 2013, 51% of financing granted for active labour market measures was used for these purposes.

A significant part of the financing was also granted for paid temporary work and subsidised employment – 30% and 14% respectively were used during this period. The rest of the financing was used for measures to promote lifelong learning, measures for business or self-employment start-ups, and measures to promote regional mobility of persons employed by merchants.

Overall, more than a half of the financing is spent on training-oriented measures – professional training, retraining, and increasing the qualification and informal education; training at the employer; lifelong learning measures for employed persons.

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

- professional training, retraining, and increasing the qualification, informal education;
- measures for specific groups of persons;
- measures to improve competitiveness;
- paid Temporary Public Work (in 2010 and 2011, this measure completely replaced the measure *Work Practice with a Grant*);
- measures for business or self-employment start-ups;
- complex support measures;
- promotion of regional mobility of persons employed by merchants;
- training at the employer (the measure has been temporarily suspended to improve the conditions for its implementation).



During the years of economic growth, the demand for active employment measures decreased, however, in 2009, due to the significant rise in unemployment, it increased considerably. The demand remained at a high level also in the following years, though it has started to drop. A total of 244.3 thousand unemployed persons were involved in the active employment measures in 2009, 299.2 thousand in 2010, 249.6 thousand in 2011, 206.1 thousand in 2012, 197.9 thousand in 2013, and 141.3 thousand during the three quarters of 2014 (one unemployed person may participate in several activities).

Most of the unemployed are involved in the measures to improve competitiveness. During the three quarters of 2014, the number of such unemployed persons was 64 thousand. The rest of the measures in this period were implemented to the following extent: 6.6 thousand unemployed (including persons transferring from the previous year) were involved in professional training, retraining, and increasing the qualification; in informal education, 16.8 thousand unemployed and job seekers; in practical training in priority sectors, 100 unemployed; in measures for specific person groups, 2.4 thousand; in paid temporary public work, 17.7 thousand; in measures for business or self-employment start-ups, 265 unemployed; the SEA inspector assistant training and practice, 100 persons; in complex support measures, 14.4 thousand; in measures to promote regional mobility of persons employed by merchants, 232 persons; in the school children employment measure, 4.2 thousand persons.

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

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

The rest of training measures support obtaining additional knowledge to improve competitiveness on the labour market. Informal education programmes are aimed at both the unemployed and job seekers. Lifelong learning measures for employed persons, however, are aimed at employed people over the age of 45 years (under certain conditions, persons aged 25 to 44 years), except public civil servants. Within the framework of the measures, existing qualification knowledge is improved by offering an opportunity to improve professional knowledge with the necessary social and professional basic skills like computer skills, foreign languages and obtaining a driving licence of a certain category. Since the implementation of the training at the employer's

workplace revealed risks that may have a negative impact on the labour market, the measure has been temporarily suspended until the conditions are improved.

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

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

In terms of the number of clients served, career consultations are the most important preventive measure for reducing unemployment. In 2009, career consultation services were provided to 55.1 thousand people, in 2010 to 78.4 thousand, in 2011 to 47.7 thousand, in 2012 to 67.1 thousand, whereas in 2013 to 44.1 thousand, and 59.4 thousand of them were unemployed and job seekers. During the three quarters of 2014, consultations were provided to 33.7 thousand, 30.2 thousand of them were unemployed and job seekers.

A training-oriented measure *Training Programmes for the Involvement of Adults in Lifelong Learning* was launched in 2010. The target group includes employed and self-employed persons (except civil servants) 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). 5155 unemployed persons started the training in 2010, 15,638 persons in 2011 (incl. 4715 transferred from 2010), and 7187 persons in 2012 (incl. 4727 transferred from 2011), 7698 persons in 2013 (incl. 1322 transferred from 2012) and during the three quarters of 2014, 8472 (incl. 5405 transferred from 2013).

Considering the changes on the labour market, a number of new active labour market measures were launched in 2013.

The implementation of the measure *Promotion of Regional Mobility of Persons Employed by Economic Operators* was launched in the first half of 2013. The measure is intended to provide support during the initial period of employment to those unemployed who have found a job in another city/county, by covering the transport and apartment rent costs for the first four months from the establishment of employment legal relationship.

In summer 2013, the pilot project *Practical Training of the Unemployed in Priority Sectors* was launched, providing practical training at an employer. Training is provided in four sectors identified in co-operation with entrepreneurs – manufacturing, transport and logistics, tourism, and information and communications technologies. This pilot project provides the employers with an opportunity to train and employ employers according to the specific nature and requirements of their enterprise. The total number of the unemployed involved in the practical training project during the three quarters 2014 was 100.

An unemployed profiling system has been developed for the work with the unemployed to provide customised services to each unemployed person.

Along with the existing youth-oriented measures: *Job for Youth* and *Support for Youth Volunteers*, a new measure *Youth Workshops* was launched in the first half of 2013. All the aforementioned measures are implemented within the framework of complex support measures. The measure is aimed at encouraging the unemployed youth aged 15 to 24 years who have not acquired vocational education and have never been employed to choose the area of their education for future working life. The measure gives the youth an opportunity to try their hand at three vocational education programmes, being engaged in each education programme for three weeks to get an insight in its specific nature.

The labour market measures were focused on specific target groups in 2013 as well.

Since it is possible to involve only a rather limited number of participants in the measure *Training Programmes for the Involvement of Adults in Lifelong Learning*, the criteria for involvement in the measure have been narrowed down to support the persons at the highest risk of unemployment. Therefore, the eligibility age for application for the measure has been raised to 45 years. Persons aged 25 to 44 years may apply for the measure under certain conditions.

In 2014, the school children employment measure was restored after it had been discontinued for five years. Hence, students have a possibility to obtain the first professional work skills, as well as to get an idea of the occupation to choose.

Using the support from the state, school children aged 15 to 20 years, attending general education schools, training-schools or vocational education establishments have an opportunity to work during the summertime. Within the framework of the measure, the state, from the state budget funds, will cover the school child's salary in amount of 50% of the minimum monthly salary in the country.

Particular attention will be dedicated to the youth unemployment issues in the coming years as Latvia will take active part in the implementation of the EC initiative *Youth Guarantee*. The measures to implement youth guarantee in Latvia are planned to take place from 2014 to 2018. The estimated funding for the implementation of youth guarantee measures is EUR 66.7 million.

As of early 2014, 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. Specific measures are offered to the youth aged 13–15 years and 25–29 years. Within the youth guarantee, young people from the target group are expected to receive the support for involvement in the labour market not later than four months after dropping out of school or obtaining the unemployed status.

17,901 persons participated in the initiative *Youth Guarantee* during the three quarters of 2014.

To promote co-operation and submit proposals for effective implementation and improvement of measures,

a consultative council for the implementation of the *Youth Guarantee Programme* was established in July.

**The social dialogue** is important in implementing the employment policy. The Employers' Confederation of Latvia and Free Trade Union Confederation of Latvia are involved in the improvement of social dialogue at state, regional, and sector level. The employment partnership includes other partners as well, including local governments of Latvia and Latvian Association of Local and Regional Governments.

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

The developed labour protection plan set forth several objectives: improving the labour protection policy planning, increasing the capacity and efficiency of the national control and supervision mechanism, introducing the "preventive culture" into the society and enterprises, ensuring economic impetus and state support to the employers.

The reduction of administrative burden was continued also in 2013. At the end of the year, the CoM approved amendments to the procedure for the investigation of accidents at work, by simplifying the conduct of investigations for employers and the State Labour Inspectorate.

In 2014, requirements for the work at height and for the respective equipment were improved. Working conditions will be improved for those working at height, ensuring better safety and reducing the possibility of accidents. New requirements will come into force on 1 September 2014.

In July 2014, the CoM approved the improved labour protection requirements when performing construction works.

Latvia has a relatively high rate of **undeclared employment** in certain sectors, increasing unfair competition and reducing employees' social security.

In the developed policy planning documents, the measures to reduce undeclared employment were implemented in the following key directions: effectivisation 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 are tax policy, reducing the administrative burden, supporting honest entrepreneurs, and promoting a transition to legal economy, improving the capacity of controlling institutions, elaborating the laws and regulations, penalties policy, work with society, and eliminating shadow economy in risk sectors.

Understanding the need for the continuation of resolving these issues, this autumn, 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 decided to foster continuous improvement and development of knowledge, skills, and competences of the public by providing the available lifelong learning to ensure that 15% of the population (aged 25-64 years) are continuously involved in educational process in 2020.

The lifelong learning principle is going to be implemented in several directions:

- promoting co-operation and ensuring coordination between partners involved in the education of adults;
- developing the 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 employed training within the framework of the sectors;

## 6. ECONOMIC POLICY AND PRIORITIES OF STRUCTURAL POLICY

### 6.1 Europe 2020 Strategy and the National Reform Programme of Latvia

#### 6.1.1 Europe 2020 Strategy and its Progress

On 3 March 2010, the European Commission published a communication “*Europe 2020: A Strategy for Smart, Sustainable and Inclusive Growth*”, which outlined the vision of the European Commission on the *Europe 2020 Strategy*.

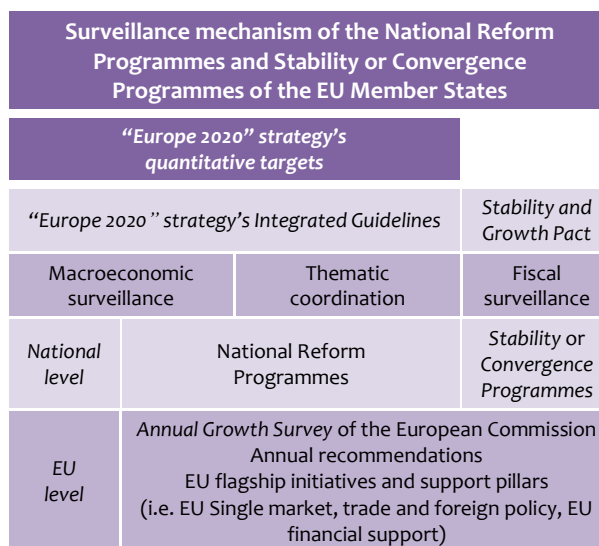
On 17 June 2010, the European Council formally approved the *Europe 2020 Strategy* and its key elements: EU-level quantitative targets for 2020, the *Integrated Guidelines* (developed according to the Articles 121 and 148 of the Treaty on the Functioning of the EU, which set the main directions of economic and employment policies, as well as serve as a base for developing National Reform Programmes of the EU Member States) and agreed that the EU Member States in cooperation with the European Commission must develop National Reform Programmes and submit them to the European Commission by the end of April 2011 together with the *Stability or Convergence Programmes* (developed and implemented for fulfilling requirements of the Stability and Growth Pact).

The surveillance of implementation of the *Europe 2020 strategy* consists of two pillars (see Figure 6.1): macroeconomic and thematic surveillance (National Reform Programmes of the EU Member States for the implementation of the *Europe 2020 strategy* and their conformity to the *Integrated Guidelines* are being assessed), as well as fiscal surveillance (the *Stability and Convergence Programmes* of the EU Member States and their conformity to the *Stability and Growth Pact* are being assessed).

On 5 March 2014, the European Commission published a communication “*Europe 2020: A Strategy for Smart, Sustainable and Inclusive Growth*”. The aim of the communication was to assess the first results and knowledge acquired during the first four years of implementation of the *Europe 2020 Strategy*, and to express an opinion on the future *Europe 2020 Strategy*. To acquire and summarize the opinions of all stakeholders, public discussion concerning the communication, initiated by the EC, took place during the period of time from 5 May 2014 until 31 October 2014. It is expected that the EC will present a report on the *Mid-Term Review*

on the *Europe 2020 Strategy* at the end of February 2015, and Latvia as the Presidency of the EU Council will have to ensure a delivery of this report in various formats of the EU Council in the first half of 2015.

Figure 6.1



Since 1 January 2011, the **European semester** is held every year to evaluate the overall economic situation in the EU and Member States, as well as to provide recommendations to the EU Member States for the implementation and strengthening of their economic policy.

*Europe 2020 strategy*, National Reform Programmes and *Stability or Convergence programmes* of the EU Member States are the core elements of the coordination and surveillance of economic policy of the EU Member States at the EU level within the European semester (see Figure 6.2). Multilateral surveillance of both programmes is carried out at the EU level, based on which the European Commission is entitled to give a policy warning, if the economic policy of any particular EU Member State is not in line with the EU *Integrated Guidelines* and the targets set at the EU level. National Reform Programmes are linked also to the EU budget, since a part of the measures is co-financed from the EU budget.

Figure 6.2

The European Semester: Partnership between the EU and the Member States							
	November-February	March	April	May	June	July	September-October
European Commission	Annual Growth Survey and Alert Mechanism Report	Common analytic document on each Member State (reform programmes and imbalances)		Publishing recommendations			Report at EU level
European Council / Council	Discussions				Discussion of recommendations	Approval of recommendations	
European Parliament	Discussions						
Member States	Approval of the National Reform Programmes and Stability or Convergence Programmes and their submission to the European Commission						Decisions at the national level

**Box 6.1****Annual Growth Survey 2015**

On 28 November 2014, the European Commission presented the *Annual Growth Survey 2015* along with other key documents, namely the *Alert Mechanism Report*, *Joint Employment Report*, as well as the *Report on the Legal Framework of the Stability and Growth Pact* (Review of the “six-pack” and “two-pack” rules).

The *Annual Growth Survey 2015* offers a review of the economic and social situation in Europe and defines the general political priorities for the EU for the next year. It initiates a new semester of coordination of the European economic policy, which ensures coordination of economic policies of the EU Member States to boost the growth and creation of jobs.

In the *Annual Growth Survey 2015*, the EC acknowledges that the EU has overcome the severest financial and economic crisis in several generations, significantly contributing to establishing the grounds for a more stable and sustainable growth in the future. However, irrespective of what has been done at the national and EU level, recovery of the European economy has been slower than forecasted a year ago. After a period of accelerated growth, the rate began to decrease in spring 2014. The economic crisis caused a social crisis, which still continues, and the slow recovery hinders measures aimed at minimizing the high level of unemployment.

The *Annual Growth Survey 2015* states that, although the reasons of the current recession are related to the global economic environment, there are specific internal factors that hinder faster growth in the EU, and the situation from the point of view of this aspect differs in the Member States significantly. The growth is being still hindered by the fragmentation of financial markets, necessity to decrease corporate, households’ and public debt, as well as the fact that the adjustment of macroeconomic imbalances is not over yet, and credibility has deteriorated due to uncertainty about the future development perspectives and commitment for implementation of structural and institutional reforms. Low increase of productivity, low level of investments and a high structural unemployment limit the European growth prospects. At the same time, it is suggested that the EU and its Member States must pay attention to several long-term tendencies, affecting the creation of jobs and growth, in particular, in relation to social and demographic changes, globalization, productivity and development of technologies, limited resources and environmental issues.

Considering the abovementioned facts and to encourage Member States to return to a higher level of growth and move towards a sustainable development, in the EC’s opinion, structural, fiscal and monetary policies must be joined in an integrated, growth-boosting approach, which includes action both for the part of the state economic supply and demand. Thus, action at all government levels is required starting with the global level and down to the EU, national, regional and local level. The Commission recommends three key pillars for the EU economic and social policy for 2015:

- **A coordinated boost to investment.** The EC suggests an *Investment Plan for Europe*, which should allow mobilizing additional public and private investments in the amount of approximately 315 billion euro and in general ensuring a considerably better environment for investments during the period from 2015 until 2017;
- **A renewed commitment to structural reforms.** The EC states that the progress at the national and EU level in such areas as services, energy, telecommunications and digital economy, as well as in the field of improvement of conditions for enterprises offers new opportunities for employment and growth. Thus, it is important to minimize bureaucracy at the European and national level within the framework of the regulation programme in order to establish an adequate regulatory environment and boost entrepreneurship and creation of jobs;
- **Pursuing fiscal responsibility.** The EC states that the Member States still have to ensure long-term monitoring of the budget deficit and debt level. The fiscal policy must be differentiated depending on the situation in each specific country. Member States with higher fiscal ability must take measures to boost the domestic demand, focusing on investments. Furthermore, the quality of public finances must be improved, by defining enhanced cost-effectiveness and productive investments in public expenditures as a priority, making the taxation system more effective and investment-friendly. Furthermore, the EC notes that it is important to fight tax fraud and tax evasion in order to ensure fairness and for the Member States to collect pertaining tax revenues.

The *Annual Growth Survey* of the European Commission (see Box 6.1) is an important element of the European semester as the publication of the survey launches the European semester with discussions at different levels of the EU Council. As a result of these discussions, the EU Member States agree on the main priorities of economic policy to be taken into consideration when updating National Reform Programmes, *Stability or Convergence programmes*.

New economic and fiscal policy surveillance rules (referred to as the “six-pack”) consisting of five

regulations and a directive came into force on 13 December 2011. By adopting these new rules in the EU, in addition to the excessive deficit procedure, a macroeconomic imbalances procedure is established to timely identify (using scoreboard of the alert mechanism) and correct macroeconomic imbalances (for example, high current account deficit, etc.) – see Box 6.2. Since the National Reform Programmes of the EU Member States are aimed at the implementation of the key structural reforms, they help eliminating timely excessive budget deficit and macroeconomic imbalances.

#### Box 6.2

##### **Alert mechanism and scoreboard**

The EC publishes an annual *Alert Mechanism Report*, which analyses the EU Member States according to certain indicators and thresholds:

- a 3-year backward-moving average of the current account balance as a percentage of the GDP, with a threshold of +6% of GDP and -4% of GDP;
- net international investment as a percentage of GDP, with a threshold of -35% of GDP;
- 5-year percentage change of export market shares with a threshold of -6%;
- 3-year percentage change in unit labour costs, with thresholds of +9% for the eurozone countries and +12% for non-eurozone countries;
- 3-year percentage change of the real effective exchange rates relative to 35 other industrial countries, adjusted according to the consumer price index with thresholds of -/+5% for eurozone countries and -/+11% for non-eurozone countries;
- private sector debt with a threshold of 160% of GDP;
- private sector credit flow with a threshold of 15% of GDP;
- year-on-year changes in housing prices relative to a Eurostat consumption deflator, with a threshold of 6%;
- public sector debt with a threshold of 60% of GDP;
- a 3-year backward-moving average of the unemployment rate, with a threshold of 10%;
- annual changes in total liabilities of the financial sector with a threshold of 16.5%.

If any of the EU Member States exceeds the thresholds, the EC carries out an in-depth analysis and publishes an *In-Depth Review*.

In the 2015 *Alert Mechanism Report*, the EC has identified 16 EU Member States that should be analysed in the *In-Depth Review*:

- in relation to Croatia, Italy and Slovenia – the in-depth review will assess whether the pre-identified *excessive imbalance* decreases, persists or increases, by paying due attention to the contribution made by policies implemented in these Member States to prevent such imbalances;
- in relation to Ireland, Spain, France and Hungary – the in-depth review will assess the risks concerning the persistence of imbalances;
- in relation to Belgium, Bulgaria, Germany, the Netherlands, Finland, Sweden and the United Kingdom – the in-depth review will assess, in which Member States imbalances are persistent and in which they have been overcome;
- the first reviews will be prepared for Portugal and Romania. Upon completion of the economic adjustment programme in mid-2014, Portugal joins the standard surveillance procedures. For Romania, surveillance of imbalances and supervision of policy has been carried out in accordance with the adjustment programme supported with financial support in the form of precautionary measures.

In the Member States receiving financial support, surveillance of imbalances and supervision of corrective measures will be carried out in relation to programmes of these states. This refers to Greece and Cyprus. However, the situation in Greece concerning the procedure of prevention of macroeconomic imbalances will be assessed upon conclusion of the current financial bailout depending on the agreement achieved at a later stage.

In relation to other Member States, the Commission will not carry out further analysis concerning the procedure of prevention of macroeconomic imbalances. The European Commission considers that macroeconomic challenges in the Czech Republic, Denmark, Estonia, Latvia, Lithuania, Luxembourg, Malta, Austria, Poland and Slovakia shall not be considered as imbalances in the sense of the procedure of prevention of macroeconomic imbalances. At the same time, the European Commission states that careful surveillance and coordination of policy is required in all Member States on a permanent basis to identify new risks and initiate growth and employment boosting policies.

### **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* (the NRP of Latvia) was approved by the Cabinet of Ministers

on 26 April 2011 along with the *Convergence Programme of Latvia for 2011-2014*. Both programmes were submitted to the EC on 29 April 2011.

The NRP of Latvia describes the medium-term macroeconomic scenario, reflects the main macro-structural bottlenecks (challenges) to the economy of Latvia and the main measures to tackle them, as well as the quantitative targets of Latvia for 2020 within the

context of the *Europe 2020 strategy* and main measures to achieve them.

The aim of Latvia is to foster growth and employment, thus ensuring growth of the GDP in the amount of 4-5% in the medium term 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* (quantitative targets of Latvia). They have been defined based on the medium-term economic growth scenario of Latvia, as well as the sustainable growth targets of Latvia set out in the *Latvia 2030 Strategy* and reflected also in the *National Development Plan of Latvia for 2014-2020* (NDP 2020) approved by the Saeima on 20 December 2012.

According to the quantitative targets of Latvia, it is planned by 2020 to achieve an employment rate of 73% in the age group of 20-64, an increase of investments in research and development (R&D) to 1.5% of GDP, an increase of the share of people having completed tertiary education to 34-36%, reduce the share of early school leavers to 10%, reduce the share of persons at-risk-of-poverty to 21%, increase the share of renewable energy in the total gross energy consumption to 40%, etc.

According to the European semester process, on 29 April 2014, the Cabinet of Ministers approved the third ***Progress Report on the Implementation of NRP of Latvia*** and the *Stability Programme of Latvia for 2014-2017*. Both abovementioned documents have been 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 and evaluates the progress of Latvia in the fulfilment of the EU Council recommendations of 2013, as well as provides a detailed description of policy directions of the NRP of Latvia, including the progress towards achievement of the quantitative targets of Latvia within the *Europe 2020 strategy*, and reflects information about the use of the EU funds.

After having assessed the updated National Reform Programmes, *Stability* or *Convergence Programmes* submitted by the EU Member States and the progress made towards their implementation, on 2 June 2014, the **EU Council approved the country-specific recommendations for the EU Member States**, including Latvia. These recommendations were approved by the EU Council on 8 July 2014. The following has been recommended for Latvia for the period 2014-2015:

- Preserve a sound fiscal position in 2014 and strengthen the budgetary strategy as of 2015, ensuring that the deviation from the medium-term objective remains limited to the impact of the systemic pension reform. Pursue efforts to further reduce the tax burden on low-income earners in the context of a shift towards more growth-friendly property and environmental taxes and by improving tax compliance and collection;
- Step up implementation of the higher education reform, in particular through the establishment of an independent accreditation agency and a financing model that rewards quality. Provide career guidance at all education levels, improve the quality of vocational education and training, including by strengthening apprenticeship, and make progress as regards the employability of young people including by putting in place outreach measures for non-registered youth not in employment, education or training. Take steps for a more integrated and comprehensive research system also by concentrating financing towards internationally competitive research institutions;
- Reform social assistance and its financing further to ensure better coverage, adequacy of benefits, strengthened activation and targeted social services. Increase coverage of active labour market policies. Improve the cost-effectiveness, quality and accessibility of the healthcare system;
- Accelerate the development of gas and electricity interconnections to neighbouring Member States to diversify energy sources and promote competition through improved integration of the Baltic energy markets. Pursue efforts to further increase energy efficiency in transport, buildings and heating systems;
- Complete judicial reforms including the pending reforms of insolvency, arbitration and mediation frameworks to ensure a more business- and consumer-friendly legal environment. Step up public administration reforms, including by implementing state-owned enterprise management reform and increasing institutional and financial independence of the Competition Council.

These recommendations for Latvia are a crucial element for identifying national priorities, developing and implementing the necessary reforms and policy measures, as well as for successful implementation of the *National Reform Programme of Latvia* and *Stability Programme of Latvia*. Taking into account the scope, impact, implementation costs and the need to discuss certain recommendations (for example, regarding education reforms, poverty elimination, healthcare and energy) with representatives of social partners, non-governmental organisations and the society, they are unlikely to be implemented within a year.

It should be noted that the *National Reform Programme of Latvia* and *Stability Programme of Latvia* is implemented in close cooperation with the European Commission. The progress of implementation of the both programmes is discussed regularly during **bilateral meetings**. For instance, bilateral meeting between the representatives of Latvia and the European Commission took place in Brussels on 5 December 2014. Progress in the implementation of the EU Council country-specific recommendations, namely on the social assistance reform



and determining a minimum level of income, public administration reforms, incl. implementation of a unified remuneration system and fostering institutional and financial independence of the Competition Council, has been discussed during the bilateral meeting. Furthermore, the European Commission discussed with the Latvian representatives the content of the *Annual Growth Survey 2015* (see Box 6.1) and key dates of the European semester of 2015 according to the plans of the Latvian Presidency in the EU Council.

The Ministry of Economics will continue monitoring the progress of measures aimed at implementation of the EU Council country-specific recommendations and the NRP of Latvia, and information on the progress of implementation of the measures will be included in the *2015 Progress Report on the Implementation of the National Reform Programme of Latvia in the Context of the “Europe 2020” strategy*.

## 6.2 Integration of Latvia in the Economic Policy and Structural Policy of the EU

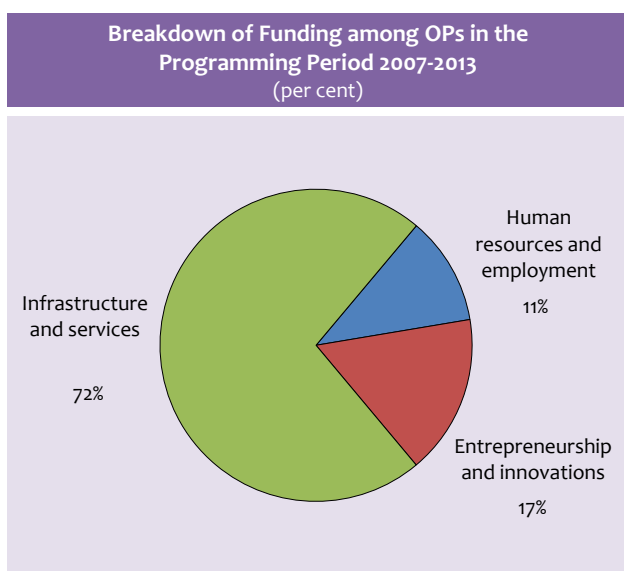
### 6.2.1 Use of European Union Structural Funds and the Cohesion Fund

As an EU Member State, Latvia has access to the financial support from the EU Structural Funds (SF) and the Cohesion Fund (CF), which are instruments for implementing the EU regional cohesion policy.

#### Programming period 2007-2013

In the programming period of 2007–2013, the SF support is mainly aimed at educating the population, technological excellence and flexibility of enterprises, as well as at development of science and research in order to promote a knowledge-based economy and to strengthen other prerequisites for sustainable economic development and general living conditions for people in Latvia.

Figure 6.3



Programming of the SF and the CF resources is implemented at 3 levels: the EU level strategy or *Community Strategic Guidelines*, strategy of the Member States or the *National Strategic Framework Document* (NSFD), and *Operational programmes* (OP) of the Member States.

NSFD, which is the basis for allocating the SF and CF funding in the amount of EUR 4.53 billion available for Latvia within the planning period of 2007–2013, was approved by the Cabinet of Ministers on 19 June 2007. On 20 September 2007, it was also approved by the EC.

According to the Decision of the EU Council of Ministers on the EU Multi-Annual Financial Framework for the programming period of 2007–2013, Latvia has received EUR 4.53 billion for implementing the cohesion policy objectives through the EU funds (the European Regional Development Fund – hereinafter the ERDF; the European Social Fund – hereinafter the ESF) and the CF.

Breakdown of the funding among OPs from the total EU funding of EUR 4.53 billion in the programming period of 2007–2013:

- 1. OP *Human Resources and Employment* (ESF) – EUR 583 mln. Together with overcommitments – EUR 653 mln;
- 2. OP *Entrepreneurship and Innovations* (ERDF) – EUR 696 mln. Together with overcommitments – EUR 771 mln;
- 3. OP *Infrastructure and Services* (ERDF+CF) – EUR 3.2 billion. Together with overcommitments – EUR 3.5 billion.

As of 31 October 2014, projects to the extent of 105% of all financing of the EU funds available for Latvia within the given programming period have been approved, and contracts for a total of EUR 4740 million have been concluded. As of 31 October 2014, the funding beneficiaries have received EUR 3607.6 million.



Table 6.1

EU Fund Financial Progress in the Programming Period 2007-2013 till 31 October 2014							
	Funding of EU funds	Concluded contracts		Paid to funding beneficiaries		Received EC's repayments (incl. advances)	
	mIn EUR	mIn EUR	%	mIn EUR	%	mIn EUR	%
ESF	583.1	647.9	111	585.2	90	482.4	83
ERDF	2407.6	2583.8	107	1870.9	71	1652.6	69
CF	1539.8	1508.4	98	1151.5	73	1004.1	65
<b>Total</b>	<b>4530.5</b>	<b>4740.0</b>	<b>105</b>	<b>3607.6</b>	<b>74</b>	<b>3139.1</b>	<b>69</b>

**Box 6.4****Activities under the responsibility of the Ministry of Economics in the programming period 2007–2013**

A total of EUR 741.4 million of the EU resources are available for the activities of the Ministry of Economics in the programming period 2007–2013, and this amount is distributed as follows:

1. OP Human Resources and Employment – EUR 50.9 million;
2. OP Entrepreneurship and Innovations – EUR 576.5 million;
3. OP Infrastructures and Services – EUR 114 million.

**Contracts concluded until 31 October 2014 within the framework of activities under the responsibility of the Ministry of Economics:**

- Within the activity *Support to Training of the Employed for Promotion of Competitiveness of Entrepreneurs – Support to Training Organized in Partnerships*, 30 contracts have been concluded for the total contract sum of EUR 31.6 million.
- Within the activity *Support to Individually Organised Trainings for Entrepreneurs*, 84 contracts have been completed for the total contract sum of EUR 2.7 million.
- Within the activity *Support to create new jobs*, 6 contracts have been concluded for the total contract sum of EUR 6.4 million.
- Within the activity *Attraction of Highly Qualified Employees*, 3 contracts have been completed for the total contract sum of EUR 143.6 thousand.
- Within the activity *Competence Centres*, 6 contracts have been concluded for the total contract sum of EUR 53.17 million.
- Within the activity *Technology Transfer Contact Points*, 8 contracts have been concluded for the total contract sum of EUR 2.2 million.
- Within the activity *Development of New Products and Technologies*, 80 contracts have been concluded for the total contract sum of EUR 7.1 million.
- Within the activity *Introduction of New Products and Technologies into Production*, 116 contracts have been concluded for the total contract sum of EUR 37.8 million.
- Within the activity *Development of New Products and Technologies – Support to Strengthening Industrial Property*, 3 contracts have been concluded for the total contract sum of EUR 0.07 million.
- Within the activity *Development of New Product and Technology Programme in Micro, Small and Medium-sized Enterprises*, 21 contract have been concluded for the total contract sum of EUR 0.2 million.
- Within the activity *High Value Added Investments*, 209 contracts have been concluded for the total contract sum of EUR 208.7 million.
- Within the activity *Access to International Trade Markets – External Marketing*, 2313 contracts have been concluded for the total contract sum of EUR 11.8 million.
- Within the activity *Development of External Markets – Strengthening International Competitiveness of Industry Sectors*, 2 contracts have been concluded for the total contract sum of EUR 18 million.
- Within the activity *Support for Self-employment and Business Start-ups*, 1343 start-up projects for over EUR 22.9 million have been supported.
- The following results have been achieved within the financial instruments of the activity *Holding Fund*:
  - (1) venture capital – on 22 January 2010, a contract on establishing a venture capital fund was concluded with *BaltCap Management Latvia*. In addition to the EUR 20 million invested by the Holding Fund, *BaltCap Management Latvia* invested another EUR 10 million of private investor co-funding. By 31 October 2014, *BaltCap Management Latvia* has concluded 11 venture capital investment contracts for the amount of EUR 14 million;
  - (2) seed and start-up capital – on 16 June 2010, a contract on establishment of a seed and start-up capital fund was concluded with *Imprimatur Capital Baltics*. The total available financing for seed and start-up capital investments amounts to EUR 9.5 million (on 10 May 2013, a contract on an increase in the seed capital to EUR 6.4 million was concluded with *Imprimatur Capital Baltics*). By 31 October 2014, *Imprimatur Capital Baltics* has concluded 48 seed capital investment contracts for the amount of EUR 4.8 million, and 6 start-up capital investment contracts for the amount of EUR 3.2 million;
  - (3) high risk loans – on 26 March 2010 contracts with AS *Swedbank* and AS *SEB Banka* were concluded. The programme was implemented until 26 September 2012. A total of 32 loan agreements for EUR 7.6 million have been signed within the programme;
  - (4) micro-loans – in August 2014, two micro-loan funds have been launched: *Capitalia* and *Grand Credit*. 13 agreements for the amount of EUR 0.2 million have been concluded;
  - (5) growth capital instruments – in 2013, three new growth capital instruments have been launched: *ZGI Capital*, *EXPANSION Capital*, *FLyCap*. 9 agreements for the amount of EUR 1.8 million have been concluded.

**Box 6.4 continued**

- Within the activity *Guarantees for Improvement of Enterprise Competitiveness*, 365 credit guarantee contracts have been concluded for the total amount of EUR 117.5 million and 142 export guarantee contracts for the total amount of EUR 13.4 million. On 30 May 2013, LGA has begun granting guarantees for housing heat insulation projects. By 31 October 2014, 45 guarantees for the total amount of EUR 6.1 million were granted for housing heat insulation projects.
- Within the activity *Mezzanine Loans*, 54 mezzanine loans have been granted for the total amount of EUR 13.8 million.
- Within the activity *Loans for Improving Enterprise Competitiveness*, 121 loans have been granted for the total amount of EUR 76.9 million within the ERDF part of the programme.
- Within the activity *Measures to Encourage Innovations and Business Start-ups*, 1 contract has been concluded for the total contract amount of EUR 2.85 million. Measures, seminars and competitions organized within the activity have involved 28,407 persons.
- Within the activity *Business Incubators*, 9 contracts on providing business incubation services in the regions of Latvia and 1 contract on providing business incubation services to creative industry enterprises in Riga have been concluded. 1059 enterprises are supported within the activity.
- the activity *Co-financing to the Investments in Micro, Small and Medium-sized Enterprises Operating in the Specially Assisted Areas*, 101 contracts have been concluded for the total contract sum of EUR 7.4 million.
- Within the activity *Cluster programmes*, 11 contracts have been concluded for the total contract sum of EUR 4.6 million.
- Within the sub-activity *Maintenance and Renewal of Town Planning Monuments of National Importance and Infrastructure Adjustment to Develop a Tourism Product*, 21 contracts have been concluded for the total contract sum of EUR 9.8 million (ERAF).
- Within the sub-activity *Development of Cycling Tourism Product of National Importance*, 7 contracts have been concluded for the total contract sum of EUR 5.2 million (ERDF).
- Within the activity *Improvement of Heat Insulation of Multi-apartment Residential Buildings*, 866 contracts have been concluded for the total contract sum of EUR 75.9 million (ERDF).
- Within the activity *Improvement of Heat Insulation of Social Residential Buildings*, 55 contracts have been concluded for the total contract sum of EUR 5.2 million (ERDF).
- Within the activity *Measures for Raising Efficiency of Central Heat Supply Systems*, 105 contracts have been concluded for the total contract sum of EUR 66.7 million (CF).
- the activity *Development of Cogeneration Power Plants Using Renewable Energy Resources*, 10 contracts have been concluded for the total contract sum of 28.8 million (CF).

**Financial absorption of EU funds in OP Human Resources and Employment, Entrepreneurship and Innovations, and Infrastructure and Services**

From the total public financing in the amount of EUR 5 billion available for implementation of EU fund projects, which include both EU fund financing and co-funding from the state budget and local government budget (excluding the granted overcommitments of the government budget in the amount of EUR 404.6 million), 7187 contracts on implementation of projects for the amount of 5.3 billion, i.e. 106.3% have been concluded. Yet, the total amount of funding paid to the funding beneficiaries has reached EUR 4 billion or 80.7 per cent.

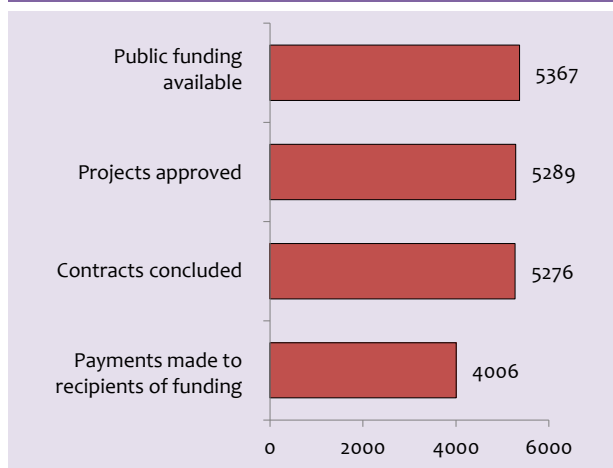
When separating the EU funding, the total amount of concluded contracts is EUR 4740 million or 104.5% of the available EU funding. It means that contracts are concluded for the granted overcommitment sums.

On 22 April 2014, the submission of projects for the fourth stage of the activity *High value added investments* ended in the field of entrepreneurship and innovation, while on 30 April 2014, the submission of projects for the second stage of the activity *Support for investments in construction or reconstruction of production premises* ended. Currently, the majority of contracts have been concluded.

Assessment of the submitted project applications has been completed within the framework of the 3<sup>rd</sup> stage of the activity *Support for science and research*, and contracts with project submitters have been signed on implementation of 41 projects. Contracts for the total amount of EUR 11.8 have been concluded within the framework of the 3<sup>rd</sup> stage.

Figure 6.4

**Financial Investments of the EU funds until 30 September 2014, total public funding (mln EUR)**



In the field of power industry within the framework of sub-activity *Measures for improvement of efficiency of the centralized heat-supply system*, nine projects have been terminated since the beginning of 2014. Considering the negative tendency, to ensure the absorption of CF funding, the 6<sup>th</sup> application selection stage has been announced in the activity. Project submission took place from 15 September 2014 until 14 November 2014. The funding available for the project selection stage was made of savings from former selection stages, as well as funding acquired from the terminated projects and as a result of non-conformities.

In the field of ICT, a decrease in the number of concluded contracts may be expected in the following periods considering the issue reviewed at Cabinet's meeting on 7 October 2014 in relation to the informative report *On the implementation of the activity programme "Infrastructure and services", sub-activity "Development of information systems and electronic services", project "Development of the website [www.skolas.lv](http://www.skolas.lv) (2<sup>nd</sup> stage) and "State education information systems (2<sup>nd</sup> stage)", and prevention of risks.* Information provided by the Ministry of Education and Science suggests that the Ministry of Education and Science provides for terminating the project *Development of the website [www.skolas.lv](http://www.skolas.lv) (2<sup>nd</sup> stage)*, as the ministry considers it useless. Accordingly the achievement of aims in effect is impossible, by creating unduly incurred costs in the amount of EUR 3.6 million within the framework of the ERDF project – an amount, by which the total costs eligible for the activity must be reduced. Overall, all costs incurred within the framework of the project, incl. ineligible costs, must be considered inexpediently spent budgetary funds, if the Ministry of Education and Science fails to provide an effective use for the said investments. In this specific activity, the Ministry of Environmental Protection and Regional Development as the ministry in charge of the sector and the responsible institution must perform an in-depth analysis on causes of the situation, as well as in relation to the programming period 2014-2020.

Figure 6.5

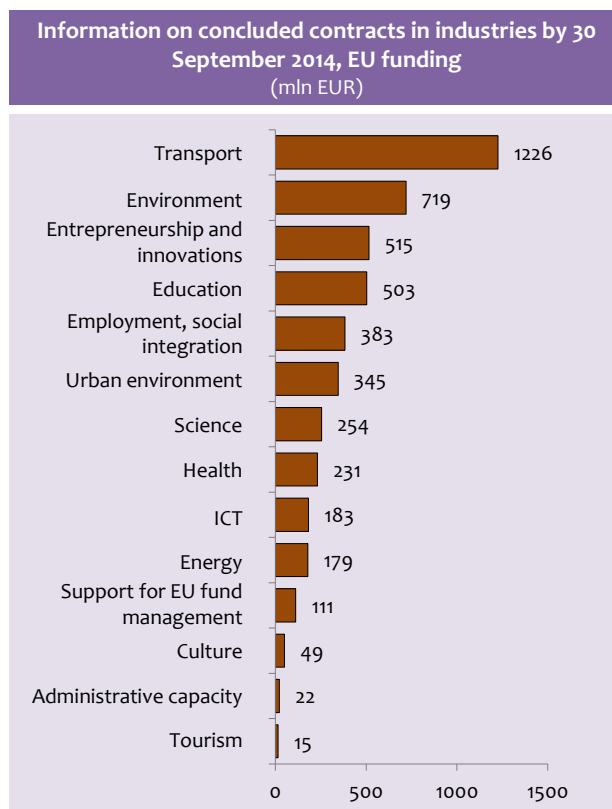
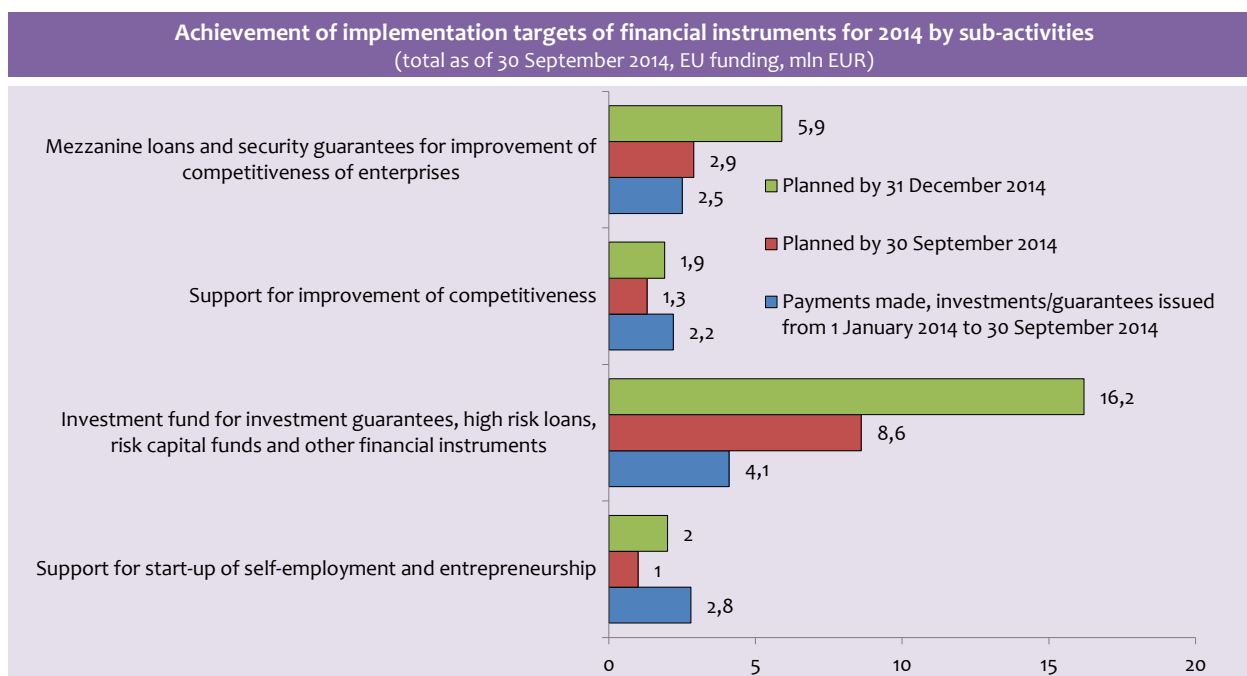


Figure 6.6



Although, the total amount of contracts is higher than the EU funding available, there are activities with comparatively high EU funding, where no contracts have been yet concluded. To absorb the entire funding, new

selection stages are or will be announced, on which information is available on the EU funds website [esfondi.lv](http://esfondi.lv).

Overall, the implementation of **financial instruments** fails to achieve the desired indicators. By 30 September 2014, within the framework of OP *Entrepreneurship and Innovations* investments to enterprises have been made, loans granted and guarantees issued for the amount of EUR 103.5 million or 70.1% of the available EU funding. Funding of OP *Human Resources and Employment* has been absorbed in the amount of EUR 10.67 million or 83.2% of the available EU fund financing. Overall, progress can be observed in the implementation of financial instruments.

The most considerable failure to achieve the goal may be observed within the framework of the activity *Investment fund for investments in guarantees, high risk loans, risk capital funds and other financial instruments*, risk capital funds Flycap; by 30 September 2014, the aim has been achieved only to the extent of 8.2%, and in EXPANSION Capital the aim is achieved to the extent of 26.5%. The goal is exceeded in the seed capital instrument – Imprimatur and start-up capital instrument Imprimatur.

Within the framework of investment funds, the risk capital funds are working actively on making new risk investments. In August 2014, two micro-loan funds – *Capitalia* and *Grand Credit* – have been launched. To ensure the availability of micro-loans by the end of 2015, amendments to the Cabinet Regulations No. 327, adopted at the Cabinet Meeting on 17 June 2014, provide for an extension of the term for granting micro-loans until 30 November 2015. However, there is a considerable risk to be unable to use the appropriated ERDF financing in full amount by the end of the period of eligibility (to ensure an adequate amount of risk investments).

Within the framework of the sub-activity *Mezzanine loans and security guarantees for improvement of competitiveness of enterprises*, to ensure availability of funding to enterprises when own funds are insufficient for raising resources, as well as to improve competitiveness of merchants, export and competitiveness guarantees are granted from 30 June 2014. The updated name of Sub-activity 2.2.1.4.2 – *Mezzanine loans and security guarantees for improvement of competitiveness of enterprises* has been approved at the CoM meeting on 17 June 2014.

Several measures have been taken **to minimize the impact of embargo by Russia** (to encourage uptaking of new markets) – *Amendments to provisions of Cabinet Regulation on the sixth and the following stages of OP “Entrepreneurship and Innovations”, supplement sub-activity 2.3.1.1.1 “Absorption of external markets – external marketing”, providing for an extension of the implementation of the sub-activity until 31 December 2015, including a new activity to be supported – individual visits at cooperation partners in target markets abroad, organized by the IDAL or a union, or foundations, as well as increasing intensity of EU co-funding support from 50% to 70% for participation in international exhibitions and in conferences to enterprises operating in the field of food processing, transport and logistics. Amendments to Cabinet regulations are made also for sub-activity*

2.3.1.1.2 *Absorption of external markets – strengthening of international competitiveness of industries*, providing for new activities to be supported (potential external trade market research, preparation measures for entering new foreign markets), permitting an advance payment in the amount of 100% to suppliers and service providers as well as other conditions.

#### **The programming period 2014-2020**

On 11 November 2014, the EC formally approved the OP *Growth and Employment* of the EU fund programming period 2014-2020.

The OP have been prepared based on such principles as the link with the *EU 2020* and other planning documents, strategic vision based on the analysis of shortcomings and needs, efficient and sustainable growth and result-oriented solutions. The priority directions defined in the planning documents and the specific support objectives are focused on achieving specific results that will contribute the most to the economic growth and promote achievement of the Cohesion policy objectives.

The new EU funding programming period 2014-2020 will provide our country with an opportunity to receive and invest in the development and growth of Latvia and its population EUR 4.4 billion over the following seven years. Latvia will be the fourth biggest net recipient among all Member States, receiving approximately EUR 3000 from the EU budget per capita during the period from 2014 until 2020. The aim of Latvia within the next programming period will be to approach the average level of welfare in the EU, using opportunities offered by the EU funds wisely and responsibly.

To detail the OP, work on the development of supplements to OP *Growth and Employment* has been commenced.

Several significant steps in the development of the EU funding planning documents for the programming period 2014-2020 have been taken. On 11 July 2014, *Law on the Management of the European Union (EU) Structural Funds and of the Cohesion Fund for the Programming Period 2014-2020* has entered into force, and development of conditions for specific support objectives to be launched at an early stage is continued.

Work on issues of the management and control system for the programming period 2014-2020 is continued. Based on the delegation stipulated in the *Law on the Management of the European Union (EU) Structural Funds and of the Cohesion Fund for the Programming Period 2014-2020*, the following instruments have been developed and:

- Submitted for approval by ministries and non-governmental organizations on 15 August 2014 – the draft Cabinet regulation *Procedures by which the institutions involved in European Union Structural Funds and Cohesion Fund management ensure implementation of the funds in the programming period 2014-2020*;
- Announced by the meeting of state secretaries (MSS) on 11 September 2014 – the draft Cabinet regulation *Procedures by which the functions of the*



*revision institution are ensured in European Union Structural Funds and Cohesion Fund management in the programming period 2014-2020;*

- Announced by MSS on 25 September 2014 – the draft Cabinet regulation *Procedures by which inspections of the European Union Structural Funds and Cohesion Fund are performed in the programming period 2014-2020;*
- Submitted for approval by ministries and non-governmental organizations on 1 October 2014 – the draft Cabinet regulation *Procedures by which resources in the state budget are planned for the implementation of projects co-financed by European Union Structural Funds and Cohesion Fund, as well procedures for making payments in the programming period 2014-2020.*

On 11 July 2014, *Law on the Management of the European Union (EU) Structural Funds and of the Cohesion Fund for the Programming Period 2014-2020 has entered into force.*

Furthermore, Guidelines No. 2.1 *Guidelines for determination of eligible and ineligible costs in the programming period 2014-2020* have been approved on 18 July 2014.

On 15 July 2014, the composition of the Supervision Committee of the EU Fund programming period 2014-2020 has been submitted to the Management Commission of the Ministry of Finance, which would supervise the efficiency of use of funding, the process of implementation of the project and conformity with the approved planning documents, would ensure effective management and operation of the Supervisions Committee, and would be able to make decisions related to the implementation and supervision of EU funds.

Significant events planned for the 1<sup>st</sup> half of 2015 are as follows:

- Development of supplements to OP “*Growth and Employment*” will be continued;
- Development and approval of SAM initial assessment preparation terms will be continued by the Advisory Assessment workgroup at planning of funds in the programming period 2014-2020;
- Preparation of the description of management and control system is continued to ensure successful accreditation of the system and beginning of the period;
- Training of employees of the EU fund managing institution on risk management is continued, by organising a strategic seminar for senior managers and practical training for all employees of the EU fund managing institution to strengthen employees’ capacity to ensure effective risk management and contribute to the development of risk management strategies for the leading institution of the EU fund programming period 2014-2020;
- Draft Cabinet regulation *Procedures by which the institutions involved in European Union Structural Funds*

*and Cohesion Fund management ensure preparation and implementation of the funds in the programming period 2014-2020, including the attached EU fund project application form will be submitted for review and approval;*

- *Procedures by which the functions of the revision institution are ensured in European Union Structural Funds and Cohesion Fund management in the programming period 2014-2020 will be submitted for review and approval;*
- *Procedures by which inspections of the European Union Structural Funds and Cohesion Fund are performed in the programming period 2014-2020 will be submitted for review and approval;*
- *Procedures by which resources in the state budget are planned for the implementation of projects co-financed by European Union Structural Funds and Cohesion Fund, as well procedures for making payments in the programming period 2014-2020 will be submitted for review and approval;*
- Cabinet draft regulation *Procedures by which communication and visual identity requirements are ensured in the implementation of European Union Structural Funds and Cohesion Fund in the programming period 2014-2020, is expected to be developed;*
- *Procedures by which reports are made on non-conformities in the implementation of European Union Structural Funds and Cohesion Fund, inadequate costs are deducted, written off or recovered and proportional financial correction is applied in the programming period 2014-2020 is expected to be developed.*

The key investments of the EU funds programming period 2014-2020 are planned to be directed for the following objectives:

- Reducing the number of population at risk of poverty by providing appropriate training, improving the health condition and integration in the labour market;
- Promoting employment by integration of the long-term unemployed and the youth in the labour market;
- Reducing the consumption of primary energy by improving energy efficiency in private and public buildings, improving energy efficiency in industrial production and supporting an increase in energy efficiency in public transport;
- Increasing investments in research and development by promoting attraction of private investments, as well as cooperation between research institutions and entrepreneurs;
- Improvements of ICT and transport infrastructure that has a direct impact on the economic productivity and serve as a basis for innovations and increase internal and external mobility of people and goods.

Table 6.2

Breakdown of Funding and Total Investments of the EU Funds in OP Growth and Employment, Planning Period 2014-2020 (formally confirmed by the European Commission on 11 November 2014)			
	Amount of the EU funding mln EUR	Structure of the EU funding per cent	Total amount of the funding mln EUR
Strengthen research, technology development and innovations	467.5	10.8	550.0
Improve the access to, use and quality of information and communication technologies	172.8	4.0	203.3
Increase SME competitiveness	314.3	7.3	369.7
Support transition to low-carbon economy in all sectors	480.6	11.1	565.4
Environmental protection and promotion of efficient resources	623.1	14.4	733.0
Promote sustainable transport and prevent weaknesses in key network infrastructures	1159.8	26.9	1364.4
Promote employment and support labour mobility and social inclusion	164.4	3.8	188.3
Investment in education, skills and lifelong learning	934.5	21.6	1099.4
<b>Total</b>	<b>4316.9</b>	<b>100</b>	<b>5073.6</b>

**Box 6.4****Activities within the competence of the Ministry of Economics in the programming period 2014-2020**

A total of EUR 764.15 million of EU funding is available for activities of the Ministry of Economics in the programming period 2014-2020, which are distributed as follows:

1. Innovations – EUR 193.5 million;
2. Improvement of competitiveness of small and medium scale enterprises – EUR 237.1 million;
3. Energy efficiency and power industry – EUR 333.55 million.

**Innovations:**

Innovation vouchers – EUR 7 million.  
 Technology transfer – EUR 49.5 million.  
 Competence centres – EUR 102.3 million.  
 Motivation of innovation – EUR 4.8 million.  
 Training of employees – EUR 29.9 million.

**Improvement of competitiveness of small and medium scale enterprises:**

Availability of funds – EUR 61.4 million.  
 Promotion of Latvia as a tourism destination – EUR 20 million.  
 Absorption of external markets – EUR 31.8 million.  
 Risk capital – EUR 45 million.  
 Business incubators – EUR 31 million.  
 Development of industrial areas – EUR 21.7 million.  
 Cluster programme – EUR 6.2 million.  
 Technology accelerators – EUR 20 million.

**Energy efficiency and power industry:**

Energy efficiency in residential buildings – EUR 150 million.  
 Energy efficiency in public buildings – EUR 97.8 million.  
 Energy efficiency in industrial objects – EUR 32.55 million.  
 Central heat supply systems – EUR 53.2 million.

## 6.2.2 Foreign Economic Policy

**Multilateral relations**

The liberalisation of the terms of international trade within the framework of the World Trade Organisation (WTO) remains to be the basic priority of the EU in the field of foreign trade. Along with the protocol approved on 27 November 2014 for the inclusion of the Trade

Facilitation Agreement in the WTO contractual framework, in 2015, there is a possibility of agreeing upon other issues of the operational programme of multilateral trade system for the successful conclusion of the WTO Doha Round (DDA). It must be noted that the next conference of WTO Ministers is planned to take place in Kenya on 15-18 December 2015.



**Box 6.5****Latvia's progress towards joining the OECD**

Accession to OECD is of high importance for Latvia, as Latvia will participate in the procedure of development of the new OECD recommendations and standards, the Latvian experts will share their experience with the OECD member states; discussions, scientific studies and analysis of economic policies of OECD will allow Latvia to identify economic priorities, potential issues and the best methods for resolving them.

Participation in the OECD would improve development of quality of state administration and provision of better services to population, learning also from other developed countries.

With the accession to the OECD, Latvia will be included in OECD's statistics databases and national economy policy reports, ensuring higher reliability by foreign investors and entrepreneurs. Latvia would be assigned the highest category OECD credit rating, which, in turn, would make Latvia even more attractive for investments, as well as would facilitate access to markets in order to fund significant projects. Better awareness of Latvia as an OECD member state will allow local entrepreneurs to conquer markets outside EU.

In 2014, Latvia held meetings with 24 OECD committees and work groups, which actively interviewed and cooperated with the Latvian experts. It is important to participate in the organization's work at the level of competent experts ensuring maximum activity and quality in participation in OECD committees, working groups and programmes, convincing all OECD member states to put Latvia at the top of the candidate list.

Currently, several OECD member states agree that Latvia is among the most visible candidate states thanks to the active work of Latvia in the OECD.

After authorisation of the Roadmap for Latvia's accession talks to the OECD, on 14 February 2014, the *Initial memorandum* of the Latvia's accession talks was forwarded to the OECD, according to which an in-depth assessment of Latvia's readiness for joining the OECD is carried out. It describes and justifies the degree to which Latvia shall conform to the OECD standards and the best practice according to all (250) OECD instruments. Currently, assessment of Latvia within the framework of different OECD committees and working groups is continued.

In the second half of 2014, OECD research missions in the field of economic and development, public capital and privatization practice, consumer protection policy, competition policy and statistics have been held in Riga.

In the fall of 2014, assessment of the OECD's Export Credit Work Group resulted in a positive opinion on Latvia.

In the second half of 2014, the Ministry of Economics provided responses to OECD questionnaires, as well as the necessary information on the sectors under the competence of the Ministry of Economics, as a result the OECD Economics and Development Commission and the OECD Competition Commission has prepared and reviewed initial reports on Latvia. In 2015, further assessment in the OECD State Capital and Privatization Practice Work Group, the OECD Consumer Protection Policy Committee and the OECD Statistics and Statistics Policy Committee will be carried out.

It is planned, that technical accession talks will be completed by the end of 2015, and in 2016, Latvia might become an OECD member state.

**Bilateral relationships within the framework of the EU Common Trade Policy**

The European Union has entered in preferential agreements that provide for the mutually beneficial terms of trade with over 50 partner countries, including Andorra, the Balkan countries<sup>1</sup>, countries of Central America<sup>2</sup>, Chile, South Africa, South Korea, countries of the European Economic Area<sup>3</sup>, certain countries of Economic Partnership Agreements<sup>4</sup>, Columbia, Mexico, Peru, San Marino, Switzerland, and Turkey.

Negotiations have ended, yet trade agreements have not come into force with the EU Eastern Partnership countries (Ukraine, Moldova, Georgia), Canada, Singapore, and Ecuador. The entry into force of these agreements depends on the completion of internal approval procedure of the parties. In the second half of 2014, in turn, the EU actively continued conducting negotiations on entering into an FTA with the USA, Japan, and Vietnam as well.

In the second half of 2014, the seventh stage of negotiations on the EU-US free trade partnership, which is the most important in future in the world, was conducted. It is crucial that along with the approval of the new EU Trade Commissioner C. Malmström, the EU has undertaken to improve the transparency of negotiations significantly, by providing the public with broader access to the documents of negotiations related to the agreement and EU's position in relation thereto. It should be noted that the Transatlantic Trade and Investment Partnership between the EU and the USA is determined as one of the priorities in the field of trade and investments during Latvia's presidency as well.

**Bilateral economic cooperation**

To promote and intensify bilateral economic cooperation with the most significant trade partners, Latvia has concluded bilateral economic cooperation agreements with Russia, China, Belarus, Ukraine, Kazakhstan, Azerbaijan, Georgia, Moldova, Uzbekistan, Kirgizstan, Turkmenistan, Tajikistan and Armenia. Inter-governmental Commissions in the field of economic, scientific and technical cooperation (IGC) and the Unified Commissions (UC), ensuring supervision of operation of the agreements and seeking opportunities to further improve cooperation, have been created within the framework of these agreements. Furthermore, Latvia

<sup>1</sup> Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro and Serbia

<sup>2</sup> Costa Rica, Salvador, Honduras, Nicaragua, Panama

<sup>3</sup> Iceland, Lichtenstein, and Norway

<sup>4</sup> Antigua and Barbuda, Belize, the Bahamas, Barbados, Dominica, Dominican Republic, Grenada, Haiti, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, Trinidad and Tobago, Papua New Guinea, Madagascar, Mauritania, the Seychelles, Zimbabwe

has signed the Declaration on Formation of the Unified Economic and Trade Commission with Turkey.

In the second half of 2014, IGC meetings have been held with Turkmenistan (Ashgabat) and Belarus (Minsk).

#### Box 6.6

##### **Bilateral economic cooperation of Latvia in the second half of 2014**

In the second half of 2014, the main activities were the following:

##### Latvia-Austria

On 1-2 July 2014, official visit of the President of Austria Dr. Heinz Fischer to Latvia took place. During the visit, to promote formation of contacts between Latvian and Austrian enterprises, the Latvian-Austrian Business Forum was held with the participation of over 20 Austrian entrepreneurs, representing such fields as IT, woodworking, real estate, mechanical engineering, engineering, etc.

Furthermore, a bilateral meeting of ministers of economics of both states was held during the visit, where economic cooperation opportunities were discussed, by paying particular attention to issues related to the power industry, science, technology development and innovation.

##### Latvia-China

On 8-10 July 2014, the Deputy Commerce of China Minister Zhong Shan along with delegation from the Ministry of Commerce of People's Republic of China visited Latvia. Before his visit to Latvia, he visited Tajikistan and Belarus.

Within the framework of the visit, the Chinese delegation had a meeting with the Minister of Economics V. Dombrovskis and State Secretary of the Ministry of Economics M. Lazdovskis. During the meeting, parties have discussed novelties in the economic development and benefits of business environment of both countries. Zhong Shan stated that the Chinese government is willing to increase export from the Central European and Eastern European countries. Furthermore, there are plenty of opportunities of investments that have not yet been used.

The delegation also has a meeting with representatives of the Ministry of Transport, the FreePort of Riga Authority, as well as IDAL.

##### Latvia-USA

On 9-10 July 2014, Latvia was visited by a delegation of 24 entrepreneurs from the USA, representing car building, pharmacology, life sciences, IT, production of various plastic films industry and other industries. The visit of the US entrepreneurs to Latvia was organized by IDAL in cooperation with the Ministry of Foreign Affairs, the Embassy of Latvia in the USA, the Embassy of the USA in Latvia, the United States Chamber of Commerce in Latvia and the Latvian Honorary consuls in USA. This was a response visit to work visits of officials to the USA during the previous years, as well as the work visit of the Prime Minister of Latvia L. Straujuma to the USA with the participation of 19 entrepreneurs from Latvia. The aim of the visit was to show Latvia as an attractive business destination to the US business representatives, as well as discuss business cooperation opportunities between USA and Latvia. A business workshop, which was opened by the Minister of Economics V. Dombrovskis, business match-making and individual meetings with the Latvian enterprises and industry associations, as well as with superior level government officials have been organized during the mission.

##### Latvia-Japan

On 23 September 2014, the Minister of Economics V. Dombrovskis participated in the Latvian-Japan Business Forum, which was held within the framework of the visit of delegation of the Japanese Enterprise Association "Koken-Kai". The aim of the visit of "Koken-Kai" was to introduce Latvian economy, politics, international relations and business to the leaders of the Japanese enterprises, as well as to improve cooperation with entrepreneurs, policy makers and implementers. The Japanese delegation consisted of representatives of 68 Japanese enterprises, representing various sectors of manufacturing, IT and financial services, infrastructure development sector, etc.

##### Latvia-Turkey

On 22-23 October 2014, the state visit of the President of Turkey *Recep Tayyip Erdoğan* to Latvia took place. The events of the visit were attended also by the Minister of Economics of Latvia V. Dombrovskis. The Latvian-Turkey Business Forum was held during the visit, where representatives of 40 Latvian enterprises, as well as over 40 entrepreneurs from Turkey participated, representing such areas as the power industry, shipbuilding, mechanical engineering, construction, architecture, IT, telecommunication, tourism, etc.

##### Latvia-Georgia

On 25-27 November 2014, the visit of the Minister of Economics D. Reizniece-Ozola took place in Georgia, within the framework of the visit of the President of the Republic of Latvia A. Berzins to Georgia with the participation of a large delegation of entrepreneurs. Two Latvian-Georgian Business Forums (Tbilisi and Batumi) were held within the framework of the visit with participation of representatives of 58 enterprises from the part of Latvia. Alongside the visit, from 24 November until 10 December, the *Days of Latvia* were held in Georgia with demonstrations of Latvian chefs, a fashion show, panels of Latvian goods, as well as labelling of food products at point of sale etc. Furthermore, the 1<sup>st</sup> Meeting of the Latvian-Georgian Business Cooperation Board (BCB) was held, during which the Statute on the Establishment of BCB was signed. During the visit, potential fields of cooperation were identified, such as tourism, food production, metal processing, woodworking and construction, IT, chemical industry, pharmacology, transport and logistics, clean technologies, incl. waste management, water treatment etc.

##### Latvia-Turkmenistan

On 9 December 2014, the 2<sup>nd</sup> Intergovernmental Commission Meeting of Latvia and Turkmenistan on economic, production, scientific and technical cooperation issues (IGC) was held in Ashgabat (Turkmenistan). Within the framework of the IGC meeting, a broad range of issues were reviewed to improve bilateral economic cooperation both at the governmental and enterprise level. Particular attention was paid to opportunities to extend the bilateral cooperation in the field of transport and transit, education and science, agriculture and other fields. Alongside the IGC meeting, bilateral meetings with the Turkmenistan officials were held, where the current cooperation and potential for economic cooperation was discussed.

The Latvian-Turkmenistan Transport Working Group was formed and its 1<sup>st</sup> Meeting was held on 8 December 2014 within the framework of the IGC. The Working Group discussed further cooperation opportunities between both countries in the field of transport, facilitating resolution of issues related to various types of transport; incl. motorized transport, aviation, railroads and ports.

**Box 6.6 continued****Latvia-Belarus**

On 10 December 2014, the 10<sup>th</sup> Intergovernmental Commission Meeting of Latvia and Belarus on economic, scientific and technical issues was held in Minsk (Belarus). The agenda of the meeting provided for a broad range of issues to improve bilateral economic cooperation between both countries, paying particular attention to opportunities to extend the bilateral cooperation in the field of entrepreneurship and production, transport and transit, agriculture, education and science, information and communication technologies, as well as tourism and regional cooperation.

Alongside the IGC meeting, the Meeting of the Business Cooperation Council of Latvia and Belarus was held, where entrepreneurs of Latvia and Belarus discussed issues on economic cooperation, fields of potential cooperation, as well as acquainted themselves with novelties in business environment of both countries.

**Presidency of Latvia in the EU Council**

In 2014, Latvia has been preparing for a significant task – the presidency of Latvia in the EU Council in the first half of 2015. Each EU Member State becomes a president country and leads the agenda of the EU Council for six months in a rotating sequence.

The presidency is carried out through cooperation between three member states. The trio-presidency was opened on 1 July 2014 by Italy, followed by Latvia in the first half of 2015, and then Luxembourg in the second half of 2015. In 2014, Latvia along with trio-partner countries Italy and Luxembourg has developed and approved a common work programme. The six-month agenda of Latvia will be published at the beginning of 2015.

During the presidency, Latvia will organize and chair approximately 1500 meetings in Brussels and Luxembourg. Representatives of both ministries and subordinate institutions thereof, as well as permanent representation offices of the Republic of Latvia in the EU will be involved in the preparation and implementation

process of the presidency of Latvia. Overall, these are about 1140 officials and employees in total, who will perform the functions of leaders of the EU Council working groups, their deputies, industry experts, coordinators and communicators during the presidency.

The task of the presidency is to be a fair and neutral intermediary through negotiations. Furthermore, the presiding state cooperates with other EU Member States, the Secretariat-General of the EU Council, the EC, the European Parliament and the President of the European Council. The presidency represents the EU Council in relations with the EC, as well as represents the EU Council outside EU.

To improve cooperation and decision-making, about 200 meetings will be arranged in an informal atmosphere in Latvia (see Box 6.7). The National Library will be the main venue for the meetings. Thus, it is expected that about 25 000 officials from other EU member states will visit Latvia. This is an opportunity to promote the image of Latvia around the world.

**Box 6.7****Events during the presidency of Latvia in the EU Council within the fields of competence of the Ministry of Economics**

In the first half of 2015, events planned in Riga will be as follows:

- Conference of the European Energy Ministers *The European Energy Union* (6 February 2015)
- Informal meeting of the EU Competitiveness Ministers (26-27 March 2015)
- EU Common Market Forum (26 March 2015)
- Informal meeting of the Environment and Energy Ministers (15-16 April 2015)
- Consumer Rights Protection Conference (23-24 April 2015)
- European Competition Day (7 May 2015)
- European Standardization Summit (3-5 June 2015)
- EU Innovative Business Week Conference *Financial Tools for Innovation and Entrepreneurship 2015* (15-17 June 2015)

To make the work programme of the presidency of Latvia more coherent and focused, values of the presidency of Latvia or *IGS* have been identified – *Involvement, Growth and Sustainability*.

Three priority directions have been established for the presidency of Latvia in the EU Council:

(1) A competitive EU as the grounds for growth and improvement of quality of life.

Latvia will actively participate in implementation of the EU growth and employment strategy, taking measures to increase competitiveness of the EU, as well as developing a *Roadmap* for coordination of the six-month presidency of Latvia in the EU. Our priority will be improvement of business environment, incl. support to small- and medium scale enterprises, creating high

quality workplaces, availability of services and education, as well as enhancing external competitiveness. Latvia will organize the Conference for the EU-Asian Ministers of Education.

(2) Strengthening of information society.

The priority of Latvia will be actions of the EU to minimize digital gaps and creating an informed society. Latvia has outpaced many EU Member States in the field of information technologies and digital solutions. In 2014, discussion of the EU Member States on the use of digital economic potential will be continued to increase the competitiveness of the EU, compared to North America and Asia. Latvia will participate in the development of the EU policies, updating the establishment of a unified EU digital market, e-

management and improvement of e-skills of population, as well as safety of information in a digital environment and the freedom of Internet issues. During the presidency, Latvia will take the opportunity to present its achievements, including e-management solutions and e-platform to promote civil cooperation.

(3) Building of the EU role at a global scale, creation of an area of welfare and security in the neighbouring regions of the EU Member States.

During the presidency of Latvia, special attention in this context will be paid to relations between the European neighbouring states, implementing the current policies and initiatives in the Eastern Partnership and Central Asian countries both in relation to the economic dimension and by strengthening democratic and safety procedures already starting from 2014. Latvia will continue to support the consolidation of transatlantic relations, placing particular emphasis on the preparation of the EU and the USA Trade and Investment Partnership Agreement, as well as promoting cooperation with Brazil, Japan, Russia, India and China within the strategic partnership of EU.

### 6.2.3 Internal Market of the European Union

The EU internal market comprises 31 countries (28 EU Member States and 3 European Economic Area (EEA) countries – Norway, Iceland, and Liechtenstein) with approximately 500 million consumers. The EU internal market encompasses a territory without internal borders where free movement of goods, persons, services, and capital is ensured. After continued and serious work within the framework of the EU, a uniform formation of a set of rules has been achieved for operators of economic activity, border control has been cancelled, a more competitive business environment is established, a wider choice of goods and services is provided for consumers, new jobs are created, an opportunity to live, work, study, and retire in another country is ensured to residents, an opportunity to introduce a single currency has been created, and many other benefits have been provided. However, the potential of the EU internal market still has not been fully employed, and its improvement is continuing by promoting sustainable and stable development of the EU economy and prosperity of the EU residents.

In May 2014, the transposition deficit of Latvia was 0.6% in the past six months, thus remaining among the Member States with a deficit below the EU average of 0.7%. Latvia is also one of the Member States that transpose directives with delayed deadline as fast as possible – on average in 5.3 months.

In Latvia, the process of implementing the principles of free movement of goods and services and the rights to do business established in Articles 34-36 and 49-62 of the *Treaty on the Functioning of the European Union (TFEU)* is supervised and coordinated by the Ministry of

Economics, constantly identifying legal regulations that may potentially or actually hinder implementation of freedoms in the EU internal market, *inter alia*, by assessing the current draft laws and regulations.

**The procedure for submitting technical regulations**, serves as a preventive, single, and transparent monitoring instrument with the aim of evaluating and preventing the setting of such requirements of the laws and regulations that may create obstacles for free movement of goods and information society services. Any business, not only the responsible institutions of the EU Member States, may take part in the harmonization process of technical regulations in order to provide its comments and objections concerning the projects prepared by other EU Member States, which may potentially influence export of production or cross-border provision of information society services of the merchant. Information on draft technical regulations announced by the Member States is freely accessible on the *Technical Regulations Information System (TRIS)* database <http://ec.europa.eu/enterprise/tris/lv/>, where draft technical regulations are available in Latvian. In case an enterprise has any objections to draft technical regulations of other countries that might or do affect the sale of its products in the market of a particular EU Member State, the enterprise is entitled to submit its objections to the responsible ministry, the authority of which includes coordination of specific policy in Latvia. Information on the procedure for submitting technical regulations is available on the website of the Ministry of Economics: <http://www.em.gov.lv/em/2nd/?cat=30412>.

**The principle of mutual recognition** is a legal instrument to ensure free movement of goods in the European Union. Overall, this principle envisages that the destination Member States may not prohibit selling within their territory goods, which are legally being sold in another member state even if they are produced in accordance with the requirements differing from those of the destination member states. This principle shall be applied to goods, to which the harmonized EU laws and regulations do not apply (free circulation of goods in a non-harmonized sector).

In order to improve the application of the principle of mutual recognition, 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*, aimed at establishing a procedure according to which the principle of mutual recognition should be observed at public institutions, as well as carrying out communication with entrepreneurs, was adopted and enforced on 2 September 2008. In order to continue improving the application of the mutual recognition principle in practice, on 16 August 2013, the EC published legally non-binding operational document *Instructions. Correct application of the term "lawfully released into free circulation" in the Mutual Recognition Regulation (EC) No. 764/2008*, providing explanation for correct application



of the term “*lawfully released into free circulation*” to state institutions is provided.

Regulation 764/2008 also prescribes the obligation of the state to establish *Product Information Points* (PCP). A PCP provides information to companies and competent authorities of Member States about provisions being applied to the specific type of product, as well as information, if any type of products requires any permits prior to putting them on the market. Currently, the functions of the product information contact point (PCP) in Latvia are performed by the Ministry of Economics (e-mail: [pcp@em.gov.lv](mailto:pcp@em.gov.lv)). In 2014, the PCP has replied to information requests from 39 merchants.

In order to ensure administrative cooperation among public administration authorities of EEA, the EC has introduced the **Internal Market Information (IMI)** system. Through the IMI system, the Member State institution can verify information, authenticity of documents issued in other Member States and submitted by legal entities and individuals, as well as to resolve other issues in accordance with regulatory enactments of the EU. Thus, the person submitting the documents is released from additional bureaucratic barriers to solve various issues in the Internal Market of the European Union. The national coordinator of the IMI system in Latvia is the Ministry of Economics. Currently, the IMI system in Latvia is available in the field of the *Service Directive* (2006/123/EC), the *Professional Qualification Directive* (2005/36/EC) the *Posting of Workers Directive* (96/71/EC), the *Patients' Rights Directive* (2011/24/EU), the *Regulation on the professional cross-border transport of euro cash by road between euro-area Member States* (1214/2011), the *Directive on the return of cultural objects unlawfully removed from the territory of a Member State*, as a pilot project – the *E-commerce Directive* (2000/31/EC) and the *Commission Implementing Decision on train driving licences* (2014/89/EU). Taking into account the obligation under the *Service Directive* – the Member States have to notify each other about services that might be harmful to human health, life, and environment, the IMI system includes a *Warning mechanism* that ensures successful cross-border cooperation among supervisory institutions in risk elimination. In the IMI system, 74 responsible institutions of Latvia are registered, 59 institutions are involved in the sphere of services, 18 in the sphere of professional qualification, 6 in the sphere of employee secondment, 4 in the sphere of patients' rights, 2 in e-commerce, 2 in train driving licences (one institution can be involved in several spheres).

From January until November 2014, Latvia submitted 24 requests for information via the IMI system: 5 in the field of services, 11 in the field of professional qualification, 8 in the field of employee secondment; Latvia has received 81 requests for information: 4 in the field of services, 66 in the field of professional qualification, 8 in the field of employee secondment, 3 in the field of patients' rights.

Since 2004, the alternative *On-line problem solving network of the European Union Internal market* established by

the European Commission and the Member States – **SOLVIT centre network** – is available in Latvia. The task of the *SOLVIT coordination centre network* is to find a quick and practical solution to problems in the EU internal market occurring as a result of misapplication of European Union laws and regulations by public institutions. The *SOLVIT coordination centre network* serves as a free of charge problem-solving instrument in situations when a citizen or an enterprise has suffered from unlawful decisions made by the responsible institutions of other Member States. *SOLVIT coordination centres* are located in every Member State of the European Union (also in Iceland, Norway, and Lichtenstein). From January until November 2014, the SOLVIT coordination centre in Latvia has received 35 complaints. In order to lodge a complaint with the *SOLVIT coordination centre*, the case must meet the following criteria for case solving: (1) a decision has been made by a public institution; (2) the public institution is located in another Member State of the European Union (cross-border element); (3) the European Union law has been violated (regulations, directives, etc.). Most often, the *SOLVIT coordination centre* in Latvia has solved cases lodged by individuals regarding the issue of social benefits and residence permits in other Member States, whereas entrepreneurs regarding restrictions of free movement of goods and services and recognition of professional qualification.

Based on the EC statement *On Good Common Market Management* (8 June 2012) to the European Parliament, Council, European Economic and Social Committee and Region Committee, currently, formation of the **Unified Market Centre** on the unified website of the Ministry of Economics (see [https://www.em.gov.lv/lv/eiropas\\_savieniba/es\\_vienota\\_tirgus\\_centrs/](https://www.em.gov.lv/lv/eiropas_savieniba/es_vienota_tirgus_centrs/)), to ensure common source of information on EU information and assistance services.

In order to promote business activity and innovations in the service sector, as well as gradual modernisation and simplification of state administration, one of the priorities set for Latvia within the EU is **promotion of free movement of services**. In the field of services, in cooperation with non-governmental organizations and public institutions, requirements of laws and regulations are regularly analysed, and proposals on necessary amendments are prepared in order to eliminate the current administrative burden for enterprises. Current administrative barriers and procedures are under revision, respectively repealing or simplifying requirements for issuing permits (licences, certificates, confirmations, and other documents), as well as making it possible to handle all the necessary procedures electronically. Additionally, implementation of the one-stop shop principle still continues, thus improving access to services rendered by public administration in one place – in the single portal of state and municipal services [www.latvija.lv](http://www.latvija.lv).

The principle of “silence means consent” is one of the tools that fosters modernization of public administration to reduce delays of public institutions in decision-making, costs and adverse effect incurred to

small and medium-sized enterprises. The principle defines that in case the responsible institution fails to make a timely decision on application for a permit, it shall be considered that the service provider has received the permit and is entitled to start rendering services. On 12 June 2012, the CoM adopted Decree No. 264 *Plan of Measures for Implementation and Application of “Silence-means-consent” Principle in the Administrative Practice of Institutions in Charge*, where initially adoption of the “silence-means-consent” principle was planned for 15 services. According to the plan of measures, the “silence-means-consent” principle is implemented already in relation to 14 of the services mentioned in the plan (the principle is not yet adopted in accordance with the procedure, according to which the social service provider is registered in the register of social service providers and deleted from it). Along with the said activities and services mentioned in the plan of measures, the “silence-means-consent” principle has been implemented for four other services. Implementation of the principle is continued in the work group formed by Decree No. 94 of the State Secretary of the Ministry of Economics adopted on 20 May 2013, which has assessed services provided by 229 public institutions, and identified services to implement the mentioned principle. By the end of 2014, development of a new plan of measures is expected, incorporating it into the *Business Environment Improvement Measure Plan*.

Latvia participates also in the **frontrunners initiative**. This was initiated by the state administration institutions of the United Kingdom, Denmark, Sweden and the Netherlands and currently 16 EU Member States are involved. The purpose of the *Frontrunners* initiative is to resolve specific problems encountered by entrepreneurs and consumers in the internal market of the EU, cooperating and exchanging good practice. Currently, Member States cooperate in the following fields:

- Formation of the *Unified Market Centre* to ensure to entrepreneurs access to all help and information on the internal market of EU;
- In the field of development of the Unified Contact Points where entrepreneurs may carry out any and all necessary formalities to operate in the field of rendering services, incl. in another Member State;
- Recognition of professional qualifications to minimize the number of regulated professions and prevent any obstacles in the procedure of recognition of the professional qualification in another Member State;
- Review of the procedure for assignment of the highest level domain names carrying out research of obstacles in the procedure of registration of the highest level domain names.

## 6.3 Industrial Policy

The framework of the Latvian industrial policy (NIP) planning document is formed of a set of several documents, of which the most significant are the *National Development Plan*, the *Strategy for Smart Specialization* included in the *Guidelines on Science, Technology Development and Innovation*, the *Guidelines on National Industrial Policy of Latvia*, the *Guidelines on Development of Education*, etc. industry policy planning documents.

### **Guidelines on National Industrial policy**

*Guidelines on National Industrial policy of Latvia* were approved by the Cabinet of Ministers on 28 May 2013. They are aimed at promoting structural changes in the economy in favour of production of goods and services with a higher value added, namely by increasing the role of industry, modernizing the industry and services and export sophistication.

In order to reach the defined aim, the following expected results are determined:

- the share of manufacturing shall reach 20% of the gross domestic product by 2020;
- the increase of productivity of manufacturing to reach 40% by 2020 compared to 2011;
- the growth of manufacturing to reach 60% by 2020 compared to 2011;
- investments in research and development shall reach 1.5% of GDP.

In order to identify market failures, the potential of export-capable niches and products and services with a higher value added was identified, as well as in-depth analyses of producers were carried out. The analysis revealed the following key challenges to the NIP to be actively addressed by the state:

- Limited financing;
- Labour costs and competitive prices;
- Low productivity and weak innovation performance;
- Transformation of international business;
- Demographic situation (ageing labour).

Based on advantages and main challenges of Latvian enterprises, actions of the NIP are aimed at:

- Issues related to **access to and skills of labour force** such as: further implementation of reforms of the vocational education system and higher education system by concentrating and customizing appropriate education programmes to the labour market demands, as well as increasing the share of the practical part of the programmes; continuing state support instruments aimed at improving qualification and skills of specialists working in enterprises, as well as retraining possibilities to market demanded specialties; reducing the number of students of



- secondary education in favour of the vocational education system;
- Issues related to **development of industrial areas** such as: adapting existing industrial areas; improving roads and engineering communications (electricity, water-main, sewerage, gas, lightning, etc.) to manufacturing objects; developing new industrial premises and spaces in centres of international, national and regional significance;
  - Issues related to **access to finance** such as: providing the necessary funding to new, micro- and small-sized enterprises; support for current assets or initial investments; continue issuing loan guarantees; extending the CIT relief for promoting manufacturing with respect to purchasing new production equipment; developing venture capital instruments for stimulating investments in development and expanding activities of enterprises;
  - Issues related to **promoting innovation** such as: building research and innovation capacity of enterprises; replacing the current CIT reliefs for research and development costs with new relief, envisaging a threefold write-off of certain research and development costs; developing a research base and excellence;
  - Issues related to **promoting exports** such as: supporting cluster initiatives; minimizing export transaction risks; entering external markets and reimbursing certification costs;
  - Issues related to **costs of energy resources** such as: developing support programmes for improving energy efficiency and reducing emissions in manufacturing.

A detailed plan of activities for the period until 2017 has been developed according to the proposed directions, envisaging a number of activities for each direction of action, appointing the institutions in charge of the

activities and defining the expected performance of results.

Within the framework of implementation of the action plan, the Ministry of Economics has begun the development of support measures for the EU planning period 2014-2020.

#### Strategy for Smart Specialization

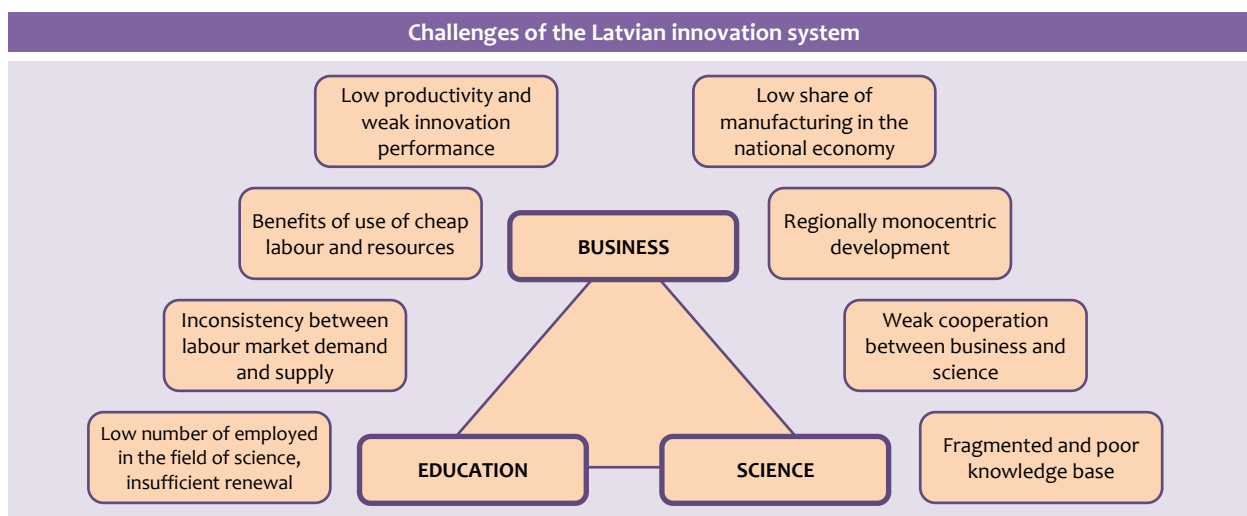
The *Smart Specialization Strategy* (SSS) provides for development of a vision, finding advantages of competitiveness, selection of strategic priorities and choosing of the policy that allows discover the development potential of the region insofar as possible, based on knowledge, thus, ensuring growth of national economy.

The strategy has been included and approved by the Cabinet's *Scientific, Technology Development and Innovation Guidelines for 2014-2020* adopted on 28 December 2013.

When developing the *Smart Specialization Strategy*, the scenario of the development of the national economy must be taken into account. Upon conducting an analysis of the national economy of Latvia, it has been concluded that sustainable development is aimed at promoting structural changes in the economy in favour of production of goods and services with a higher value added, namely by increasing the role of industry, modernizing industry and services and export sophistication. It is a significant pre-condition for the convergence of the Latvian economy with the developed EU states and for growth of welfare in population, which may be achieved by increasing the competitiveness of the economy of Latvia, based upon innovation.

At the same time, when developing the *Smart Specialization Strategy*, the existing issues in the innovation system must be identified (see Section 6.9). In the opinion of the Latvian and EC experts, there are eight principal challenges in the Latvian innovation system, which are described in Figure 6.7.

Figure 6.7



According to the analysis, challenges may be encountered in all of the most significant pillars of the innovation system.

Based on the conclusions and the performed analysis, the framework of the *Strategy for Smart Specialization* has

been developed defining directions of the national economy transformation, national economy growth and areas of the smart specialization (see Table 6.3).

Table 6.3

Framework of the Smart Specialization Strategy		
Directions of national economy transformation	Priorities of development	Areas of the smart specialization
1. Change of the industry and export structure in traditional fields of the national economy	<b>Priority 1:</b> Use of a more efficient pre-treatment of products to make products with higher added value, creation of new materials and technologies, as well as diversification of use thereof. More extensive use of non-technological innovations and the Latvian creative industry potential to produce national economy products with a higher added value.	1. Knowledge-intensive bio-economics;  2. Bio-medicine, medical technologies, bio-pharmacy and bio-technologies;
2. Sectors of future growth with products and services with high added value	<b>Priority 2:</b> Development of an innovation system that ensures the support for the creation of new products and technologies within the framework of existing industries and inter-sectors, as well as for new sectors with a high development potential based upon growth for determining key technologies, ensuring identification system of new products/services and is able to find and support the creation of new products both within the frame of the existing and industries and inter-sectors, and to create new sectors with a high development potential.	
3. Sectors with significant horizontal influence and contribution into the transformation of the national economy	<b>Priority 3:</b> Increasing the energy efficiency, including creation of new materials, optimization of manufacturing procedures, implementation of technological novelties, use of alternative energy resources, etc. solutions.	
	<b>Priority 4:</b> Development of a modern and adequate ICT system in the private and governmental sector.	3. Smart materials, technologies and engineering systems
	<b>Priority 5:</b> A modern educational system conforming to the requirements of the future labour market, which promotes transformation of national policy and development of competences, abilities and creativity required to implement SSS priorities at all levels.	
	<b>Priority 6:</b> A well-developed knowledge base (fundamental science and science infrastructure) and human capital in the fields where Latvia has comparative advantages and which are significant in the national economy transformation procedure: in the fields of knowledge related to the smart specialization (1) knowledge-intensive bio-economics, (2) bio-medicine, medical technologies, bio-pharmacy and bio-technology, (3) smart materials, technologies and engineering systems, (4) smart power industry (5) in key technologies identified by ICT, as well as (nanotechnologies, micro- and nano-electronics, photonics, advanced materials and production systems, bio-technologies).	4. Smart power industry
	<b>Priority 7:</b> Identification and specialization of the existing territory resources, developing perspective opportunities and directions of economic growth, incl. the leading and perspective directions for entrepreneurship in local government territories.	5. Information and communication technologies

To specify the indicators and specialization areas in order to achieve aims of policy defined in the *Smart Specialization Strategy*, the Ministry of Economics, the Ministry of Education and Science, and the Ministry of Agriculture have organized 14 public discussions with the participation of over 500 representatives from scientific institutions, educational institutions, and industry associations. The principal conclusion drawn from the discussions is that the industry of Latvia features a high level of relative specialization, thus, the overall industry specialization is not considered an issue of the national economy of Latvia. It has been recognized that the support of single-sided growth of economy will be avoided when implementing the *Smart Specialization*

*Strategy* – national economy environment, which promotes economic activity, and development of human resources must be ensured.

Improvement of productivity has been mentioned as the basic task in several discussions. Opportunities for increasing it are seen by representatives of the industry both in new products and in the improvement of production methods and technologies of existing products. The Latvian enterprises have a relatively low productivity, in particular, labour force productivity, both in the field of production and services in Latvia, specialization in areas with a low value added occurs, where the total value added is above the average; the Latvian enterprises are often involved in production

where the value added is comparatively low, and in low or medium technology industries, one of the ways to increase productivity is gradual transition to high technology industries and products. Furthermore, it has been emphasized that science requires diversity of knowledge. Specialization for industry needs may be ensured by focusing operation on resolution of specific issues, involving representatives of industries in the procedure of approval of research grants and projects.

One of the tasks of the discussion was to identify the niches of potential competitiveness within the framework

of each specific specialization. Potential specialization niches of the Latvian industries within the framework of the *Smart Specialization* identified by participants of the discussions have been provided in Table 6.4 below. Participants of the discussions emphasized that the listed niches of specialization are those, in which Latvia currently has specific advantages and in which further growth may be expected according to the current information available.

Table 6.4

Potential specialization niches of the Latvian industries within the framework of the Smart Specialization according to guidelines of science, technology development, and innovation	
Areas of specialization	Potential specialization niches in the view of discussions of 2014
1. Knowledge-intensive bio-economics.	Sustainable and productive forest cultivation under changing weather conditions; complete use of timber biomass for chemical processing and energy; innovative, risk-minimizing technologies for growing plants and animals; development of innovative products from timber, traditional and non-traditional raw materials from agricultural plants and animals; technological solutions for use of by-products of plant and animal farming and processing; food safety.
2. Bio-medicine, medical technologies, biopharmacy and biotechnologies.	<ol style="list-style-type: none"> <li>1. Chemical and biotechnological methods and products for acquiring pharmaceutical and bioactive substances;</li> <li>2. Development and research of new human and veterinary medicines;</li> <li>3. Molecular and individual treatment and diagnostic methods and cell technologies;</li> <li>4. Functional food, curative cosmetics and bioactive natural products.</li> </ol>
3. Smart materials, technologies and engineering systems.	Implant materials, composite materials, thin layers and coatings, units, mechanisms and machine tools, glass fibre products and glass fibre-based smart materials.
4. Smart power industry.	Price of resources; intensity of consumption of energy resources; the EU climate and power industry network for 2030.
5. Information and communication technologies.	Innovative knowledge management, methods and tools for system modelling and development of software; innovative use of ICT hardware and software; cyber-physics systems, language technologies and semantic network; large-scale data and knowledge infrastructure; information safety and quantum computers; computer system testing methods.

## 6.4 Energy Policy

The principal directions of an effective, balanced energy policy of Latvia, based on market principles and defined in the *Long-term Energy Strategy 2030 – competitive energy for society* (Energy Strategy 2030), developed and

approved at the meeting of the CoM on 28 May 2013, are aimed at developing competitiveness of the national economy, improving public welfare.

### Box 6.8

#### Energy Sector in Latvia

Both imported (natural gas, electricity, oil 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, electric 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. Electric energy output in Latvia depends on the run of the river Daugava and other rivers. Over 80% of electric energy produced in Latvia is produced by AS “Latvenergo”, which ensures also the import of electric energy and delivery thereof to users. Mainly imported fuels – natural gas, charcoal and heavy fuel oil – and local fuels – firewood – are used in heating energy generation.

In 2013, energy resource generation and recycled products in Latvia reached 89.8 PJ, whereas 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 was by 1.8% lower than in 2012. In 2013, self-security in the total consumption of primary energy resources was 34.9%. In the total consumption of primary energy sources, firewood with its total consumption of 53.1 PJ, while electricity generated in hydropower stations and wind power stations constituted 10.9 PJ.

The key objective of the *Energy Strategy 2030* is to ensure a positive impact of the energy sector on the national economy of Latvia, while striving for a safe and sustainable energy supply:

- Secure energy supply – a stable energy supply and developed infrastructure provided to energy users;
- 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 energy policy development directions laid down in the *Energy Strategy 2030*, the Ministry of Economics develops new *Energy Policy Guidelines for 2014-2020*, which will supersede the *Energy Development Guidelines for 2007-2016*, approved by the CoM Decree No. 571 on 27 June 2006. The guidelines will include measures to be implemented until 2020 to achieve the energy sector development objectives in Latvia.

Table 6.5

Consumption of Primary Energy Resources in Latvia, PJ (PJ)							
	2000	2005	2009	2010	2011	2012	2013
<b>Total consumption*</b> including:	<b>163.8</b>	<b>192.1</b>	<b>189.0</b>	<b>194.8</b>	<b>184.2</b>	<b>190.6</b>	<b>187.1</b>
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 electric energy net imports							
*** Used tyres, municipal waste for heating, charcoal, straw, other biomass, biogas, bioethanol, biodiesel							

### Electric energy market

According to the electricity trade register of the Public Utilities Commission, as of 19 November 2014, 61 traders have been registered for electricity trade. A

total of 23 traders, who have signed a contract on the use of the system with AS “Sadales tīkls”, are operating in the electric energy market.

#### **Box 6.9**

##### **Social support instrument**

Social support instrument for a specific circle of electric power users, defined as protected users, will ensure support related to the increase in electric power prices, which is expected along with the opening of the electricity market for households from 1 January 2015, when the application of the administratively governed electric energy prices (tariffs) to electric power trade will be discontinued.

A protected user is a poor or low-income family (person) or a large family, using electric energy in their household for personal needs (end consumption). The social support instrument of the protected user will be implemented in two steps.

During the first or transitional step – in 2015 – the support to the protected users will be ensured by AS “Latvenergo”. The following support will be ensured during the transitional step:

- support to a poor or low-income family (person) will not exceed 100 kilowatt-hours for the price of EUR 0.0131 per one kilowatt-hour in each payment period (a calendar month);
- support to a large family will not exceed 300 kilowatt-hours for the price of EUR 0.0131 per one kilowatt-hour in each payment period (a calendar month).

In this case, the total price of electric energy (including electric energy price, trade services, mandatory procurement component, value added tax and network services) will be equal to the Start Tariff – EUR 11.64 per one kilowatt-hour. For the amount of electric energy, which exceeds the said service amount for the protected user (i.e. 100 kilowatt-hours for a poor or low-income family (person) and 300 kilowatt-hours for a large family) in the payment period, the protected user will pay the price offered by AS “Latvenergo” and chosen by them, or the universal service price of AS “Latvenergo”.

During the second step – from 1 January 2016 – the trade services for the protected user will be provided by the enterprise, selected by the Ministry of Economics in a tender based on ability to ensure trade services with the lowest co-funding from the state budget. Conditions for providing services to a protected user, the amount and the procedure of funding during the second step will be governed by the CoM regulations developed by 1 June 2015.

The Latvian energy market is being gradually opened already since 2007, when entrepreneurs and other legal entities became active market players. Currently, there are over 24 thousand electric energy consumers in the free market, who spend 75% of electric energy.

On 20 March 2014, the Saeima, by approving the draft law *Amendments to the Electricity Market Law*, established that the final step of electricity market liberalization, fully cancelling electric energy price regulation (tariffs) and providing to households, as well as legal users opportunity to freely choosing the provider and agree on the electric energy price, will be carried out on 1 January 2015.

A permanent social support instrument has been created by amendments to the *Electricity Market Law* of 18 September 2014 (see Box 6.9).

According to the provisions set in the EU *Third Internal Market Liberalization Energy Package*, one of factors ensuring optimum functioning of the electric energy market will be a separation of network services from production and trading activities.

During the procedure of restructuring of AS “Latvenergo” – a vertically integrated energy supply merchant with the Ministry of Economics as the shareholder, electric energy transfer and distribution system operators have been legally separated.

#### Box 6.10

##### **Mandatory Electricity Procurement Component**

Taking into account risk assessments<sup>1</sup> carried out by the Ministry of Economics in 2012 and 2013<sup>1</sup> 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 aid 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 – 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 users. These 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 the end users of electricity.

Pursuant to Annex 4 to the Law on State Budget for 2014, the sub-programme 29.02.00 Aid to Electricity Users provides for the funds of EUR 29.3 million in 2014. While pursuant to Annex 4 to the Law on State Budget for 2015, the sub-programme 29.02.00 Aid to Electricity Users provides for the funds of EUR 28 million in 2015. The MPC volume has not increased for electricity users in Latvia since 1 April 2014. The implementation of aid to electricity users from the state budget funds is planned until 2017.

At the CoM sitting of 19 November 2014, the informative report of the Ministry of Economics *On the Progress of Fulfilment of the Subsidised Electricity Tax*, which examines in detail the application of the SET in practice, as well as explains the financial flow of the aid mechanism to electricity users, substantiating the need for the State budget funds, was taken into consideration.

At the sitting on 26 August 2014, the Cabinet of Ministers examined the informative report of the Ministry of Economics *On the Promotion of Competitiveness of Energy-Intensive Enterprises*, which provides proposals on actions to further limit MPC payments for energy-intensive enterprises of the manufacturing industry, the activities of which on regional and international markets are mostly affected by the increase in the electricity price, in relation to similar enterprises on the relevant markets. By identifying the competitiveness challenges of Latvian enterprises of the manufacturing industry when facing the risks of increased electricity prices, within the framework of preparation of the state budget for 2015, deputies prepared a proposal on amendments to the Electricity Market Law (EML) (adopted by the Saeima in the final reading on 17 December 2014), which provides for a delegation to the Cabinet of Ministers to determine the procedure, according to which the energy-intensive enterprises of the manufacturing industry are to obtain the right to the reduced participation for the compensation of losses to a public seller. The new provision (Section 30.2 of the EML), which includes the referred to delegation, will come into force on 1 July 2015. Until then, it is planned to finish the work on the development of the new Cabinet Regulation. 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 users as a result of the referred to 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.

<sup>1</sup> Informative report *On Aid Mechanisms for Electricity Production, Using Renewable Resources* (minutes of the CoM sitting on 28 August 2012, No. 49, § 41). (<http://www.mk.gov.lv/lv/mk/tap/?pid=40246892&mode=mk&date=2012-08-28>); Informative report *On the Risks of Increase in Electricity Prices and Their Restriction* (minutes of the CoM sitting on 8 January 2013, No. 29, § 41). (<http://www.mk.gov.lv/lv/mk/tap/?pid=40272838&mode=mk&date=2013-01-08>); Informative report *On the Production Aid Fund of the Mandatory Electricity Procurement* (minutes of the CoM sitting on 4 June 2013, No. 33, § 29), (<http://www.mk.gov.lv/lv/mk/tap/?pid=40286844&mode=mk&date=2013-06-04>); Informative report *Complex Solution for the Problems of the Electricity Market* (minutes of the CoM sitting on 13 August 2013, No. 44, § 156), (<http://www.mk.gov.lv/lv/mk/tap/?pid=40294599&mode=mk&date=2013-08-13>); Informative report *Action Plan for Restricting the Risks of Increase in Electricity Prices* (minutes of the CoM sitting on 9 April 2013, No. 18, § 35), (<http://www.mk.gov.lv/lv/mk/tap/?pid=40280663&mode=mk&date=2013-04-09>).



Since 1 January 2012, the AS “Augstsprieguma tīkls” – an independent transmission system operator – commenced their operations outside the AS “Latvenergo” group, and it is responsible for the development of a transmission network, safety of the electric power transmission, stability of the power system and quality of electric energy, providing it in accordance with technical and economic requirements and modern technologies, and having the Ministry of Finance as a shareholder. The owner of the transmission system assets is the AS “Latvenergo” subsidiary company AS “Latvijas elektriskie tīkli”, which started operating on 1 April 2011. Since 1 July 2007, the operator’s functions

of the electric energy distribution system are performed by the AS “Sadales tīkls” – an independent subsidiary company of the AS “Latvenergo”. AS “Sadales tīkls” ensures the supply of electric energy to over one million users, covering with their service 99% of the entire territory of the state. Overall, there are 11 distribution operators in Latvia. The main requirements in relation to the quality of distribution services are laid down in CoM *Regulations on Requirements for 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.

#### Box 6.11

##### Electricity and Centralized Heat in Latvia

In 2013, the total supply of electricity was 7564 GWh, which is by 3.8% less than in 2012. AS “Latvenergo” generated 64.2% of the total electricity supply in their plants; it purchased 17.9% from small electricity energy producers, and net imports of electric energy constituted 17.9% per cent.

Since 2013, 41.2% of the total generated electric energy has been distributed, 27.5% has been supplied to the industrial and construction sector, 27.1% to households, 2.2% to agriculture, 1.9% to transport.

In 2013, the centralized heat energy for sale was produced by 638 boiler houses and 166 co-generation stations, which produced in total 7.29 TWh of centralized heat energy. Natural gas was the main resource for generating heat energy and electric energy. The share of the centralized heat energy produced using natural gas as fuel was 71.2%, 21.8% woodchips, 2.0% firewood, 0.34% heavy fuel oil, and other types of fuel – 4.66 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 end consumption to households has been distributed, 25.6% to services, 2.2% to industrial and construction sector, 1.1% to agriculture. However, the breakdown of the centralized heat energy distributed by regions is the following: Riga region – 52.6%, Pierīga region – 10.9%, Vidzeme – 7.1%, Kurzeme – 10.3%, Zemgale – 8.4%, and Latgale – 10.7 per cent.

Complete **integration** of Latvian, as well as Lithuanian and Estonian electric power markets **into the EU common market**, joining the Nordic electric power market, is also a significant aim for the EU and the Baltic States.

On 17 July 2009, the protocol of intent on development of the *Baltic Energy Market Interconnection Plan* (BEMIP) was concluded between the European Commission and a number of Baltic States including the Republic of Latvia. BEMIP is aimed at developing an efficiently functioning Baltic energy market, a possibility to implement solidarity mechanisms of the Member States, improving the security of electricity supply in the Baltic States and integrating the Baltic energy market into the Northern electricity market, thus ensuring its integration in the common EU energy market. The main measures planned within the BEMIP are related to the internal electricity market (developed cross-border trade, separation of transmission system operators, competitive prices), electricity interconnections and generating powers, and internal gas market and infrastructure, including for interconnections.

The electricity market of Latvia, just like the whole 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 price areas. Despite the fact that the implementation of such a project may potentially have a positive influence on the integration of Estonian-Finnish energy systems and liquidity of Estonian-Finnish price areas, it does not reduce the risk of congestions in the Latvian-Estonian interconnection, which is a highly seasonal issue but has a negative influence on pricing in Latvian and Lithuanian NPS price 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 congestion 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 hindrances for Latvia and Lithuania, as well as the Kaliningrad region to import electric power from cheaper electric energy regions – Estonia and Scandinavia. As a result, the average electric power price in Latvia and Lithuania is higher than in Estonia and Scandinavia.

Currently, the Lithuanian-Swedish interconnection “NordBalt” with the transmission capacity of 700 MW is being developed within the framework of the project *Kurzeme Circle*, envisaging the construction of a 330 kV



overhead line in the western part of Latvia to prevent the possibility of increased capacity connection, to ensure the development of wind farms and improve the safety of electric power supply in Kurzeme. The first stage of *Kurzeme Circle* includes the construction of a 330 kV high voltage line, connecting the Riga city 330 kV sub-station “Rīgas TEC-1” to the sub-station “Imanta”; the line construction works, incl. inspections, were completed by 25 September 2013. The second stage of *Kurzeme Circle* includes the construction of the 330 kV high-voltage line Grobiņa-Ventspils; design stage initiated in 2010, but all works have been finished in 2014. Construction costs of the first and the second stage of *Kurzeme Circle* are EUR 98.5 million, of which EUR 38.5 mill. are from the European Energy Regeneration Programme. To date, EUR 66 million have been invested in the first and second stage of the project. Costs of the third stage of *Kurzeme Circle* are EUR 127.42 million, and it must be finished by the end of 2018. BEMIP states that the third Latvian-Estonian interconnection is strategically important since it allows preventing overload of the current transmission networks and increase the available transmission capacity of the Estonian-Latvian interconnection. The third Latvian-Estonian interconnection project significantly improves the electricity supply security in the interconnection between Estonia and Latvia, as well as energy 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 EUR 112 million. Depending on the length of the line to be constructed, Latvia will have to assume costs amounting to EUR 102.3 million, while Estonia ~ EUR 9 million, and 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 researched. Construction of the interconnection will be commenced in 2017, and put into operation in 2020.

To prevent isolation of the electric power market, electric power supply merchants in Latvia, within the framework of the *Connecting Europe Facility* (CEF), have registered 2 projects – *Third Stage of Kurzeme Circle* and the *Third Latvian-Estonian Interconnection* for inclusion in the list of the Projects of Common European Interest (PCEI).

Upon assessing the decisive effect of the submitted projects on the development of electric energy market in Latvia and in the Baltic States within the framework of CEF, funding in the amount of EUR 55.1 million has been granted for the project *Third Stage of Kurzeme Circle*, whereas EUR 112.3 million have been granted for the project *Third Latvian-Estonian Interconnection*.

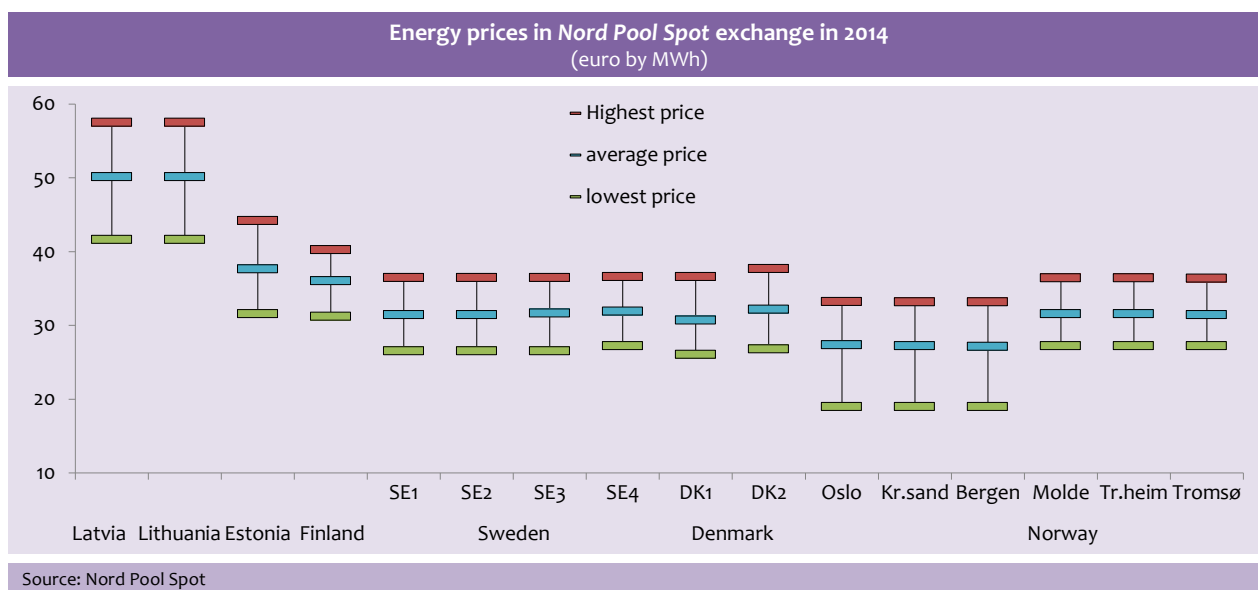
From the regional point of view, the most significant issues to be solved to ensure effective operation of the electric power market are as follows:

- Complete fulfilment of requirements of the internal market in the Baltic States, including opening of the market, ensuring participation of the Baltic States in the EU common market;
- Overload management based on market principles, indirect power auctions organised by the electric power exchange Nord Pool Spot (NPS) among the Baltic States (useful for overload management of Latvian-Estonian interconnections);
- Creation of a common reserve and balancing market;
- Creation of a financial product market in Latvia and Lithuania, as the exchange *Nasdaq OMX Commodities* starts its operations;
- Implementation of the Baltic States infrastructure projects included on the PCEI list;
- Improvement of elements being developed in the regional dimension Pan-European electric power market models;
- Change of synchronization of the Baltic State power system (transmission network).

Establishment of a functional regional market is considered a pre-condition for further integration of the Baltic States into the NPS Nordic Region, at the same time, adopting NPS principles of operation. NPS is the largest electric power exchange in Europe, offering to their participants the same day and next day electric power trade opportunities, and operation of the Baltic States therein would develop cross-border trade, as well as would create competition in the market. The 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 only the following day. The next step for the development of an electric power 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 of these 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.

Figure 6.8



One of the factors affecting the sustainability of the electric power sector is state guarantee of generating capacity, since it defines the scale of risks related to the import of electric power and primary energy resources. Although the actual level of self-granting with generating power in Latvia at the end of 2013 was 77%, all electric power stations of Latvian in common are able to cover 100% of electric power demand.

Since approving of the *EU Energy Action Plan for 2050*, prescribing that development of generations and sufficiency of national capacities must be focused on the territories with the potential of renewable resources, to

stimulate minimization of CO<sub>2</sub> emissions and greenhouse effect, to promote more effective, competitive development of electric power stations, when assessing sufficiency of the generated power, the available throughput to and from the state and region, i.e. capacity, shall be taken into account.

The issue on synchronization of the Baltic electric energy transmission system with the continental Europe is significant for the development of Latvian and Baltic State energy sector and market integration in the long-run.

Table 6.6

Electricity Supply in Latvia (GWh)							
	2000	2005	2009	2010	2011	2012	2013
<b>Total electricity supply</b>	<b>5922</b>	<b>7054</b>	<b>7223</b>	<b>7500</b>	<b>7340</b>	<b>7859</b>	<b>7564</b>
<b>Gross electricity generation</b> including:	<b>4136</b>	<b>4906</b>	<b>5569</b>	<b>6627</b>	<b>6095</b>	<b>6168</b>	<b>6209</b>
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 CHPs	149	214	538	590	592	650	718
<b>Net electricity imports</b>	<b>1786</b>	<b>2148</b>	<b>1654</b>	<b>873</b>	<b>1245</b>	<b>1691</b>	<b>1355</b>
* Daugava cascade – Riga HPP, Ķegums HPP and Pļaviņas HPP							
** Riga CHP-1 and Riga CHP-2, source: AS „Latvenergo”							

In October 2013, 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 electric energy is synchronization of the Baltic electric energy transmission system with the energy systems of the continental Europe, terminating actual isolation thereof from other EU states.

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. Currently, cross-border operation with Russia and Belarus is carried out only in the direction towards the Baltic States on the NPS electric power change platform in accordance with legislation of the Baltic States and the procedure established by the Baltic management system operators. Operational functions of energy systems are governed by BRELL contract concluded between Belarus, Russia, Estonia, Latvia and Lithuania. Domestic trade of electric 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 legal regulation of EU in the electric energy market, in particular, in relation to calculation of capacities and planning, overload management, balancing of lines.

After closing the Ignalina nuclear power plant at the end of 2009, the new *Visaginas nuclear power plant project* is one of the most topical issues in the context of the Baltic energy policy. Latvia supports the *Visaginas NPP project* based on the regional solidarity principle. When deciding on the involvement of the Latvian energy company “Latvenergo” in the *Visaginas NPP project*, the economic benefits of the project and other significant issues related to implementation of the project will be assessed.

#### **Natural gas market**

The Latvian gas supply system is not connected to the European Union single gas supply system. Latvia receives natural gas only from Russia. The only natural gas storage in the Baltic States – the Inčukalns underground gas storage (UGS) with 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 1461 million m<sup>3</sup> or by 3.1% lower than in 2012. The biggest consumers of natural gas in 2013 were CHP and heat supply enterprises of AS “Latvenergo” with 68.9%, manufacturing and construction with 11.9%, other consumers with 16.8%, while the remaining part was formed of consumption and loss of natural gas in the energy sector. The Riga region uses about 65% of natural gas consumed in Latvia.

Currently, AS “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.

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)*.

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/EU* until 2017. On 20 March 2014, the Saeima approved the draft law *Amendments to the Energy law*, envisaging gradual market liberalization, stating that all users of natural gas will be entitled to choose a natural gas supplier from 3 April 2017. Until then, the separation of the supply system operator must be finished. The separation of the supply system operator must be finished 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 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, amendments envisage that from 4 April 2014 that operators of the natural gas transmission, distribution, storage and liquefied natural gas system must ensure equal and open access to the corresponding 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. Considering that 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 order to diversify the sources of natural gas supply and minimize the dependency on one supplier, biogas and gas produced from biomass, as well as liquefied natural gas will be allowed to the natural gas transmission system as of 1 January 2015.

In order to strengthen the security of natural gas supply in the EU, the *Regulation (EU) No 994/2010 of the Parliament and of the Council of 20 October 2010 concerning measures to safeguard security of gas supply and repealing Council Directive 2004/67/EC of the European Parliament and of the Council (Regulation 994/2010)* was adopted. Among other things, the *Regulation 994/2010* imposes an obligation on the competent authority of the Member States (in the case of Latvia, the Ministry of Economics) to prepare a *Risk Assessment of Natural Gas Supply*, and, based on it, a *Preventive Action Plan* and an *Emergency Action Plan* (see Box 6.12).

The *Preventive Action Plan* and the *Emergency Action Plan of Latvia* has been approved by the Decree No 98 of 23 May 2013 of the State Secretary of the Ministry of Economics.

**Box 6.12****Risk Assessment of Natural Gas Supply**

The Risk Assessment provides an analysis of the natural gas market, assessment of the existing natural gas supply infrastructure, assessment of political and administrative risks, cause and effect scenarios, risk effect scenarios and operational measure scenarios, develops a gas supply interruption risk matrix at the national level and measures for incorporation into the *Preventive Action Plan*.

The *Preventive Action Plan* contains measures to remove or mitigate the risks identified in the risk assessment of the security of natural gas supply in Latvia in the field of both natural gas supply (investments in infrastructure, use of long-term contracts, planning actions in case of an emergency) and the demand (use of interruptible contracts, replacing fuel), preventive measures in relation to the need to improve interconnections between neighbouring member states and possibility to diversify gas channels and supply sources.

The *Emergency Action Plan* suggests the measures to be taken to eliminate or mitigate the effect of a gas supply disruption if it cannot be eliminated by the measures specified in the *Preventive Action Plan*, and energy suppliers alone can no longer properly respond to gas supply disruptions. The *Preventive Action Plan* of Latvia has been developed, based on the three main crisis levels laid down in the Regulation 994/2010:

- Early warning level (early warning);
- Alert level (alert);
- Emergency level (energy crisis).

The *Emergency Action Plan* defines the role and responsibilities of natural gas undertakings and of electricity producers; competent authorities and other structures to which tasks, role and responsibilities have been delegated at each of the crisis levels; procedures and measures to be taken concerning each crisis level, persons responsible for risk management and their roles, measures to be implemented to eliminate an alert level situation and mitigate an emergency level situation, reporting obligations imposed on natural gas undertakings, ensuring access to gas supply in an emergency situation, as well as mechanisms used in cooperation with other Member States.

In order to diversify the natural gas market in Latvia and in the entire Baltic region, it is necessary to ensure an alternative supplier of natural gas in the market. It is possible by (see Box 6.13):

- constructing the interconnection GIPL of the gas supply system 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 main infrastructure (i.e. diversifying sources of natural gas rather than ways).

Since the 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 in the Baltic Sea region, as well as to enhance diversification of ways and sources for the supply of energy resources after completion of GIPL and Estonian-Finland interconnections. The project costs for modernization are EUR 191 million, for enlargement, EUR 360 million. 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 conditions 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****Natural gas supply diversification projects**

GIPL will connect the *Rembelszczynska* 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 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 technical and economic justification of the project was prepared in 2013. Construction of GIPL is planned for 2014–2017, though, considering the scale and nature of the project, time-limits for implementing it may be changed. The project investors are the Lithuanian company “Amber Grid” and the operator of the Natural Gas Board of Poland GazSystem S.A. Development of technical and economic justification of the project received 50% funding from EU. GIPL has been included in the list of the EU priority projects, and funding in the amount of EUR 305.98 million has been allocated to the project in November 2014 within the framework of CEF. The total construction costs of GIPL are estimated at EUR 558 million. Construction of GIPL will ensure access for Latvia to other sources of natural gas supply, apart from Russia, and 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 must be noted that in all versions, a significant role in operation of the Baltic region natural gas market is played by Inčukalns UGSF.

### Oil product security reserve

From 1 January 2013, the method for calculation of the oil product security reserve has been changed, thus, the EU Member State within the Community territory must ensure the biggest stock of oil products of two versions 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 oil products, oil product security reserves are formed for 90 net import average volume days.

### Renewable energy resources

Latvia, similar to 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 energy renewable resources and amending and subsequently repealing *Directives 2001/77/EC* and *2003/30/EC* and 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. 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 greatly contributing to the reduction of greenhouse gas emissions.

Figure 6.9

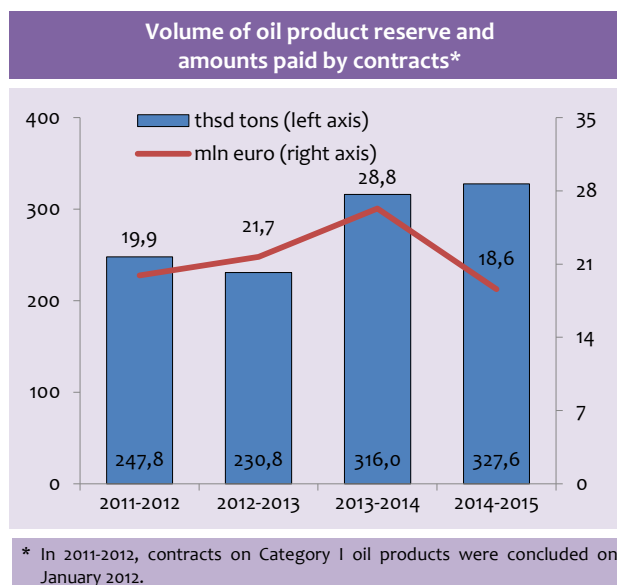


Table 6.7

Share of Energy Produced from RER (%, in accordance with the methodology of Directive 2009/28/EC)							
	2000	2005	2009	2010	2011	2012	2013
In the gross final energy consumption	33.0	32.3	34.3	32.5	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	43.8	44.8	47.4	49.7
In the transport sector	1.5	1.4	1.1	3.3	3.2	3.1	3.1

Amendments to the CoM 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 electric energy exchange NordPoolSpot, ensuring conformity of electric energy 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 electric energy costs on competitiveness of these enterprises, the informative report *On improving of competitiveness of energy intensive enterprises* has been reviewed at the CoM meeting on 26 August 2014.

#### Box 6.14

##### Renewable Energy in Latvia

Taking into account the target 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 35.78% was achieved in 2012.

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 produced gross electricity volume was generated from RE (HPPs, wind, biogas, biomass, etc.).

The total installed capacity for electricity production from RE in 2013 increased by 63 MW constituting 1764 MW, as compared to 59 MW in 2012, whereas the installed capacity of biomass and biogas stations was 108 MW (66 MW in 2012), thus increasing also the volume of produced electricity.

A total of 23.8 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 (in 2012, 279 TJ) and biodiesel fuel consumption of 521 TJ (in 2012, 526 TJ).



The informative report *On the progress of implementation of subsidized electric energy tax* has been reviewed at the CoM meeting on 19 November 2014, discussing the progress of implementation of the subsidized electric energy tax in relation to the state budget.

By 2020, not only the contribution of the existing instruments, but also support measures for energy produced from renewable resources chosen to be implemented during the following years will be critical for Latvia to contribute to prevention of climate changes and reduction of the import of fossil energy resources, making particular emphasis on the sector of heat supply. When implementing new support measures for electric energy produced using renewable resources, development of economically disadvantageous projects shall be limited.

Decision of the European Council on the framework of EU climate and energy policy for the period until 2030 adopted at the meeting of 23–24 October 2014, and objectives of policies arising of the framework must be also taken into account.

In order to achieve the set target 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 implement additional measures aimed at development of a public and private electric transport infrastructure, for example, electrification and private electric vehicle charging.

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 Cogeneration 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 30.5 million.

Table 6.8

Final Energy Consumption in the Transport Sector							
	2000	2005	2009	2010	2011	2012	2013
TJ							
<b>Final energy consumption</b>	<b>31 360</b>	<b>44 658</b>	<b>47 773</b>	<b>50 269</b>	<b>45 231</b>	<b>43 834</b>	<b>44 478</b>
Fossil fuel	30 814	44 018	47 164	48 679	43 850	42 565	43 247
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

### Energy efficiency

While implementing the energy efficiency measures within the sector of energy final consumption and energy transformation, Latvia attempts to achieve its indicative energy saving target – to save 0.67 Mtoe by 2020. Along with this, Latvia must achieve also 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.

Adoption of 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 continued. The draft law *Energy Efficiency Law* has been developed. The aim of the law is to ensure energy efficiency in the energy production,

distribution and final consumption, to ensure availability of energy audit and regular, mandatory energy audits in large companies, as well as to promote the development of the energy service market and to establish an energy efficiency foundation in the country.

A draft law *Amendments to the Public Procurement Law* has been developed. The draft law is aimed at promoting consumption of energy efficient products and services, imposing an obligation in direct administration authorities to purchase only goods and services of high energy efficiency level.

A draft law *Amendments to the Energy Law* has been developed. Purpose of the draft law is to ensure the use of common terminology in regulatory enactments governing the field of power industry, as well as to ensure conditions for improvement of energy efficiency, which will encourage a decrease in primary energy consumption.



To increase the efficiency of energy production, to minimize the loss of thermal energy in transmission and distribution systems and to promote the substitution of fossil fuel with renewable fuel, several projects are implemented within the framework of CF. 106 agreements on implementation of projects for the total amount of EUR 67.1 million of CF funding have been concluded by 27 November 2014 within the framework of the activity 3.5.2.1.1 *Measures to Increase Efficiency in Centralized Thermal Supply Systems* of the supplement to the Operational Programme *Infrastructure and Services*, of which 49 projects for the amount of EUR 39.9 million of CF funding have been completed. As a result of implementing the project, setting of 291.81 MW thermal capacity will be ensured, as well as thermal lines of 156.98 km will be reconstructed. Furthermore, the 6<sup>th</sup> selection stage of the activity project applications for CF funding of EUR 14.2 million has been announced from 15 September until 14 November 2014, with 50 projects submitted. Decisions on approving or denial of project applications will be made by 1 January 2015.

#### **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 achieve higher energy savings over their lifetime, as well as on the development of energy labelling for various product groups to expand knowledge of consumers on 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 also on Latvian producers, importers and distributors. Eco-design and energy labelling regulations apply to such product groups as household and office equipment, lighting, household appliances (incl. 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](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](http://ec.europa.eu/energy/efficiency/labelling/doc/overview_legislation_energy_labelling_household_appliances.pdf)). New eco-design regulations are expected to be adopted for at least another 15 product groups, including compressors, windows, waste water pumps and shower heads within the upcoming two years.

## **6.5 Construction and Housing Policy**

One of the principal aims of the state construction policy is improvement of the business environment and reducing administrative barriers. To achieve this, improvement of the regulatory enactment system in the field of construction, as well as improvement and optimization of the institutional system in the sector is carried out.

On 1 October 2014, the **Construction Law** has entered into force, providing for new regulation for organization of the construction procedure in Latvia. The law governs mutual relationships between the participants in the construction process, their rights and obligations in the construction procedure and responsibility for conformity of the structure to its purpose, economic profitability, expected lifetime and the respective laws and regulations, as well as competence of public administration and local government institutions in the respective field of construction.

The Cabinet regulations *General Construction Regulations* and special construction regulations: *Building Construction Regulations*, *Construction Regulations for Electricity Production, Transition and Distribution Structures*, *Construction Regulations for Ports, Hydrotechnical, Thermal Energy, Gas and Other Non-Classified Engineering Structures*, *Railroad Construction Regulations*, *Construction Regulations for Hydrotechnical and Melioration Structures* and *Construction Regulation for Electric Communication Network Structures*, arising from the *Construction Law*, have entered into force on 1 October 2014. Another two special construction regulations –

*Construction Regulations of Motor Roads* and *Regulations on Inland Waters, Territorial Seas and Construction of Exclusive Economic Areas* – have entered into force on 25 October 2014.

**Regulation 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 Council Directive 89/106/EEC, provides for several measures facilitating the acquisition of CE labelling, thus, reducing the administrative burden to enterprises, in particular, micro-enterprises, which will be subject to a simplified procedure to acquire CE labelling, if construction products marketed by them cause no concern in relation to their safety. Particularly simplified measures are provided for in relation to construction products developed through non-industrial individual or made-to-order process. *Regulation No 305/2011* identifies the specific meaning of CE labelling, as well as specifies obligations of manufacturers, distributors and importers. Approved technical specifications define the most adequate testing or calculation methods to assess and verify compliance of operational properties of construction products with an approved standard or the European technical assessment. *Regulation No 305/2011* defines new and stricter criteria for authorization (notification) to institutions, as a third party carrying out verification and assessment of the declared operational properties and stability thereof, as well as establish

stricter provisions to the procedure of assigning technical assessment institutions (TAI).

To establish the procedure, according to which the requirements set out in *Regulation No 305/2011* are implemented in Latvia, the Cabinet Regulation *Procedure of Supervision of Construction Market* and *Regulations on the European Technical Assessment* have been adopted on 25 February 2014.

*Regulations Regarding the European Technical Assessment* provides for the procedure for selection of the European Technical Assessment Institution, as well as the procedure for issuing the European Technical Assessment. The *Procedure of Supervision of Construction Products* defines the institutions for carrying out supervision of the construction product market, as well as the procedure, according to which supervision of construction products is carried out, construction products samples are requested and received, laboratory or other expertise is carried out, and cases, when costs for the respective expertise are covered by the producer or distributor of the construction materials. In Latvia, supervision of the construction product market is carried out by the Consumer Rights Protection Centre, verifying the conformity of construction products with requirements set out for these products in laws and regulations, as well as operational properties declared by the producer.

In order to ensure quality and safety of construction, as well as to improve the public supervision system in the field of construction, the new *Construction Law* provides for establishment of the **State Construction Supervision Bureau**. On 1 October 2014, the Cabinet Regulation *On the Regulation of the State Construction Supervision Bureau* has been adopted, setting out the competence, structure and responsibility of the bureau. From 1 January 2015, the bureau will ensure supervision of operation of public buildings; from 1 July 2015, the bureau will ensure state control of new public buildings and public building reconstruction works in commissioned public buildings, as well as the construction of new buildings or reconstruction of commissioned buildings, if the applicant of the project is a local government and the contract price of public construction works is at least 1.5 million euro. The bureau will arrange expertise of construction projects and structures, when the commissioning party of the construction is a legal entity having public rights, as well as in disputes; provides methodical aid within the framework of its competence.

To ensure compensation of loss to third parties, having suffered due to actions or inactivity of builders, construction professionals and construction experts, the Cabinet *Regulations Regarding Mandatory Civil Liability Insurance of Construction Experts and Builders*, establishing the procedure for insurance of mandatory professional civil liability of construction expert, builder and the procedure of mandatory civil liability insurance and minimum liability limit, have been adopted on 1 October 2014.

To harmonize the interests of the public and the initiator of the construction, as well as to ensure transparency of decision-making by the Construction Board in relation to development of the respective territory, the Cabinet Regulation *Procedures for Public Discussion of an Intended Construction*, establishing the procedure according to which public discussions shall be organized, has been adopted on 5 November 2014.

To encourage public involvement in the development and implementation of construction policy, the Cabinet Regulation *on Establishment of the Construction Council and Its Work Procedure* has been adopted on 26 August 2014. The council is an advisory coordination institution, which aims to provide Ministry of Economics and other line ministries with proposals on draft laws and regulations and draft policy planning documents, as well as EU draft laws and regulations concerning the construction industry according to public interests, as well as to inform the public on novelties in the field of construction. On 24 November 2014, the first meeting of the Construction Council was held.

To inform representatives of local governments of Latvia, employees of construction boards and enthusiasts of the industry about the key changes in the construction procedure along with the entering into force of the new regulation in the field of construction, the Ministry of Economics has organized a workshop cycle *The New Regulation of the Construction Procedure, Application Thereof* in September 2014.

Currently, the development of the Latvian Construction Standards in accordance with the new regulation has been initiated.

**In the field of housing**, to encourage competitiveness in the residential house management market and high quality management of residential houses, the Register of Residential House Managers has been created and is operating in the Ministry of Economics since 1 January 2012 in accordance with the procedure established in the *Residential House Management Law* and the Cabinet *Regulations on Maintenance and Updating of the Registry of Residential House Managers* adopted on 3 May 2011, and available in the *Construction Information System* ([https://bis.gov.lv/bisp/lv/house\\_managers](https://bis.gov.lv/bisp/lv/house_managers)) since 2014.

The principal task of the register is to ensure updated information on persons, operating or willing to operate in the field of management of residential houses and to comply with legal requirements. Entries of the register of managers on the services provided by the manager, territory of provision of services, qualification of the manager or their employees are published on the *Construction Information System* website, and the register contains an indication on the manager's rights to offer management services depending on the professional qualification acquired. Data from the register on residential buildings managed by the specific manager are available to authorized users.

As of 25 November 2014, 601 managers are registered in the Register of Residential House Managers, incl. 53 managers, in 2014.

To encourage the use of electronic environment services, *Amendments to the Cabinet Regulations "Regulations on Maintenance and Updating of the Registry of Residential House Managers" of 3 May 2011* were adopted on 21 October 2014, providing for an opportunity for individuals to provide the information required by the Register of Residential House Managers in an electronic form, performing authorization in the *Construction Information System* and signing applications using a safe electronic signature, thus, minimizing the administrative burden on the managers of residential houses. Managers will have opportunity to specify in the Register of Residential House Managers the types of services provided according to statistic classification of economic activity NACE Ed. 2, as well as to include data on the contact person appointed by the owner of the residential building (owner of apartment), who ensures circulation of information related to management of the residential building. The Ministry of Economics will be entitled to update the data in the register based on the information provided by the contact person in case of a change of the owner.

On 7 October 2014, the Cabinet has adopted *Regulations on Assessment of Competence of Construction Experts*

and *Supervision of Permanent Practice*, establishing the procedure for assigning, registering and cancelling, suspending and restoring certificates to natural persons for independent practice in architecture, construction, or power industry. The Regulations specify the requirements in relation to the duration of practical experience in the respective field for acquisition of construction expert's certificate, provisions for arrangement and content of competence tests of construction experts, procedure of permanent supervision of construction experts, volume of paid services, authority of the testing institution and volume of data submitted to the register.

According to regulations, testing of competence and supervision of practice of construction experts in engineering survey, design, management of construction works and construction supervision will be carried out by authorities for testing construction expert competence, accredited as personnel certification institutions. The Ministry of Economics will conclude delegation agreements with these institutions. As from 2016, in construction expertise, this task will be carried out by the State Construction Supervision Bureau.

#### Box 6.15

##### Data characterising the construction sector

Data of the CSB show that in the 3<sup>rd</sup> quarter of 2014, the construction volume or construction works carried out by construction enterprises independently amounted to 559.4 million euro, including new construction volume of 261.9 million euro and the volume of repair works of 297.5 million euro, while the total construction volume (in actual prices) amounted to 574.0 million euro (new construction of 268.8 million euro and the volume of repair works of 305.2 million euro, respectively).

In the 3<sup>rd</sup> quarter of 2014, compared to the 3<sup>rd</sup> quarter of 2013, the construction production volumes according to the seasonally adjusted data in comparable prices have increased by 0.6 per cent.

In the 3<sup>rd</sup> quarter of 2014, compared to the 3<sup>rd</sup> quarter of 2013, the construction production volumes according to the adjusted calendar data in comparable prices have increased by 0.6%. The construction of buildings has increased by 34.7%, including the construction of administrative buildings, by 10.9%, and the construction of residential buildings, by 24.4%, non-residential buildings, by 38%, schools, universities and scientific research institutions, by 106.9%. A drop in production volumes was observed in the construction of traffic and communication buildings – by 40.4%, in construction of industrial production buildings or warehouses, by 1.7% and sport buildings, by 38.4 per cent.

The engineering production in the 3<sup>rd</sup> quarter of 2014 decreased by 19.1%, compared to the 3<sup>rd</sup> quarter of 2013, due to a drop in construction of bridges and tunnels, highways, streets, roads and railway lines, as well as other engineering structures – by 19.6%, 11.2% and 30.5% respectively.

In the 3<sup>rd</sup> quarter of 2014, 725 building permits were issued for the construction, capital repairs, reconstruction and restoration of single-dwelling houses with the total floor space of 149.26 thousand m<sup>2</sup>. That is by 48 building permits more, compared to the respective period of the previous year, while the total floor space has increased by 0.6%. 478 building permits have been issued for the construction of single-dwelling houses with the total floor space of 104.3 thousand m<sup>2</sup> or by 0.01% larger floor space.

Moreover, 133 building permits were issued for the construction of industrial production buildings and warehouses with the total floor space of 177.5 thousand m<sup>2</sup>. In comparison with the 3<sup>rd</sup> quarter of the previous year, 9 building permits less have been issued for floor space that is by 0.2% smaller.

In the 3<sup>rd</sup> quarter of 2014, the volume of construction work (in current prices) performed by Latvian builders abroad was EUR 21.5 million, compared to the 4<sup>th</sup> quarter of 2013 (20.4 million euro), the volume of the performed construction works has increased by EUR 1.1 million.

In the 3<sup>rd</sup> quarter of 2014, compared to the 3<sup>rd</sup> quarter of 2013, the construction costs have increased on average by 0.2%, wages of workers, by 3%, for maintenance and operation of equipment and machinery increased by 0.1%, while the costs for construction materials decreased by 0.6 per cent.

By 25 November 2014, a total of 5235 enterprises performing commercial activities in the field of construction, architecture or power industry were registered in the Register of Construction Enterprises maintained by the Ministry of Economics ([https://bis.gov.lv/bisp/lv/construction\\_merchants](https://bis.gov.lv/bisp/lv/construction_merchants)), including 904 construction enterprises in 2014, as well as 9146 construction experts were registered in the Register of Construction Experts (<https://bis.gov.lv/bisp/lv/certificates>), including 732 construction experts in 2014.

To identify the requirements for construction inspectors, the procedure of registration of construction inspectors and the procedure, according to which construction inspectors are deleted from the register of

construction inspectors, ([https://bis.gov.lv/bisp/lv/building\\_inspectors](https://bis.gov.lv/bisp/lv/building_inspectors)), the Cabinet on 19 August 2014 has adopted *Regulations on Construction Inspectors*. Regulations provide for different volume of rights to construction inspectors

depending on the 1<sup>st</sup> or 2<sup>nd</sup> level vocational education – local government and public control rights for operation of construction works and structures, as well as supervision rights for construction works of railroad engineering structures. State and local government inspectors must have a construction expert certificate, and acquire at least 5 years of independent experience in the respective field within the last 10 years. General regulations envisage the prohibition to construction inspectors to be employed by a construction company or to provide construction services. Fulfilment of obligations of a construction inspector will be included in the practical work experience, required to acquire a certificate of a construction expert, as well as for permanent practice of a construction expert.

As of 25 November 2014, 213 construction inspectors are registered in the Register of Construction Inspectors, incl. 28 construction inspectors in 2014.

In 2014, the Saeima continued the revision of the draft law *Amendments to the Law on Residential Properties* developed by the Ministry of Economics in 2012, and adopted in at the 2<sup>nd</sup> reading in October 2014. The draft law specifies the provisions for alienation of apartment property to encourage the clearing of debts for management services and services related to the use of apartment property in case of alienation of the apartment property; furthermore, the draft law specifies the period within which the owner of an apartment must begin settling payments for management services and services related to the use of apartment property, if the property is alienated by compulsory auction.

Considering that the review of the draft law was not completed within the term of mandate of the 11<sup>th</sup> Saeima, it will be continued by the 12<sup>th</sup> Saeima from the 1<sup>st</sup> reading.

## 6.6 Tourism policy

The tourism policy in Latvia is intended to promote development of local and international tourism, thus improving competitiveness of the tourism sector and increasing exports of tourism services.

In 2010, the *Tourism Marketing Strategy of Latvia for 2010-2015* was developed and approved, defining the vision of Latvian tourism development and objectives to achieve it, as well as identifying the priority products of the Latvian tourism, basic principles of development and target markets thereof. According to the priorities set in the strategy and by involving experts of the tourism sector, a new image of the Latvian tourism was developed, which is now the uniting idea and a common element for the public and private sector products and marketing development activities.

On 1 July 2014, the medium-term tourism policy planning document *Guidelines for the Development of Tourism in Latvia for 2014-2020* has been adopted, defining what is known as MICE (business and event) tourism, health tourism, nature-based tourism, cultural tourism and creative industry tourism as the strategic forms of tourism. The objective of the tourism policy is development of a sustainable Latvian tourism, boosting competitiveness of tourism services in foreign markets. The results and effective indicators to be achieved by the policy:

- Boosting the number of overnight foreign travellers;
- Increasing the average occupancy (beds) of accommodation establishments outside of the busy summer season (except June to August);
- Increase in average costs of an overnight foreign traveller per day;
- Increase in total costs of overnight foreign travellers per year.

Principal areas of activities:

- To ensure awareness of the Latvian tourism market offer in target markets, particularly using modern means of communication;
- To boost improvement of the tourism product quality, incl. by ensuring better legal regulation in the sector and support both to tourism companies and product consumers;
- To improve development of competitive tourism products, supporting development of new, innovative tourism products with a higher added value, incl. by developing an infrastructure for tourism development, improving formation of regional tourism clusters and inclusion of the tourism products of Latvia into the common tourism offer of the Baltic Sea region states.

Further development of tourism products should be based on seven core values – quality, sustainability (including introduction of environmentally-friendly technologies and approaches), individualization, high value added, collaboration, involvement of tourists / gaining experience and co-operation in ensuring competitiveness.

In order to ensure constant involvement of sectoral partners in the implementation of the tourism policy, the Advisory Council of the Latvian Tourism Development Agency (LTDA) is actively operating, and it is composed of authorized representatives from professional and regional tourism associations, the advertising sector, as well as from the Ministry of Foreign Affairs, and the Riga Tourism Development Bureau.



**Box 6.16****Tourism Development Indicators**

According to the data of the UN World Tourism Organization (UNWTO), the number of international tourists in 2013 has reached 1.087 million which is by 5% or 52 million travellers higher than in 2012. Although Asia and Oceania have achieved the best results (+6%) among regions, Europe has also shown stable growth (+5%), which is boosted to a great extent by the increase in the number of travellers in Central and Eastern Europe (+7%), as well as Southern Europe and the Mediterranean countries (+6%).

In accordance with the data from the Central Statistical Bureau, the tourism sector keeps growing also in Latvia – in 2013, export of tourism services increased by 7.5% compared to the previous year. Travellers' expenses for recreation and other personal trips in Latvia increased by 16.6%, while those of business trips decreased by 1%. The impact of tourism on the national economy of Latvia in 2013 reached almost 4% of GDP.

In 2013, the total number of foreign travellers increased by 4.5%, compared to 2012. Last year, foreign travellers spent EUR 608.4 million in Latvia, which is by EUR 62.5 million or 11.5% more than in the previous year. In the 2<sup>nd</sup> half of 2013, compared to the 2<sup>nd</sup> half of 2012, the number of persons having received services in Latvian hotels and other tourism accommodation establishments increased by 14.3% (up to 1.1 million). It must be noted that the number of foreign guests having received services in overnight accommodation establishments increased by 16% (in the 2<sup>nd</sup> half of 2013, 723.6 thousand). The largest share or 25% was formed of tourists from Russia, followed by tourists from Germany (10%) and Lithuania (9%).

In the 3<sup>rd</sup> quarter of 2014, the number of visitors receiving service in hotels and other accommodation establishments reached 764.6 thousand, which is by 11.3% more than in the 3<sup>rd</sup> quarter of the previous year. 68.6% of all visitors were foreign guests, while 31.4% were from Latvia. A similar division of visitors was observed also in the previous quarters. The number of foreign guests increased by 11.1%, while the number of travellers from Latvia increased by 11.8%, compared to the 3<sup>rd</sup> quarter of the previous year.

The total number of overnight stays during the 3<sup>rd</sup> quarter of 2014 was 1.5 million, which is by 13.5% more than in the 3<sup>rd</sup> quarter of 2013. The average duration of the stay of foreign tourists in the 3<sup>rd</sup> quarter was 2 nights. The number of tourists from the neighbouring states has increased, compared to the 3<sup>rd</sup> quarter of the previous year: by 29.9%, from Belarus, by 9.6%, from Lithuania, by 8.1%, from Estonia, while the number of visitors from the Russian Federation decreased by 14.2%. Considerable increase in the number of visitors from Japan – by 63.5%, the United Kingdom, 59.6%, Turkey, 37.6%, Austria, 32.9%, and Germany, 31.5% has been observed in this quarter of 2014, compared to the respective period of the previous year.

**Support measures**

In 2014, the key priorities of the LTDA, which is subordinated to the Ministry of Economics, is related to the promotion of a single tourism information system, raising awareness about the Latvian tourism image and promotion of Latvia as a tourism destination, conducting marketing research on local and international tourism markets, improvement of tourism service quality, as well as development of local tourism and implementation of international co-operation.

The annual state budget funding for promoting tourism development within the framework of the Operational Programme *Access to International Trade*

*Markets – Strengthening International Competitiveness of Industry Sectors* of the ERDF is envisaged for the following activities:

- Organizing national stands at international exhibitions abroad;
- Organizing advertising campaigns abroad;
- Providing consultancy services to entrepreneurs, local governments, and port administrations about foreign markets, including organizing direct visits, trade missions, and support to participation in exhibitions and searching for co-operation partners.

**Box 6.17****Improvement of the legal framework**

On 19 November 2013, the draft decree of the Ministry of Economics was approved in the CoM meeting with an aim to grant a resort status to the entire administrative territory of the Jūrmala city, except the territory of Vārnukrogs, Priedaine and Bražciems. The CoM regulations *Procedure for Granting and Annuling the Resort Status* govern the procedure for granting the resort status and were approved on 18 December 2012, whereas the Jūrmala city submitted an application for the status in February 2013.

The *Amendments to 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*, adopted on 13 April 2010, came into force on 8 February 2013 for the purpose of introducing the principle of “silence means consent” (according to the Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market) in registration of activity of tourism agents and operators in the *Database of Tourism Agents and Tourism Operators (TATO)*.

In order to ensure efficient enforcement of the European Council Directive of 13 June 1990 on package travel, package holidays and package tours, informing the consumers and other interested parties about activities of entrepreneurs engaged in the sector, as well as promoting prevention of fraudulent situations in the sector, in 2010, the Ministry of Economics has developed the *Database of Tourism Agents and Tourism Operators (TATO)* (<http://tato.em.go.lv>). Overall, 644 entrepreneurs were registered in the database by 20 November 2014, 53 of them were registered as tourism operators, 176 as tourism agents and operators, whereas 415 as tourism agents. Every interested person can access the information contained in the database, and the Ministry of Economics urges Latvian travellers to check the conformity of the activity of service providers to the requirements of legislation, in particular the security guarantee of money deposited by tourists.

In 2014, the total amount of funding (state budget funding and the ERDF co-funding, as well as funding for implementation of the project *EDEN*) for tourism marketing is EUR 3.9 million.

Currently, LTDA is developing the *Tourism Marketing Strategy of Latvia for 2015-2020*.

#### **International co-operation in the field of tourism**

In 2014, Latvia continues developing closer co-operation in the field of tourism with other countries, particularly with the high priority tourism target markets: Lithuania, Estonia, Finland, Sweden, Russia, and Germany. Issues related to the promotion of co-operation in the field of tourism are regularly on the agenda of intergovernmental commissions and chief state officials during their foreign visits.

Funds allocated by LTDA are mainly used for advertising campaigns and marketing activities in the said target markets.

The *Protocol on Amendments to the Agreement among the Government of the Republic of Latvia, the Government of the Republic of Estonia and the Government of the Republic of Lithuania on Co-operation in the Field of Tourism* has been signed at the XII European Tourism Forum held in Vilnius, Lithuania, on 17 October 2013, which shall be considered an international acknowledgement of the achievements of the Baltic States at international level in developing regional co-operation in the field of tourism.

The amendments to the agreement are aimed at promoting integration of the Baltic States in the international tourism activities. One of the core amendments provide for an opportunity to establish joint tourism information offices or appoint joint tourism representatives in the respective and the third countries. The amendments to the agreement also specify and update the co-operation directions of the contracting parties, for example, co-operation in development of the Baltic tourism brand, reducing the administrative burden, applying modern technologies to tourism development, and project development of various international support programmes (like the EU funds).

In October 2013, Latvia received an invitation to join the OECD Tourism Committee which is a significant

step towards promotion of international co-operation. The responsible Latvian tourism institutions will work together with other OECD member states to develop local and international tourism perspectives and to promote the growth of sustainable tourism.

In 2014, national tourism organizations of the Baltic States co-operate in the implementation of common marketing activities in the distant markets (Japan, USA, China), as well as implement other co-operation activities: organising international workshops for tourism professionals *Baltic Connecting 2014*, journalist and tour operator visits, issuing the Baltic tourism information materials, organising the Baltic State tourism presentations and press conferences.

Representation of Latvian interests in the tourism sector at an international level is basically ensured by involvement in the work of the European tourism institutions. Latvia participates in the work of the Tourism Advisory Committee of the European Commission on a regular basis, as well as Latvia is an active member of the European Travel Commission, which deals with raising awareness about European, including Latvian, tourism destinations.

In 2014, the Latvian Tourism Development Agency has begun implementing two projects funded by the European Commission. The project *European Destinations of Excellence – EDEN* in co-operation with the Lithuanian State Department of Tourism, as well as the project *The Iron Curtain Trail – Euro Velo 13*, aimed at improving of the development of the *Euro Velo 13* route in states where it is not yet completed, developing bicycle tourism products for cycling tourists to boost the tourist flow along the route. To achieve the aims of the project, the leading partner of the project and the coordinator of the *Euro Velo* route in Europe – the European Cyclists' Federation, following an assessment of the current situation and development of the route in each individual state, has attracted tourism organisations, tour operators and representatives of educational institutions as partners at the national and regional level in total, 13 organizations from 8 countries.

## **6.7 Improvement of Business Environment**

An important tool for evaluating the business environment in Latvia is the international survey of the World Bank *Doing Business*, as well as the *Study of Administrative Procedure Impact upon Business Environment* which help to find out the opinion of entrepreneurs about the factors hindering their activity and to prepare a list of tasks within the annual *Action Plan to Improve the Business Environment*.

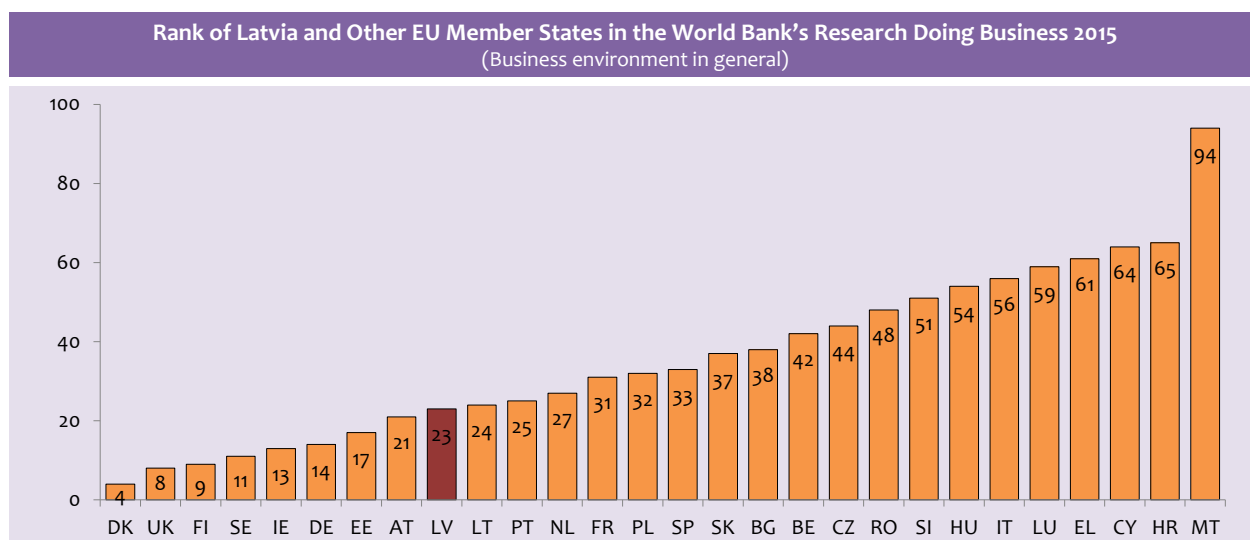
The World Bank research *Doing Business 2015* which covers the reporting period from 2 June 2013 to 1 June 2014, has ranked Latvia 23<sup>rd</sup> among 189 countries. Latvia

is ranked 9<sup>th</sup> among EU Member States, following Denmark, the United Kingdom, Finland, Sweden, Ireland, Germany, Austria and Estonia in the assessment of business friendly environment.

It must be noted that numerous indicators of *Doing Business 2015* have experienced changes in applied methods, thus, the assessment includes indicators, which up to now have been measured otherwise, and the assessment of Latvia has been changed. Thus, no objective comparison may be performed between assessments from previous years and *Doing Business 2015*.



Figure 6.10



At the beginning of 2014, the seventh survey of entrepreneurs on the impact of administrative procedure on business environment was carried out at the request of the Ministry of Economics, and its results were published in June 2014.

*Environment*, which is updated and approved by the government every year.

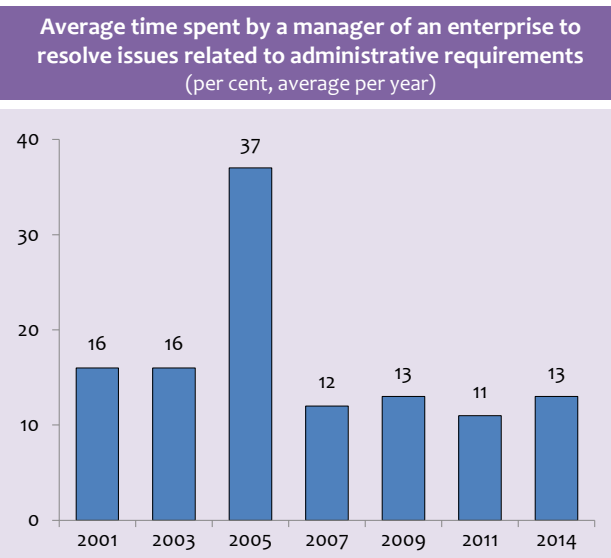
Figure 6.7

Table 6.9

Rank of Latvia in the World Bank's Research Doing Business in 2014-2015			
	2014	2015	Changes
Starting business	26	36	-10
Construction permits	48	47	-1
Getting electricity	82	89	-6
Registering property	33	32	+1
Getting credit	3	23	-20
Protecting investors' rights	48	49	-1
Paying taxes	28	24	+4
Trading across borders	26	28	-2
Enforcing contracts	15	16	-1
Closing a business	38	40	-2

The poll of 2014 suggests that the Latvian entrepreneurs spend 13% of their time to resolve issues related to administrative requirements, furthermore, the regulatory fields, administrative procedures and business obstacles contained in the set of instruments of the research have been assessed as preventing development of the enterprise less often than in former researches (since 2001).

Measures to improve the business environment in Latvia have been implemented since 1999 when the Ministry of Economics together with a large number of ministries and organizations representing entrepreneurs prepares the first *Action Plan to Improve the Business*



On 24 April 2013, the Cabinet approves the plan for 2013-2014, which includes 31 measures and 55 sub-measures – of which 12 measures and 30 sub-measures gave been implemented by 1 October 2014. The following are the most important:

- **Dealing with construction permits** – the *Construction Law* has entered into force and the Cabinet regulations related to the new construction regulation have been adopted, establishing considerable changes in the procedure of construction, particular attention paying to the procedure of arrangements and liability of the parties involved, at the same time, reducing the number of bureaucratic procedures;

- **Starting a business** – it has been established that shareholders of a company, when founding an enterprise, must certify their signatures at the notary public of the Register of Enterprises (RE), as well as that the costs for starting a business have been reduced (costs for registering a micro-enterprise are 50 euro);
- **Paying taxes** – an electronic form of the payroll tax booklet has been created and simplified filling in of the tax declaration form in the electronic declaration system has been ensured;
- **Protecting investor rights** – a new service has been implemented at the RE: sending notifications on applications received in the registration file of a subject at law, to give the stakeholders an opportunity to timely get acquainted with potential changes in the registration file of the law subject, and thus giving an opportunity to quickly respond to a potential violation of personal rights and legal interests;
- **Enforcing contracts** – an opportunity for individuals to study legal procedure data and court judgments online; an improved regulation of arbitration courts has been approved (will come into force on 1 January 2015). Thus, not only improvements of high quality work of the institution are planned, but also the potential of relieving the court in relation to resolution of commercial disputes is expected. Furthermore, the role of the Chief Judge has been strengthened in relation to the duration of litigation in the respective court – an obligation has been prescribed to determine the objectives of the court work in relation to average time periods for adjudication of matters in a court prior to the beginning of each calendar year and to monitor actual duration of adjudication of matters in a court;
- **Closing business** – amendments to the *Insolvency Law*, which will enter into force on 1 March 2015, have been approved. Amendments provide for improvements in insolvency regulation of legal entities, as well as balanced changes to insolvency regulation of natural persons. For legal entities, amendments provide for a higher level of protection of enterprises in insolvency procedures – curtailed “raiderism” in auctions, possibilities for owners of enterprises and management to clean out the enterprise before insolvency, as well as other improvements.

On 28 November 2014, the plan for 2014-2015 has been approved. It is aimed at “simple and high quality business services: higher number of e-services”. The plan for the next period includes 49 measures, of which 31 are new. The following priority tasks have to be implemented in the next year:

- **Starting a business** – to review the RE e-service *Registration in registers kept by the RE* to improve the efficiency of services, to facilitate the procedure of amending enterprise data in the Commercial Register, by simplifying information provision requirements, to carry out electronisation of the documents contained in the archive of RE and to abandon geographical jurisdiction over companies’ cases;
- **Construction process** – to ensure full operation of the Construction Information System project from 1 July 2015; to implement classification of construction entrepreneurs;
- **Registering property** – to ensure introduction of electronic property registration, as well as to develop amendments to laws and regulations providing for increasing the volume of electronic information to be received by the Land Register from local governments, i.e. information on waiving pre-emptive rights.
- **Accounting and tax payments** – to develop new *Annual Accounts Law* in line with *Directive 2013/34/EU*, aimed at ensuring the opportunity for Member States to establish facilitated requirements to micro- and small enterprises, and to review thresholds of mandatory audits. Furthermore, accounting of tax payments is prescribed according to the principle of accrual – to ensure one account for all tax payments and create payments according to the principle of FIFO method (first in – first out);
- **Protecting investor rights** – to review the provisions of the *Commercial Law* and to assess the opportunity to determine the validity of terms and conditions, consequences and enforceability of capital company agreements, and to assess opportunity to carry out verification of correctness of the data submitted to the Commercial Register, as well as to assess the opportunity to include imperative provisions in the *Commercial Law* in relation to joint stock companies (also limited liability companies), where decisions of management institutions thereof and other actions to be automatically invalidated in case of material violations;
- **Enforcing contracts** – to improve the regulation for the implementation of circulation of electronic documents in court institutions, as well as to continue the work on strengthening the principle of specialization of judges and to establish case load indicators.

Representatives of line ministries and institutions subordinate thereto, as well as cooperation partners from the Employers' Confederation of Latvia, the Latvian Chamber of Commerce and Industry have participated in the development of the *Plan of Measures for Improvement of Business Environment*, as well as recommendations provided on 25 May 2014 by the Foreign Investors'

Council in Latvia has been considered. Information on the implementation procedure of the *Plan of Measures for Improvement of Business Environment* is available on website of the Ministry of Economics: [https://www.em.gov.lv/lv/nozares\\_politika/nacionala\\_industriala\\_politika/uznemejdarbibas\\_vidē/uznemejdarbibas\\_vidēs\\_uzlabošana/](https://www.em.gov.lv/lv/nozares_politika/nacionala_industriala_politika/uznemejdarbibas_vidē/uznemejdarbibas_vidēs_uzlabošana/).

## 6.8 Small and Medium-Sized Enterprises

In Latvia, similar to other European countries, small and medium-sized enterprises (SMEs) form a major part of the national economy and play a significant role in the GDP building and employment.

### Measures to promote micro-enterprise establishment and development.

On 30 October 2009, the CoM approved the *Concept of Micro-enterprise Support Measures* with an aim to create the necessary preconditions to encourage unemployed inhabitants to start a business activity, to create a business environment favourable to micro-enterprises, as well as to develop entrepreneurial skills, thus increasing the share of entrepreneurs in the total number of working

population. The concept is being successfully implemented, and the key accomplishments in business improvement are described below.

Amendments to the *Commercial Law* of May 2010 significantly reduced the costs required to start a business, envisaging that a limited liability company (LLC) can be founded with a reduced equity capital (from EUR 1). Additionally, the state dues for the registration of such a limited liability company were reduced. According to the data of the RE, 12 thousand limited liability companies were registered as of 1 December 2014, 60.7% of them were limited liability companies with reduced equity capital.

#### Box 6.18

##### The number of small and medium-sized enterprises in Latvia

According to the CSB data for 2013, there were 93,775 economically active individual merchants and commercial companies in Latvia (excluding farms, fish farms and self-employed persons, who carry out economic activity), 99.6% of which belonged to the category of SMEs. The breakdown of economically active SMEs in Latvia is the following: micro-enterprises – 86.2%, small enterprises – 11.1%, medium-sized enterprises – 2.3%, large enterprises – 0.4%. An important indicator characterising economic activity is the number of economically active merchants and commercial companies (excluding farms, fish farms and self-employed persons, who carry out economic activity) per 1000 inhabitants. This indicator in Latvia has grown constantly over the last 10 years from 17 in 2001 to 78 in 2013.

However, it is equally important to emphasize the number of performers of individual work (self-employed persons) in 2013 – 50,882 (25 per 1000 inhabitants), as well as the number of farms and fish farms in 2013 – 11,366 (6 per 1000 inhabitants). Taking into account the fact that there is no single methodological practice in the EU for calculating such an indicator characterising the economic activity as the number of enterprises per 1000 inhabitants, it is difficult to perform an objective comparative analysis of this parameter. The current practice of the EU institutions in charge shows that the calculation of the number of enterprises per 1000 inhabitants includes not only individual merchants and commercial companies, but also performers of individual work, farms, and fish farms, etc. Therefore, by applying an analogous practice, in 2013 in Latvia there were 78 performers of economic activity per 1000 inhabitants.

According to the statistics of the RE, 18,035 subjects were registered and 4300 subjects were liquidated in 2013. Whereas, as of 1 December 2014, 13,813 subjects were registered and 5145 subjects were excluded from the registers of the RE.

##### Definition of SMEs

Definition of SMEs is stipulated in the Law on Control of Aid for Commercial Activity, Regulations of the CoM of 25 November 2008, No. 964 *Regulations on Declaration Procedures of Commercial Companies According to Small or Medium-sized Commercial Company*, and Commission Regulation (EC) No. 800/2008:

medium-sized enterprises:

- number of employees: 50–249;
- annual turnover does not exceed EUR 50 million;
- total sum of annual balance is under EUR 43 million;

small enterprises:

- number of employees: 10–49;
- annual turnover does not exceed EUR 10 million;
- total sum of annual balance is under EUR 10 million;

micro enterprises:

- number of employees: 1–9;
- annual turnover does not exceed EUR 2 million;
- total sum of annual balance is under EUR 2 million.

Since 1 September 2010, legal and natural persons can obtain the status of a micro-enterprise taxpayer, if they meet certain criteria (members are natural entities, the turnover does not exceed EUR 100 thousand per calendar year, and the number of employees does not exceed 5) and make micro-enterprise tax payments in the amount of 9% (includes all state determined tax payments, except consumer taxes) of turnover or profit from economic activity. 32 thousand micro-enterprise tax payers were registered at the State Revenue Service from 1 September 2010 until 1 January 2014, and 53.5% of them are new companies. Micro-enterprises employ over 75.9 thousand employees and their average salary is EUR 432. These micro-enterprises are subject to simplified SRS formalities (quarterly declarations).

It should be noted that on 6 November 2013, the Saeima approved amendments to the *Micro-enterprise Tax Law*, introducing changes to the procedure for calculating the micro-enterprise tax rate. According to the amendments, a taxpayer with annual turnover below EUR 7 thousand, is subject to a tax rate of 9%; however, if the annual turnover exceeds the said amount, the tax rate is going to be 11% in 2015, 13% in 2016 and 15% starting from 2017. Such a regulation has been

introduced to increase the social guarantees of employees of micro-enterprise tax payers.

Starting from 1 January 2010, any natural entity performing economic activity in specific professions or operations may choose to pay the patent fee, which is a complete tax payment for the economic activity of a natural entity in a specific profession (mainly for craft services). Relevant social guarantees are ensured to all payers of the patent fee. A total of 2.2 thousand applications for patent fees have been submitted to the State Revenue Service from 1 January 2010 until 1 December 2014, 1.8 thousand of them have been proved for making patent fees. Within the respective period, the number of average monthly patent fee payers is 353. Most often, these are representatives of such professions as photographers, baby-sitters, hairdressers and nail care specialists choose to register as patent fee payers.

#### Measures to promote business start-ups

In order to foster the establishment and development of new, viable, and competitive enterprises in the regions of Latvia by ensuring the environment and consultancy services necessary for their business activity, the IDAL implements the project *Development of Business Incubators in Latvia* co-funded by the ERDF).

#### Box 6.19

##### Activities of the EU in Promoting Entrepreneurship

##### *Small Business Act for Europe*

On 25 June 2008, the European Commission approved the review of the *Small Business Act for Europe*, mainly aimed at integrating the use of *Think Small First* principle in the preparation process of political documents, improving the overall political approach to entrepreneurship, particularly promoting the development of small and medium-sized enterprises, and helping in eliminating obstacles preventing their development. The Act includes proposals for 10 politically binding guidelines and several specific proposals for regulations of normative enactments. Different activities that comply with the guidelines determined in the Small Business Act are currently being implemented at the level of the EU and Member States.

On 8 September 2014, the European Commission commenced a public consultation to summarise the opinions and ideas of Member States and organisations representing entrepreneurs as to how the *Small Business Act for Europe* should be reviewed, continuing European support policy for SMEs in 2015–2020. The consultation is based on a research work carried out by the network of envoys of SMEs, as well as on political debates on further policy of SMEs, which took place at the Competitiveness Council of Ministers in September 2013. The four main directions of the Small Business Act – to facilitate the access of SMEs to funding and markets, to reduce administrative burden, and to foster business – are the priorities for the next years as well. Moreover, a fifth priority has been introduced following a proposal by the envoys of SMEs – to eliminate the lack of qualified labour force.

Public consultation about the *Small Business Act for Europe* ended on 15 December 2014, and it is planned that the European Commission will publish the results of consultations in the first half of 2015.

##### *European Small- and Medium-Sized Enterprises Week*

In order to achieve the objectives of the Act, in 2014 the European Commission organised the annual European-scale campaign *European SME Week* – for small and medium sized enterprises to provide information (seminars, conferences, discussions etc.) to existing and potential entrepreneurs about the activities of the European Union, Member States, and local government institutions in entrepreneurship improvement, promotion and to honour entrepreneurs for contributing to European welfare, creation of jobs, innovations and competitiveness.

46 events were held from September until November in Latvia within the framework of the *SME Week 2014*, involving over 2000 entrepreneurs. These events were devoted to the implementation of business ideas, starting business, promotion of export and strengthening of cooperation network between entrepreneurs, the scientific sector and potential investors. *Small Business Days* were organised within the framework of the referred to events in Latvia, in order to practical information to entrepreneurs on how to expand the customers' base, address potential partners and see new business opportunities. *Small Business Days* was organised in Daugavpils, Ogre, Liepāja, Ventspils, Valmiera, Jelgava, and Riga, involving over 300 participants.

Information about the *SME Week 2014* is available on the website of the Ministry of Economics: [https://em.gov.lv/lv/nozares\\_politika/nacionala\\_industriala\\_politika/uznemejdarbibas\\_vid\\_ej\\_uznemejdarbibas\\_veicinasana/es\\_mv\\_u\\_nedela/](https://em.gov.lv/lv/nozares_politika/nacionala_industriala_politika/uznemejdarbibas_vid_ej_uznemejdarbibas_veicinasana/es_mv_u_nedela/).

Overall, 600 micro-, small and medium-sized enterprises receive incubation services in 10 business incubators operating in the regions of Latvia and the creative business incubator located in Riga as at the end of the 3<sup>rd</sup> quarter of 2014. The incubated enterprises have created (maintained) 1360 jobs. In the 3<sup>rd</sup> quarter of 2014, by attracting the representatives of the Ministry of Economics and the representatives of the IDAL Institution for the Cooperation of Programmes, the final assessment of activities was carried out for the operators of business incubators, with whom the period of validity of signed procurement contracts had expired, concluding that in general, the expected results had been achieved. EUR 3.2 million were used to ensure Business incubator services within the framework of the programme in 2014 (including the 3<sup>rd</sup> quarter), whereas, EUR 20.3 million were used in total within the framework of the programme until the end of 2014. The total funding available within the framework of the programme is EUR 28.6 million (incl. ERDF funding of EUR 24.4 million).

To use the entire funding available within the framework of the project, on 2 September 2014, the IDAL announced a procurement on the provision of Business Incubation services (the total contract price is EUR 4 million; the contract is planned to be signed in

January 2015 for a period until 31 October 2015). The IDAL accepts tenders until 11 December 2014.

#### **Ensuring availability of financing to enterprises**

ALTUM, which has taken over the functions of the Mortgage and Land Bank of Latvia (the Mortgage Bank) since 1 January 2014, plays an important role in the implementation of support instruments. Although ALTUM operates in a new status – as a financial institution without a credit institution licence, the purpose of operation of this institution remains unchanged, namely, implementation of the state support programmes, funding the development of SMEs, promoting the startup of enterprises and supporting other forms of business to improve the efficiency of the Latvian economy and, consequently, the living standard of the population in Latvia.

In 2013 and 2014, ALTUM continued to implement the following programmes:

- *Support Programme on Improvement of Competitiveness of the Enterprises* co-financed by the ERDF;
- *Support programme for Support for Self-employment and Business Start-ups* co-financed by the ESF;
- *Micro Crediting Programme of Latvia and Switzerland,*
- *SME Growth Loan Programme;*
- *Programme of Agricultural Liquid Assets;*
- *Crediting Programme for Purchasing Agricultural Land.*

#### **Box 6.20**

##### **Establishment of the Development Institution**

In October 2012, the CoM accepted the informative report on the establishment of a unified development financial institution (DFI). It is expected that a unified DFI will implement state support programmes in the form of a financial instrument, which up to now have been implemented by the Mortgage Bank, LLC Latvian Guarantee Agency (LGA) and PJSC Rural Development Fund (RDF), ensuring the continuation of the existing programmes, initiation of new programmes, and, at the same time, being able to honour the previously assumed commitments. AFI will promote the provision of one-stop shop type state support programmes and ensure a high quality management of investments and optimisation of costs.

On 29 July 2014, the government became acquainted with the informative report of the Ministry of Finance on the progress of the establishment of a unified Development Financial Institution (DFI) and approved the process of establishment of the DFI at two stages, along with the necessary activities. Pursuant to the decision, the shares of ALTUM, Latvian Guarantee Agency and Rural Development Fund will be transferred to the DFI in the first stage, establishing a group of development financial institutions. In the second stage, the DFI, ALTUM, LGA and RDF will be re-structured by merging subsidiary companies and the DFI.

On 11 September 2014, the group JSC Development Financial Institution was established. The group includes ALTUM, Latvian Guarantee Agency and Rural Development Fund.

Currently, the most significant support programme in terms of the amount of loans implemented by ALTUM is the *Support Programme for the Improvement of Competitiveness of the Enterprises* approved by the CoM in May 2008. The support within the programme is provided to small, medium-sized, and large enterprises registered in Latvia, which have economically reasonable further activity plans, but cannot receive funding from credit institutions due to increased risks. Within the programme, investment loans (up to EUR 1.4 million) and current assets loans (up to EUR 0.7 million) are granted. In case the loan is expected to exceed EUR 500 thousand, the customer should, prior to receiving the loan at ALTUM, obtain an approval from their commercial bank if the customer has commitments at the bank. Within the part of the Support Programme for the Improvement of Competitiveness of the

Enterprises co-financed by the ERDF, since its launch until November 2014, a total of 121 loans in the amount of EUR 76.9 million have been issued. Most often projects represent such sectors as wood processing, production of electricity, manufacture of pharmaceutical products and food production.

The programme *Support for Self-employment and Business Start-ups* co-funded by the ESF and approved by the CoM in March 2009, offers complex support to business start-ups and newly established enterprises, i.e. consultations, trainings, and funding in a form of loans (up to EUR 85 thousand) and interest rate subsidies for starting a business. The support is available for the working-age population including the unemployed who have expressed willingness to start a business or self-employment, as well as new enterprises. For the purposes of this programme, a new enterprise is an enterprise



having registered its activity in accordance with the procedure specified in the law not earlier than three years prior to applying for the support within the programme, as well as entrepreneurs having business experience and planning to produce a completely new product or provide a new service provided that they establish a new enterprise for this purpose. The amount envisaged in a business plan may not exceed EUR 85 thousand, and at the same time co-funding in the amount of at least 10% of the total amount of the plan must be provided for the projects with the loan amount exceeding EUR 7 thousand for the implementation of the business plan.

Since the launch of the programme, 1343 start-up projects have been supported for the total loan amount of EUR 22.9 million.

In September 2009, the CoM adopted regulations On Loans for the Promotion of Development of Small (Micro), and Medium-Sized Enterprises and Agricultural Service Cooperatives. In accordance with these regulations, in February 2010, ALTUM launched the implementation of the **SME Growth Loan Programme**. The programme is aimed at improving access for economic activity operators registered in Latvia to funding, thus promoting the development of the national economy. The maximum amount of loans for one economic activity operator is EUR 430 thousand and EUR 3.1 million for farmers. Besides, according to the conditions of the programme, the maximum amount of a loan within this programme per one micro-entrepreneur operating in the service industry may not exceed EUR 43 thousand. As of October 2014, 1066 loans in the amount of EUR 69.7 million have been granted within the framework of the programme.

In May 2010, ALTUM launched the **Programme of Liquid Assets Loans for the Producers of Agricultural Produce**. The producers of agricultural produce, as well as the groups of fruit and vegetable producers may receive liquid assets loans from EUR 7 thousand up to EUR 1 million with a term of up to 2 years, while the maximum loan for agricultural service cooperatives can reach EUR 2.8 million. Guarantees of the RDF may be attracted for these loans. As of now, 1098 loans in the amount of EUR 51.2 million have been granted within the framework of the programme.

In September 2011, the CoM approved the **Micro Crediting Programme of Latvia and Switzerland**. The programme is aimed at improving the possibility of micro-enterprises to receive financial support for business start-ups or development. The programme is implemented within the framework of the cooperation programme between Latvia and Switzerland, and the total funding of the programme is EUR 7.2 million<sup>1</sup>, including

EUR 6.6 million that are earmarked for micro-loans for investments and liquid assets of up to EUR 14.2 thousand, as well as EUR 620 thousand for grants to repay the loans. The programme will run until June 2015. As of now, micro-loans have been granted to 1040 micro-enterprises in the amount of EUR 8.6 million.

In May 2012, the CoM approved the regulations of the **Crediting Programme for Purchasing Agricultural Land**. Up to EUR 430 thousand are available for purchasing agricultural land within the programme for the purpose of producing agricultural products and purchasing buildings on the land if the cadastral value of buildings does not exceed 30% of the cadastral values of land. According to the Cabinet regulations, ALTUM deals with accepting, assessing the applications and issuing and administering the loans within the programme, whereas the decision on granting the loan is adopted by the RDF based on the bank's recommendations. The practical implementation of the programme was launched in July 2012, and as of now 464 loans in the amount of EUR 23.23 million have been granted.

**LLC Latvian Guarantee Agency (LGA)** is a state-owned capital company aiming to promote access to funding for enterprises registered in Latvia. Currently, LGA offers six financial instruments to improve competitiveness:

- Direct instruments for enterprises:
  - loan guarantees aimed at helping enterprises to attract credit resources in cases when their collateral is insufficient to receive credit resources;
  - export loan guarantees aimed at supporting exporters covering political and commercial risks related to export transactions;
  - mezzanine loans aimed at providing long-term funding to Latvian enterprises in addition to the granted bank loans to cover all investment project costs in material and non-material assets;
- Indirect instruments for enterprises (through other institutions):
  - seed capital investments aimed at providing funding for the pre-investigation, assessment and development of a product or a business idea concept. This instrument is implemented by *Imprimatur Capital* within the Holding Fund administered by the LGA;
  - start-up capital investments aimed at providing funding for the development and first marketing of entrepreneurs' products. This instrument is implemented by *Imprimatur Capital* within the Holding Fund administered by the LGA;

<sup>1</sup> Within the framework of the programme, the Loan Fund has been established for providing financial support – micro-loans and grants; the Fund is administered by Switzerland to an extent of 80% and the Mortgage Bank to an extent of 20%. The management costs of the

programme are funded by Switzerland to an extent of 80% and the state budget to an extent of 20 per cent.

- venture capital investments aimed at providing funding for the development and first marketing of products, growth and expanding activities of entrepreneurs by increasing production capacity, developing sales markets and products or attracting additional working capital. This instrument is implemented by *BaltCap* within the Holding Fund administered by the LGA.

On 10 March 2009, the CoM adopted Regulations *On activity 2.2.1.3 “Guarantees for the Improvement of Enterprise Competitiveness” of the Supplement to the Operational Programme “Entrepreneurship and Innovation”*. The goal of the regulations is to provide the enterprises with access to funding for the development of commercial activities and for the implementation of projects of the EU funds by ensuring guarantees in situations when the collateral at the disposal of the enterprise is not sufficient to attract sufficient credit resources, and the banks evaluate the enterprise as too risky, as well as to facilitate the competitiveness of Latvian enterprises, to promote absorption of new markets and secure positions in the existing ones.

In April 2009, the LGA launched the implementation of the activity *Guarantees for the Improvement of Enterprise Competitiveness*. At the moment, the ERDF funding available within the activity is EUR 15.4 million. At the end of 2013, this activity was closed. The funding allocated within the framework of the activity will be used to provide governmental support, including for the issuance of guarantees.

The LGA issues guarantees for such financial services as loans for investments, liquid asset loans, financial leasing, local factoring, as well as bank guarantees (tender, advance payment, payment, execution or time guarantee). The guarantees cover up to 80% of the principal amount of the financial service but not exceeding EUR 1.5 million per one enterprise.

365 loan guarantees were issued for the total amount of EUR 117.5 million within the framework of the *Loan Guarantee Programme* within the period from 2009 until 31 October 2014.

Within the framework of the Loan Guarantee Programme until 31 March 2014, the majority of guarantees have been provided to enterprises operating in the following sectors: 44% in manufacturing, 22% in construction, 8% electricity, gas supply, heat supply, and air conditioning. In terms of the number, most (44%) of the issued guarantees are guarantees for liquid assets, 21% are investment guarantees, and 24% are financial leasing guarantees.

On 30 May 2013, the LGA initiated the issuance of guarantees for the heat insulation project of residential houses. By 31 March 2014, 45 guarantees for the total amount of EUR 6.1 million have been issued for heat insulation projects. In terms of the amount, most guarantees (29%) are issued in the Kurzeme region, 27% in Vidzeme, 21% in the Riga region.

In May 2009, the CoM adopted regulations *On Short-term Export Loan* establishing the coverage and beneficiaries of **short-term export loan guarantees**, as well as the procedure for granting guarantees and the procedure under which the guarantor covers the loss. The LGA export loan guarantee covers up to 90% of the amount of deferred payment but not exceeding EUR 1 million or an equivalent amount in another currency. The deadline of the deferred payment may not exceed 2 years.

142 export guarantee contracts have been signed for the total amount of EUR 13.4 million within the framework of the **Export Loan Guarantee Programme** within the period from the launch of the programme to 31 October 2014.

Most companies (99%) that have entered into contracts represent the manufacturing sector (for example, manufacture of communication equipment, manufacture of electrical household appliances, manufacture of veneer sheets and wood-based panels, manufacture of soap and detergents, cleaning and polishing products, manufacture of food products, etc.). In terms of countries, most of the guarantees have been granted to markets in the CIS countries: Russia (31%), Kazakhstan (19%), and Belarus (18%), as well as such countries as Azerbaijan (6%), Indonesia (5%), Uzbekistan (4%), etc.

In August 2011, the CoM approved the *Regulations Regarding Mezzanine Loans for Improving Competitiveness of Economic Operators*, setting the requirements for granting the support in a form of **mezzanine loans** for improving the competitiveness of economic operators. The maximum amount of a mezzanine loan is EUR 5,000,000. The amount of a loan does not exceed 40% of the total costs of an investment project.

54 mezzanine loans have been issued for the total amount of EUR 13.8 million as of 31 October 2014. The purpose of the mezzanine loan is to issue long-term loans to Latvian merchants in addition to loans issued by banks to cover the investment costs of the project, which are associated with the set-up of a new merchant, the expansion of an existing merchant, increasing the diversity of production with new products or significant changes in the production process.

In January 2012, the activity 2.2.1.1 *Holding Fund for the investment in guarantees, high-risk loans, and venture capital funds and other financial instruments* was taken over from the European Investment Fund.

**Within the framework of the Holding Fund loan instruments**, as of 31 October 2014, 32 loan agreements for EUR 7.6 million have been concluded, whereas within the framework of venture capital instruments, 74 different stage venture capital investments in the amount of EUR 23.9 million have been made.

On 6 August 2013, three new venture capital funds were established and are operating in accordance with the new venture capital state support programme the **Growth Capital Funds** approved by the CoM on 29 May 2012. These funds – *Expansion Capital Fund*,

*FlyCap Investment Fund I* and *ZGI-3* – will continue providing access for Latvian small and medium-sized enterprises to venture capital financing for business start-up and development, as well as improve the competitiveness and growth of enterprises. The Growth Capital Funds will improve and expand the venture capital sector in Latvia by complementing the range of

other venture capital fund opportunities implemented by the LGA. The Growth Capital Funds allow receiving venture capital if an enterprise has insufficient own resources and the expected investment risk is too high to attract the required amount of financing from credit institutions.

#### Box 6.21

##### Growth Capital Funds

**Expansion Capital Fund** is focused on enterprises in the development stage that have already completed the product development stage and need funding to start commercial manufacturing, apply more aggressive marketing and sell products. The fund prefers export-oriented enterprises and enterprises with a high growth potential. The team of the fund is highly experienced in wood processing, metal processing, manufacture of machinery and equipment, chemical industry, transport, food, IT services, waste recycling, publishing, health care, and packaging sectors.

In addition to the funding intended for enterprises in the development stage, the *FlyCap Investment Fund I* plans to invest 20–30% of the fund's resources in new enterprises that have already developed a business model and have verified viability of a product, 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 fund's resources in enterprises in the seed capital stage, 20% in the start-up capital stage, whereas the remaining resources in the development capital stage.

Two **micro-loan funds** started to operate in August 2014: *Capitalia* and *Grand Credit*. A micro-loan is a medium-term loan for small and medium-sized enterprises to fund the investment of current assets and fixed assets. This type of funding is particularly suitable in the event that bank's funding is unavailable to an enterprise or it is not suitable because of the required loan terms and conditions, for instance, the area and duration of enterprise's activity, available collateral or other reasons. A micro-loan is an amount not exceeding EUR 25 thousand, which is granted to ensure funding for the establishment and development of economic activity operators, as well as for the expansion of activities, and to attract current assets for the implementation of viable business projects. 13 micro-loans were issued for the total amount of EUR 0.2 million by 31 October 2014.

The development capital funds will invest in micro-, small, and medium-sized enterprises operating in Latvia. An enterprise will be able to receive investments of up to EUR 1.5 million to provide financing for the pre-investigation, assessment and development of a product or a business idea concept, development of products, growth and expanding the activity by increasing production capacity, developing sales markets, and products. The growth capital funds will invest in enterprises with a high growth potential. The growth capital funds will be funded from financing available within the sub-activity *Holding Fund for the investment in guarantee, high-risk loans, and venture capital funds and other financial instruments* of the EU structural funds. The total amount of investments of the growth capital funds in Latvian enterprises is expected to reach EUR 30 million.

## 6.9 Innovation and New Technologies

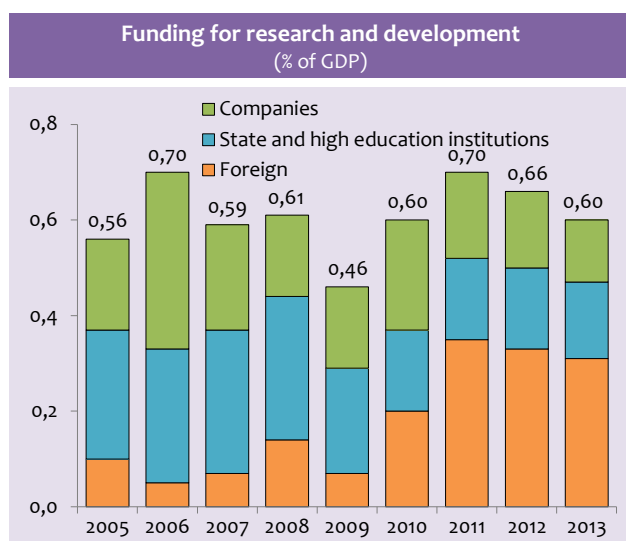
According to data of the CSB, the total financing for research and development (R&D) in Latvia in 2013 decreased and was 0.6% of GDP or EUR 139.2 million (in 2012 – 0.66% or EUR 145.4 million). Investments of the private sector (enterprises) in 2013 were only 21.8% of the total investments in R&D or 0.13% of GDP (in 2012 – 0.16% of GDP). A slight drop was observed in 2013 also in funding of public and private higher educational establishments for R&D, which in 2013 in actual numbers was EUR 37 million or 0.16% of GDP, in contrast to EUR 38.5 million in 2012 (0.16% of GDP). Upon performing an analysis of investments of foreign, incl. EU structural funds in R&D, it becomes apparent that they have slightly decreased in 2013, compared to 2012, and have reached EUR 71.8 million (in 2012 – EUR 73.3 million), constituting 0.31% of GDP (in 2012 – 0.33%).

Considering the negative tendency of the total R&D costs to decrease over the last two years, it must be noted that achieving the aim of the *National Reform Programme of Latvia for the Implementation of EU 2020 Strategy* (see Section 6.1.2) for R&D investments (in 2015, to increase the total amount of investments in R&D of Latvia to 1% of GDP, while in 2020 – to 1.5% of GDP) must be considered a significant challenge.

Upon considering the survey of innovations carried out by CSB for the period from 2010 until 2012, it must be concluded that the number of the enterprises active in the field of innovations in Latvia has increased during the accounting period, reaching 30.4% of all enterprises, compared to 29.9% of the enterprises in Latvia innovative during the survey period from 2008 until 2010. Upon performing an analysis of the structure of innovative enterprises by size, it is obvious that the most active in the field of innovation are big enterprises with

64.6% out of all big companies. However, only 43.2% of all medium-scale enterprises can be considered active in the field of innovation, while in the group of small-scale enterprises only 26.5% are identified as innovative. Innovation performance of small- and medium-sized enterprises is affected both by the limited human resources and own financial resources available to these enterprises for the implementation of research, development and innovation activities, including a limited opportunity to attract funding due to the high technological and business risk. It must be noted that 64% enterprises out of 30.4% active in the field of innovation from 2010 until 2012, had implemented innovations of products and processes, while 36% of all innovative companies had implemented marketing or organizational innovations.

Figure 6.12



The main directions for improving the innovation system in Latvia are focused on:

- developing the scientific activity potential;
- establishing a long-term platform for cooperation between enterprises and scientists;
- supporting the development of innovative enterprises.

In 2014, implementation of several measures were continued to develop **the scientific activity potential** with an aim to establish competitive scientific institutions with state-of-the-art materially-technical provisions (by consolidating state scientific institutions and strengthening their infrastructure), to increase the number of people employed in science and research in Latvia.

On 16 September 2014, the CoM approved 14 *State Research Programmes*<sup>1</sup> for 2014-2017. The state research programmes are public procurements for scientific research in a specific field of economy, education, culture or other state priority industry to promote development of this field. Funding for state research programmes is appropriated from the funding of the annual state budget.

In 2014, the implementation of the EU structural funds activity *Development of Science Infrastructure* was continued to improve the infrastructure of the leading state research centres and to ensure research activities on the grounds of a modern material and technical basis. The total co-financing of the activity from the EU structural funds is EUR 103.9 million and it is implemented in two selection stages. Since late 2011, 9 projects are being implemented within the first selection stage to modernise and properly equip 9 research centres of national importance for the total co-financing of the EU structural funds of EUR 80.2 million, thus covering 27 public scientific institutions. Projects of 8 enterprises have been approved for the total co-financing of the EU structural funds of EUR 23.7 million within the second selection stage. The projects deal with the development of a research infrastructure in the private sector and research service rendering to the private sector. A total of EUR 64.7 million of EU Structural Funds financing has been paid for the purpose of improving the scientific infrastructure since the launch of the projects until the middle of 2014.

In 2014, implementation of the EU structural funds activity *Support to Research and Development* continued, providing support for the implementation of practical research projects in the state priority science directions. At the end of 2013, implementation of 120 projects selected at the first stage of selection for the total EU funds financing of EUR 45.8 million was completed, while in 2014, implementation of 24 projects approved at the second selection stage for the total EU funds financing of EUR 6.2 million continued. At the same time, in the 3<sup>rd</sup> quarter of 2014, selection of project applications for the third selection stage was completed, where 41 projects for the total amount of EUR 11.9 million out of 112 applications were approved. By

<sup>1</sup> State Research Programmes (SRP) approved by CoM: 1) SRP *Energy Efficient and Low Carbon Capacity Solutions for Safe, Sustainable and Climate Change Minimizing Energy Supply*; 2) SRP *Value of Eco-systems of Latvia and its Dynamics in Climate Impact*; 3) SRP *Multi-functional Materials and Composites, Photonics and Nano-technologies*; 4.) SRP *Innovative Materials and Smart Technologies for Safety of Environment*; 5) SRP *Cyber-physical Systems, Ontology and Bio-photonics for Safe and Smart City and Society*; 6) SRP *State Programme for Research of Next Generation Information and Communication Technologies*; 7) SRP *Bio-medicine for Public Health*; 8) SRP *Research of Forests and Earth Entrails, Sustainable Use – New Products and Technologies*; 9) SRP *Agricultural Resources for Sustainable Production of High Quality and Healthy Food in Latvia*; 10) SRP *Innovative Solutions for Social Telerehabilitation in Latvian Schools in the Context of Inclusive Education*; 11) SRP *Transformation of National Economy, Smart Growth, Management and Legal Framework for Sustainable Development of State and Public – New Approaches to Establishment of Sustainable Knowledge Society*; 12) SRP *Innovation and Sustainable Development: Post-crisis processes in Latvia in Global Context*; 13) SRP *Sustainability of the Latvian Culture Traditions in Innovative Environment*; 14) SRP *Letonika*.



November 2014, 795 internationally recognized publications have been published and 92 international patent applications have been submitted.

**To foster long-term cooperation between enterprises and scientists** in 2014, implementation of activities continued to promote commercialization of research results and to improve the technology transfer system. The main activity in this area is the state support within the framework of the programme *Competence Centres*, as well as the work commenced to implement a new technology transfer system.

Within the framework of the EU structural fund programme *Competence Centres*, support by the IDAL is provided for cooperation between scientists and enterprises in conducting large-scale industrial research and development of new products and technologies in 2014. Competence centres are established in six sectors important to the national economy of Latvia and they are as follows: pharmacy and chemical industry, information and communication technologies, forestry sector, manufacturing of electric and optical equipment; environment, bioenergetics and biotechnology, as well as transport and engineering. The programme *Competence Centres* will be implemented until June 2015 for the total public funding of EUR 53.17 million. Additional co-funding in the amount of at least EUR 19 million is expected to be attracted for R&D activities from the private sector as a result of operation of the competence centres. 197 production research and new product and technology development projects are implemented in the six competence centres, out of which 56 projects have been completed. A total of 140 enterprises and 15 scientific institutions are involved in the competence centres, while over 336 researchers are involved in the conduct of researches. Implementation of the competence centre programme has been extended until the end of 2015.

Implementation of the *Cluster Programme* co-funded from the EU funds and administered by the IDAL was continued in 2014, to promote the collaboration between mutually unrelated enterprises, research, educational and other institutions to improve competitiveness of sectors and enterprises by implementing activities aimed not only at the creation of new products and services, but also at planning determined actions for taking up new export markets. The *Cluster Programme* supports 11 cluster projects which involve at least 300 enterprises, more than 20 educational and research institutions, as well as a range of non-governmental organisations and local governments. The total public financing of the programme until 2015 is EUR 4.83 million.

In 2014, improvement of the technology transfer system was implemented to attract funding available during the EU structural fund programming period for 2014–2020. The technology transfer system has been developed to create an environment for increasing the income of scientific institutions from commercialization of state funded research projects, as well as to promote the transfer of the research results acquired by the

scientific institutions into the practical business. Formation of a two-level transfer system is envisaged, to strengthen the capacity of the state agency in the field of technology transfer and provision of services to scientific institutions, as well as to support the creation of 1–2 technology transfer centres at the level of universities and scientific institutions. Additional support is envisaged within the framework of the commercialization foundation for the development of offers to increase the readiness thereof and improve attraction of licentiates/investors.

**For the development of innovative enterprises**, in 2014, the support continued for projects envisaging the development and introduction of new products in production, incl. development of technologies having minimum impact on environment, as well as for investments in the development of new production plants.

The programme *Development of New Products and Technologies in Production* co-funded from the EU structural funds in 2014 provides support to projects of companies focusing on developing and introducing new or significantly improved products, technologies or technological processes in production. In 2014, implementation of 116 projects (for a total funding of EUR 37.7 million) is continued during the first and the second application selection stage, of which 112 projects for a total amount of EUR 35.3 million have been completed by 1 December 2014. Within this programme, the support was mainly granted to medium-sized enterprises operating in the production industry, and the average amount of the support allocated within the framework of the programme was EUR 0.37 million per one project. In 2014, the implementation of 3 agreements concluded within the framework of the programme *Development of New Products and Technologies – Support for Securing Industrial Property Rights* for the total funding of the EU structural funds in the amount of EUR 0.06 million was continued.

In the state support programme *High Added Valued Investments*, funded from the EU structural funds, in 2014, implementation of 107 projects selected during the first, second and third stage of the programme for the total amount of EUR 137.1 million was continued. By 1 December 2014, a total of EUR 92.4 million have been paid to the implementers of the projects selected during the first and the second selection stage of the programme, as well as 28 projects for the total amount of EUR 61.9 million were completed. At the same time, in 2014, the 4<sup>th</sup> stage of the programme was organized with the available funding of EUR 82.1 million, thus, allowing the support of a wider range of enterprises. According to the CoM decision on allocation of funding to the 4<sup>th</sup> stage of the programme, it was decided to increase the intensity of the support from 35% to 45% per one project, as well as an agreement has been reached that the minimum amount of eligible costs per one project are to be reduced to EUR 50 thousand, while the maximum amount of public support to one group of persons



related to the project applicant is to be increased to EUR 2.13 million. 157 project applications for the total amount of support of EUR 110 million have been received within the 4<sup>th</sup> stage of the selection. After assessing the projects, 102 agreements were concluded on supporting the submitted projects for the total support amount of EUR 71.5 million. The programme aims to increase the potential of Latvian production enterprises to invest in knowledge or technology-based projects, including the attraction of foreign investments to high added value sectors, by supporting the purchase of production equipment, construction or modernization of production plants with an aim of promoting new jobs.

From the end of 2012 until 30 April 2014, the IDAL continued to accept project applications for the programme *Development Programme of New Products and Technologies of Micro-, Small and Medium-Sized Enterprises* co-funded from the EU structural funds. The programme is aimed at promoting innovation activities focusing on developing new products or technologies, supporting acquisition of external services to conduct surveys, strengthen industrial proprietorship and certification of a new product or technology. The total EU structural funds financing available within the programme is EUR 2.85 million. The financing per one beneficiary is EUR 14.23 thousand with the maximum aid intensity of 60%. By 30 April 2014, a total of 41 projects have been submitted within the programme, out of which 25 project applications have been approved (completed) for financing in the amount of EUR 0.3 million. 7 projects for funding of EUR 0.08 million have been completed by 1 December 2014 (incl. funding has been disbursed), and in December 2014, IDAL aims to conclude a contract with another one implementer of the supported project.

On 21 January 2014, the IDAL announced the open call for project applications within the framework of the programme “Green” *Industry Innovation* under the Norwegian Financial Mechanism for 2009-2014. Within the framework of the open call of the programme with available funding in the amount of EUR 7.77 million, the support has been provided for the invention of products and technologies with minimum environmental impact into production. Assessment of 13 project applications was carried out supporting 3 projects for the total funding in the amount of EUR 1.5 million. Considering that EUR 6.3 million have not been uptaken as a result of the first open call for project applications, the IDAL has announced the 2<sup>nd</sup> stage of the selection of the open call for project applications from 14 November 2014 until 16 January 2015. Within the framework of the programme “Green” *Industry Innovation*, the “Green” *Technology Incubator* established by the University of Latvia, the Riga Technical University and the Norwegian Industrial Development Corporation (SIVA) has been launched. The operations of the incubator are aimed at promoting commercialization of technologies, supporting formation and development of new enterprises. 40 business idea developer teams receive pre-incubator support within the “green” technology incubator. At the

same time, in July 2014, the IDAL announced the 1<sup>st</sup> selection stage of the small grant scheme projects within the frame of the programme “Green” *Industry Innovation* under the Norwegian Financial Mechanism for 2009-2014. 7 project applications were submitted during the 1<sup>st</sup> stage of selection for the entire funding available at the 1<sup>st</sup> stage in the amount of EUR 0.87 million. On 30 September 2014, the IDAL announced the 2<sup>nd</sup> selection stage of the small grant scheme projects within the framework of the programme for the available support in the amount of EUR 0.9 million, which concluded on 1 December 2014. Evaluation of project applications is expected to be concluded by February 2015.

In 2014, for the fifth year running, the IDAL continued to support the implementation of various measures within the framework of the programme *Measures to Encourage Innovations and Business Start-ups* co-funded from the EU structural funds, aimed at raising awareness and educating about the innovation and entrepreneurship, as well as motivating the public to engage in marketing activities and practically involve people in the process of further development of innovative ideas and solutions. The target audience of the Motivation Programme includes students and teachers from the elementary, secondary and vocational schools, students from the higher education establishments, prospective and operating entrepreneurs, developers of innovative ideas, individual inventors, etc. As of September 2014, 4165 enthusiasts have participated in events of the Motivation Programme. Within the framework of the programme in 2014, informational and educational events for various groups of enthusiasts were organised – information seminars and seminars on commercialization of technologies, training courses and the popular competition *Idea Cup 2014*, as well as the TV competition *Business Secret*. Several hundreds of school students and teachers have acquired useful knowledge in business start-ups and have participated in the creation of training enterprises, including visiting the most successful Latvian enterprises within the framework of their studies. Meanwhile, enterprises ensure an opportunity for high-school students to work on the development of new products within the framework of the international cooperation platform *DEMOLA*. Mentoring activity is implemented within the Motivation Programme as well, where the new entrepreneurs can receive advice from experienced mentors and support for improvement of their business. In 2014, a new activity is expected to be implemented within the framework of the Motivation Programme with an aim to promote start-ups of new and innovative enterprises in their early stage, by providing the necessary consultations and knowledge to authors of business ideas and business developers regarding preparation and implementation of projects, including providing support in attracting external financial sources. Total financing available within the Motivation Programme is EUR 3 million, in 2014, EUR 0.9 million is expected to be used for the implementation of all

activities envisaged within the framework of the programme. To ensure further consecutive support to prospective and new entrepreneurs, the duration of the Motivation Programme will be extended until the end of 2015.

Since 1 July 2014, enterprises can use the income tax stimulus for R&D costs, which may be written off in the year when they have occurred, applying a value increasing factor of 3. Eligible R&D costs, to which the tax stimulus may be applied, are as follows: (1) costs for scientific and science and technical personnel of the enterprise related to research and development carried out by the enterprise, (2) costs for research services acquired from

scientific institutions, as well as (3) costs for certification, testing and calibration services when receiving services of accredited certification, testing and calibration institutions. The R&D tax stimulus has been invented based on amendments to the *Law On Company Income Tax* adopted by the Saeima on 6 November 2013. Furthermore, the *CoM Regulation On Research and Development Operation For Application of the Company Income Tax* came into force on 1 July 2014, prescribing the requirements for assessing the conformity of R&D, requirements for R&D project documentation, as well as accounting procedures for R&D costs and requirements for the eligibility and assessment of R&D costs.

## 6.10 Information Society

Information society is a social development phase based on free mutual information exchange, developing a knowledge-based economy. Information society consists of the technological base (infrastructure, software), a range of information services available to the society, and of the level of individual skills and knowledge.

As a result of development of information and telecommunications technologies (ICT), information and knowledge are more increasingly used in work and in labour relations, education and everyday life (see Box 6.22).

### Box 6.22

#### The role of the ICT sector

According to the CSB data, in 2013, the share of the ICT sector in the GDP constituted 3.7%. In 2013, 5053 companies operated in the ICT sector in Latvia, employing over 23.6 thousand persons, with the turnover of companies exceeding EUR 3.1 billion, staff costs – EUR 362 million. The value added to the ICT production reached EUR 47 million, the provision of the ICT services – EUR 620 million. The foreign trade balance of the ICT was negative: EUR -105.9 million, because imports amounting to EUR 873.1 million exceeded exports with EUR 767.2 million. It should be noted that in 2013 the imports of ICT products increased by 18.6%, whereas exports – by 27.1% in comparison with 2012.

According to the data of the CSB survey *Computer and Internet Usage in Households*, 73% of all households had an Internet connection in 2014 (households with at least one person in the age group of 16–74 years). Most often, households with an Internet connection used the following devices to access the Internet: a laptop – 68%, a desktop – 58%, a mobile phone and other mobile devices – 37%, other devices – 10%. The best situation in terms of Internet accessibility was observed for households in the Riga region and Pierīga region – 79%, while in other regions, the situation was worse – in the Zemgale region – 71%, Kurzeme region – 69%, Latgale region – 66%, and Vidzeme region – 63%. 72% of inhabitants in the age group of 16–74 years used a computer and Internet on a regular basis (at least once a week). Broadband Internet connection was available to 86% of households with an Internet connection.

In 2014, 98% of all companies having 10 and more employees had computers, 96% of such companies had an Internet connection, and 56% of enterprises had their own website. In 2014, 41% of all employees of enterprises used a computer connected to the Internet.

At the beginning of the academic year 2013/2014, general education schools used 25.6 thousand computers in the learning process, which is about 1 computer per 8 students. 615 or 74.4% out of 827 schools with an Internet connection had their own homepage on the Internet.

In preparation for the new multiannual budget period (2014–2020), concepts, guidelines and informative reports have been developed, for example, *Guidelines on Information Society Development for 2014–2020*, *Guidelines on Cyber Security Strategy of Latvia for 2014–2018*, *Concept of the State Education Information System (SEIS) Development*, *Geospace Information Development Concept of Latvia*, the informative report “On Safe and Protected Document Circulation in Public Administration”, the informative report “On Measures to Minimize Administrative Burden for Development of Broadband Electronic Communication Network”, etc., as well as draft guidelines, concepts and informative reports, for example, the draft *Guidelines on Protection and Maintenance of Intellectual Property Rights for 2014–2018*, the draft *Concept of Development of Internet Websites of State Direct Administration*

and *Central Public Administration Institutions*, the informative report “On Developing of the Mapping Information System of Electronic Communication Infrastructure”, the informative report on the introduction of the *Guidelines on e-Health in Latvia for 2008–2013* and the implementation plan of the *Guidelines on e-Health in Latvia for 2008–2013*, etc.

On 1 October 2013, the CoM approved the *Guidelines on Information Society Development for 2014–2020* which analyse the achievements over the past seven years and define the priorities for the period until 2020.

Some of the key policy results achieved are: the high number of regular Internet users, a relatively high share of households with broadband Internet connection, the high number of employees using a computer and Internet on a daily basis, as well as a relatively high share of

population using distance-learning services. As regards the results not yet achieved, the main factors are the target share of the ICT sector in the GDP that has not been achieved, the low number of people shopping online and the low turnover of companies from online sales.

The guidelines set the following objectives for the new programming period:

- to increase the efficiency of public administration (by streamlining processes);
- to improve the business environment (by improving e-commerce results);
- to improve the e-skills of people (by improving the average skills level and reducing the share of non-Internet users);

- to improve access to the Internet (by increasing the number of households having access to the Internet);
- to ensure easy access to services in the electronic environment (by increasing the share of people and companies using the Internet for co-operation with public and local government authorities, as well as medical treatment institutions);
- to increase investments in research and innovations (by increasing investment volumes and the share of innovative businesses).

#### Box 6.23

##### Action Plan for the Digital Agenda for Europe

The *Digital Agenda for Europe* sets seven priority measures (action areas): a vibrant digital single market, improving the interoperability of ICT-based tools and services, building trust and security of users, fast and ultra-fast Internet access, research and innovation, enhancing digital literacy, skills and inclusion, ICT-enabled benefits for EU society, such as climate change, health care and ageing population. The programme areas include 132 measures.

The Action Plan emphasizes the following areas as particularly supported:

- *Fast and ultra-fast Internet access.* In order to ensure equal access to electronic communication services across Latvia: a national implementation plan for broadband network must be developed and implemented, relevant laws and regulations must be adopted to facilitate investments in broadband networks, fully absorb the EU structural funds and the Rural Development fund financing (see Sub-chapter “Broadband Internet”) and implement a European radio spectrum policy programme;
- *Enhancing digital literacy, skills, and inclusion.* In order to promote the development of information society by giving the Latvian population an opportunity to obtain e-skills according to their level of education and professional activity: to implement a long-term policy for e-skills and use of digital tools and properly encourage SMEs and disadvantaged groups; to introduce telecommunication regulation and the provisions of the *Audiovisual Media Services (AMS) Directive* regarding disability; to integrate e-learning in the national policy for the modernisation of education and training;
- *Trust and security.* In order to build public trust in the use of the Internet: to join and use the European scale *Network of Computer Emergency Response Teams (CERT network)*; to carry out a large scale attack simulation and test mitigation strategies; to implement hotlines for reporting offensive or harmful online content, to organise awareness raising campaigns on online safety for children.

The Action Plan includes measures also in the rest of action areas. The action area *Digital single market*: to implement the key Directives supporting the digital single market, including the *Services Directive*, *Unfair Commercial Practices Directive* and the *Telecoms Framework*, as well as adapt laws on e-invoicing. The action area *Interoperability and standards*: to apply the *European Interoperability Framework* (including the geospatial information) and implement commitments on interoperability and standards in the *Malmö and Granada Declarations*. The action area *Research and innovations*: by 2020, to double annual total public spending on ICT by attracting equal private funding, and to engage in large-scale pilots to test and develop innovative and interoperable solutions in areas of public interest. The action area *ICT-enabled benefits for EU society*: to implement smart meters and agree on their additional functionalities, include specifications for total lifetime costs for all public procurement of lighting installations; improve the interoperability of e-government; ensure the conformity of a single contact point of the *Services Directive*; to agree on a common list of key cross-border public services; meet the requirements of the *European Rail Traffic Management System*.

In order to assess the results achieved within the *Digital Agenda for Europe*, the European Commission in May 2014 has published the programme implementation progress report since the beginning of the programme (*Progress Report Digital Agenda Targets 2014*). Overall, measures are being implemented successfully, since the use of the Internet has grown rapidly (by 12 percentage points), reaching 72% of all population; online sales have also increased by 10 percentage points reaching 47%; fast broadband Internet is available to 62% of population (by 33 percentage points more), most, however, living in urban areas (indices of rural regions are considerably worse). The following were listed as drawbacks: the slow increase in the use of e-management (only by 4 percentage points in 4 years), and even its decrease in other countries; a insignificant increase in e-commerce across the SME sector to 14% (by 2 percentage points in 4 years), which is considered a challenge in creating new jobs; insignificant public support to R&D in ICT; cross-border online trade develops at a very slow pace.

Unlike general EU tendencies, in Latvia, the indicators of the use of e-management and the coverage of the next-generation broadband access network (in cities) are above the average EU indicators. Digital skills and the share of persons employed in the ICT sector from the total number of employed persons are slightly below the average EU level. However, the increase in e-commerce in the SME sector and state support for research and development in the ICT sector is insufficient. The greatest difference from the average EU indices in 2013 was observed for the accessibility of broadband Internet in rural regions (in Latvia – 44%, on average in the EU – 90%), which was partially compensated by a comparatively good coverage of the next-generation broadband access network (in Latvia – 29%, on average in the EU – 18%).

The EU structural funds financing and financing from the state and local government budgets in the amount of EUR 149 million has been used for the development of electronic government and information society until 2014.

The EU structural funds financing in the amount of EUR 192.8 million is expected to be used within the next multiannual budget period (2014–2020).

Within the implementation of the measures under the Cohesion policy priority direction *Access to ICT, e-government and services*, it is expected to provide support to promote the balanced development of the entire territory of Latvia through the construction or improvement of an electronic communication infrastructure, at the same time developing an economic activity-friendly environment based on available information, reuse of public sector information, integrated ICT solutions of the public and private sector and integration of Latvia into the European single digital market, as well as improvement of the general quality of life of people, contributing to the access to services, increasing the social productivity, reducing the administrative burden and improving mobility.

NGOs of sectors are also actively participating in building information society. In 2012, the Latvian Information and Communications Technology Association (LICTA) developed the *ICT Sector Priority*

*Charter*, which set 6 key directions for the next 5 years. On 9 April 2014, LICTA, MEPRD, Lattelecom SIA, LALRG, LLPA, and LCCI signed a cooperation memorandum on the national-scale measuring of efficiency of e-management systems of public institutions and local governments – *E-index of Latvia*.

Along with Latvia's accession to the EU, the EU initiatives related to the development of the information society have become binding for Latvia.

A new aim was set in the European Commission's communication *Digital Agenda for Europe* adopted on 26 August 2010 (see Box 6.23) – in relation to the *Europe 2020 Strategy*, to gain economic and social benefit from the digital single market based on fast and ultra-fast Internet.

In the first half of 2015, Latvia will be the presiding country in the Council of Europe. One of three priorities of Latvia's presidency will be the creation of the truly digital Europe, by paying particular attention to fostering trust to the Digital Single Market, the digitalisation of the public sector, as well as promoting the security in the digital environment. On 18 December 2012, the EC assessed the progress of the *Digital Agenda for Europe* and prepared an urgent 'to-do' list in digital area for the next 2 years, particularly emphasizing the role of broadband internet in fostering economic growth in Europe (see Box 6.24).

#### Box 6.24

##### **Communication of the European Commission Digital 'to-do' list: new digital priorities for 2013–2014**

On 18 December 2012, the EC defined an urgent 'to-do' list in digital area setting 7 main priorities for 2013–2014:

- Creation of a new and stable broadband regulatory environment;
- Creation of new public digital service infrastructure through the Connecting Europe Facility;
- Launch Grand Coalition on Digital Skills and Jobs;
- Proposing EU cyber-security strategy and Directive;
- Updating EU's Copyright Framework;
- Acceleration of cloud computing through public sector resources;
- Launch of a new electronics industrial strategy.

The Memorandum of Cooperation on Establishment of the *"E-skills partnership"* in Latvia was signed during the E-skills week in 2013 (18–24 March). It was signed by the public sector, the representatives of the ICT sector and the NGOs in response to the European Union initiative *The Grand Coalition for digital jobs creation*.

Being aware of the expected opportunities of the ICT sector in the field of the European ICT growth after the crisis and carrying out the analysis of the compliance of digital priorities, on 16 January 2014, the EC presented the study *Unbinding the ICT growth potential in Europe: activation of population and companies* (see Box 6.25).

#### Box 6.25

##### **EC study *Unbinding the ICT growth potential in Europe: activation of population and companies***

On 16 January 2014, the EC presented the study, which concludes that the ICT sector growth potential must be unbound in Europe and provides a strategic opinion that Europe must be ready to guide the new technology development waves (mobile broadband, cloud computing, big data, the Internet of things). The study investigates 4 different possible development scenarios. In order for Europe not to become a "digital desert", bottle-necks must be addressed, namely, the fragmentation of market and legislation, lack of investments in the ICT infrastructure and skills, ability to accept and integrate new technologies. An urgent need to have a unified integrated digital and telecommunication market has been emphasized. The EC must continue the work on several measures, such as the development of a cloud computing strategy and the development of "Big Coalition" future digital skills covering the broad network of business, government and academic institutions.



### **Electronic services**

An Internet website *www.latvija.lv* has been developed as a single access point for the services of the state and local governments in Latvia. In order to improve its visual presentation, in 2013, the portal was complemented with important sections “Life Events” (approximately 80 various life events) and “Returning to Latvia”.

Information on e-procurement and development of e-services is available on the website of the State Regional Development Agency (*www.vraa.gov.lv*), whereas information on e-government and the policy of information society is available on the website of the Ministry of Environmental Protection and Regional Development (*www.varam.gov.lv*).

According to the data of the State Regional Development Agency, in 2013, the public and local government institutions have purchased goods in the *Electronic Procurement System* for about EUR 31.1 million (in 2012 – EUR 26 million). The majority were procurements of computer technologies, medicines, printing equipment, and office supplies.

According to *Eurostat* data 18% of Latvian enterprises (except the financial sector) with 10 and more employees in 2013, used the Internet to offer goods and services on the Latvian Electronic Procurement System (EU average – 13%) and 6% in other EU countries (EU average – 2%).

On 2 April 2012, the issue of electronic identification cards (eID) was launched. The card is also used as the carrier of a secure e-signature (it includes 120 free timestamps for signing documents with a secure electronic signature). In late 2014, the number of electronically signed documents exceeded 7 million.

Prior to the 12<sup>th</sup> elections of the Saeima (the Parliament) on 4 October 2014, the issue regarding the possibility of voting online became topical. Since eID was the only personal identification document for a part of Latvian citizens (27.5 thousand), a single-use voter's certificate had to be obtained from the Office of Citizenship and Migration Affairs to participate in the elections. This certificate was received by only 20% of these citizens. Prior to the 12<sup>th</sup> elections of the Saeima, an incentive “Voting on the Internet” was submitted; however, on 26 November 2014, having examined the application, the Mandate, Ethics and Submissions Committee of the Saeima decided to urge the Saeima to reject this incentive, substantiating it with the lack of proper secure technological solutions.

### **Broadband Internet**

According to *Eurostat* data, at the end of 2013, 97.4% of all Internet connections in Latvia featured broadband Internet speed (EU average – 97.3%). Moreover, 50.8% of all broadband connections had speed above 30 Mbit/s (EU average – 21.2%) and 35.6% even had speed above 100 Mbit/s (EU average – 5.3%).

According to the data published on the Internet speed measurement website *speedtest.net* of the Internet research company “Ookla Net Metrics”, at the end of December 2014, Latvia with the download speed of 40.8 Mbit/s was ranked 14<sup>th</sup> and upload speed of 36.7 Mbit/s was ranked 7<sup>th</sup> among 195 countries.

On 9 November 2011, the EC pursuant to the EU state support conditions approved the support scheme for EUR 101.7 million aimed at providing ultra-fast broadband Internet network all over Latvia.

The first stage of the project *Development of Next-Generation Electronic Communication Networks in Rural Regions* is expected to be implemented within the period from October 2012 until August 2015 using the ERDF funding in the amount of EUR 23.1 million and private funding in the amount of EUR 3.4 million. The project is implemented by the SJSC “Latvia State Radio and Television Centre”, establishing 165 Internet access points and installing optical cable lines for a total length of 1900 km, thus providing high-quality Internet connection with speed from 30 to 100 Mbit/s to the citizens and enterprises and eliminating the gap between urban and rural areas. Over 1/3 of the 1<sup>st</sup> stage of the project was implemented by 1 June 2014. Construction of new access points and installation of optical cables are planned to be continued within the second stage of the project. The second stage is expected to be finished by 2018. The expected funding is EUR 78.7 million (including the EU structural funds).

In order to identify the development directions of next-generation electronic communication networks, on 7 December 2012, the Cabinet of Ministers approved the draft solutions proposed in the *Concept for Next-Generation Broadband Electronic Communication Network Development for 2013–2020* that envisage further development of grids, new optical internet access points in rural municipalities (281 territorial units), attracting new electronic communication companies to network development, state aid programmes for establishing local loops (“last mile” connections) and other measures.

In order to promote private investments in 4G network development, CIT allowances will be granted to the largest investors. On 21 May 2013, the Cabinet of Ministers approved granting the CIT allowance to LLC “Latvijas Mobilais Telefons” for the implementation of the investment project “Development of Next Generation Mobile Communication Network in Less Densely Populated Territories”, as well as on 26 November 2013 it approved granting this CIT allowance to LLC “Bite Latvija” for the implementation of the investment project “BITE 4G network development outside the largest cities of Latvia”.

### **Combating computer piracy**

According to the data of the international software copyright protection organisation “Business Software Alliance” (BSA), the level of computer piracy in Latvia in 2013 reached 53% (on average in Central and Eastern Europe – 61%). Losses to the Latvian economy caused by piracy amounted to EUR 39.6 million.



**E-commerce**

According to the *Eurostat* data, 34% of Latvian population in 2014 ordered goods or services online (EU average – 50%), while 16% of the Latvian population ordered goods or services online from other EU Member States (EU average – 15%).

In 2014, 32% of all enterprises (except the financial sector) with 10 and more employees purchased goods or

services on the Internet or other computer networks (EU average – 38%). However, 9% of all enterprises (except the financial sector) with 10 and more employees sold goods or services on the Internet or other computer networks in 2014 (EU average – 18%). The turnover of e-commerce amounted to 8% of the total turnover of these enterprises (EU average – 15%).

## 6.11 Competition Policy

The aim of the competition policy is to ensure that every market participant has an opportunity to operate their business under circumstances of free and fair competition, as well as to promote the development of competition in all sectors of national economy according to the public interests. Competition promotes development of the company and national economy as well as ensures lower prices, more choices and better quality to consumers of innovative solutions.

The Competition Council (CC) is responsible for implementing the competition policy in Latvia – it investigates and prevents violation of competition law, makes sure that the laws and regulations of the government and local government cause no obstacles for free and fair competition, as well as educates companies and representatives of the state and local government, promoting their understanding in relation to competition law and intolerance towards offences.

The main directions, in which the institution operates is protection of competition and control by preventing offences and development of competition culture by facilitating the creation of an environment favourable to fair competition among companies.

**Protection of competition and control**

The CC carries out protection of competition, by handling violations of the *Competition Law* – prohibited agreements and abuse of a dominant position – and ensuring control of mergers of big enterprises.

The priority of the CC is identification and prevention of the most severe breaches of the *Competition Law* – the prohibited agreements and dominant position abuse causing the most severe damage to markets, competition and consumers.

According to the *Competition Law*, any such agreements between companies are prohibited, which are aimed at limiting free and fair competition. For instance, companies may not agree on a specific price level for similar goods, on the division of market to avoid competition in the same territory, on participation or, on the contrary, non-participation in public procurements and on other activities pushing out the competition beneficial to the consumers and replacing it with a prohibited cooperation.

In the second half of 2014, the CC concluded investigation of several significant prohibited agreements. For example, in three cases the institution established that competition was distorted by enterprises within the framework of industry associations (see Box 6.26).

**Box 6.26****Market participants use associations to implement prohibited agreements**

In the second half of 2014, the CC identified three cases when enterprises have used associations to make competition-distorting decisions. Consequently, the Latvia Leasing Association and the union *Auto Asociācija* were inflicted a penalty for committing similar violations.

The Latvia Leasing Association made a prohibited agreement between members, including the biggest leasing companies of Latvia, on significant principles of commercial activity. For example, the association agreed on conditions in relation to the term of operating leasing and the amount of the first deposit, redemption value of the car and pre-emptive rights, as well as conditions in relation to service and provision of technical maintenance. Furthermore, members of the association agreed on principles, according to which they would carry out settlements with car dealers, as well as agreed on principles of co-operation with insurance companies.

Members of the union *Auto Asociācija* – the biggest sellers of new vehicles and owners of authorized services in Latvia – have discussed issues, which, according to the *Competition Law*, must be resolved individually within each specific enterprise. Members of *Auto Asociācija* discussed development of a common strategy in relation to insurance joint stock companies, as well as development of common rules, specifying the place, where new cars are maintained and repaired in case of operating leasing.

While the National Association of Ship Brokers and Agents of Latvia had imposed on its members the minimum or fixed price for services provided by ship agents. Such prohibited agreement is aimed at specifying a set price level, thus, minimizing the pressure by competition and providing an opportunity for ship agents to develop their independent price policy.

It shall be noted that in 2014, the CC of Latvia had the first opportunity to identify a prohibited agreement between enterprises following a report of the breaching

party within the framework of the tolerance programme (see Box 6.27).

**Box 6.27****For the first time in Latvia, a violation has been discovered following a report within the tolerance programme**

After receiving the report from the company involved in the violation, the CC identified a prohibited agreement between two construction companies while participating in procurement tenders. The company reporting was released from the penalty. The other participant of the violation – the initiator of the violation *RCI Gulbene Ltd* – received a penalty in the amount of EUR 125,001.32.

Both companies had agreed not to compete in three procurements for the total contract price of EUR 684,770. Two of the procurements were organized by farms, whereas the third, by a municipal school, but in all cases, EU funds were attracted for constructions works.

The prohibited agreement was implemented as follows: one enterprise submitted to the commissioning party their cost estimate, while the other one submitted a cost estimate with intentionally increased costs. In two procurements, the contract was awarded to *RCI Gulbene Ltd*. In one of the procurements, the contract was awarded to the other company, but 100% of actual works were transferred to *RCI Gulbene Ltd* as a sub-contractor. For such “helping out”, *RCI Gulbene Ltd* paid remuneration to the other applicant in the amount of 3% of the contractual price of procurement.

If enterprises substitute actual competition with imitation, the commissioning party is deceived about the actual situation in the market, as well as fails to enjoy benefits ensured by competition – lower prices, more options, better quality, higher rate of execution of works, more beneficial guarantee conditions or other benefits, which may be offered by enterprises when competing for a contract.

The violation was discovered owing to a report of an enterprise (the breaching party). The tolerance programme allows any company, which is involved or has been involved in prohibited agreements, to be the first to report to the CC on their own initiative, to submit evidence on the violation and be released from the penalty in full. In majority of the Western European states, as well as at the EC level, majority of violations in the area of competition, which are concealed and very difficult to detect, are discovered using information submitted within the framework of the tolerance programme.

Like prohibited agreements, considerable damage to competition and harm to customers can be caused by dominant companies abusing their market power. Abuse of the dominant market power in larger companies is

prohibited by the *Competition Law*. To prevent less significant violations as soon and as effectively as possible, the CC may operate as an intermediary in negotiations between enterprises (see Box 6.28).

**Box 6.28****The CC warns *Rīgas ūdens SIA* and mediates a conflict between enterprises**

Having received a warning from the CC, *Rīgas ūdens SIA* concluded an agreement on the use of municipal water supply and sewerage with the property management company *Hausmaster SIA*, who initially received a refusal due to debts accrued by the former property manager.

Negotiations with *Rīgas ūdens SIA* have been commenced by the CC after receiving an application from *Hausmaster SIA*. After assessing the application, the CC decided not to proceed with the case, but decided to resolve the conflict by way of mediation. After the CC's negotiations with each of enterprises, they reached an agreement on resolution in relation to payment of debts and amending the service provision agreement.

Usually, an investigation of violation of competition law is a complicated and time-consuming process, which can last even for two years; furthermore, most penalty decisions are followed by litigation of approximately the same duration. Thus, in similar situations, when the potential violation is comparatively insignificant and the enterprise voluntarily eliminates it at the initial stage of investigation following a warning of the Competition Council, the institution may give a warning and proceed with no official case. Thus, harm to the market and consumers is prevented as soon as possible, without waiting for a conclusion of investigation of the case, official identification of the harm and the time of potential litigation, and to spare resources of all parties involved.

In order to prevent a significant decrease in competition as a result of agreement between enterprises, the CC carries out control of the large companies, allowing only such merger agreements that do not affect the market. Furthermore, when permitting a merger, the CC is entitled to impose binding terms on the companies to prevent the possible harm resulting from such mergers. According to the *Competition Law*, the CC's permission is required, if the total amount of liquid assets of participants in the previous financial year within the territory of Latvia has reached at least EUR 35,572,000, or if the total market share of the merged members in the specific market exceeds 40 per cent.

In the second half of 2014, the CC has assessed seven mergers and in all events companies have been given the permit to carry out the planned merger.

One of the most significant tools of promoting competition is the market monitoring or the in-depth competition analysis by the CC in a specific market. Market monitoring allows an institution not only to identify and prevent a violation of the *Competition Law*, but also to identify the existing barriers, develop and submit to the responsible institutions recommendations for improving competition, as well as inform the public on the competition situation in a specific market. One of monitoring operations completed in the first half of 2014 allowed the CC carry out an in-depth assessment of the issue of payment of fines, as well as intentional analysis of evasion and search for a solution of an effective penalty system (see Box 6.29).

**Box 6.29****The CC carries out a study on the payment of penalties inflicted on enterprises**

The CC has concluded market monitoring, during which it verified, how penalties are paid by companies, which have been imposed a penalty for participation in the cartel of household appliances in 2009. Conclusions drawn from the monitoring, as well as related court practice allows to conclude that violators cannot avoid a payment of penalty when undergoing liquidation or continuing the same business in form of new companies.

Usually, enterprises pay the penalty after the CC's decision enters into force (usually, after litigation). If the enterprise is recognized insolvent, the CC proceeds with the claim against the creditor. In turn, if any reasonable suspicion arises that assets of the company are transferred to another legal entity to avoid the payment of penalty, the CC initiates a penalty recovery claim against the enterprise having overtaken these assets and liabilities.

This must be particularly taken into account by enterprises planning acquisition of other companies. The buyer must verify, whether the enterprise to be overtaken has not been involved in a violation of competition law. When taking over an enterprise or its assets and in case of economic and functional succession, the buyer may take over also the seller's commitment to assume responsibility for payment of penalty imposed for violations of the Competition Law.

Aiming to achieve payment of penalties imposed on enterprises, the CC has for the first time carried out such an extensive and both legally and economically complex study within the framework of market monitoring, using options provided for the institution by competition law. Although, significant information has been acquired during the study, the CC concludes that monitoring of payment of penalties is a considerable burden for an institution, related to investigation of violations of competition law. Similar situations when enterprises attempt to avoid the payment of penalty are encountered also by other public institutions in Latvia, thus, the CC considers that a more efficient and simple solution must be found to recover debts at the state level. The practice of other states suggests that the applicable penalties in competition matters are provided with a guarantee and a court appeal does not cease fulfilment of penalty.

**Promotion of competition culture**

To promote competition in all sectors of the national economy, the CC supports the prevention of administrative obstacles to free competition and educates entrepreneurs and the public on the competition law and the role of competition in ensuring public welfare. Furthermore, the CC cooperates with competition supervisors and international organizations of other countries, participating in the development of the international competition policy and using information and experience of other states for more effective protection of competition in Latvia.

To minimize administrative obstacles, which regulatory enactments may cause to free trade, the CC reviews draft enactments and gives their opinion, if they find that the specific regulatory enactment may cause unreasonable damage to competition, thus, it must be amended. Regulatory enactments reviewed in the second half of 2014 include the CoM's draft Regulation *Procedure For Natural Resource Tax Relief For Environmentally Hazardous Goods, Packaging and Disposable Dishes and Tableware*. The CC stated that this project must eliminate barriers for operation of waste management companies in the market (for example, the manager must ensure waste collection of spent packaging and disposable dishes used in households in 50 sorted waste areas in the first year of operation), as well as recommended other improvements to enhance the competition situation.

Considerable attention is paid by the CC to informing and educating the public to promote intolerance to violations of the competition law, as well as to prevent cases when enterprises make violations due to lack of knowledge of law. To assist small- and medium-scale enterprises to develop their programmes on following

competition law – to train the employees and minimize the risk of violations of the law, the CC has developed a special digital manual. Principles of the use of the tolerance programme are explained using an easy to comprehend and visual info-graph. Furthermore, an informative animation movie has been created to explain the harm caused by cartels and to inform about the possibilities offered by the tolerance programme, if the enterprise has been involved in such a deal. In turn, in order to ensure that daily communication is as dynamic, convenient and quick as possible, the CC has created a Twitter account for the institution: @KPgovLV.

To explain to various target audiences those aspects of application of the competition law, which are significant for these audiences, the CC has organized seminars, conferences and other events for meeting the audiences, notifying on novelties and answering questions. One of the most significant informational and educational events is the seminar for entrepreneurs organized within the framework of *Rēzekne Business Days*, as well as the seminar for members of the Chamber of Commerce and Industry. Furthermore, two seminars have been held for organizers of state and local-government procurement competitions at the State Administration School, whereas organizers of procurement competitions of several institutions have been trained individually.

One of the priorities of the external economic policy of Latvia is joining the OECD. At the end of 2014, experts of the CC represented Latvia during the review of the final report on the competition policy of the OECD Competition Committee. This measure is a significant step in the procedure of admission of Latvia.

## 6.12 Export Promotion and Foreign Investment Attraction Policy

In order to achieve the “economic breakthrough” of Latvia referred to in the National Development Plan and to successfully implement the objectives set in the Guidelines on National Industrial Policy (see Section 6.3.), the Cabinet of Ministers approved *the Guidelines for Export Promotion of Latvian Goods and Services and Attraction of Foreign Investment in 2013-2019 in the meeting on 28 May 2013*.

Improvement of competitiveness of Latvian enterprises, targeted measures to attract foreign direct investments and support to enterprises for accessing foreign markets are the key strategic objectives defined in the guidelines that will ensure a favourable environment for investments in Latvia and will promote its international recognition and facilitate entry of Latvian enterprises in foreign markets.

The guidelines define the key aims, principles, and main directions of action of export promotion and foreign direct investment (FDI) attraction policy for the next seven years. A successful implementation of the guidelines requires a single and dynamic cooperation model for all parties involving public and local government authorities and the private sector, and scientific institutions alike.

Specific measures in these directions of action are implemented pursuant to the *Task and Action Plan for 2013-2019 Referred to in the Guidelines for Export Promotion of Latvian Goods and Services and Attraction of Foreign Investment*, which is added to the guidelines document.

### **Attraction of Foreign Direct Investments**

The FDI attraction policy is aimed at improving competitiveness of Latvia as an investment-friendly environment, based on the aspects important for investors: macroeconomic indicators of the country, business environment – simple bureaucratic procedures and a stable tax policy, access to properly qualified labour, market potential, access to the necessary infrastructure, offered support instruments and incentives. It is important to attract foreign investments to industries that ensure changes in the structure of national economy in favour of foreign demand-oriented<sup>1</sup> industries, particularly medium-high and high technology industries<sup>2</sup>.

FDI play an important role in the promotion of continued economic growth in Latvia both through the

acquisition of industrial and management skills and by creating new jobs, thus giving an opportunity to apply new technologies and preconditions to technology transfer, promoting integration of the country in international trade and involvement of enterprises in industrial sales chains.

Foreign investment attraction should be primarily aimed at geographically close neighbouring countries where Latvia is recognised and no extra resources are required for informative measures, economically stable and developed countries with growth potential and needs of sectors of national economy that meet the perspective cooperation possibilities of Latvia, as well as countries that ensure the largest global investment outflows – the USA, France, Germany, the **United Kingdom** of Great Britain and Northern Ireland, Japan, China, Russia, and India.

In order to compete successfully in the foreign investment attraction market and to improve the progress of local and foreign investment projects of national importance, since 2010, the IDAL has been implementing the investment attraction methodology *Polaris* envisaging unified and coordinated activity of ministries, municipalities, infrastructural companies, and public institutions in implementing strategically important domestic and foreign investment projects, as well as involvement of the private sector, universities, and scientific research institutions.

In order to concentrate the available resources in a more targeted way and to increase the return on resources in the FDI attraction, the following key principles are determined for further action:

- An expanded and active FDI attraction methodology – *POLARIS process*, according to which all further activities related to investment attraction are carried out;
- Investment attraction marketing activities.

Taking into account the limited resources, activities for FDI attraction in 2013–2015 are planned to focus on few target countries (the Nordic countries, Germany, the United Kingdom) and certain target sectors (metal processing and engineering industry, wood industry and information technologies, including the establishment of shared service centres).

<sup>1</sup> Foreign demand-oriented industries – agriculture, mining and quarrying, manufacturing, transport and storage, information and communication services.

<sup>2</sup> Medium-high and high technology industries – manufacture of pharmaceutical products, computers, electronic and optical products, air and spacecraft and related machinery and medical instruments, and manufacture of chemicals and chemical products, weapons, electrical equipment, machinery and work equipment, motor vehicles, ships, railway and other transport (except aircraft) and repairs and installation of machinery and equipment (NACE Rev. 2. 20, 25.4, 27, 28, 29, 30 (except 30.3), 33)



With the present tax incentives to promote investments and develop a business-friendly environment in Latvia, on 13 March 2013, the Cabinet of Ministers approved the Regulations Regarding Sub-activity 1.3.1.1.6 **“Support to create jobs”** of the Supplement to the Operational Programme “Human Resources and Employment” aimed at increasing the number of well-paid jobs and growth of added value and export. Currently, six of the approved projects are being implemented. Overall, all projects submitted within the activity have been supported for the total amount of LVL 17.17 million, out of which financing from the EU structural funds accounts for LVL 4.54 million. At least 863 new jobs are expected to be created. Four of the supported projects involve combined office administrative services; one of the project applications has been submitted by a plastic packaging manufacturer, while another one – by a car manufacturer. Currently, the projects are being implemented, and 418 new jobs were created until 30 September 2014.

In order to promote the development of manufacturing companies and to provide support for construction or reconstruction of industrial premises, on 21 May 2013, the Cabinet of Ministers approved the Regulations Regarding Sub-activity 2.3.2.2.2 **“Support for Investments in Construction or Reconstruction of Industrial premises”** of the supplement to the Operational Programme “Entrepreneurship and Innovations”. The activity is aimed at establishing or expanding new enterprises, by developing industrial facilities in the regions. Construction, renovation or reconstruction of one or several buildings is supported within the project for the purpose of creating industrial buildings. The maximum support financing for one project is LVL 1 million. The maximum acceptable support intensity is 50%. According to the conditions of the activity, the project applicant has to lease the commissioned building to at least three mutually unrelated micro, small- or medium-sized manufacturing enterprises operating in the field of manufacturing, as well as to ensure that the said enterprises create at least 50 new full-time jobs within 3 years. Six of the 9 applied projects were supported at the first stage. In this activity, projects are expected to be implemented in Daugavpils, Jelgava, Jūrmala, Liepāja, and Ventspils or near these cities. Two of the 4 applied projects were supported in the second stage. Both projects will be implemented in Jelgava.

**In order to promote investment attraction**, on 6 November 2013, the Saeima adopted the amendments to the *Law on Enterprise Income Tax* envisaging extension of the governmental support programme *Tax rebate for the initial long-term investments made within the framework of supported investment projects* until 31 December 2020, at the same time, increasing the minimum required sum of investments to 10 million euro. For entrepreneurs, to be able to submit investment project applications for support in 2015, currently, national legal enactments are being updated to meet the new EU governmental support regulations, which will become valid on 1 July

2014. By 31 December 2013, the CoM has supported 25 eligible large-scale investment projects for the total investment amount of EUR 318.7 million. The majority or 23 of 25 supported investment projects have been implemented in the manufacturing industry, while 2 investments projects, in the field of information communication technologies.

Additional information about the attracted foreign direct investments is available in Section 4.3.3.

#### **Export support instruments**

Latvian exporters are offered a wide range of direct export support services, covering consultations on export-related issues, including foreign markets, specific trade requirements and search for business partners. Furthermore, export skills and informative seminars about external markets are organized and identification and fostering of export and investment projects is carried out.

To promote growth of foreign competitiveness of Latvian companies, in the nine months of 2014, the IDAL has organized 32 trade missions and 9 delegations of entrepreneurs within the framework of visits of superior officials and inter-governmental commissions abroad. In this period, national stands for in 12 international industry exhibitions abroad have been arranged and support to 51 Latvian entrepreneurs in 27 international exhibitions abroad have been provided. Furthermore, 45 individual visits of Latvian entrepreneurs have been arranged and 433 initial consultations on foreign markets and search for business partners have been provided.

In three quarters of 2014, activity of Foreign Economic Representative Offices of Latvia was ensured in Belarus, China, Denmark, France, Germany, Great Britain, Japan, Lithuania, the Netherlands, Norway, Poland, Russia, Sweden, and Ukraine. The representations offer support to Latvian companies in developing and keeping business contacts, implementing external marketing measures, and provide information about requirements of the particular foreign markets.

Services of the Foreign Economic Representative Offices of Latvia and the IDAL are provided to the entrepreneurs according to the one-stop agency principle, thus the representations arrange individual business visits of entrepreneurs, provide support for participation of enterprises in international exhibitions abroad, process export requests and projects, and ensure processing of consultation requests and information requests in the field of foreign investment attraction.

Activity 2.3.1.1 **Access to International Trade Markets – external marketing** is implemented within the framework of the measure *Entrepreneurship Support Activities of the Operational Programme of the EU Structural Funds for 2007-2013 Entrepreneurship and Innovations*. Within the framework thereof, merchants are offered extensive support in implementation of international marketing measures – participation in exhibitions, business matchmaking, trade missions, organizing seminars and



conferences. In the three quarters of 2014, 530 project applications have been assessed.

In 2014, the Council for Coordination of Foreign Economic Policy continued the work on ensuring coordinated cooperation between public institutions and entrepreneurs in developing and implementing successful foreign policy to improve competitiveness of the Latvian economy and to strengthen exportability. Entrepreneurs have access to the public officials' schedule of foreign visits for 2014 involving Latvian entrepreneurs. The schedule makes it possible for entrepreneurs to duly plan the participation in business delegations, while organizers of the visits have a possibility to timely identify interests of entrepreneurs. On 3 July 2014, a meeting of the Foreign Economic Policy Coordination Council was held at the Ministry of Foreign Affairs, where experts of the council were presented plans and development of the Latvian higher education export promotion.

In response to the embargo introduced by the Russian Federation on 6 August 2014 for the import of food products from the EU, the USA, Australia, Canada, and Norway, tax and credit support to enterprises suffering from sanctions of Russia has been provided, as well as additional funding to update new markets has been allocated. The CoM decision provides for governmental support to those enterprises, whose proportion of export transactions to Russia, subject to sanctions exceeds 10% of the total sales volume, or the activity of which is related to export and production of goods subject to such sanctions in the amount of the total sales volume.

When making amendments to Cabinet Regulation No. 887 *Regulations Regarding Sub-activity 2.3.1.1.2 "Uptaking of Foreign Markets – fostering of international competitiveness of industries" of activity 2.3.1.1 "Uptaking of Foreign Markets" of the supplement to the Operational Programme "Entrepreneurship and Innovations"* adopted on 21 September 2010, an additional funding of 4 million euro was allocated to ERDF project *National industry stands at international exhibitions and export consultations abroad* from 31 October 2014, to arrange a set of export support measures for the Latvian enterprises with the purpose of uptaking new export markets.

To uptake this funding purposefully, by implementing measures, which best conform to the interests of enterprises, discussions, information and opinion exchange with social partners, including industry associations, have been arranged since August. Several meetings have been arranged at the Ministry of Economics and the IDAL, discussing measures and markets required the most to minimize consequences of the embargo of Russia. The support is provided mainly to

industries that have endured most losses due to the embargo of Russia. Thus, the IDAL concludes cooperation agreements with the biggest industry associations of Latvia to carry out market researches, to establish temporary representations of sales agents abroad, and for other services to ensure the expansion of export market.

Furthermore, amendments to the Cabinet Regulation No. 582 *Regulations on the Sixth and Further Phases of Sub-activity 2.3.1.1.1 "Uptaking of Foreign Markets – external marketing" of supplement to the Operational Programme "Entrepreneurship and Innovations"* adopted on 17 June 2009, supplementing them with new operations – individual visits at cooperation partners in target markets abroad, arranged by the IDAL, or society or foundation, assessment of conformity of production plants and goods (certification), if such assessment of conformity is a mandatory precondition to sale of products in foreign markets. Support shall be provided also to arrange large-scale international conferences in Latvia. At the same time, the intensity of EU co-funding was increased up to 70 percent.

In 2014, the Latvian enterprises processing dairy products were the first in the Baltic States that were granted the opportunity to export their products to the China market. In July, the General Administration of Quality Supervision, Inspection and Quarantine of the People's Republic of China accepted the milk certificate submitted by Latvia. Further commencement of trade requires only exchange of certificates and no additional agreements shall be signed; only acceptance by China is required, which is issued upon performing inspection of the enterprise.

In order to promote the increase of the total export volume of enterprises (especially to countries with a high risk degree) and to expand the export markets (the CIS region, rapidly growing economies, etc.), as well as to secure positions in the existing export markets, short-term export credit guarantees are available and described in more detail in Section 6.8. To supplement the range of insurance instruments available on financial markets and to promote the development of export-oriented enterprises, in 2015, the Ministry of Economics is planning to develop the programme of medium- and long-term export loan guarantees. The programme and the model of implementation thereof will be developed according to market research results, as well as taking into account the experience of other countries in the introduction of insurance instruments and the results achieved – impact on the flow of export transactions and, accordingly, on the development of export-oriented enterprises.

## 6.13 Consumer Rights Protection and Market Surveillance

The consumer rights protection system in Latvia is constantly improved and developed to ensure an effective market supervision and protection of consumer rights.

The Ministry of Economics works to improve and develop the existing regulation and to ensure a high level of protection of consumer rights.

### Box 6.30

#### Improvement of the Legal Framework

On 4 February 2014, Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 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 was adopted. The Directive envisages setting requirements for advertising mortgage crediting services, information to be provided prior to signing a contract, verifying consumer's creditworthiness, calculation of the annual interest rate, early clearing of the credit, access to databases for assessing the creditworthiness, as well as a surveillance mechanism of credit intermediaries and creditors, and competence requirements for the said service providers. On 11 July 2014, the Ministry of Economics has formed a working group to draft the *Consumer Crediting Draft Law*; the working group includes representatives of both non-governmental consumer interest organizations and involved public institutions. The Draft Law will be forwarded to the Saeima by 1 July 2015.

To promote the protection of consumer rights, providing consumers with an opportunity to exercise and protect their legal rights using independent, quick, effective and fair out-of-court dispute resolution methods, the Ministry of Economics has developed draft laws – *Consumer Out-of-court Dispute Resolution Law and Amendments to Consumer Rights Protection Law* (submitted for inter-institutional approval on 14 November 2013). The draft laws will implement **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**, as well as will ensure conformity to the principles of consumer dispute resolution and indemnification set out in the OECD recommendation C(2007)74 (12 July 2007). The abovementioned draft laws are aimed at ensuring effective, quick and available procedure of out-of-court dispute resolution, when consumers may resolve contractual disputes on acquisition of goods and services with the seller or service provider without applying to the court. The draft laws are expected to come into force from 9 July 2015, and the new procedure of out-of-court dispute resolution will be applicable from 1 January 2016.

*Amendments to the Consumer Rights Protection Law* have been adopted by the Saeima on 24 April 2014. On 13 June 2014, regulatory enactments clearly laying down the rights and obligations of the parties when consumer exercises the right of refusal, i.e. withdraws from the contract within 14 days (refers also to online auctions, for instance, eBay; however, goods acquired at an auction may be returned only, if bought from an official dealer) enter into force. The regulation is unified across the entire EU, thus, in future, dealers will have to repay to the consumer the price of the article within 14 days from the date of receipt of such refusal, covering the shipping costs as well. The new regulation sets the prohibition for further use of pre-marked boxes on the Internet sites; prohibition to set higher charge for calls to contact the dealer, as well as dealers will have no opportunity to charge consumers with higher charge than actual costs, if the consumer pays using a credit card. Furthermore, the new regulation ensures higher price transparency, avoiding fraudulent attempts to request a charge for a free-of-charge service, introduction of a specific unified refusal form in the EU, as well as prescribes better protection of consumer rights in the field of digital goods, namely, consumers in future will have an opportunity to withdraw from the procurement of digital content, for instance, music or video recordings. *Regulations Regarding Distance Contracts and Regulations Regarding Contracts Negotiated Away from Business Premises* also have entered into force on 13 June 2014.

To avoid situations when the merchant issues credits without sufficient assessment of the consumer's solvency, *Amendments to the Consumer Rights Protection Law* have been

adopted on 1 July 2014. Amendments prescribe clear requirements, what information the creditor must request from the consumer when assessing their ability to repay the credit. Furthermore, it is established that the consumer's solvency must be assessed when granting credits of any amount, i.e. the ability of the person to repay the credit must be assessed even for a credit of one euro. The law prescribes that, if the consumer's ability to repay the credit has not been assessed, the consumer shall be entitled to pay only legal interest, i.e. 6% per year, for the use of the capital. Furthermore, the law contains the requirement on the first mandatory instalment of crediting agreements, stating that, if the crediting agreement funds acquisition of a new article for the amount exceeding EUR 1400, the credit shall be issued in the amount not exceeding 90% of the respective price of the article.

**The Consumer Rights Protection Centre (CRPC)** is the main institution ensuring coordination in the field of supervision of laws and regulations regarding the protection of consumer rights, and it works to guarantee the protection of consumer rights and interests. In order to ensure implementation of functions of the institution, the CRPC implements activities for the supervision of consumer rights observation (both in the field of protection of consumers' economic interests and supervision of compliance with consumer rights in draft contracts and contracts concluded by consumers and producers, sellers, or service providers), considers consumers' complaints, provides information and consultations to consumers and entrepreneurs, implements supervision measures of unfair commercial

practice, e-commerce, and advertisements, supervision measures of safety and conformity of goods and services, carries out national metrological supervision, supervision

of dangerous equipment and investigation of dangerous equipment accidents.

#### Box 6.31

##### **Measures in the field of consumer rights protection during the presidency of Latvia in the Council of the European Union**

On 9 July 2013, the EC approved the proposal of the European Parliament and of the Council for the directive on package travel services and supported travel services. The purpose of the draft directive is not only to establish equal conditions for operators, eliminate legal obstacles for cross-border trade and reduce costs for ensuring compliance to enterprises, but also to achieve a high level of consumer rights protection and to minimize damage to consumers, specifying travel service combinations protected in accordance with the EU package travel conditions, replacing unclear and out-of-date provisions. Currently, the working group of the EU Council of Ministers is actively working on the draft directive. The work with the directive will be continued also during the presidency of Latvia in the Council of the European Union in the first half of 2015.

Furthermore, it is expected that during the presidency of Latvia in the Council of the European Union, work will be continued with laws and regulations on safety of products and market supervision, which includes the proposal for a regulation of the European Parliament and of the Council in relation to product market supervision and the proposal for a regulation of the European Parliament and of the Council on consumer products, initiated by EC on 13 February 2013. The projects envisage considerable improvements to safety of consumer goods available in the common market and an increasing level of market monitoring in relation to all non-food consumer goods. The draft regulation on safety of consumer goods provides that consumer goods must be safe, specific obligations have been established for entrepreneurs, and conditions on the development of standards supporting safety requirements have been described. The new market supervision draft regulation aims to harmonize the application of market supervision conditions in different EU Member States, providing better protection for consumers and other users, as well as reducing administrative burden to entrepreneurs, and to govern information exchange between market supervision institutions.

On 23-24 April 2015, within the framework of the presidency of Latvia in the EU, a conference on the consumer rights protection will be organized. The international conference dedicated to novelties in the field of consumer rights protection will be held in a form of opinion and best practice exchange platform, gathering high level policy makers and representatives of consumer supervision institutions from the EU, EFTA member states, the European Commission, OECD, as well as representatives from European consumer and business organizations. Development of consumer policy will be discussed during the Conference, holding discussions on priorities of the following period, listening to the best practice both of EU Member States and of the OECD, as well as opinions of the EC and the European business and consumer organizations. Furthermore, discussions on the following steps in the Consumer Rights Agenda and practical aspects of consumer rights protection are planned within the framework of the Conference.

**Within the protection of consumers' rights** the CRPC in 2014 has identified such priority areas as supervision of commercial practice related to indication of online plane ticket prices, food supplements, supervision of commercial practice related to consumer crediting, supervision of commercial practice and agreement provisions related to offering electricity supply services to consumers, in the field of vehicle rental services, driving school services, collective online shopping, assessment of commercial practice in the field of price comparison websites, supervision of commercial practice in the area of waste management and supervision of security guarantees and contract provisions offered by complex tourism service providers to consumers, as well as supervision in the field of specification of prices for the commercial practice goods and services related to a transition to euro and supervision of commercial practice applied outside the regular point of sales or place of service provision.

During the nine months of 2014, 205 cases regarding violations of collective interests of consumers, incl. in the field of commercial practice, advertising, e-commerce and agreement provisions have been initiated. The cases have been mainly initiated in relation to the implemented commercial practice and agreement provisions in the area of crediting services, offering food supplements, in the field of e-commerce, introduction of euro, collective shopping and power supply. Licensing and re-registration of licences to creditors who fail to conform to the credit institution and recovery service provider status is

continued, as well as regular supervision of entrepreneurs is continued.

The European Consumer Centre (ECC Latvia) continues providing support and information to consumers in case of unsuccessful **EU cross-border purchases**. The ECC Latvia is a member of the *European Consumer Centres Network* (ECC-NET) operating within the framework of the Consumer Rights Protection Centre with the support of the European Commission. In the nine months of 2014, the ECC Latvia has provided 680 consultations to consumers concerning cross-border issues in the EU and reviewed 181 complaints on cross-border issues in the EU. Consumers have mainly applied to the ECC Latvia concerning cross-border online issues, which is due to the fact that consumers more actively use advantages provided by the Internet environment.

In 2014, the CRPC in the field of **market surveillance** has identified the following priority directions: safety and conformity improvement of products in such areas as construction materials, electric goods, machinery, radio and telecommunication end-units, toys. Projects for testing dangerous units in the field of cargo cranes and playground units are planned.

Along with market surveillance, the price surveillance project launched in 2013 is continued in relation to the fact that Latvia has joined the eurozone on 1 January 2014, and the *dual display period of prices* from 1 October 2013 to 30 June 2014 has been implemented (see Box 6.32). During the period of time from 1 October

2013 until 30 June 2014, the CRPC has carried out (incl. the Consumer Interest Protection Association, based on a cooperation agreement) 27 056 inspections in the field of specification of prices, identifying violations in 31% of

cases. The positive trend is that 86% of the merchants subjected to a inspection eliminated the violations at the moment of the inspection or within 5 business days from the date of the inspection.

#### Box 6.32

##### Conclusion of euro introduction measures

In 2014, transition to the new currency – from lats to euro, has been carried out, thus, measures related to introduction of euro will be concluded at the end of 2014.

Monitoring the prices for goods and services, in the framework of which prices for most popular goods and services are observed in more than 400 points of sale or service provision locations in the largest cities and towns of Latvia, has been continued until the end of 2014. From 1 October 2013 until 30 March 2014, information on the monitoring results was published four times in a month, and from 1 April to 31 December 2014, once per month. Monitoring of consumer prices was one of the measures included in the *Latvia's National Euro Changeover Plan*, which was mainly aimed at observing price fluctuations prior to and during the introduction of the euro to identify unreasonable and speculative growth of prices at points of sale and service provision sites. The results of the monitoring show that the prices for majority of goods and services remain unchanged. Within the frame of price monitoring, price converting non-conformities have been established, and in the group of services, few cases have been identified where the price fluctuation may be explained with rounding off the price in euros. However, in some cases, service prices have been rounded down. Monitoring results show that the price level for goods and services is stable and the current fluctuations depend on processes that are unrelated to the introduction of the euro.

On 30 June 2014, initiative *Fair Euro Introducer*, implemented since 12 July 2013, was concluded. The aim of the initiative was to protect consumer interests, by asking entrepreneurs to provide accurate and correct recalculation of prices, as well as displaying prices before and after introduction of the euro. Over 1224 merchants have joined the initiative and the recognition sign of the initiative has been placed in more than 12 thousand points of sale or service provision places, thus, agreeing to implement fair business practice during the period of introduction of euro and help people to get accustomed to the new currency.

Furthermore, the dual *display period of prices*, which was implemented from 1 October 2013 until 30 June 2014, *has been concluded*. During the dual *display period of prices*, the CRPC has carried out control of prices to supervise fulfilment of requirements at points of sale and service provision sites. The mandatory requirements to display prices in both currencies have been imposed to protect consumer rights and to help consumers make a well-informed and economically justified decision. Since October 1, 2013, a total of 27 056 inspections have been carried out. Non-conformities have been identified in 31% of cases. At the moment of inspection, violations have been eliminated, or proof has been submitted that the identified violations are eliminated within 5 working days by 86% merchants (objects). The CRPC has made 183 administrative violation decisions. The information is published on the website: [www.ptac.gov.lv](http://www.ptac.gov.lv).

Considering the tragic events in 2013 when the roof of a supermarket collapsed, and the results of inspections in the field of construction products where significant non-conformities were identified both in all construction sites subjected to inspection and in construction material tests, in 2014, supervision and public information activities were launched to improve the level of information and proficiency of merchants and persons involved in the construction process. In nine months of 2014, 53 inspections in construction objects have been

carried out and 420 construction products in the regulated sphere have been tested. Overall, non-conformities have been identified in 186 models of construction products, incl. 140 models of construction products, i.e. 33%, had no manufacturer's declaration of conformity. This fact suggests that constructors fail to verify operational qualities of construction products and conformity thereof to the design. Considering the negative trend, the CRPC has initiated an educational campaign for consumers and merchants.

#### Box 6.33

##### Activities of the CRPC in nine months of 2014

Within the framework of its activities, in the nine months of 2014, the CRPC has provided 27,536 consultations to consumers and legal entities. The number of rendered consultations has slightly increased compared to the respective period of the previous year – the CRPC has provided by 1339 consultations more, or the number of rendered consultations has increased by 5%. When requesting a consultation, consumers most often have been interested in issues related to their rights if they have purchased a product or received a service of poor quality. Most questions are related to footwear, mobile phones, electric appliances, distance contract services, rent and public utilities and aviation services. In some cases, consumers have been interested in what to do if the time-limit for delivery of goods or services has not been observed. Consumers have been interested also in issues beyond the competence of the CRPC or issues on which the CRPC have no right to make a binding decision, just provide consultations, for instance, quality of electronic communications, payments of insurance compensation, as well as public utilities and food.

In this period, the CRPC has received 1734 consumer complaints. Most often consumers have filed complaints concerning goods and services incompliant with contract provisions. A large number of complaints have been about commercial practice, advertising and e-commerce, as well as failure to observe the principle of legal equality of contracting parties. Out of all received complaints, the majority concerned mobile phones, followed by electronic goods and footwear quality. In the field of services, the majority of complaints concerned aviation, rent/public utilities services, as well as distance agreement services. A slight increase in the number of claims by 5% has been observed, compared to the period of nine month of the previous year. Issues in relation to goods acquired through distance methods become increasingly topical due to the Internet environment development trends and activity of consumers, choosing for their purchases options provided by the Internet environment.



In the nine months of 2014, the CRPC has carried out field inspections in the field of **state metrological supervision** to assess the conformity of measuring devices to regulatory requirements at 64 production, trade and service provision enterprises. 420 measuring devices were subjected to the state metrological inspection. Considering that the offer of spices, salt, tea

and coffee in Latvia has changed considerably and the number of local producers has increased, pre-packed goods in the field of spices, salt, tea and coffee have been inspected during the accounting period, selecting goods with the compliance sign “e” as a priority. Inspections at 23 enterprises have been performed within the framework of the project.

## 6.14 Quality Assurance

### 6.14.1 Quality Structural Policy

The main task of public authorities in the field of product and service conformity assurance is to promote adequate application of and compliance with laws and regulations in the regulated and non-regulated sphere, as well as to improve the legal framework in accordance with the EU requirements, taking into account the needs of the national market and economy, hence ensuring compliance of products and services, and fostering better competitiveness of entrepreneurs and reduction of obstacles to international trade.

The quality assurance infrastructure system in Latvia is regulated by the *Law on Conformity Assessment, the Standardization Law*, and the *Law on Uniformity of Measurements*, as well as other related normative enactments.

The main directions of the policy are as follows:

- maintenance and improvement of the conformity assessment infrastructure (including testing and calibration laboratories, inspection and certification institutions, environmental verifiers) in line with the needs of the Latvian national economy, in order to protect consumers and the environment from low-quality products and services and to promote an increase of merchants' competitiveness and trustworthiness of Latvian production, as well as of services provided by Latvian merchants;
- improvement of the respective informational and consultative base;
- ensuring participation of national institutions of accreditation, standardization, and metrology in international organizations, by maintaining their international recognition and compliance of the Latvian quality assurance system with international requirements;
- maintenance and international comparison of the national base of metrology standards in order to ensure the necessary traceability of measurements and to protect the society from inaccurately performed measurements;
- promoting the introduction of quality management, environmental quality and other voluntary management systems in enterprises in order to ensure manufacturing of high-quality

products, service provision, and competitiveness of Latvian merchants in international markets;

- promoting efficient market surveillance, in order to provide equal conditions to all market participants, and protecting consumers from potential unfair competition of merchants.

### 6.14.2 Accreditation, Standardization, Metrology

The respective bureaus of the Limited Liability Company “Centre of Standardization, Accreditation and Metrology”: the Standardization Bureau (LVS), the Latvian National Accreditation Bureau (LNAB) and the Metrology Bureau (LATMB), have been carrying out the functions and tasks in the field of national standardization, accreditation, and metrology.

#### Standardization

LVS in capacity of the national standardization organization, in compliance with the *Standardization Law*, manages and coordinates the activities of Latvian merchants and organizations in the field of standardization.

The main functions of LVS are to set up a fund of Latvian standards and to issue Latvian standards in cooperation with international and European organizations of standardization.

Since 2004, LVS is a full-fledged member of the European Committee for Standardization (CEN) and of the European Committee for Electrotechnical Standardization (CENELEC), and from 1 January 2015, it is also a full-fledged member of the International Organization for Standardization (ISO). Furthermore, LVS is an associate member of the International Electrotechnical Commission (IEC).

In accordance with the approved plans, the priority directions of the LVS activity is distribution of standardization information, updating and maintaining the totality of Latvian standards, improvement of the electronic sales system of standards and cooperation with international, European, and national standardization organizations.

As of November 2014, over 39,900 standardization documents have been registered in the LVS, including 33,100 European standards adapted to the status of a Latvian standard. In 2014, 989 European standards have



been adapted, 42 mandatory applicable standards, including 18 Eurocodes have been translated into Latvian. Standardization information services have been provided to 3278 legal and physical persons.

The automatic electronic information notification system introduced by LVS has provided a free of charge service *Monthly Report on the Standards Registered in Latvian Standard Status and Cancelled Latvian Standards* to 546 regular customers in fields of their interest.

Within the framework of the contract signed with the official journal *Latvian Herald (Latvijas Vēstnesis)* on exchange of information, the section "Standards Regarding Legislation" of the LVS website has been updated in 2014 by adding 16 CoM regulations, as well as 35 lists of applicable standards containing 862 references to mandatory and applicable standards.

From 14 August of this year, an e-commenting website [www.viedoklis.lvs.lv](http://www.viedoklis.lvs.lv) has been launched under the supervision of LVS, where enterprises and industry experts are given an opportunity to express their opinion on the Latvian and European standard projects. This public commenting website has been created within the framework of the European Business and Innovation Programme.

From 8 August of this year, the new website of LVS is available to users, offering a range of advantages, incl. searching for a word or a phrase within the text of the entire standard, following a specific standard or ICS group, choosing the frequency of receipt of information, reading standards for 24 hours, following the history of the standard from own profile, assign standard user rights to another employee of the company (multi-user licence).

Work on organisation of the European Standardization Summit planned for 3–5 June 2015 in Riga during the Latvian Presidency of the Council of the European Union is continued. It is expected that more than 250 participants, incl. national standardization authorities from 50 states will participate in this event. It is expected that the European Standardization Summit will be visited not only by the leaders of the European Standards Organizations (currently, 33 full-fledged and 16 affiliate members), but also by superior level officials from the EU and international standards organizations – ISO and IEC.

To facilitate student access to technical documentation required during their study process, the Latvian Standard Reading Site has been created at the Riga Technical University (RTU). The online standard reading space is created for employees of the Customer Rights Protection Centre (CRPC) and students of the Fire Safety and Civil Protection College.

Further information on standardization is available on LVS's website [www.lvs.lv](http://www.lvs.lv).

### **Accreditation**

Pursuant to the *Regulation (EC) No 765/2008 of the European Parliament and of the Council*, LNAB acts in the capacity of the national accreditation institution.

LNAB has approved the conformity of the accreditation system to the *Multilateral Recognition Agreement (MLA) of the European Cooperation for Accreditation (EA)* in seven spheres of accreditation:

- 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 institutions (ISO 45011/ISO/IEC 17065);
- Accreditation of individual certification institutions (ISO 17024);
- Accreditation of inspection institutions (ISO/IEC 17020);
- Accreditation of management system certification institutions (ISO/IEC 17021);
- Accreditation of verification bodies for greenhouse gas (GHG) reports and ton-kilometre reports (ISO 14065).

Accreditation as an instrument of assuring competence and trustworthiness has been defined in more than 120 national normative acts. Furthermore, LNAB ensures accreditation of verifiers of the Environment Management and Audit System (EMAS) in accordance with *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).

On 4 April 2014, decision to maintain the competence in the field of EMAS to the Latvian National Accreditation Bureau until 2017 has been taken at the meeting of the EC Forum of the Accreditation and Licensing Bodies (FALB).

In order to continuously conform to these requirements and harmonize accreditation procedures among the EA members, employees of LNAB participate in all EA technical committees and work groups, meetings of the Multilateral Recognition Agreement Committee and General Assemblies, as well as in comparative assessments of other EA national accreditation institutions.

Employees of LNAB participate also in the meetings of the *Forum of Accreditation and Licensing Bodies (FALB)* and in comparative assessments of other FALB in the field of *Environmental Protection and Audit Systems*, in the meetings of the Organisation for Economic Co-operation and Development (OECD) and meetings and trainings of the European Commission in the field of the Good Laboratory Practice.

LNAB has also fostered participation of national laboratories in international inter-laboratory comparative testing programmes and has organized skills testing.

Furthermore, training seminars are organised for conformity evaluation institutions and LNAB involved experts.

The increase in the number of accredited institutions observed over the recent years proves the importance and stability of the accreditation process in the sphere of conformity assessment. An increasing number of new institutions want to prove their competence by gaining accreditation. At the moment, the status of accreditation is maintained for 256 accredited institutions.

At the same time, accreditation has been awarded to three laboratories in the Russian Federation and maintained for one laboratory in Kazakhstan and three laboratories in Azerbaijan. In the framework of international cooperation, LNAB also collaborates with national accreditation institutions of Georgia, Russian Federation, Belarus, Moldova, and Ukraine.

In compliance with the *Principles of Good Laboratory Practice*, conformity of one laboratory in Latvia was recognized.

In 2014, LNAB initiated accreditation in the following 8 fields:

- Certification of forest inventory performers;
- Certification of non-destructive test experts;
- Electrotechnical personnel (assigning of electric safety groups A, Bz, B, Cz, and C);
- Assessment of competence of construction experts and supervision of permanent practice thereof;
- Radiology testing of food products;
- Parasitological testing of fish processing products;
- Hydrostatic testing of transportable gas cylinders;
- In forensic science – research of information technologies; investigation of shot traces.

Further information on accreditation and the accredited institutions is available on the LNAB website [www.latak.lv](http://www.latak.lv).

### **Metrology**

The Metrology Bureau (LATMB), as of 1 July 2009, is the Latvian National Metrology Institution, and it aims to ensure and develop reliability and traceability of measurements in the state. The Metrology Bureau carries out tasks prescribed in the *Law On Uniformity of Measurements* in the field of metrology.

Within the framework of the maintenance of national measuring unit standards, calibration of the National measuring unit standards in the EU National Metrology Institutes (NMI) is carried out.

In September 2014, calibration of the national weight unit standards in Denmark's NMI Fundamental Metrology Institute was carried out.

The list of approved types is updated on a regular basis on the Internet on the Metrology Bureau's website.

In the 2<sup>nd</sup> half of 2014, the current annual report of the Quality Management System of the Metrology Bureau has been developed and submitted for assessment to the Technical Committee of the European Association of National Metrology Institutes (EURAMET) Quality (TC-Q). The necessary measures for maintenance of the acknowledgement of international calibration and measuring ability using the international BIPM database KCDB have been taken.

Calibration of 12 reference standards as well as 2 weight comparators of the Limited Liability Company *Latvian National Metrology Centre* have been carried out.

In 2014, the Metrology Bureau continues their cooperation with EURAMET, as well as with the International Organization of Legal Metrology (OIML) and the European Cooperation in Legal Metrology (WELMEC).

Further information on LATMB is available on the website: [www.latmb.lv](http://www.latmb.lv).

## **6.15 Privatization**

The goal of privatization is, by changing the owner of a property owned by the state or local government, to create a favourable environment for private capital operation in the interests of economic development of Latvia and to diminish commercial activity performed by the state and local governments as merchants.

As the goal of mass privatization in Latvia has been basically achieved, the *Law on the Completion of Privatization of State and Local Government Property and Use of Privatization Certificates (Law on the Completion of Privatization)* came into force on 1 September 2005, prescribing the procedure of completing the privatization process and land reform and ensuring the completion of the use of privatization certificates (see Box 6.34).

### **Privatization of state property and land**

Privatization of state property and land is carried out and privatization proposals are summed up by the state joint stock company "Privatization Agency" under the *Law on Privatization of State and Local Government Property*.

A decision to bring a state property object, including capital shares and vacant land to privatization is made by the Cabinet of Ministers, while a decision to bring a building land, on which there are buildings owned by another person, to privatization is taken by the Privatization Agency. The decision is made on the basis of a privatization proposal submitted by any natural or legal person.

**Box 6.34*****Law on the Completion of Privatization of State and Local Government Property and Use of Privatization Certificates***

The *Law on the Completion of Privatization* stipulates:

- the deadline of 31 August 2006, by which every legal or natural person may propose to bring any state or local government property to privatization;
- the procedure, by which a privatization proposal submitted by a person is reviewed and a decision on bringing a state or local government property to privatization is adopted;
- that privatization may be refused and the state or local government property remains in its possession, if the property is necessary for performing public administration functions or commercial activity of the state or local government;
- that decisions on bringing the state or local government property involved in a dispute regarding property rights to privatization or conforming to unowned status is adopted upon coming into force of a court decision;
- that the state joint stock companies “Latvenergo”, “Latvijas pasts”, “International airport “Rīga””, “Latvijas dzelzceļš”, “Latvijas gaisa satiksme” and “Latvijas valsts meži” are not subject to privatization or alienation;
- the deadlines by which the persons willing to buy out land allocated for permanent use have to submit an application on buying land property (30 November 2007), as well as by which a land boundary plan or confirmation of the land redemption payment made with privatization certificates before concluding the land redemption contract has to be submitted to the State Land Service (1 September 2008), as well as for the application for a decision on the allocation of the property for payment has to be submitted (31 August 2011) and that the land purchase agreement has to be concluded by 30 December 2011;
- that privatization certificates do not have an expiry term, but may only be used within the framework of the privatization process;
- the procedure for completion of the issuance of privatization certificates. The final deadline by which applications for granting of privatization certificates could be submitted was 28 December 2007.

In order to ensure a successful and open progress of the privatization completion processes, the Cabinet of Ministers has set the procedure on how the institutions implementing privatization and land reform have to set up publicly available registers of privatization proposals and land property buy-outs.

From 1 September 2005, when the *Law on the Completion of Privatization* came into force, until 31 October 2014, 636 proposals for privatization of real estate, 57 proposals for privatization of state capital shares, and 4465 proposals for privatization or continuation of privatization of land have been registered in the Register of Privatization Proposals of the Privatization Agency. After 31 August 2006, those privatization proposals were registered in the Register of Privatization Proposals, which were submitted by mistake to other state and local government institutions up to that date and later were transferred to the Privatization Agency according to its competence.

Due to legal issues, the Cabinet of Ministers has not yet considered 4 proposals for privatization of state property objects.

The Privatization Agency has received proposals for privatization of 79 state property objects with issues regarding ownership rights. The Privatization Agency is authorized to address a court or a notary on behalf of the state in order to take all the necessary steps to recognize it as a property without an owner or an heir. The Privatization Agency has not addressed the court regarding 12 property objects because these objects are owned by a local government or a private individual or it is established that the structure in reality does not exist. The Privatization Agency has addressed the court regarding 67 property objects to establish a legal fact and recognise the abovementioned objects as a property without an owner or an heir that belongs to the state. Out of these, 54 legal proceedings have been closed and the court has ruled on approving the application of the Privatization Agency and establishing the legal fact that the property is a property without an owner and thus belongs to the state. In 12 cases, in which legal

proceedings are finished, property objects were to be handed over to the Privatization Agency for privatization or alienation according to the *Law on Privatization of State and Local Government Residential Houses* or *Law On Alienation of the Property of a Public Person*. In 13 cases, the application of the Privatization Agency has been left unadjudicated based on Section 258 of the *Civil Procedure Law* because a dispute regarding the rights has arisen in a matter to be adjudicated in accordance with a special adjudication procedures and such a dispute must be adjudicated in court in accordance with procedures regarding actions. After passing a court ruling on recognizing the property as a property without an owner or an heir, the CoM is drafting decrees on bringing the property object to privatization or a justified rejection to bring it for privatization. The CoM has already made decisions on bringing 19 property objects to privatization.

A natural or legal person eligible to acquire movable or immovable property in Latvia can be the subject of privatization of state-owned property (real estate, capital shares, land). Payments for the property objects have to be made in euro (EUR) and/or privatization certificates.

From 17 April 1994 until 31 October 2014, privatization conditions in the statutory procedure have been approved for 2542 state property objects (excluding land). 94 companies have been transformed into public joint stock companies, thus emitting 439.14 million shares into public circulation. During this period, income obtained from privatization of state-owned property objects (excluding land and sale of shares and alienation of capital shares and apartments emerged as a result of capitalization of debts) amounted to EUR 2.378 billion, of which EUR 574.20 million was in cash and EUR 1.802 billion in nominal values was for privatization certificates.

New owners took over obligations of privatized state companies (enterprises) for the value of more than EUR 267.43 million. The amount of the specified investments was EUR 208.24 million, while the amount of investments actually made reached EUR 380.68 million.

The Privatization Agency has been carrying out privatization of state-owned land since 1997. By 31 October 2014, 5261 state land lots were privatized (purchase agreements signed). The total sales price for the privatized state land constitutes EUR 289.88 million, of which EUR 143.78 million was in cash and EUR 146.10 million in property compensation certificates. On 31 October 2014, income from privatization of these land lots amounted to EUR 284.06 million, of which EUR 142.01 million was in cash and EUR 142.06 million – in property compensation certificates.

#### **Privatization process of residential buildings**

The procedure of privatization of state and local government residential buildings is governed by the *Law on Privatization of State and Local Government Houses*. In accordance with the *Law on Privatization of State and Local Government Residential Houses*, privatization of the governmental residential houses is carried out by the state joint stock company “Privatization Agency”, while privatization of local government residential buildings is carried out by the city or regional residential building privatization commissions.

On 31 October 2014, in the possession and under the management of the Latvian Privatization Agency there were:

- 257 residential buildings;
- 1391 state apartment properties, of which
- 745 state apartment properties were in buildings under the management of the Latvian Privatization Agency;
- 646 state apartment properties were in residential buildings handed over under the management of owners of apartment properties.

#### **Privatization process of state residential houses**

Privatization of 7 state residential houses has been commenced according to the decision of the board of the Privatization Agency within time period from 1 May 2014 until 31 October 2014.

Privatization announcements have been sent to 70 tenants of state apartments to be privatized and owners of apartments handed over for ownership until privatization of residential buildings, as well as 107 purchase contracts of state apartment properties have been signed according to the procedure specified in the *Law on Privatization of State and Local Government Residential Houses* within time period from 1 May 2014 until 31 October 2014.

#### **Management process of residential buildings and apartments**

A total of 13 residential buildings have been handed over to owners of apartment properties in possession within time period from 1 May 2014 until 31 October 2014.

From 1 May 2014 to 31 October 2014, 23 state apartment properties have been handed over for ownership by town and regional municipalities.

#### **Privatization certificates**

A privatization certificate is a state-allocated dematerialized security that can be used only once as the means of payment for a state or local government property to be privatized.

Privatization certificates are issued and used according to the *Law on Privatization Certificates*. By 31 October 2014, 112.38 million privatization certificates have been issued to 2.4 million people. Out of that, 103.58 million privatization certificates are granted for the time they have lived in Latvia and 794.7 thousand privatization certificates are granted to 41.4 thousand politically repressed persons. 8.01 million property compensation certificates out of all granted privatization certificates have been issued to 117.2 thousand former owners or their heirs, including 691.7 thousand certificates for property alienated for the state needs at the privatized specialized state agricultural enterprises, 4896.4 thousand for land in rural areas, 969.8 thousand for house ownership, 816 thousand for urban land, 461 thousand for companies and other property units, 89.8 thousand for property taken away from politically repressed persons and 85.6 thousand for property alienated illegally.

As from 1 December 2007, in accordance with the Section 27 of the *Law on Completion of Privatization*, 58.2 thousand persons have lost their rights to transfer 1.64 million privatization certificates to their accounts.

According to the *Law on Privatization of Land in Rural Areas*, 11 076 decisions on payment of cash compensations for former land ownership in rural areas have been made by 31 October 2014. Compensations for the total amount of EUR 25.04 million have been paid to 8411 persons, thus cancelling 0.63 million property compensation certificates.

As a part of cancelling 165.72 thousand privatization certificates for political repressions, compensations for the total amount of EUR 6.60 million have been paid to 26.23 thousand politically repressed persons by 31 October 2014. According to Section 28 of *Law on Completion of Privatization*, 3.5 thousand politically repressed persons have lost the right to cancel 16.15 thousand privatization certificates.



By 31 October 2014, 107.29 million privatization certificates or 95.5% of the total number of issued certificates have been used for privatization of state and local government property (see Table 6.7). From 1 April

2008 until 31 October 2014, instead of 587.28 thousand property compensation certificates 734.93 thousand privatization certificates have been used.

Table 6.7

Use of Privatization Certificates (by 31 October 2014)			
Type of property	Amount	Number of privatization certificates (mln)	including the number of property compensation certificates (thsd)
Residential buildings	446 thousand apartment privatization units	38.0	589.8
Enterprises and other properties	no exact data	7.3	109.6
Capital shares (stocks) including:	no exact data	44.5	954.0
in public offering	128.7 million shares	37.1	858.0
Land	317.1 thousand land lots	17.5	5166.6
<b>Total:</b>		<b>107.3</b>	<b>6820.0</b>
% of total certificates issued		95.5%	85.1%

In October 2014, holders of privatization certificates could use services of 8 licensed intermediary capital companies for transactions in the market of privatization certificates. The total amount of monthly transactions with privatization certificates (buying from natural persons and selling) performed by intermediary capital companies until 31 October 2014, ranged from 2 thousand privatization certificates in August to 29.6 thousand privatization certificates in June and from 0.04 thousand property compensation certificates in June to 0.6 thousand property compensation certificates in March.

On 31 October 2014, 2.3 million privatization certificates or 2% of the total number of granted privatization certificates, including 106 thousand property compensation certificates were held on the accounts of 379.4 thousands of natural persons. 361 thousand privatization certificates or 0.3% of the total number of granted privatization certificates, including 6 thousand property compensation certificates were held on the accounts of legal persons.

*Amendments to the Law on Privatization Certificates* became effective on 1 January 2014 prescribing that public administration shall deal with handling privatization certificate accounts. Furthermore, amendments to the law state that in cases mentioned in and according to the procedure prescribed by the regulatory enactments, CoM may entrust handling privatization certificate accounts to a private person. As from 1 January 2014, the state company “Latvijas Attīstības finanšu institūcija “Altum”” was entrusted to handle privatization certificate accounts, which includes opening and maintenance of certificate accounts, the transfer of certificates to the privatization certificate account and other services related to servicing of

certificate accounts and circulation of certificates. By 1 June 2014, the said services were ensured also by the insolvent Joint Stock Company “Latvijas Krājbanka”, still holding a considerable number of privatization certificate accounts. As from 1 June 2014, Latvijas Krājbanka carries out no servicing of any privatization certificate accounts, but it has to maintain privatization certificate accounts held by Latvijas Krājbanka until a centralized transfer thereof to the company “Altum”. Individuals willing to carry out any operations with privatization certificates on the privatization certificate accounts of Latvijas Krājbanka, must appear at any of the nine “Altum” branches and fill in the application for transfer of the privatization certificate accounts to “Altum”. Those individuals currently planning no operations with privatization certificates are not required to carry out operations mentioned above, since the privatization certificate accounts held by Latvijas Krājbanka will be transferred to “Altum” using a centralized procedure.

#### Land reform

The main goal of the land reform is to rearrange the legal, social, and economic relations of land use and ownership from command economy to market economy.

The state land reform process includes allocation of vacant land and land pertaining to the state for permanent use, restoration of ownership rights, and redemption (purchase) of the land allocated for permanent use, as well as restoration of ownership rights to land allocated for permanent use and land for completion of the land reform are carried out with regard to the rural and urban land reform being implemented in the country.

In cities, claiming land in accordance with the *Law On Completion of Land Reform* was completed on 1 March 1999, while allocation of the claimed land had to be completed



by 1 July 1999, but in Riga and Daugavpils cities – by 1 October 1999.

According to the *Law On Completion of Land Reform in Rural Areas*, claiming free, state-owned land completed on 1 June 2006, while allocation of the claimed land to permanent use – on 1 September 2007.

In cities and rural regions, allocation of land for the use and land for payment has been completed. According to the *Law on Completion of Privatization* land redemption (purchase) agreement for the allocated urban or rural land had to be concluded with “Latvijas Hipotēku un zemes banka” (Mortgage Bank) by 30 December 2011.

Overall, during the land reform until 30 December 2011, the Mortgage Bank concluded 174 231 agreements on 181 945 land units of more than 1.2 million hectares.

The Central Land Commission (CLC) with its last decision on recognition of ownership rights to land provided for completion of land reform, taken on 25 August 2014, has completed its final land reform completion task – the process of restoration of ownership rights to land provided for completion of land reform in rural areas, implementation of which has been stipulated in Section 16 Paragraph 1 of the *Law On Completion of Land Reform*.

Overall, during the land reform until 30 December 2011, the Mortgage Bank concluded 174 231 agreements on 181 945 land units of more than 1.2 million hectares.

When commencing the process of restoration of ownership rights to land provided for completion of land reform, 7393 land units with total area of 24 212 ha were available for selection. Overall, claimants have chosen 2547 (34%) land units with total area of 11 872 ha. The highest number of land units has been allocated for restoration of ownership rights in Latgale (30%), where the highest number of allocated land units is in the former Daugavpils district (217). 28% of land units allocated for restoration of ownership rights are located in Vidzeme, where the highest number of land units has been selected in the former Valmiera district (126). Both in Zemgale and in Kurzeme, the number of land units allocated for restoration of ownership rights constitutes 18% of all the selected land units, and the highest number of land units allocated in these regions is situated in the former Aizkraukle district (163) and Liepāja (137)

district, respectively. The lowest number (6%) of land plots allocated for restoration of ownership rights has been allocated in the Riga Region, where the highest number of land plots has been allocated in the former Tukums district (79).

In order to corroborate ownership rights in the Land Register, the claimers have to carry out a cadastral survey of the land unit and obtain a decision of a relevant institution on the restoration of the ownership rights. Based on the aforementioned, the CLC, the SRS and local governments of cities and towns continue decision-making regarding the restoration of ownership rights of former land owners or their heirs, as well as allocation of land in possession for payment in case the cadastral survey of land has revealed that the total area of the land unit of the concerned person exceeds the area of land to which ownership right has been restored.

Although, considering the above-mentioned deadlines for the execution of land reform tasks and that the land reform approaches its completion, it will be considered completed with a CoM decree on the completion of land reform in the territory of the respective local government according to Section 5 of the *Law On Completion of Land Reform in Rural Areas* and Section 7 of the *Law on Completion of Land Reform in Cities*. For CoM to develop and adopt the respective draft decree, according to Section 6 of the *Law on Completion of Land Reform in Cities*, the relevant local government must prepare and submit a notification regarding the completion of land reform and a report on execution of the relevant works specified in regulatory enactments regulating the land reform to the State Land Service by 30 November 2014. According to Section 4 Paragraph four of the *Law On Completion of Land Reform in Rural Areas*, land report shall be prepared by the State Land Service and approved by the respective local government by 30 November 2014.

By 20 November 2014, a report on execution of the relevant works specified in regulatory enactments regulating the land reform has been approved by the State Land Service and report on completion of land reform has been submitted to the State Land Service for 11 towns: Olaine, Līgatne, Ludza, Preiļi, Zilupe, Rēzekne, Varakļāni, Lielvārde, Skrunda, Pāvilosta and Gulbene. Concerning rural areas, a land report has been approved between the State Land Service and the Ādaži region by 20 November 2014.

## 6.16 Reform for Management of Commercial Activities of Public Persons and Capital Shares

Latvia fully or partially owns a large number of capital companies having a major impact on the national economy, i.e. 18.2% of the gross domestic product of Latvia. State-owned capital companies have considerable assets and some of these companies are the leading employers in the country. Thus, the state must constantly monitor the performance of state-owned capital

companies to promote responsible, efficient, and performance-oriented management of capital companies, as well as to increase the value of capital companies in the future. Some local government capital companies play an important role in providing certain services within a particular administrative territory.

Currently, the state holds 100% shares in 66 capital companies; it has the decisive influence over 6 capital companies and holds less than 50% shares in 62 companies. The state holds shares directly in a total of 134 companies.

There are 323 capital companies in Latvia, in which a local government is the sole shareholder (local government capital companies), in 39 capital companies local governments hold decisive influence, while local governments hold 50% or less shares in 243 companies.

Four local governments have no holdings in capital companies.

The Cabinet of Ministers considered and approved the *Concept for Commercial Activity of Public Persons* and the *Concept for Management of State Capital Shares* developed by the Ministry of Economics in line with the principle laid down in the Organisation for Economic Co-operation and Development (OECD) guidelines on management of state capital corporate Governance of State Owned Enterprises at the meeting of 15 May 2012 on state capital management principles.

#### Box 6.35

##### **Commercial Activity of Public Persons**

Involvement of public persons in commercial activity causes a risk of market distortion. Therefore, it is acceptable for a public person to perform commercial activity only in exceptional cases where there is a particular reason for performing commercial activity. The main economically justified reason for state participation in capital companies is prevention of market failures and thus raising social welfare. All the limitations of commercial activity under the *State Administration Structure Law* are set for a legitimate purpose, i.e. a public person shall be an equal partner to a private business without distorting competition only in case it is necessary for implementing security functions and the national policy in a public area of life. Yet, they often are interpreted much more broadly thus resulting in commercial activities of the state and local governments in sectors that formally comply with Section 88 of the *State Administration Structure Law*, though actually contradict the purpose of the given provision to limit state commercial activities.

##### **Management of state capital shares**

Latvia applies a decentralised model for state capital shares management which is implemented by the holder of capital shares – a line ministry or any other institution. Analysis of the practice of state capital shares management in Latvia resulted in identifying the following key issues:

- the holder of state capital shares plays several simultaneous roles (the role of a customer, owner and sectoral policymaker in one person);
- low return on equity;
- no clear definition of financial and non-financial objectives and no analysis and evaluation of the performance of capital companies with respect to the objectives;
- no single and transparent state capital shares management;
- insufficiently professional state capital shares management (including involvement of professionals);
- no single management system that would promote improvement of the business environment;
- the regulation of state capital shares management is fragmented and incomplete;
- political decision-making in day-to-day management.

The reform of management of capital shares owned by public persons is aimed at increasing return on capital and introducing the principles of good corporate governance in the management of capital companies, as well as revising conditions for commercial activity of public persons. Implementation of management reforms of capital shares will ensure a higher return on capital (higher dividends), the public will have access to information about management of state-owned capital shares and capital companies, achievement of defined financial and non-financial objectives.

For the purpose of implementing the solutions proposed in the concepts and approved by the Cabinet of Ministers, the Ministry of Economics has developed a package of draft laws, which has been approved at the Cabinet meeting on 28 May 2013 and submitted to the Saeima for consideration. On 16 October 2014, the Saeima approved the 3<sup>rd</sup> final reading of the law *On Management of Capital Companies and Capital Shares of Public Persons* based on the effective *Law on Capital Shares and Capital Companies of the State and Local Governments*, which will govern regulations on the management of public person capital companies (capital shares). The law enters into force on 1 January 2015, and provides for an

obligation of the Cabinet to develop eight subordinate Cabinet regulations. Moreover, the Saeima in the 1<sup>st</sup> reading has approved amendments to the *State Administration Structure Law* envisaging changes in conditions giving the right to public persons to establish a capital company or acquire interest in an existing capital company.

The reform of commercial activity of public persons envisages the following:

- changes in the conditions for commercial activity of public persons, i.e. stipulating that a public person may acquire interest in a capital company in order to eliminate a market failure or if the capital company deals with property management, bearing strategic importance for further development of state or local government administrative territory, or for state security. Moreover, a public person may acquire interest in an existing capital company if the market failure cannot be eliminated efficiently in another administrative way or by providing aid, and such involvement of a public person is a reasonable way to improve social welfare;

- overall strategic objectives should be defined for a public person to be pursued by involvement in a capital company; these objectives should arise out of legislation and policy planning documents. Social non-financial medium-term objectives should be derived from the overall strategic objectives defined for the public person and included in the medium-term strategy for activities of the capital company;
- imposing an obligation on a public person to reassess shareholding in capital companies and its conformity to the principles of commercial activity of public persons at least once in five years and specifying the overall strategic objectives as necessary. Reassessment of state shareholding in a capital company should be coordinated by the institution assigned by the Cabinet of Ministers;
- a capital company of a public person should be transformed into an institution (public agency) in case of establishing that the status of the capital company is not an appropriate model to achieve the objectives for a public person shareholding in the capital company.

**Box 6.36****Coordination Institution**

The Coordination Institution has the following competence:

- 1) to develop guidelines on efficient management of capital companies and capital shares;
- 2) to provide a conclusion to holders of state capital shares regarding the financial objectives laid down in the medium-term strategy for activities of the capital company and financial indicators of activities of the capital company (the share payable as dividends, profit indicators, return of capital, etc.), as well as coherence between them and the non-financial objectives laid down in the medium-term strategy;
- 3) to consult the Cabinet, the holders of the public person capital shares and capital companies regarding the aspect of implementing corporate governance;
- 4) to ensure that current information about state-owned capital companies (those under the decisive influence of the state) is published, as well as an annual public report on state owned assets is prepared;
- 5) to assess the financial objectives and performance achieved by capital companies;
- 6) to provide an opinion to the Cabinet on acquisition, maintenance or termination of the public person shareholding, as well as on the need to provide an opinion to derived public persons, incl. local governments, on acquiring or terminating shareholding in specific capital companies;
- 7) to develop draft laws and regulations and policy planning documents according to its competence and submit them to the Cabinet for approval;
- 8) to arrange training of representatives of the holders of capital shares and members of state administration institutions in the field of corporate governance.

The reform of the management of state capital shares envisages the following:

- the reform applies to the management of all capital companies (capital shares) owned by public persons;
- the Cabinet to appoint an institution, which will be responsible for coordination of administration of state owner capital companies (capital share) (the Coordination Institution) (see Box 6.32). The proposed model envisages that the state capital shares management is shared by: (a) a line ministry responsible for the growth of the sector and sector-specific issues (for example, developing legislation, policy planning documents, sectoral policy objectives, proposals for the draft government budget), as well as defining specific, non-financial objectives of capital companies; (b) the coordination institution responsible for monitoring financial performance and introduction and implementation of corporate governance principles;
- to impose an obligation on capital companies to develop a medium-term strategy for activities, and establish a procedure for coordination of the strategy. The coordination institution appointed by the Cabinet of Ministers is expected to get involved in an assessment of the medium-term strategy for activities of a capital company by providing a conclusion;
- to lay down the conditions for the assessment of performance of capital companies coordinated by the Coordination Institution appointed by the Cabinet of Ministers (the Guidelines on Good Corporate Governance, a common framework for achievement of financial objectives). The holder of capital shares must assess the above mentioned, make a decision on further action to increase the return on assets and the value;
- to lay down requirements for ensuring transparency of information – a possibility to access information about the objectives, performance, latest financial results, management structure of capital companies and other information;
- the Coordination Institution shall prepare the annual public report on state owned capital companies and capital shares for the previous year and submit it to the Cabinet and the Saeima for information by 30 August of the current year;
- to establish a council in the largest capital companies of a public person and public private capital companies – a capital company may establish a council only in case the company in the current financial year meets both of the following

- criteria: (1) net turnover above EUR 21 million; (2) total amount of the balance above EUR 4 million;
- motivating remuneration – a system for the board and the council members where remuneration is also linked with the performance. Remuneration conditions must be revised and updated once a year;
- to establish a new procedure for appointing the board and the council members. The board and the council members should be appointed within the framework of the nomination procedure. Initially, the holder of state capital shares or the council of the capital company develops a list of candidates of the council and the board members, based on criteria of professionalism and competence required for the respective candidate of the council and the board members. Potential council and board members are invited, by arranging a public procedure of application of candidates, involving personnel selection consultants or applying other personnel selection methods. The holder of state capital shares or the council of the capital company forms an Appointment Commission to assess candidates of

the council and the board members. The Appointment Commission is composed of representatives of the holder of state capital shares or the council (if any such council has been established) and representatives nominated by the coordination institution, as well as independent experts and observers with an advisory authority, as necessary. The holder of state capital shares or the council is entitled to reject, based on justified reasoning, the candidates nominated by the appointment commission or the line ministry. In such case, another selection process shall be organised to select the necessary candidate;

- A dividend policy – the aim is to introduce a flexible dividend policy to increase the value of capital companies according to the objectives of each capital company, including subsidiary companies of state-owned capital companies to differentiate the long-term applicable dividend policy.

The reform of commercial activity and capital companies (capital shares) management of public persons is expected to be implemented by the end of 2015.

## 6.17 National Economy Council

The National Economy Council (NEC) of the Ministry of Economics is an advisory institution established by the NEC founder organizations – the Ministry of Economics, the Latvian Chamber of Commerce and Industry, the Latvian Association of Local and Regional Governments, the Free Trade Union Confederation of Latvia, and the Employers' Confederation of Latvia, and it takes part in the process of solving issues related to business policy and acts in compliance with Subparagraph 6.11 and 7.2 of Regulations No 271 *Regulations of the Ministry of Economics* of the Cabinet of Ministers of March 23, 2010, *Agreement on Cooperation in the National Economy Council* concluded on February 17, 1999, and NEC Bylaws No 1-7-33 of August 29, 2013.

In order to represent the interests of sectors professionally, as well as to improve the cooperation between the Ministry of Economics and other state institutions, the NEC invites sectoral associations, representing entrepreneurs of the respective sector and their interests, as well as independent experts – economists, representatives of education and science – to participate.

The objective of the NEC activity is to promote the development and implementation of a favourable business environment policy in Latvia, as well as to promote the introduction of principles of sustainable development of national economy and to encourage the process of sustainable development of the state and participation of the society in it, to identify the

circumstances hindering entrepreneurship, and to perform all the necessary activities to eliminate them, to participate in the drafting of laws and regulations and policy programming documents that promote commercial activity, and to promote innovations and external trade.

The NEC reviews and monitors the settlement of issues, draft normative documents, national economy development concepts, the state budget, and other documents important for the development of Latvian economy. The NEC prepares proposals and adopts recommending decisions on these issues. The NEC carries out a dialogue between the entrepreneurs and the Ministry of Economics, as well as with other state institutions and public organizations.

The decisions adopted by the NEC are of recommending nature.

The NEC cooperates with the Cabinet of Ministers, ministries, and other state institutions to achieve that the proposals suggested by the NEC that are necessary for improving the business environment are included in the laws and regulations prepared by the responsible institutions.

On May 21, 2009, the NEC, the Ministry of Economics, and the Ministry of Finance signed a cooperation memorandum on *Growth, Competitiveness, and Employment*. The cooperation memorandum focused on cooperation and harmonized action of the NEC, the Ministry of Economics, and the Ministry of Finance to promote economic growth, employment, and



competitiveness of Latvia, as well as active participation in the development and implementation of a sustainable strategy of Latvia.

#### Box 6.37

##### **NEC Personnel and Organisation of Work**

Based on a decision of the Managing Committee, the NEC personnel are approved by the Minister for Economics.

The Minister for Economics represents the NEC opinion on behalf of the NEC in the Coordination Council for *Large and Strategically Important Investment Projects* and the Coordination Council for Foreign Economic Policy, as well as other cross-industry forums.

The NEC Managing Committee is a consulting and coordinating institution that takes part in settlement of issues related to business policy and is responsible for assessment and approval of issues of the agenda of NEC meetings and action plan of NEC, as well as for ensuring and improving the efficiency of the NEC activity.

The Minister for Economics approves the personnel of the Managing Committee. The Managing Committee is composed of the Minister for Economics and representatives of the four NEC founders, who are simultaneously the NEC members:

- 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 Managing Committee is entitled to involve representatives in reviewing issues included on the meeting agenda within their competence (for example, the Foreign Investors' Council in Latvia, the Latvian Academy of Sciences, the *Cooperation Council of Agriculture Organisations, relevant state institutions and public organisations*).

The NEC consists of 28 NEC experts designated by the NEC Managing Committee, including the Minister for Economics, the NEC chairperson and representatives from business organisations, public institutions and other organisations.

Representatives from the Foreign Investors' Council in Latvia, the Riga Technical University, the Latvian Agricultural Organization Cooperation Council, the association "Latvian Market Association", the Latvian Academy of Sciences, and the Latvian Chamber of Crafts participate in the NEC meetings in an observer status.

The NEC founders in the meetings of the NEC Managing Committee make decisions on changes or additions to the composition of the NEC.

The NEC is managed by the Chairman elected by the members of the NEC Managing Committee from among its members in a rotation sequence for a term of office of one year.

The NEC meetings are held on average once per month.

The work of the NEC is ensured by the Secretariat of the National Economy Council, activity of which is ensured by the Ministry of Economics.

The NEC Managing Committee makes the recommending decisions of the NEC between NEC meetings.

In order to improve the cooperation model of the Ministry of Economics and the non-governmental sector and to enhance the advisory mechanism, on April 28, 2012, the NEC Managing Committee made a decision on improving the NEC structure, by establishing six sub-committees whose tasks and mission are to unite advisory councils established by a decree of the Ministry of Economics, to promote a dialogue between the Ministry of Economics, the minister, other ministries and non-governmental organizations regarding important criteria for policy development of a business-friendly environment in Latvia, as well as to ensure the implementation of principles for development of sustainable national economy and to promote a sustainable development process of the country and public involvement in this process.

The NEC Managing Committee evaluated and developed this model to make it possible for the NEC to discuss important and subordinated matters regarding a comprehensive economic policy and to review these matters through industry committees that directly or indirectly cooperate with the non-governmental sector.

The NEC structure consists of six committees:

- Domestic Market Committee;
- Competitiveness Committee;
- Energy Committee;
- Construction and Housing Policy Committee;
- Tourism Committee;
- Micro-, Small- and Medium-sized Enterprise Committee.

By signing the protocol of understanding, the parties agreed to pool their resources for the development of programming documents, take measures for the implementation of the programmes for the improvement of economic development and business environment adopted within the framework of the declaration by the government, and that sectoral associations will assess and give an opinion on the draft legislation elaborated by the ministries.

The NEC reviews proposals for the improvement of legislation submitted by the institutions-associations representing the entrepreneurs. Sectoral associations evaluate and give an opinion on the draft legislation. The Ministry of Economics, for its part, informs the drafters of the laws and regulations about proposals on improving the legislation submitted to the NEC and carries out other measures to implement programmes for the development of national economy and improvement of business environment approved within the framework of the government declaration.



At the moment, 15 sectoral associations are represented in the NEC (chemistry and pharmaceuticals, finance, transport-transit, logistics, power engineering, information and communication technologies, IT cluster,

trade, electrical engineering, electronics, light industry, wood industry, engineering industry and metal working, construction, tourism, hotels and restaurants, food, publishing, education, and science, and agriculture).

#### Box 6.38

##### NEC on Priorities of Economic Policy

The NEC believes that Latvia should continue the work on developing a stable macroeconomic environment and on the overall growth of national economy. In order to promote competition, Latvia must form a balanced budget, competition control must be intensified, and competition development must be promoted in all sectors of national economy in the interests of society, by timely identifying the risk sectors where violations of the competition law are possible, by limiting administrative and other barriers to the competition.

The NEC still considers that the most problematic areas are the taxation policy and administration, labour force education, macroeconomic stability, and non-predictability of amendments to the legislation.

Regulatory enactments must be assessed already during their drafting process, in order to identify and prevent possible violations of the competition law, technical barriers to trade, and discriminating conditions within the sector of free movement of goods and services and the business law. The state support and procurement monitoring must be improved, thus achieving a high transparency level for projects with state support.

Establishment of an efficient and competitive sectoral structure must be facilitated, research and development and innovations must be promoted, especially within the private sector, measures must be developed and implemented facilitating co-operation of education, research, and national economy sectors by ensuring transfer of knowledge and technologies.

Faster absorption of Structural Funds and new export markets and consolidation in the existing markets must be promoted. The institutional basis of export promotion, as well as raising its capacity, development of Foreign Economic Representative Offices, accessibility of financial instruments, and support to enterprises in export marketing must be provided.

In the second half of 2014, 8 extraordinary meetings of the National Economy Council have been held to discuss the significant issue of and to provide information on measures to minimize negative consequences caused by economic sanctions of Russia.

The meetings were attended and recommendations for further actions were provided also by representatives of the Investment and Development Agency of Latvia (IDAL), the Latvian Federation of Food Companies, the association *Latvijas Auto*, the association *Farmers*

*Parliament*, The Union of Latvian Fish Processing Industry, the State Revenue Service (SRS), the Procurement Monitoring Bureau, the Ministry of Agriculture, the Ministry of Transport, the Ministry of Finance, the Ministry of Foreign Affairs, and the *Ministry of Environmental Protection and Regional Development*.

Furthermore, issue has been reviewed and recommendations have been provided on *Implementation and Planned Measures of Business Environment Improvement Plan for 2014-2015*.

## 7. RECOMMENDATIONS

By implementing a cautious macroeconomic policy after the crisis, Latvia has significantly improved its fiscal condition and situation in the financial sector. However, the GDP is still slightly below the pre-crisis level of 2008. The geopolitical situation in the region and the slow economic growth in the European Union is a crucial impediment for investments and the increase in the national economy lending, as well as for the increase in the exports of Latvia.

Under such conditions, the decisive role in ensuring our growth is attributed to the ability to improve competitiveness and ensure the accessibility of financial resources. It is essential to find the most effective ways to support the development of the knowledge-intensive economy, to increase the competitiveness of companies across sectors, and to increase productivity and innovation capacity.

At the same time, in order to ensure 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 by both entrepreneurs and public persons. The fight against tax evasion should be continued by supporting the authorities in charge and addressing the causes of the problem.

In order to prepare for and adapt to the significant structural changes, the labour market requires proactive reforms. The social assistance system must be improved and reformed to make it more efficient and simultaneously ensure a better protection of the poor. Latvia has to focus on organising and encouraging the motivation to work.

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 collateral for attracting the necessary amount of credit resources;
- to develop venture capital instruments for stimulating investments in the development and expanding activities of enterprises. The financing of venture capital funds requires private investor resources;
- **for developing a knowledge-intensive economy:**
  - to facilitate co-operation 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 performance, 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 more actively the development of the potential of science 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 absorption of new markets;
  - to develop and expand the network of Latvian foreign economic representation offices, thus providing Latvian entrepreneurs with a range of state export support services broadly and easily accessible on export markets;
  - to activate economic co-operation with the priority 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 Latvian goods and services;
  - to continue the work on the reduction of trade barriers Latvian entrepreneurs face on both the EU internal market and external export markets, thus promoting the exportability of 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 co-operation between various institutions in implementing pre-emptive changes on the labour market;
  - to improve the lifelong learning system to prevent the current mismatch on 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;
  - to pay particular attention to the youth who are neither studying nor working in order to return them back to the education system for obtaining qualification and practice;
  - to encourage active involvement of employers in improving the quality of education — establishing practice places, participation in the development and improvement of education programmes, as well as the development and implementation of active labour market policy measures;
  - to develop interdisciplinary education/study programmes focusing on developing business competence; to increase the role of hard sciences and natural sciences in basic and secondary education;
  - to develop 1<sup>st</sup> 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 national economy;
- **for improving business environment and ensuring competitiveness:**
  - to develop an excellent business environment. To ensure the introduction of electronic registration of real estate in the field of real estate registration 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 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 laws 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 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 the repeated requests of information from respondents;
  - to prioritise cases and actively address the most severe violations of the *Competition Law* – prohibited agreements and abuse of the dominant position. 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 program;
- to improve the regulation of a merger report consideration 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 review of reports;
- to implement measures to promote free and fair competition within the regulatory framework of the sectors (including the legislation drafting process), thus reducing the risks to competition caused by the actions of public persons;
- **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 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 identify the best energy economy scheme for Latvia imposing an obligation on energy traders to save energy in the end-consumption sectors under the *Energy Efficiency Directive 2012/27/EU*;
- **for ensuring efficient, safe, and sustainable energy supply:**
  - to continue the integration of the Latvian and Northern electricity market and liberalisation of the Latvian market of natural gas by promoting an increase in market liquidity, transparent electricity pricing, as well as the implementation of energy infrastructure development projects, particularly common interest projects;
  - to develop an economically reasonable and flexible policy for the use of renewable energy resources in producing energy.

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. 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.