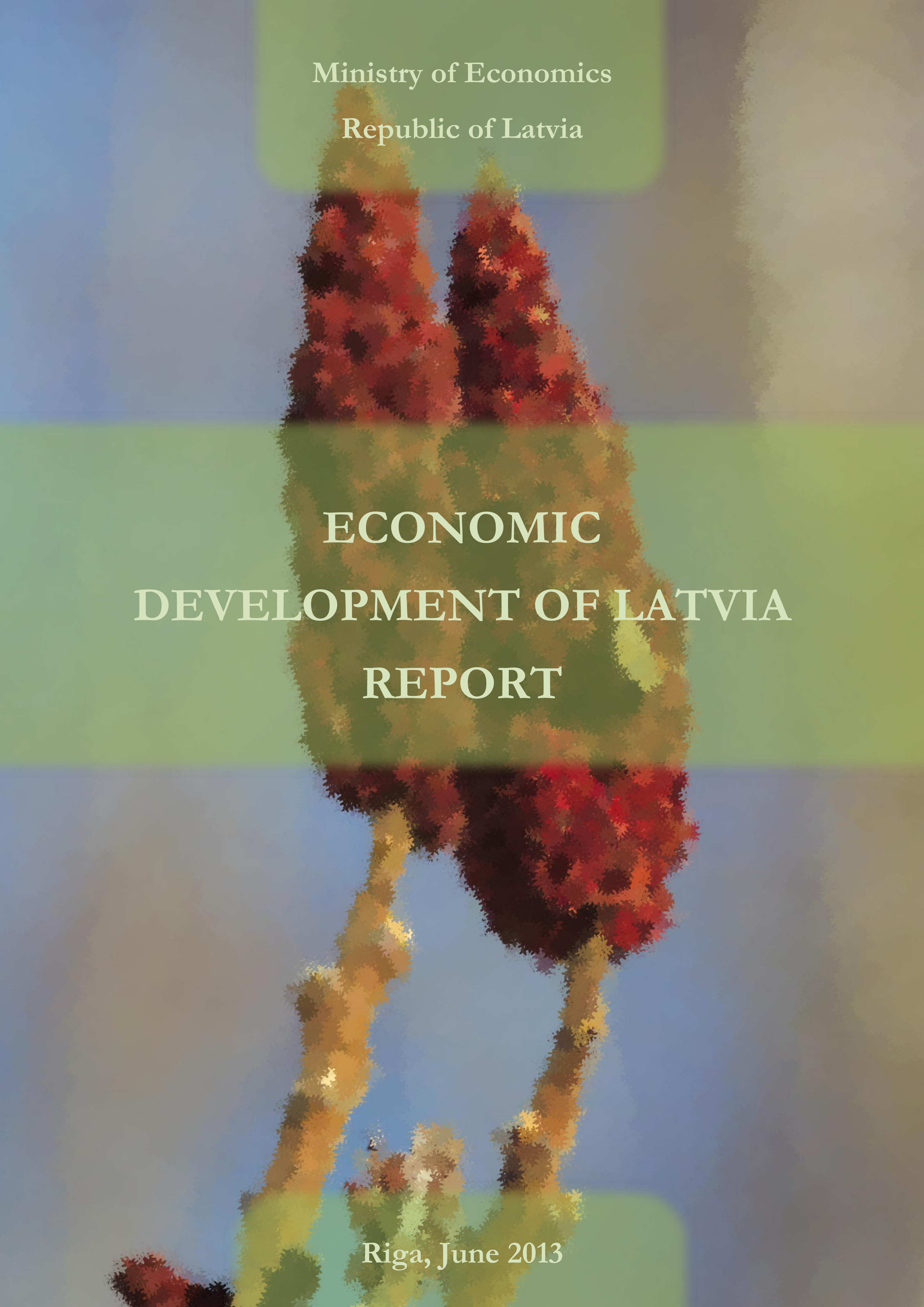

Ministry of Economics

Republic of Latvia

ECONOMIC DEVELOPMENT OF LATVIA REPORT

Riga, June 2013

Ministry of Economics
Republic of Latvia

ECONOMIC DEVELOPMENT OF LATVIA

REPORT

RIGA

JUNE 2013

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All figures and data, except for specifically indicated cases, have been obtained from the Central Statistical Bureau of the Republic of Latvia. The data of the European Union have been obtained from the *Eurostat*. The data of the Bank of Latvia and the Financial and Capital Market Commission have been used in the description of balance of payments and the bank and monetary indicators of Latvia. The data of the Treasury have been used in the description of financial indicators.

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Dear reader!

The experts of the Ministry of Economics have prepared the regular Report on the Economic Development of Latvia. The first Report was published in September 1994 and the following Reports since 1995 were published traditionally twice a year – in June and December. The present Report, just like the previous ones, provides an evaluation of the state's economic situation and policy, as well as gives a forecast of development perspectives of the economy.

The economy of Latvia keeps successfully recovering from the crisis. In 2012, the GDP increased by 5.6%, while in the 1st quarter of 2013, GDP was by 3.6% higher than in the 1st quarter of the previous year. Latvia has been one of the fastest growing economies in the European Union for several quarters in a row. Moreover, we have been able not only to grow, but also to implement structural changes in the economy and to turn public finances in a more sustainable direction. Over the past few years, exports have become the key driver of economy. The export volumes of goods and services have reached the highest level ever, and the total exports exceed the highest point of the pre-crisis period by 20 per cent.

Previously, the increase in exports allowed also trade and construction sectors to recover from the crisis. Considering the deep drop of both sectors during the crisis, currently the increase in these sectors causes no concerns about any potential bubbles. However, it is essential to maintain the balance and continue targeted structural economic changes in favour of manufacturing and other exporting sectors.

At the same time, the uncertainty about global economic growth perspectives forces us to take a cautious attitude towards the economic growth perspectives of Latvia in 2013. Therefore, the experts of the Ministry of Economics have forecasted a more moderate, however relatively strong economic growth of Latvia in 2013 than it was in 2012, and the GDP might reach 4.5 per cent.

Recovery of the Latvian economy has been also recognized internationally. Latvia has received the Convergence Reports of the European Comission and the European Central Bank indicating that Latvia has met all Maastricht criteria to successfully join the euro zone countries in 2014. Such a positive assessment serves as recognition of the changes achieved in the Latvian economy. Joining the euro zone will help ensuring sustainable growth of the entire country, thus reducing the various costs for people and businesses related to currency exchange and creating a more stable business and investment environment.

The invitation to start negotiations on accession of Latvia to the Organisation for Economic Co-operation and Development (OECD) is a significant step towards improving the quality of our economy and business environment. The invitation to become a full member of the group of world's most developed countries is acknowledgement and the result of the active work of experts from the entire public administration and sectors for several years. The status of an OECD member will raise the profile of the country outside the EU, making Latvia more attractive for investments and giving businesses easier access to credit markets for the implementation of their development plans and projects.

However, in order to maintain long-term economic growth, one of the main objectives and challenges will be the increase of productivity. Higher productivity in both the private and public sector will be a precondition for a rise in wages and thus – for the overall social welfare. Our aim is to help enterprises develop, produce high profitability goods and services, and create new, well-paid jobs through the *National Industrial Policy* (NIP) that has been approved by the Cabinet of Ministers on May 28, 2013. As a cross-industry policy the NIP envisages implementation of activities in such areas as access to labour and improvement of skills, access to industrial space and territories, access to finance, promoting innovations, exports and limiting costs of energy resources.

A regular and tight dialogue with industry associations and businesses is an essential part of the NIP that may help the country to obtain more specific information about the situation in sectors. The Ministry of Economics has consulted with the largest industry associations and non-governmental organisations representing enterprises at each stage of NIP implementation, thus obtaining the necessary information on the principles and main micro-level challenges of the economy.

A number of pilot projects are being implemented as well, for instance, green industry innovations and establishment of industrial areas in regions. Yet, successful and efficient implementation of the NIP is closely linked with collaboration of all involved parties, and regular and constructive cross-industry dialogue. Implementation of the NIP will be limited and less productive without reforms in education system, labour market policy or the approach of local governments in dealing with businesses. Dialogue and common vision often play an even more important role than the available funding, which currently is allocated for the NIP measures in the amount of LVL 700 million.

Along with the NIP, the Cabinet of Ministers approved also the *Guidelines for Export Promotion of Latvian Goods and Services and Attraction of Foreign Investment in 2013-2019* on May 28, 2013. Improvement of competiveness 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 favourable environment for investments in Latvia and promote its international recognition and facilitate entry of Latvian enterprises in foreign markets.

I believe that foreign direct investments play an important role in promotion of further economic growth in Latvia both through acquisition of industrial and management skills and creation of new jobs, thus giving an opportunity to apply new technologies and preconditions for technology transfer, promoting integration of the country in international trade and involvement of enterprises in industrial sales chains.

I am satisfied with the completion of the elaboration, coordination and adoption of the E*nergy Long-Term Strategy 2030* this year. On May 28, 2013, the government approved the informative report *Latvian* E*nergy Long-Term Strategy 2030 – Competitive Energy for Society* prepared by the Ministry of Economics. It is the first energy industry document of such level in Latvia. The main objective of the Strategy 2030 is to promote competitive economy by developing energy policy that is well-balanced, effective, as well as economically, socially, and ecologically reasonable and based on market principles.

The Ministry of Economics has started working on development of necessary legislation and planning documents to achieve the long-term energy policy objectives of Latvia under the Strategy 2030. A number of amendments are going to be made to the regulations of the Cabinet of Ministers, laws, and more specific *Guidelines for Energy Policy* for 2014-2020 are going to be developed by May 1, 2014 based on the key directions defined in the Strategy 2030.

The Ministry of Economics also continues active work on establishment of the Development financial institution. This year, an institutional framework for the Development Financial Institution will be developed in cooperation with the Ministry of Finance in order to provide support for business development at different stages through various financial instruments. At the same time, all involved parties must activate their work on further reforms for the purpose of improving business environment, particularly for the purpose of improving functionality of the judicial system and adoption of the *Construction Law* by the Saeima. The final reading of the law is expected to be adopted within next few weeks by the Saeima. Both measures are crucial for improvement of competitive business environment in Latvia.

One of the main objectives for this year is further implementation of the state capital share reform. The Ministry of Economics is gradually implementing the reform in areas under its supervision; however, in order to make the management of all state capital shares more efficient, transparent and responsible, the *Saeima* must adopt the *Draft Law on the Management of Capital Companies and Capital Shares of Public Persons*, as well as amendments to related laws. The reform is aimed at promoting quality and professional management of capital companies and capital shares of public persons according to internationally recognized principles of good corporate governance, as well as meeting conditions for commercial activities of public persons. After adopting the laws, establishment of the State Capital Shares Management Bureau will be launched and state capital shares will be gradually transferred to the bureau thus introducing appropriate principles of activity and supervision in all state and local government enterprises according to the good governance practice.

One of the key priorities of the Ministry of Economics is implementation of the *Remigration support measure plan* to provide qualitative and coordinated public and local government services to those people who have decided to return to Latvia.

In order to achieve the set objectives, we will continue the active dialogue with entrepreneurs and non-governmental organizations representing them.

The present Report provides information about the main economic and social indicators, development of economy sectors and external economic environment, the economic policy of the government for fostering growth and employment, as well as the key instruments for implementing the policy, including utilisation of the EU structural funds.

In the conclusion of the Report, the authors provide recommendations regarding improvement of the national economic policy. The Cabinet of Ministers has not assessed all issues discussed in the report, therefore some conclusions on economic growth of the country and proposals for further activities reflect the opinion of experts from the Ministry of Economics.

I hope that the Report will be useful for economists and entrepreneurs, as well as for everyone interested in the economic development of Latvia, and that it will encourage an exchange of ideas between public institutions, various organisations and interest group representatives, as well as other stakeholders.

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

Daniels Pavļuts,
Minister of Economics
June 2013

CONTENTS

ABBREVIATIONS

Abbreviations	
CC	Competition Council
CF	Cohesion Fund
CHP	Combined Heat and 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
CIS	Commonwealth of Independent States
CLC	Central Land Commission
CoM	Cabinet of Ministers
CPI	Consumer Price Index
CRPC	Consumer Rights Protection Centre
CSB	Central Statistical Bureau
EAGGF	European Agricultural Guidance and Guarantee Fund
EC	European Commission
ECC	The European Consumer Centre of Latvia
ERDF	European Regional Development Fund
ESF	European Social Fund
EU	European Union
EU-15	European Union Member States before the enlargement on May 1, 2004
EU-27	European Union Member States after the enlargement on January 1, 2007
EU SF	European Union Structural Funds
FDI	Foreign Direct Investment
FIFG	Financial Instrument For Fisheries Guidance
FOB	Price of the goods, including value, and transport and insurance costs to the border of the exporting country
FTA	Free Trade Agreement
GDP	Gross Domestic Product
HPP	Hydroelectric Power Plant
ICT	Information and Communication Technologies
IDAL	Investment and Development Agency of Latvia
IGC	Intergovernmental commission
IMF	International Monetary Fund
JSC	Joint Stock Company
LGA	Latvian Guarantee agency
LLC	Limited Liability Company
LNAB	Latvian National Accreditation Bureau
LTDA	Latvian Tourism Development Agency
LVS	Latvian Standard
NEC	National Economy Council of the Ministry of Economics
NPP	Nuclear Power Plant
NSFD	National Strategic Framework Document
OP	Operational Programme
PJ	Petajoule
SEA	State Employment Agency
SJSC	State Joint Stock Company
SMEs	Small and Medium-Sized Enterprises
SMM	Small and Medium-Sized Merchants
SOLVIT	EU Internal Market Problem Solving System (SOLVIT Network)
SRS	State Revenue Service
TPI	Trade Protection Instruments

Country Abbreviations

AT	Austria	IE	Ireland
BE	Belgium	IT	Italy
BG	Bulgaria	LT	Lithuania
CY	Cyprus	LU	Luxembourg
CZ	Czech Republic	LV	Latvia
DE	Germany	MT	Malta
DK	Denmark	NL	The Netherlands
EE	Estonia	PL	Poland
EL	Greece	PT	Portugal
ES	Spain	RO	Romania
EU	European Union	SE	Sweden
FI	Finland	SI	Slovenia
FR	France	SK	Slovakia
HU	Hungary	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 reached 10.3%, which was one of the highest in the EU. In 2008 and 2009, the inflow of foreign capital halted due to the global financial crisis and the recession began. During the crisis, GDP decreased by ¼, external debt almost doubled, the number of employed decreased by 16%, the real wages dropped by 12 per cent.

Since the end of 2009, the economic recession in Latvia has stopped and growth has resumed. Since the lowest point of the economy in the 3rd quarter of 2009, until the 1st quarter of 2013, the GDP has increased by 18%. Still, GDP is by 11% lower than during the pre-crisis period in 2007.

Stable growth of national economy of Latvia has been observed in 2012, although the overall GDP amount in the EU slightly decreased. In 2012, GDP in Latvia was by 5.6% higher than in 2011. The GDP growth was determined by the increase in both exports and domestic demand.

Despite the strained global economic situation, national economy of Latvia will continue growing also in 2013. In the 1st quarter of 2013, GDP was by 3.6% higher than in the 1st quarter of the previous year. Compared to the 4th quarter of 2012, GDP has increased by 1.4% (according to seasonally adjusted data).

Table 1.1

Latvia: Key Economic Development Indicators

	2008	2009	2010	2011	2012	2013f	2014f
	(changes in comparison with the previous year, %)						
Gross domestic product	-3.3	-17.7	-0.9	5.5	5.6	4.5	4.5
Private consumption	-5.8	-22.6	2.4	4.8	5.4	5.0	5.0
Public consumption	1.6	-9.4	-7.9	1.1	-0.2	0.6	1.4
Gross fixed capital formation	-13.8	-37.4	-18.1	27.9	12.3	-0.5	3.6
Exports	2.5	-13.3	12.7	12.4	8.3	3.0	4.0
Imports	-10.0	-31.6	11.8	22.1	2.9	4.6	3.6
Consumer prices	15.4	3.5	-1.1	4.4	2.3	0.5	2.5
	(% of GDP unless indicated otherwise)						
General government sector balance	-4.2	-9.7	-8.1	-3.6	-1.2	-1.1	-0.9
General government debt	19.8	36.9	44.4	41.9	40.7	44.5	41.0
Export-import balance	-13.6	-1.5	-1.4	-4.8	-3.3	-3.3	-3.4
Changes in the number of employed (aged 15-74 years)*	*0.5*	*-12.2*	*-4.6*	2.5	2.8	2.4	1.3
Unemployment rate (share of unemployed persons to the economically active population aged 15-74 years, %)*	*7.5*	*16.9*	*18.7*	16.2	14.7	12.0	9.6

f – forecast
* – data since 2011 has been recalculated according to the Population Census. Until then, all data after 2011 cannot be compared with the previous periods

Exports have become the economic driver in the recent years. Export volumes of goods and services have reached the highest level ever. In 2012, exports of Latvian goods and services increased by 8.3%, while in the 1st quarter of 2013 – by 2.9 per cent.

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 in labour costs, however, further improvement of competitiveness will depend on the ability to raise productivity.

Positive tendencies are observed also in the domestic market. An increase in employment and a gradual rise in wages foster an increase in private consumption. In 2012, private consumption increased by 5.4%, while in the 1st quarter of 2013 it was by

4.7% higher than in the corresponding period a year ago. However, overall, private consumption falls behind the level of the 1st quarter of 2008 when it started to decline by nearly 15%. Faster recovery of private consumption is limited by the still high unemployment level.

In relation to the absorption of the EU structural funds, including public investments in infrastructure and enterprise investments in production equipment, in 2011 and in the first half of 2012, investments increased rapidly. The increase in investments is based to a great extent on investments in such sectors as energy, wood processing and production of metal articles. In the 1st quarter of 2013, compared to the corresponding period a year ago, the amounts of investments dropped since a number of large investment projects have been completed in several sectors of national economy and no new ones have been launched yet. The low bank crediting level is still one of the factors hindering investments. Despite the substantial increase in 2011 and in 2012, investments are still at a rather low level. Average quarterly amounts of investments are nearly by a half fewer than in 2007.

It should be noted that after the substantial decrease of incoming foreign direct investments (FDI) in 2008 and 2009, they have been increasing since 2010. The amount of attracted FDI in 2012 was slightly lower than a year ago. The FDI stock in the economy of Latvia constituted LVL 7038 million at the end of 2012. Comparing to the end of 2011, the FDI stock has increased by 7%, including manufacturing – by 4.2 per cent.

Both, the increase of demand for intermediate consumption goods in manufacturing **and improving situation in the domestic market foster an increase of imports.** In 2012, the volumes of goods and services imports exceeded the level of 2011 by 2.9%. Since imports grew at a slower pace than exports, the foreign trade deficit dropped to 3.3% of GDP. Although the volumes of imports have been growing relatively fast over the past few years, they still are far behind the pre-crisis level.

Positive export tendencies foster the growth of manufacturing. In 2012, production volumes of the sector were by 9.3% higher than a year ago. Production volumes continue increasing in almost all manufacturing sectors, especially in wood processing, metal processing and production of electric appliances, machinery and equipment. In general, manufacturing ensured on average ¼ of the total economic growth in 2012.

In the 1st quarter of 2013, production volumes in manufacturing decreased by 4.8%, compared to the corresponding period of the previous year. Growth of the sector was slowed down by results of certain sub-sectors of manufacturing. The growth of wood processing was affected by the low demand in foreign markets, while production volumes of metal processing decreased due to JSC "Liepājas metalurgs" which faced financial difficulties. At the same time, production volumes continue increasing at a stable pace in manufacturing sectors like manufacture of computers, electronic and optical products, manufacture of electrical equipment, manufacture of furniture, manufacture of clothing and textiles. Production volumes are largely growing also in domestic demand-oriented sectors – manufacture of food products and manufacture of non-metallic minerals.

The increase in revenues from exports has a positive impact on the sectors operating mainly in the domestic market. The amount of services provided in the trade sector increased by 7.3% in 2012, but in the 1st quarter of 2013 – by 4.9% in comparison with the corresponding period of the previous year. After the substantial decline during the crisis, the construction sector resumed growth in 2011. In 2012, the construction sector grew by 14.6%, while in the 1st quarter of 2013 – by 9.8%, compared to the 1st quarter of 2012.

After the deflation caused by the crisis when the 12-month consumer price inflation decreased to 4.2% in February 2010, **prices started increasing again**. In 2012, the 12-month consumer prices increased by 1.6%; the increase was mainly determined by the rise in administratively regulated prices, as well as the increase in food prices and transport costs. Considering the relatively rapid price increase in 2011, the average price level in 2012 was by 2.3% higher than a year ago.

In the first half of 2013, prices increased at a moderate pace since they had a positive impact on the dynamics of world food and fuel prices. The overall consumer price level in May 2013, compared to May 2012, has decreased by 0.1%. **In May 2013, the annual average inflation rate used in assessment of the Maastricht criteria was just 1%**. Further changes in consumer prices in Latvia will mainly depend on price trends in the world. Although the consumer price dynamics has been moderate over the past few months, consumer inflation expectations are growing gradually in relation to the planned introduction of the euro. **Overall, the Ministry of Economics forecasts a low inflation in 2013** (average -0.5% in a year).

After facing the financial market crash at the end of 2008 and at the beginning of 2009, the **monetary indicators of Latvia have been gradually stabilising.** The balance of deposits attracted by both residents and non-residents continue increasing, and at the end of 2012, they exceeded the level of the corresponding period of 2011 by 12.7%. It should be noted that the balance of non-resident deposits increases faster than that of residents. Non-resident deposits constitute already almost a half of all deposits.

The quality of the loan portfolio continues improving, nearly reaching the level of 2008. In the 4th quarter of 2012, the amount of loans with overdue payments in the total loan portfolio was 17.4% (the highest indicator was achieved in the 2nd quarter of 2010 when the amount of loans with overdue payments was 28.6%). Loans with overdue payment above 180 days have shrunk most rapidly (by 43.4%, compared to the 4th quarter of 2011). The share of these loans constitutes nearly 60% of all loans with overdue payments.

The amount of loans granted anew continues increasing. In 2012, compared to the previous year, the amount of loans granted anew to residents in the banking sector increased by 11.4%, while to non-residents – by 31.9%. 40% of all loans granted anew have been granted to non-residents. In terms of amount, most of loans granted anew have been granted to financial and insurance operations. In 2012, enterprises have received new loans in the amount of LVL 654.8 million, yet, compared to 2011, the amount thereof decreased by 13.1 per cent.

Although the amount of loans granted anew is gradually increasing, the total balance of loans is decreasing. The amount of loans granted anew is too small to compensate the current loan portfolio payments and gradually increasing amount of written-off loans. Overall in 2012, they were by 10.3% lower than a year ago. It is mainly due to the decrease in the balance of mortgage loans.

As economic situation improved, fiscal situation of the country is improving gradually – budget revenues are growing and deficit is decreasing. Deterioration of the economic situation in 2008 and 2009 considerably worsened the fiscal situation in the country. 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 to 2012, fiscal consolidation measures with fiscal impact of 16.9% of GDP have been carried out. As a result of budget consolidation implemented by the government, the budget deficit decreased gradually and in 2012, it was just 1.2% of GDP. Since the general government budget deficit was considerably below the 3% Maastricht criterion in 2012, **the European Commission has abrogated the *Decision 2009/591/EC on the existence of an excessive deficit in Latvia.***

In order to ensure development of sustainable and counter-cyclical fiscal policy, the Saeima has adopted the EU *Fiscal Discipline Treaty* which entered into force on March 6, 2013. The Law stipulates binding fiscal conditions for the annual government budget and the medium-term budget. In order for these systemic new approaches towards development of fiscal policy and observing discipline to be sustainable without being constantly amended or even cancelled, amendments to the Constitution (*Satversme*) have been prepared and are now being considered by the Saeima committees.

The Saeima **approved the government budget for 2013 with a deficit of 1.4%** of GDP. According to the forecasts of the Ministry of Finance, the general government budget deficit is expected to be 1.1% of GDP in 2013. The general government deficit is expected to be below 0.9% of GDP in 2014 and 2015.

During the economic recession from 2008 until 2010, the situation in the labour market has deteriorated significantly. **Since the beginning of 2010, the situation in the labour market has been improving along with gradually resuming economic activities –** employment increases, unemployment decreases gradually, and the number of vacancies grows.

In 2012, the average number of employed reached 885.6 thousand which is by 2.8% or 24 thousand more than in 2011. The average unemployment rate in 2012 was 14.9% which is by 1.3 percentage points lower than a year ago.

The registered unemployment rate at the end of December 2012 reached the lowest point since April 2009 constituting 10.5% – there were 104.1 thousand unemployed which is by 26.2 thousand less than in December 2011. The highest unemployment rate remained in the Latgale region (21.1%), while the lowest – in Riga (6.4%). In late 2012, 44.6% of the total number of registered unemployed was long-term unemployed (jobless for longer than a year).

In 2013, the situation in the labour market continues improving. In the 1st quarter of 2013, the number of employed increased by 4.7%, while the unemployment rate dropped to 12.4%. The situation in the labour market is expected to continue improving, however, the main risks are related to growth tendencies of global economy that may affect the situation of the labour market in Latvia.

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

There is high uncertainty about further growth perspectives in global environment. There is a low overall demand in a part of the sales markets of our goods and the economic situation is expected to improve only in the second half of the year. It means that the overall volumes of Latvian exports will grow at a moderate pace this year. At the same time, the domestic demand continues increasing this year, mainly due to gradual improvements of the situation in the labour market. **The Ministry of Economics forecasts that the overall economic growth of Latvia may reach 4.5% in 2013.**

Economic growth of Latvia in the medium-term will depend to a great extent on two factors. Firstly, on the solutions that the euro zone countries will manage to adopt for tackling the current tension in the financial sector in order to avoid possible economic stagnation. Secondly, on how efficient the structural policy implemented by the Latvian government for the improvement of economic competitiveness will be under the conditions of limited access to finance, including the state budget.

The more rapid development scenario expects that **the growth rate of GDP in Latvia may reach growth of 4-5% per year.** However, the slower development scenario assumes that the economy of Latvia will recover much slower from the consequences of the crisis due to the remaining weak growth in Europe and due to being unable to improve competitiveness of tradable sectors.

2. Global Economic Environment

The global economic recovery still is slow due to slowly resuming economic activities in the developed countries. That affects most of the developing countries where growth has slowed down due to the weak foreign demand[1].

Table 2.1

GDP Growth

(per cent in comparison with the previous year)

	2011	2012	2013f	2014f
World	**4.0**	**3.2**	**3.3**	**4.0**
including:				
USA	1.8	2.2	1.9	3.0
Japan	-0.6	2.0	1.6	1.4
EU	1.6	-0.3	0.0	1.3
including:				
Eurozone countries	1.4	-0.6	-0.3	1.1
CIS	4.8	3.4	3.4	4.0
China	9.3	7.8	8.0	8.2

Source: *The World Economic Outlook April 2013, International Monetary Fund*; f – forecast.

In 2012, economic growth in the **USA** was faster than a year ago and the growth continues also in 2013 due to strong macroeconomic policy incentives and financial stabilization measures. The increase in consumption and investments has a positive impact on the growth that is to a great extent influenced by stabilizing housing market and the growing lending to the private sector. And yet, a more rapid increase in GDP is hindered by the slow growth of manufacturing due to the low foreign demand.

Asian countries have overcome the global crisis more successful than the countries of other regions. Yet, the weak demand in foreign markets affects the growth of Asian countries. In 2012, GDP of Japan increased by 2%. The growth was manly based on the increase in private consumption and exports. Economic growth in 2013 is expected to be at 1.6%, which is determined to a great extent by the extensive monetary and fiscal policy incentive programme launched in Japan in early 2013.

In 2012, the economic growth of China dropped to 7.8%, compared to 2011. Domestic demand still ensures more than a half of the increase in GDP, and therefore risks to the economic growth of China are related not only to global environment but also to fluctuations in domestic demand.

After a rather fast rise in economic activities in early 2012, the growth of the **CIS countries** slowed down in the second half of the year, overall reaching 3.4% in a year.

The weak global economic growth had a negative impact on exports in the region. At the same time, domestic demand was weak as well due to several factors: in Russia – slowdown of oil price dynamics in the world markets, in Ukraine – a rise in interest rates in relation to currency exchange stabilization measures, in Kazakhstan – decrease in volumes of oil extraction.

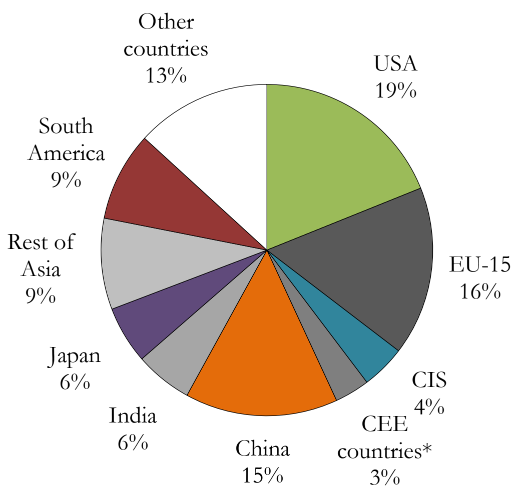
In 2013, the growth in the CIS countries is expected to remain at 3.4 per cent.

Further drop in oil and gas prices would be a risk to the growth of the region that would affect the largest exporting countries, particularly Russia, causing a negative subordinated impact on other countries of the region. The growth of the region will also depend on foreign demand in relation to economic growth in the eurozone countries.

Figure 2.1

Breakdown of the World's GDP by Groups of Countries in 2012

(structure, GDP by purchasing power parity units)



Source: *The World Economic Outlook April 2013, International Monetary Fund.*

* Central and East European countries – Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Malta, Poland, Romania, Serbia, Montenegro, Slovakia, Slovenia, Turkey

[1]The preparation of the section is based on periodicals *International Monetary Fund- World Economic Outlook, April 2013; European Commission- European Economic Forecast, Spring 2013; European Central Bank- Monthly Bulletin, June 2013.*

Since late 2011 economic activities have been slowing down in the **European Union** in general and the **euro zone** in particular, mainly due to problems in the financial market of the southern euro zone countries. Although targeted policy has resulted in obvious improvements in financial markets, lending to the private sector still is weak. A rise in lending volumes is significantly hindered by the high debt level of the private sector (including banking sector). In 2013, economic activities in the European Union in general are expected to be moderate, particularly due to the need to implements measures to balance the items of the balance sheet in both the private sector and the public sector. The economic growth in the EU countries (including the euro zone countries) might resume in the second half of 2013. Progress in restructuring of banks, improved lending conditions and improved business and consumer confidence and its positive impact on consumption and investments are a substantial precondition for growth.

The implemented structural reforms and economic balance measures will have a positive effect in the long run.

Table 2.2

The Main Macroeconomic Indicators of the EU Member States

(per cent)

	GDP growth			Consumer prices			Unemployment		
	2012	**2013f**	**2014f**	**2012**	**2013f**	**2014f**	**2012**	**2013f**	**2014f**
EU	**-0.3**	**-0.1**	**1.4**	**2.6**	**1.8**	**1.7**	**10.5**	**11.1**	**11.1**
Austria	0.8	0.6	1.8	2.6	2.0	1.8	4.3	4.7	4.7
Belgium	-0.2	0.0	1.2	2.6	1.3	1.6	7.6	8.0	8.0
Denmark	-0.5	0.7	1.7	2.4	1.1	1.6	7.5	7.7	7.6
Finland	-0.2	0.3	1.0	3.2	2.4	2.2	7.7	8.1	8.0
France	0.0	-0.1	1.1	2.2	1.2	1.7	10.2	10.6	10.9
Germany	0.7	0.4	1.8	2.1	1.8	1.6	5.5	5.4	5.3
Greece	-6.4	-4.2	0.6	1.0	-0.8	-0.4	24.3	27.0	26.0
Ireland	0.9	1.1	2.2	1.9	1.3	1.3	14.7	14.2	13.7
Italy	-2.4	-1.3	0.7	3.3	1.6	1.5	10.7	11.8	12.2
Luxemburg	0.3	0.8	1.6	2.9	1.9	1.7	5.1	5.5	5.8
The Netherlands	-1.0	-0.8	0.9	2.8	2.8	1.5	5.3	6.9	7.2
Portugal	-3.2	-2.3	0.6	2.8	0.7	1.0	15.9	18.3	18.6
Spain	-1.4	-1.5	0.9	2.4	1.5	0.8	25.0	27.0	26.4
Sweden	0.8	1.5	2.5	0.9	0.9	1.4	8.0	8.3	8.1
United Kingdom	0.3	0.6	1.7	2.8	2.8	2.5	7.9	8.0	7.9
Bulgaria	0.8	0.9	1.7	2.4	2.0	2.6	12.3	12.5	12.4
Cyprus	-2.4	-8.7	-3.9	3.1	1.0	1.2	11.9	15.5	12.4
Czech Republic	-1.3	-0.4	1.6	3.5	1.9	1.2	7.0	7.5	7.4
Estonia	3.2	3.0	4.0	4.2	3.6	3.1	10.2	9.7	9.0
Hungary	-1.7	0.2	1.4	5.7	2.6	3.1	10.9	11.4	11.5
Latvia	5.6	3.8	4.1	2.3	1.4	2.1	14.9	13.7	12.2
Lithuania	3.6	3.1	3.6	3.2	2.1	2.7	13.3	11.8	10.5
Malta	0.8	1.4	1.8	3.2	1.9	1.9	6.4	6.3	6.1
Poland	1.9	1.1	2.2	3.7	1.4	2.0	10.1	10.9	11.4
Romania	0.7	1.6	2.2	3.4	4.3	3.1	7.0	6.9	6.8
Slovakia	2.0	1.0	2.8	3.7	1.9	2.0	14.0	14.5	14.1
Slovenia	-2.3	-2.0	-0.1	2.8	2.2	1.4	8.9	10.0	10.3

Source: *European Commission-European Economic Forecast, Spring 2013*;
f – forecast.

Although the level of economic activities in several EU Member states in 2012 was lower than a year ago and GDP has decreased in the EU in general, GDP dynamics remained positive in **the largest trade partners of Latvia**.

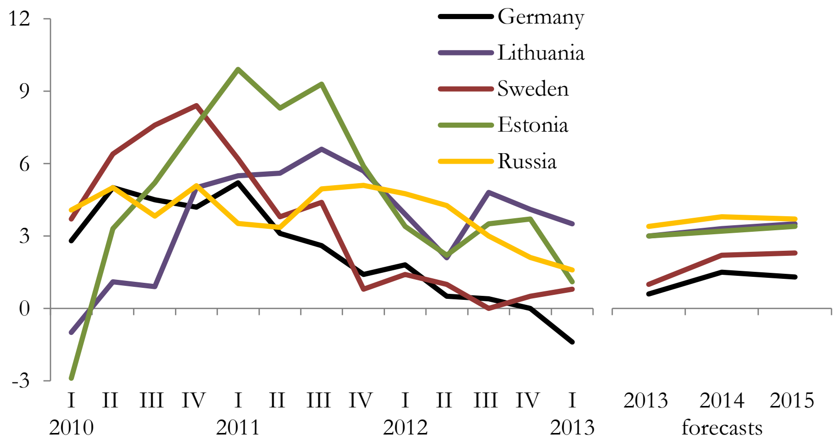
In 2012, GDP has increased by 3.6% in **Lithuania**. The increase was to a great extent based on a rise in export volumes and private consumption. Private consumption was first the key driver of growth, yet it significantly decreased in a year. The drop in public funding for investments in infrastructure objects had a negative impact on investment dynamics. Yet, a rapid increase in exports compensated for the decrease in domestic demand.

In the near future, economic growth of Lithuania will to a great extent depend on the dynamics of domestic demand. Overall, the growth in Lithuania is expected to be 3.1% in 2013, which is slightly lower than in 2012.

Figure 2.2

Economic growth of partner countries of Latvia

(GDP growth rates, compared to the corresponding period of the previous year)



Source: *Eurostat*, National Statistics Service of Russian Federation, IMF forecasts

The growth of **Estonia** in 2012 was driven by a stable domestic demand and improving situation in the labour market. Exports of Estonia were affected by a weaker growth in the Nordic countries which are its largest trade partners, on the one hand. Exports of Estonia were positively influenced by the increasing trade to Russia, on the other hand, due to its accession to the WTO. The growth is also fostered by confidence of entrepreneurs which constantly exceeds the average EU level.

The growth of Estonia is expected to be balanced and the increase in GDP might reach 3% in 2013. Key risks to the growth are related to the situation in the external sector.

Economic growth of **Germany** significantly slowed down in 2012 (from 3% in 2011 to 0.7% in 2012). The slowdown in growth rates was mainly determined by a slower increase in exports and a drop in investment amounts. Economic activities are expected to be moderate in 2013 – a rise at 0.4%, while a rapid growth is likely to resume in 2014.

In 2012, economic growth in **Sweden** was considerably slower than a year ago. The drop in economic activities in Sweden was mainly based on the decrease in export volumes due to the low foreign demand. Competitiveness of Swedish goods export was affected by a rise in the nominal effective exchange rate for the krona as well. In 2013, the export volumes are expected to grow again along with the improving situation in foreign markets and economic growth of Sweden is expected to rise to 1.5%, which will be the fastest rise among the EU-15 countries.

In 2012, GDP increased by 3.4% in **Russia**, which was nearly by 1 percentage point slower than a year ago. The growth rates in 2013 are expected to remain at the same level as a year ago. The slowdown of growth rates was mainly influenced by a drop in agricultural production output and the low demand of European countries for Russian products (the EU constitute about a half of the foreign trade of Russian products). At the same time, services sector shows a steady increase. Further growth of Russia as one of the largest oil and gas exporting countries will to a great extent depend on world price fluctuations of these products.

3. Growth

3.1 Gross Domestic Product Dynamics and Aggregate Demand

3.1.1 Development Trends

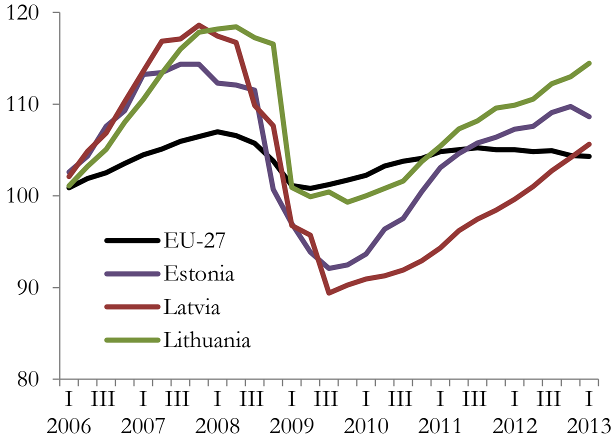
The global financial crisis severely affected the economy of Latvia; yet, gradual growth has been observed since 2010. In 2011, the GDP increased by 5.5%. In early 2012, economic perspectives of Latvia were estimated rather cautiously due to concerns about the high uncertainty in foreign markets, particularly, in the euro zone. However, the economy of Latvia was relatively resistant to external collapses, and overall, the GDP exceeded the level of 2011 by 5.6% in 2012.

Despite the strained global economic situation, the national economy of Latvia keeps growing and GDP increased even faster than expected. In the 1st quarter of 2013, GDP grew by 3.6%, compared to the 1st quarter of 2012. Comparing to the lowest level in the 3rd quarter of 2009, GDP has been by 18% higher in the 1st quarter of 2013, constituting 89% of the pre-crisis level at the moment. The national economy of Latvia has been one of the fastest growing economies in the EU over the past few years.

Figure 3.1

GDP Dynamics

(seasonally adjusted data, 4th quarter of 2005 = 100)



Although Latvia has been the fastest growing economy in the EU over the past two years, GDP still is by 12% lower than before the crisis in 2007.

Table 3.1

GDP by Expenditure Items

(changes compared to the previous year, percentage)

	2008	2009	2010	2011	2012
GDP	-3.3	-17.7	-0.9	5.5	5.6
Private consumption	-5.8	-22.6	2.4	4.8	5.4
Public consumption	1.6	-9.4	-7.9	1.1	-0.2
Gross fixed capital formation	-13.8	-37.4	-18.1	27.9	12.3
Exports	2.5	-13.3	12.7	12.4	8.3
Imports	-10.0	-31.6	11.8	22.1	2.9

Due to the restored competiveness during the crisis, export has become the main driver of recovery of Latvian economy.

In 2012, the exports of goods and services in actual prices exceeded the level of 2011 by 8.3%. Almost a half of the total increase in Latvian export in 2012 is related to the markets of EU countries less affected by the crisis – mainly Poland, Denmark, Estonia and United Kingdom. Export to the CIS and other world countries in terms of volumes have also increased rapidly, which means that entrepreneurs are accessing new markets. In 2012, the overall exports of goods and services exceeded the pre-crisis level by 20 per cent.

The increase in export had a positive impact on growth of tradable sectors, particularly on growth of the key export industry – manufacturing.

Also in 2013, the exports of goods and services continue growing, yet, the increase in the volumes of exports is tended to become moderate due to the low demand in foreign markets. In the 1st quarter of 2013, export of goods and services increased by 2.9 per cent.

Table 3.2

GDP by Expenditure Items by Quarters

(changes compared to the respective period of the previous year, percentage)

	2011				2012				2013
	I	II	III	IV	I	II	III	IV	I
GDP	3.6	5.7	6.6	5.7	7.0	5.2	5.2	5.1	3.6
Private consumption	3.5	5.2	5.9	4.3	5.4	7.1	5.1	4.2	4.7
Public consumption	1.4	1.7	2.8	-1.1	0.7	0.5	-1.7	-0.2	1.1
Gross fixed capital formation	31.4	28.8	27.6	26.0	39.0	20.5	2.0	4.2	-10.6
Exports	14.5	15.3	10.4	10.2	12.7	4.7	8.1	8.5	2.9
Imports	24.2	26.1	21.5	17.8	9.8	3.5	-16	1.3	1.0

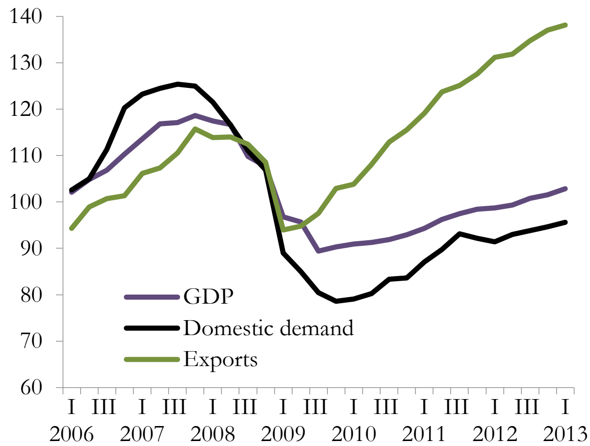
Increased profits from export have fostered growth of domestic demand. Since 2010, domestic demand has been increasing largely due to the increase in private consumption and rapid increase in investments.

Domestic demand kept growing in 2012 and it was by 6.2% higher than in 2011.

Figure 3.2

Quarterly Changes in GDP and Major Expenditure Items

(seasonally adjusted data, 4th quarter of 2005 = 100)



Also in early 2013, domestic demand considerably contributed to the growth, however, due to the drop in investments in the 1st quarter of 2013, compared to the corresponding period of 2012, domestic demand increased only by 1%. Comparing to the lowest level during the crisis – in the 4th[t] quarter of 2009, domestic demand has increased by 20 per cent.

As domestic demand decreased during the crisis, also volumes of imports shrunk fast. The gradually increasing economic activities in the domestic market are fostering the demand for import of goods and services.

In 2011, import increased by 22.1%, while in 2012, the import volumes of goods and services were by 2.9% higher than in the corresponding period of 2011. In the 1st quarter of 2013, import increased by 1% (at constant prices), yet, it still increased at a considerably slower pace than the volumes of export. Despite the relatively rapid growth of import over the past few years, it is still far behind the pre-crisis level. 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 has stabilized. In the 1st quarter of 2013, the export-import balance was -3.2% of GDP.

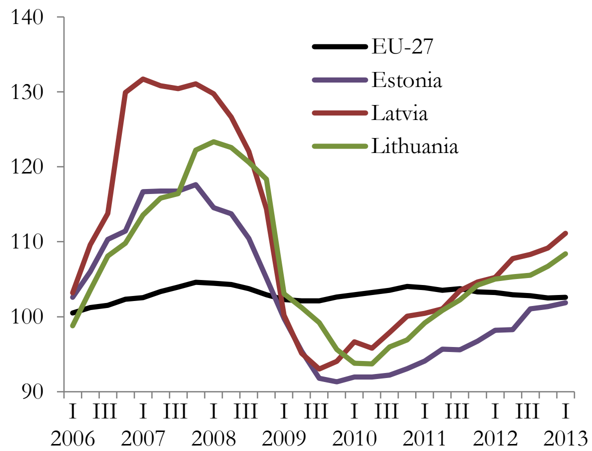
3.1.2 Private and Public Consumption

Since 2010, **private consumption** has been growing again along with the improving situation in the labour market. In 2010, it was by 2.4% higher than a year ago, while in 2011 it already increased by 4.8 per cent.

Figure 3.3

Changes in Private Consumption by Quarters

(seasonally adjusted data, 4th quarter of 2005= 100)



In 2012, growth of private consumption still was fostered by the increasing employment and wages. In 2012, private consumption exceeded the level of the corresponding period of 2011 by 5.4%. In the 1st quarter of 2013, compared to the 1st quarter of 2012, private consumption increased by 4.7%; however, it still is far behind the pre-crisis level.

Consumer confidence is also improving. Since August 2009, consumers have been becoming more optimistic though their confidence is still negative. Yet, it should be noted that consumer confidence has been negative also during the rapid growth years.

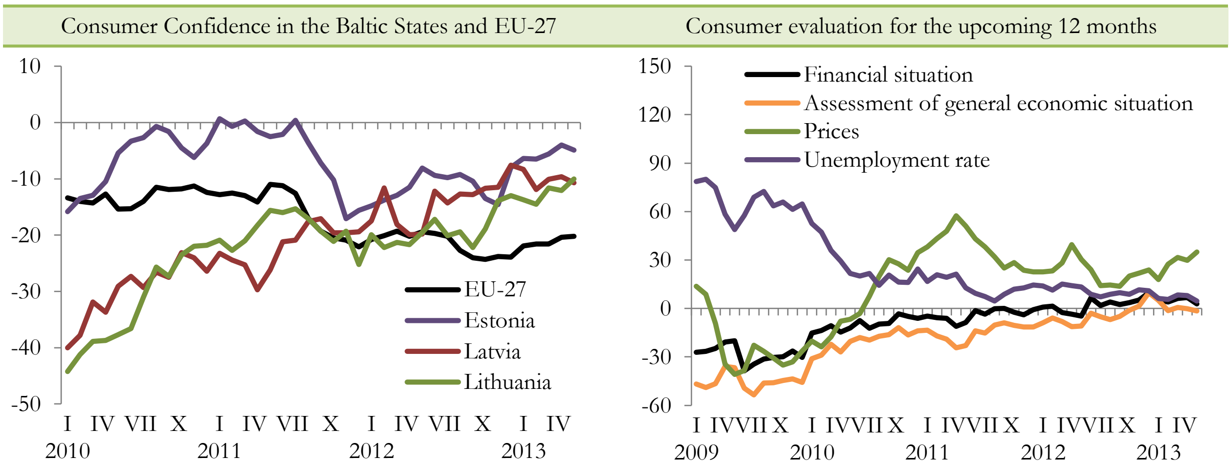
In general, consumer confidence in Latvia exceeded the average consumer confidence in EU in 2012. The difference between the Latvian and EU average consumer confidence has been explicitly seen in December 2012, when the Latvian consumer confidence exceeded the EU average by 16.3 points. Overall, consumer confidence has improved by nearly 12 points in 2012. The improvement is largely based on more optimistic consumer evaluation of the overall economic situation in the country and of the financial situation in their families. In spite of general consumer optimism, they are concerned about potential increase in prices and unemployment.

In the five months of 2013, consumer confidence has continued growing. In May 2013, compared to May 2012, consumer confidence has improved by 9.1 point. The improvement of consumer confidence in the five months has been significantly influenced by the optimistic consumer evaluation of the overall economic situation in the country, of the financial situation in their families, and of unemployment; however, they are concerned about potential increase in prices due to the expected introduction of the euro as of January 1, 2014.

Figure 3.4

Consumer Confidence Indicator*

(response balance, seasonally adjusted data)



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

The volumes of **public consumption** or public services shrunk fast during the crisis. In 2011, public consumption was by 14.4% lower than in 2007. The drop was based on implementation of the state budget consolidation measures.

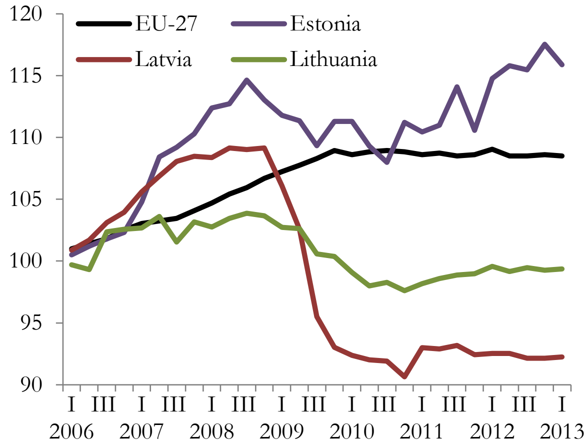
It resulted in a reduced share of public consumption in the GDP. In 2008, public consumption accounted for 20% of GDP, in 2009 – 19.6%, in 2010 – 18.4%, but in 2011 – 17.7% of GDP.

Although the economic situation is improving, the government commitment to keep on reducing the budget deficit delays rapid increase in expenditures. Overall, in 2012, the volumes of public services were by 0.2% lower than in 2011, constituting just 15.3% of GDP.

In the 1st quarter of 2013, compared to the 1st quarter of 2012, the volumes of public services increased by 1.1%, yet, the increase remains small due to continuing government measures to limit expenditures.

Figure 3.5

Public Consumption by Quarters
(Seasonally adjusted data, 4th quarter of 2005 = 100)



3.1.3 Investments

The dynamics of investments is characterized by an explicitly cyclic nature. Investors are highly sensitive to any changes in the economic situation and business environment, thus correspondingly adjusting their investment plans. Investments are an essential part of the domestic demand and therefore may change the direction of the business cycle phase and become the booster of cyclic fluctuations.

During the global financial crisis, investment activities decreased in almost all EU Member States.

Sensitivity of investors to economic fluctuations was to a great extent determined by the worsening financial situation of companies due to a rapidly narrowing market. From 2008 until 2010, investments in the EU Member States decreased on average by 13.8%, i.e. almost ten times faster than GDP. The only EU Member State with positive investment dynamics was Poland (investments increased by 7.8% in 2010 compared to 2007). However, the decrease of investment volumes in the Baltic States and Ireland has exceeded the EU average almost four times.

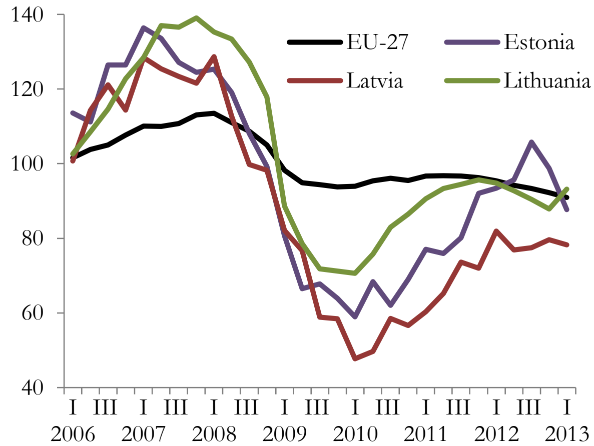
Investment activities grew rather fast in Latvia and other Baltic States along with the stabilizing economic situation. In 2012, investments in national economy of Latvian increased by 43.7%, in Estonia – by 52.1% and in Lithuania – by 15.4%, compared to 2010. The Baltic States took the leading position among the EU member states in terms of the growth rates of investment volumes.

Investments kept growing at a high pace also in the first half of 2012. As compared to the corresponding period of the previous year, investments have increased by 28.4% in the first half of 2012. Yet, in the second half of the year, the dynamics of investments was already considerably more moderate and the investment volumes were by 3.1% higher than in the second half of 2011. Such an increase in investment volumes was expected because the rapid increase in the volumes was to a great extent related to the low base effect.

Overall, in 2012, investment volumes exceeded the level of the previous year by 12.3% and constituted 23.5% of GDP. Over the past two years, investments in national economy of Latvia exceeded the volumes of 2009-2010 by 1.2 times, however on average, quarterly investment volumes were half of what they were in 2007.

Figure 3.6

Changes in Investment Volumes
(4th quarter of 2007 = 100)



In the 1st quarter of 2013, investment volumes were by 10.6% lower than a year ago, which was mainly determined by completion of the large investment projects implemented last year. An increase in investments is prevented by the still weak crediting, as well as the awaiting behaviour of entrepreneurs considering the uncertain external situation.

The state plays an important role in the investment process. The state provides significant support to private investments through the EU structural funds co-financing under weak crediting conditions.

Although the amount of public investments decreased during the economic recession, its share in the overall investments in the economy of Latvia increased and reached 19.1% in 2010, i.e. by 2.4 percentage points more than in 2007. In 2011, public investments increased by 24.9%, contributing 5 percentage points to the total increase in investments. In 2012, the amount of public investments was by 6% lower than a year ago and constituted 16.7% of the total investments in national economy of Latvia.

Table 3.2

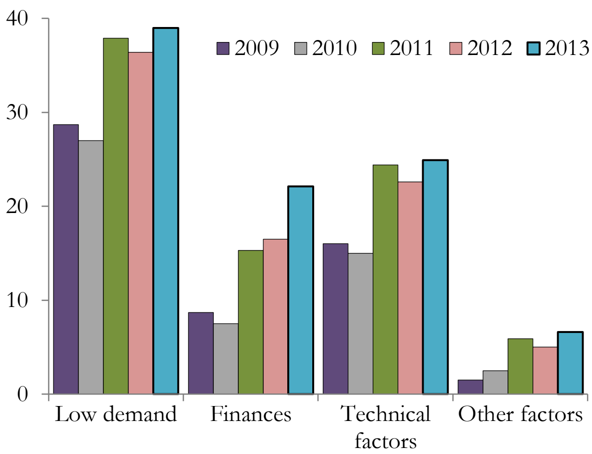
Gross Capital Formation

	2008	2009	2010	2011	2012	2013 Q1
	changes in per cent					
GDP	-3.3	-17.7	-0.9	5.5	5.6	3.6
Gross Capital Formation	-19.7	-47.1	4.2	42.7	-3.8	5.3
– gross fixed capital formation	-13.8	-37.4	-18.1	27.9	12.3	-10.6
	% of GDP					
Gross Capital Formation	31.2	20.5	19.8	25.3	25.9	22.0
– gross fixed capital formation	29.7	21.6	18.2	21.3	23.5	17.9
– changes in inventories	1.6	-1.1	1.6	3.6	2.4	4.1

Survey results of enterprise managers show that the increase in demand is the main factor promoting investments. However, in 2011, the role of technical factors – access to human resources and technologies – has significantly increased compared to the previous years. Yet, in 2013, the role of "access to finance" factor in the investing process is increasing, which is related to the slow restoration of lending.

Figure 3.7

Factors Affecting Investments in Manufacturing*



* Business and consumer surveys of the European Commission

The capacity load level in manufacturing has been gradually increasing since the beginning of 2010. At the end of 2011, it reached 69.4%, but at the end of 2012 it increased to 71.6%, which is only by 0.8 percentage points below the level of the end of 2007. It indicates that the current manufacturing volume is approaching its potential. An increase in demand, as well as entrepreneurs' positive future expectations may foster not only an increase in the capacity load, but also an increase in investments. Positive trends in the investing process to a great extent are expected to depend on access to credit resources and other external financing sources and on the desire to strengthen the positions in foreign and domestic markets including by technologically renewing the existing capacity loads.

Structure of investments by sectors.[1] Despite the higher decrease of the total investment volumes in 2008 compared to the years before the crisis, the changes, if considered by sectors, appear to be very different.

The majority of sectors have maintained positive investment dynamics in 2008. However, the investing activities in production of goods and in the financial intermediary sector are becoming weaker. A particularly significant decrease of investment volumes was observed in the energy sector, financial services, manufacturing and construction. In total, investments in the sector of production of goods decreased by 18%, but in the services sector increased by 6 per cent.

As the economic crisis intensified, in 2009, the investment activities continued decreasing in all sectors, including manufacturing – by 46% and in the services sector – by 28% in comparison with 2008. The most significant decrease of investments was observed in the construction sector (by 46%), financial and insurance operations (by 55%), and manufacturing (by 53%).

In general, the investment process in 2010 was weak, especially in the services sectors. Comparing to 2009, investments in the services sectors were by 31% lower while investments in the sectors of production of goods decreased by 20%. At the same time, investments increased also in agriculture (by 19.6%), energy sector (by 47%), transport and storage sector (by 8.1%), and information and communication services (by 8.2%). Investments in manufacturing were by 5.5% higher than in 2009.

Stabilization of the economic situation has positively affected the investment process in Latvia. It was recovering rather rapidly. According to provisional

[1] Investments in sectors are presented according to the non-financial investment statistics.

data, investments in sectors of production of goods were by 48% higher than a year ago. It was mainly due to the substantial investments in the energy sector and manufacturing. Yet, investments in services sectors increased by 17% and constituted almost 60% of total investments in the economy of Latvia.

In 2012, investing activities were slightly moderate than a year ago. In 2012, investments in the economy of Latvia were by 12.3% higher than a year ago.

In 2012, investments in services sectors have increased by 19% which is slightly faster than in the sectors of production of goods. It was mainly influenced by the extensive investments in the transport and storage sector, as well as real estate transactions. Investments in the given sectors have increased correspondingly by 49.7% and 99.3% constituting one third of the investments in the services sectors. The considerable increase in real estate transactions was due to the investments for the purpose of improving infrastructure of several public utilities companies.

Table 3.3

Dynamics and Structure of Investments by Sectors *

	Growth rates				Structure			
	2009	2010	2011*	2012*	2009	2010	2011*	2012*
Agriculture and forestry	-43.9	19.6	59.2	33.6	3.3	5.1	6.4	7.4
Manufacturing	-53.1	5.5	41.6	-6.8	9.3	13.0	14.3	15.7
Construction	-46.1	-33.3	21.3	24.3	9.1	8.0	7.6	1.9
Trade	-50.6	-24.2	24.5	15.4	8.0	8.0	7.7	7.5
Transport and communications	-44.2	8.1	48.1	49.7	8.1	11.5	13.3	20.4
Other commercial services	-30.5	-32.2	-3.5	30.3	28.4	25.4	19.1	8.5
Public services	0.1	-44.3	22.5	1.5	25.1	18.5	17.6	21.6
Other industries	-34.3	-9.3	71.0	27.5	8.8	10.5	14.0	17.0
Total	**-37.4**	**-18.1**	**27.9**	**12.3**	**100**	**100**	**100**	**100**

* 2011 – provisional data and 2012 – estimated based on quarterly data

It should be noted that public services sectors have shown fast investment dynamics in 2012. For instance, investments in education exceeded those of the last year by 18.2 per cent.

Investment volumes in goods production sectors have increased by 12.6% constituting 38% of the total investment volume in the national economy. In 2012, most of the investments have been made in the electricity, gas supply, heat supply and air conditioning sector. Investments in this sector exceeded the investment volumes of the previous years by 25.6%. Investments in water supply, sewerage, waste management and remediation activities have increased nearly by one and a half time. Investments in these two sectors constituted nearly 16.6% of the total investment volumes.

Investments in manufacturing have been increasing since the end of 2010. From 2007 until 2009, investments in manufacturing decreased by 64.2% due to the financial crisis. It was determined to a great extent by the decrease of investments in production of consumer goods (including food production – by 44%), as well as production of intermediate consumer goods (including wood processing – by 88% and production of chemical substances and its products – by 77%).

In total in 2010, investments in manufacturing were by 5.5% higher than in the previous year. Investments in the sectors of production of non-durable consumer goods and investment goods are increasing most rapidly. The wood processing sector, paper industry and publishing, as well as production of pharmaceutics had the largest contribution to the increase in investments in manufacturing. Positive investment trends in 2010 were observed also in metal processing and production of vehicles.

According to provisional data, investments in manufacturing have increased by 41.6% in 2011, compared to 2010. More than a half of the investments in manufacturing were made in wood processing and production of metals.

In 2012, LVL 292.4 million or 13.8% of the total investment volumes in the economy of Latvia have been invested in manufacturing, which is by 6.8% less than in 2011, which was mainly determined by lower investment volumes in the wood processing sector (26.4%) and production of metals (by 55.4%). It should be noted that the decrease in investments in these sectors was to a great extent related to the vast investments made in 2011.

The most considerable investment activities in manufacturing have been seen in the first half of 2012.

Investment amounts in almost all industry sectors either increased or remained at the level of the corresponding period of the previous year, except paper and paper article production, vehicle production and production of construction materials. It should be noted that investments in the first two sectors increased considerably in 2010 and 2011. Yet, investment volumes in production of construction materials have decreased annually by almost 20% since 2008 due to deterioration of the situation in the real estate market. As the situation improved, investment volumes in production of construction materials increased by 8.4%, constituting 4.7% of the total investments in manufacturing. Positive investment dynamics have been observed since 2012 in production of machinery and equipment, electronic and optical equipment and production of vehicles. In 2012, investments in these sectors constituted 10.5%, i.e. almost twice as much as in 2008.

Table 3.4

Dynamics and Structure of Investments in Manufacturing *

(per cent)

	Growth rates				Structure			
	2009	2010	2011*	2012*	2009	2010	2011*	2012*
Food industry	-52.0	-6.1	60.1	46.6	15.1	13.4	17.7	30.9
Light industry	-32.8	-30.0	83.1	-20.8	2.5	1.7	1.6	1.3
Wood processing	-88.3	139.6	147.0	-28.6	8.4	19.1	31.0	26.7
Paper industry and publishing	-71.5	152.6	44.5	0.2	2.5	5.9	3.0	1.8
Chemical industry and related industries	-11.4	16.3	6.9	-19.8	12.2	13.5	8.5	7.4
Production of other non-metallic mineral products**	-19.7	-51.9	-78.5	8.4	39.3	17.9	6.5	4.7
Production of metals and metal articles**	-59.4	130.1	157.5	-37.8	7.0	15.2	20.4	15.4
Production of machinery and equipment	-43.7	90.1	173.7	5.1	2.0	3.6	1.4	1.3
Production of electrical and optical equipment	-53.7	15.8	106.9	66.2	1.1	1.9	1.8	2.6
Production of vehicles	0.4	43.2	148.2	18.9	4.5	3.5	4.4	4.1
Other industries	-27.0	-23.7	255.3	-7.2	5.4	4.3	4.0	3.8

* 2011 – provisional data and 2012 – estimated based on quarterly data
** estimation of the Ministry of Economics

According to conjuncture survey results, investments in manufacturing in 2012 were mainly related to replacing used equipment and machinery and extending production capacity – respectively 37% and 26% of the total investments in manufacturing. At the same time, it should be mentioned that investments for rationalizing the production process have been increasing over the recent years.

In the nearest future, investment volumes in the economy of Latvia are likely to increase gradually. However, the dynamics of the investing process to a great extent will depend on access to financial resources, increase of the total demand, and implementation of the state support measures for fostering entrepreneurship.

3.1.4 Exports and Imports

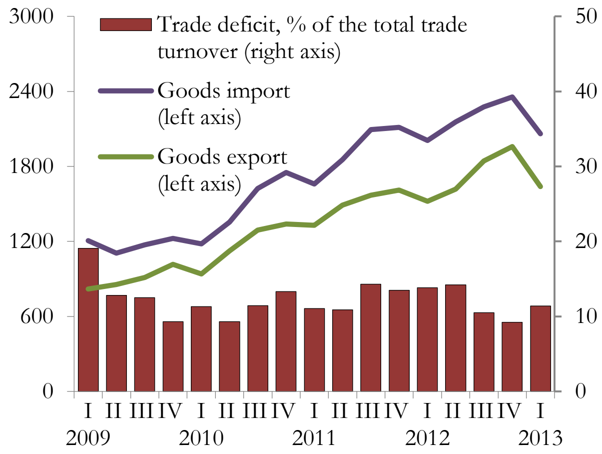
Exports and imports of goods

Despite the remaining uncertain global situation, Latvian export has been growing rather fast over the past few years. In 2011, exports of Latvian goods in current prices increased by 27.8% while in 2012 – by 15.7% (by 13.9% and 11.6% correspondingly at constant prices). Also in 2013, exports of goods continue increasing and in January-April 2013, exports have increased by 10.3% in current prices compared to the four months of 2012.

In 2011, imports of goods in current prices increased slightly faster than exports – by 30.6%, while in 2012 – by 14% (by 23.2% and 5.6% correspondingly at constant prices). Yet, in January-April 2013, imports of Latvian goods already increased at a moderate pace – by 3.1%, compared to the level of January-April 2012.

Figure 3.8

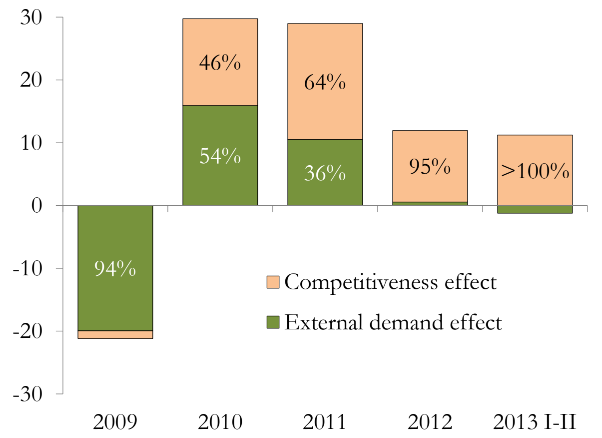
Exports and Imports of Latvian Goods
(million LVL and per cent)



As exports increased faster than imports, the external trade deficit was decreasing as well. Overall, in 2012, it was considerably lower than it was in the period of rapid growth and constituted just about 12% of the foreign trade volume, while in the four months of 2013 – 11%. Yet, in 2007-2008 it constituted over ¼ of the total foreign trade volume.

Figure 3.9

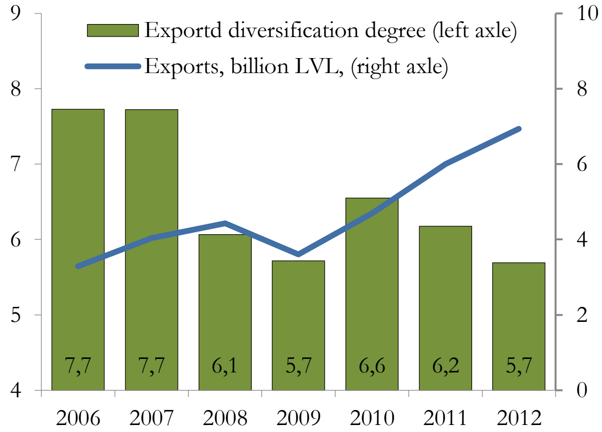
Breakdown of Export Changes by Analysing the Constant Market Share
(structure of changes in Latvian export to the EU countries, percent)



In the post-crisis period, the growth of Latvian exports was influenced equally by the improving competiveness of Latvian enterprises and by a steady foreign demand. Yet, in late 2011, the deteriorating growth in the EU led to a significant drop in foreign demand and thus the growth of exports was determined by the improving competitiveness. Also in early 2013, the growth of Latvian exports remained stable due to the remaining weak economic growth in the EU and thus also foreign demand.

Figure 3.10

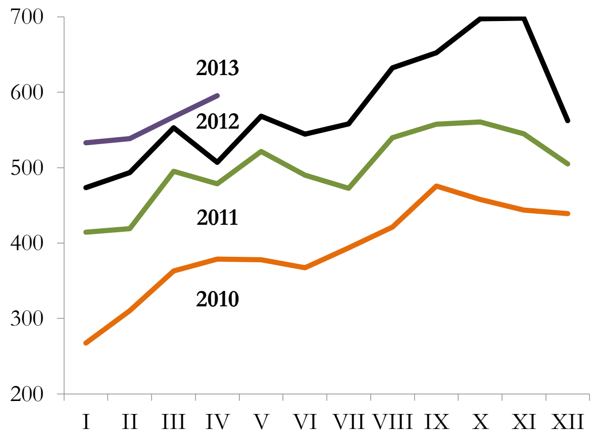
Diversification of Latvian Goods Exports
(index, calculated using the CN 2 classification of symbols, lower index means higher diversification degree)



Over the past few years, diversification degree of Latvian goods exports has been considerably improved. During the years of rapid growth certain 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 improvement of the diversification index. Yet, as growth resumed in the post-crisis period, the volumes of exports grow at a similar pace, which is a sign of a higher diversification degree. It should be noted that recently this index in Latvia has become equal to the average level of the EU-15 countries and is considerably higher than that of Lithuania and Estonia.

Figure 3.11

Dynamics of Exports of Latvian Goods
(million LVL)



The total exports of Latvian goods in 2012 were affected by the worsening trade conditions, the import unit value index increased by 7.9%, whereas that of export – by just 3.7%. Export prices grew faster for food industry products, machinery and chemical industry products. Yet, export prices decreased for timber and timber articles. In the 1st quarter of 2013, the trade conditions have slightly improved.

In 2012, export volumes of goods increased in all of the largest product groups. The overall export growth was influenced to a great extent by the increase in export volumes of agricultural and food products. This product group ensured nearly half of the total increase in exports and the share of the group in the total export structure has increased correspondingly by 4.1 percentage points and constitutes 20.5%. Growth of the agricultural and food product group is due to the high harvest of crops and oilseeds in 2012, as well as the increase in certain food production products. In 2012, exports of machinery and metal processing product group have also considerably increased. Both of the product groups constituted correspondingly 20% and 11% of the total export increase.

In January-April 2013, the volumes of agricultural and food products and machinery products continue growing, altogether constituting about 80% of the total export increase in this period.

Table 3.5

Exports by the Main Commodity Groups

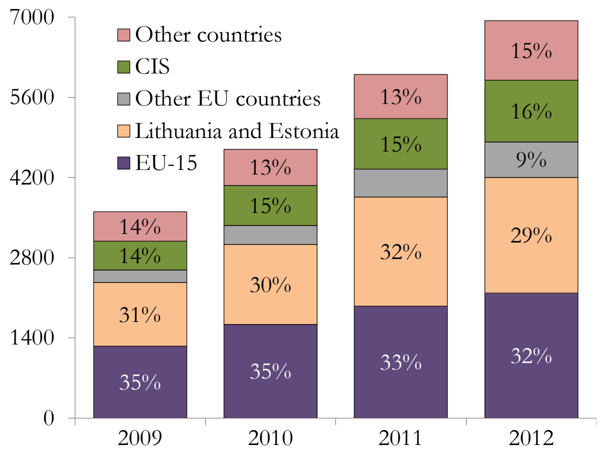
(%, in current FOB prices)

	2012		2013 I-IV	
	structure	changes compared to the previous year	changes compared to the respective period of the previous year	contribution to changes in volumes
Total including:	**100**	**15.7**	**10.3**	**10.3**
agriculture and food products	20.5	44.9	23.3	3.9
wood and wood products	14.9	2.1	9.1	1.6
metal and metal articles	14.0	11.8	-7.5	-1.2
machinery products	13.7	24.6	36.5	4.7
products of chemical industry and related industries, plastics	9.5	4.5	11.5	1.1
minerals	8.8	10.7	-0.1	0.0
vehicles	5.4	-7.1	-25.5	-1.5
light industry products	4.7	16.5	8.0	0.4
other goods	8.6	16.4	14.8	1.3

Figure 3.12

Structure of Latvian Exports by Groups of Countries

(million LVL)

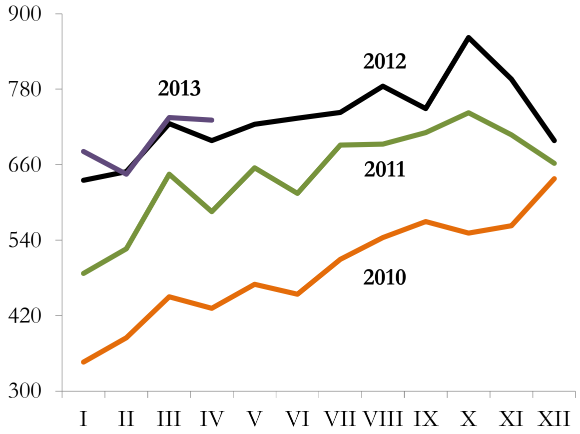


Exports to the EU Member States increased by 10.9% in 2012. The growth in exports of agriculture and food product group constituted about a half of the increase. Yet, in January-April 2013, exports to the EU Member States increased by 9.5%. Exports of machinery products have increased the most rapidly in this period.

In 2012, exports to the CIS countries increased by 22.1%. The growth in exports of agriculture and food product group contributed the most to this increase (50%), similarly to the EU Member States. Yet, in January-April 2013, exports of goods to the CIS countries increased by 7.3 per cent.

Figure 3.13

Dynamics of Imports of Latvian Goods by Months
(million LVL)



The increase in imports of goods in 2012 was mainly influenced by the increase in imports of machinery products, mineral products and agriculture and food products, altogether constituting 2/3 of the total increase in imports. Yet, in January-April 2013, the increase in imports of chemical products, agriculture and food products, and machinery products had positive impact on the growth of imports of goods.

Import from the EU countries in 2012 has increased similarly to the total import (by 14.8%), while it has grown slightly faster than the total growth of imports (increase by 4.3%) in the four months of 2013.

Import from the CIS countries has increased faster due to a rapid increase in import of mineral products and vehicles in 2012. Yet, in January-April 2013, imports from these countries have even slightly dropped.

Table 3.6

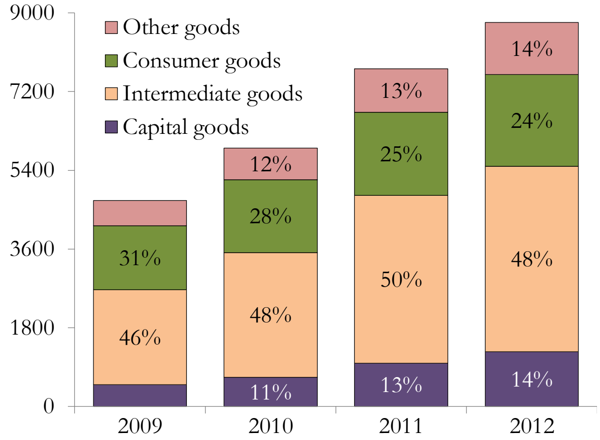
Imports by the Main Commodity Groups
(%, in current CIF prices)

	2012		2013 I-IV	
	structure	**changes compared to the previous year**	**changes compared to the respective period of the previous year**	**contribution to changes in volumes**
Total including:	**100**	**14.0**	**3.1**	**3.1**
machinery products	18.3	20.5	5.6	1.0
mineral products	17.7	16.3	2.0	0.4
agriculture and food products	15.4	16.3	6.9	1.0
products of chemical industry and related industries, plastics	14.0	7.0	13.0	1.8
metal and metal articles	10.4	8.6	-14.7	-1.7
vehicles	8.5	8.3	-18.7	-1.5
light industry products	5.5	16.5	11.5	0.6
wood and wood products	1.6	21.1	44.2	0.7
other goods	8.5	13.9	10.1	0.8

Until 2009, the share of import of capital goods shrunk along with the decreasing investments, yet, an opposite tendency has been observed since 2011, namely, import of capital goods and intermediate goods have been growing faster, while the share of import of consumer goods has been dropping.

Figure 3.14

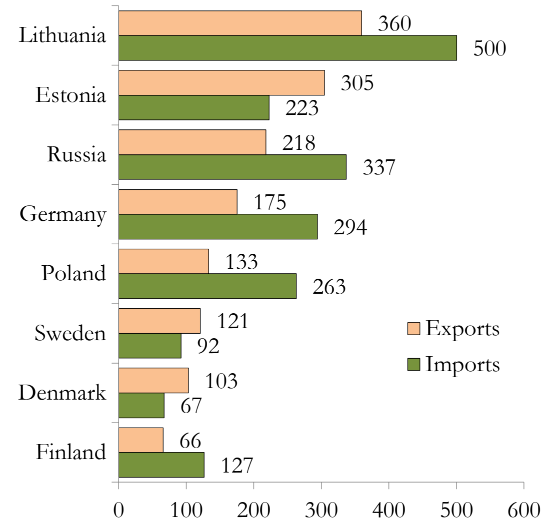
Imports by Classification of the Broad Economic Categories
(million LVL, related to the basic sections of national accounts, CIF prices)



The biggest **trade partners** of Latvia in the four months of 2013 have been Lithuania – 17% of the total foreign trade turnover, Russia – 11%, Estonia – 10%, Germany – 9%, Poland – 8%, Sweden and Finland – 4% each, and Denmark and the Netherlands – 3% each.

Figure 3.15

Foreign Trade Turnover of Latvia in January-April 2013 with Major Partner Countries *
(million LVL, exports in in current FOB prices, imports in current CIF prices)

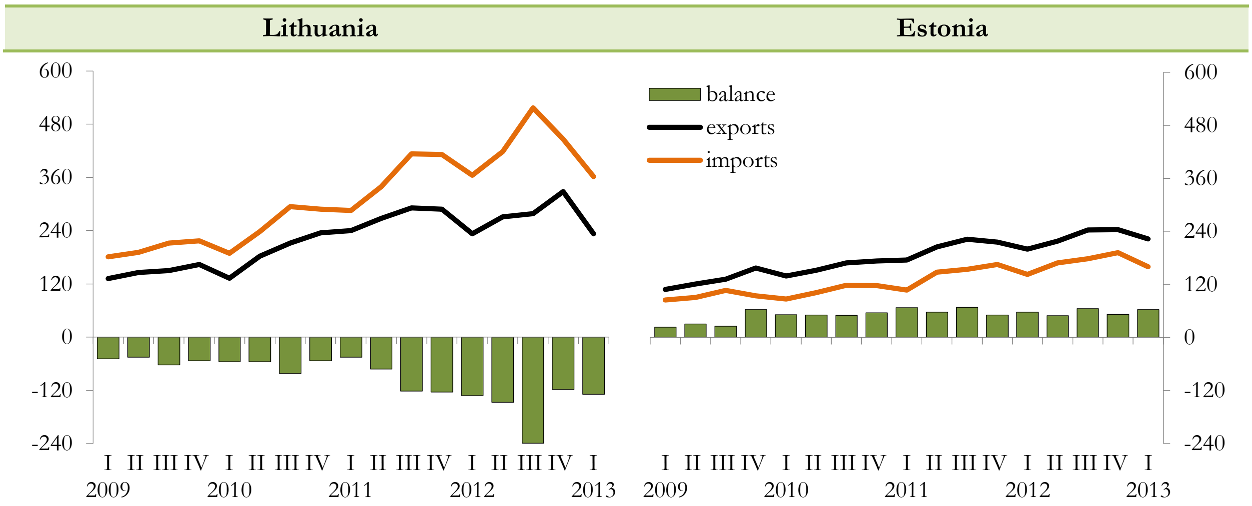


* countries where the foreign trade turnover with Latvia constitute more than 3% in the total share.

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

Figure 3.16

Foreign Trade Turnover of Latvia with Lithuania and Estonia
(million LVL)



Recently, the trade balance with Estonia has remained steadily above 10% of the total trade turnover, while the balance with Lithuania slightly decreased mainly due to faster imports of mineral products and agricultural and food products in 2012.

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 constitute mineral products and agricultural and food products.

Exports and imports of services

The decrease in exports of services during the crisis was considerably smaller than exports of goods. In 2011-2012, exports of services are growing similarly to exports of goods at a stable pace. The positive balance of services in 2011 covered approximately 60% of the negative trade balance of goods. Yet, taking into account the improvement in trade balance of goods, the positive balance of services in 2012 covered nearly 70% of the negative trade balance of goods. Also in the 1st quarter of 2013, the negative trade balance is decreased due to a rapid increase in exports of services than imports.

The revenues from transit transport still constitute a half of the exports of services. The increase in exports of this service group ensured the largest part of the total increase in exports of services in 2012. Yet, in the 1st quarter of 2013, the total volume of transit has slightly dropped mainly due to the decrease in the volume of rail transit.

Both in 2012 and 2013, commercial services export groups have been growing at a steady pace.

Exports of services to the EU Member States constitutes about a half of the total exports of services of Latvia. In 2012, export volumes of services to the EU Member States increase similarly to the total exports of services, while in the 1st quarter of 2013 – at a faster pace – by 13.3%. Transit exports and exports of commercial services constitute the largest share in exports of services to the EU Member States.

The export volumes of services to the CIS countries increased slightly slower than the total exports of services 2012, while in the 1st quarter of 2013, it grew similarly – by 5.9%. The increase in exports of commercial services to the CIS countries contributed the most to this increase. The revenues from transit transport have also increased.

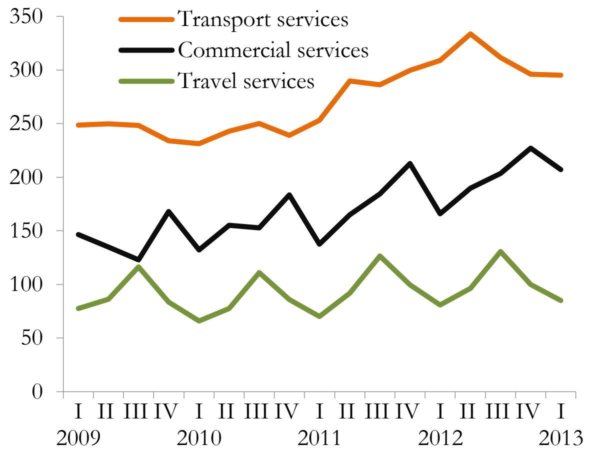
Table 3.7

Exports and Imports of Services
(per cent)

	2012				2013 Q1			
	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
Services – total	**100**	**100**	**10.1**	**7,4**	**100**	**100**	**5.6**	**2.4**
including:								
Transport services	**50.5**	**32.4**	**10.7**	**12.1**	**49.6**	**33.1**	**-4.6**	**2.7**
– sea transport	13.4	7.3	14.5	3.2	14.2	7.6	-2.1	-0.7
– air transport	7.7	11.2	7.8	18.8	6.5	11.2	1.9	5.1
– rail transport	13.3	4.9	8.5	2.8	14.1	4.8	-12.8	-9.6
– road transport	15.0	8.8	10.9	18.0	13.9	9.4	2.6	10.2
– other transport	1.2	0.2	13.3	14.7	1.0	0.2	-34.3	7.0
Travel	**16.5**	**26.2**	**5.3**	**-3.6**	**14.4**	**23.8**	**5.4**	**-7.5**
Other services	**32.9**	**41.3**	**11.6**	**11.8**	**36.0**	**43.1**	**24.0**	**8.6**
– communication services	2.8	4.9	34.9	7.8	2.8	4.3	22.2	-18.0
– construction services	2.7	4.2	55.6	69.5	2.8	2.6	55.0	-28.5
– insurance and financial services	7.0	4.2	1.3	-11.8	8.1	7.1	31.1	89.2
– information and computer services	4.3	4.6	18.8	7.5	4.8	4.9	20.6	-2.3
– other commercial services	15.0	22.0	7.4	11.4	16.3	22.6	19.2	8.3
– other services	1.1	1.5	-4.8	24.4	1.2	1.7	10.6	32.8

Figure 3.17

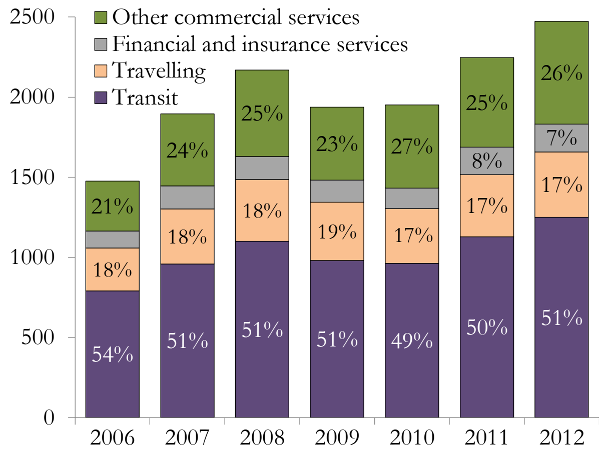
Exports of Services by Quarters
(million LVL)



In 2012, services exports to Lithuania (by 42%) and Estonia (by 27%) significantly increased. Also in the 1st quarter of 2013, services exports to both countries are growing rapidly – approximately by 20% to each country. The main services export groups to both countries are commercial services, as well as services related to transportation.

Figure 3.18

Exports of Services by Items
(million LVL)



3.2 Contribution of Sectors

3.2.1 Structure of the Economy and Development Tendencies of Sectors

As the demand dropped in both domestic and foreign markets during the economic crisis, a downturn was observed almost in all sectors of the economy. A significant drop was observed in the trade, construction and manufacturing sectors. Narrowing economic activities affected commercial services, while reduction of government expenditures had an impact on the output of public services.

The decreasing overall wage level during the crisis fostered competiveness of Latvian producers leading to export growth and thus also to development of tradable sectors. Production volumes have been increasing rapidly in the key export sector – manufacturing and the volumes of freight have been increasing gradually since the second half of 2009. The structure of national economy has changed. In 2008, tradable sectors (agricultural, forestry, manufacturing and transport service sectors) constituted only 26% of the total value added; however, in 2012, the share of these sectors has reached 37 per cent.

Table 3.8

Structure of the Economy
(by value added, per cent)

	2000	2005	2008	2009	2010	2011	2012
Agriculture, forestry	4.5	3.9	3.0	3.8	5.0	5.1	5.0
Manufacturing	14.4	12.9	10.8	10.8	13.3	14.1	14.5
Other industries	4.2	3.3	4.3	4.9	5.3	5.2	5.1
Construction	6.8	7.0	10.1	8.0	5.3	5.4	6.1
Trade, accommodation, and catering	18.5	21.6	18.8	16.9	17.3	17.6	17.9
Transport and storage	9.5	10.5	8.1	11.1	11.4	12.3	12.1
Other commercial services	25.1	25.7	28.4	27.5	27.3	26.3	26.1
Public services	17.0	15.1	16.5	17.0	15.2	14.0	13.2
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Despite the tense economic situation and even the obvious recession in several EU countries, national economy of Latvia kept growing in 2012. The increase in the total export revenues has progressively fostered the domestic demand and thus also growth of mainly domestic market-oriented sectors.

Table 3.9

Dynamics of GDP
(changes compared to the corresponding period of the previous year, in %)

	2008	2009	2010	2011	2012
Agriculture, forestry	-2.2	9.1	-8.9	-0.5	6.9
Manufacturing	-8.6	-17.8	19.1	11.7	9.3
Other industries	6.0	-3.9	2.8	-0.9	-2.0
Construction	-3.5	-32.0	-31.1	11.9	14.6
Trade, accommodation	-7.0	-25.2	0.2	9.5	7.3
Transport and storage	-0.3	1.1	-1.8	8.1	4.0
Other commercial services	5.4	-14.7	2.5	1.2	3.4
Public services	-0.1	-9.3	-8.2	0.6	-0.6
GDP	**-3.3**	**-17.7**	**-0.9**	**5.5**	**5.6**

In 2012, **manufacturing** kept growing at a steady pace – production volumes increased by 9.3%. Considering the increasing share of the sector in national economy, the increase in production volumes ensured over ¼ of the total economic growth in 2012. In early 2013, the weak demand in foreign markets affected the output of the sector and the production volumes of manufacturing in the 1st quarter were lower than in the corresponding period of the previous years.

Despite the increase in production volumes **in other industries** (electricity, gas supply, heat supply) at the end of the last year, overall the production volumes in 2012 were by 2% lower than in 2011. Also in 2013, the production volumes in the sector kept dropping – in the 1st quarter the volumes were behind the level of the corresponding period of the previous year. The drop in production volumes in the sector is mainly related to weather conditions, since lower volumes of produced electricity and heat energy are needed in comparison with the previous periods.

Table 3.10

GDP by quarters
(changes compared to the corresponding period of the previous year, in %)

	2011				2012				2013
	I	II	III	IV	I	II	III	IV	I
Agriculture, forestry	2.1	1.5	-1.9	-3.4	7.0	7.6	9.9	1.1	-1.3
Manufacturing	14.7	14.6	9.3	9.2	16.5	9.0	7.2	6.2	-4.8
Other industries	-0.9	3.1	4.8	-7.8	-2.8	-5.2	-2.2	1.6	-1.6
Construction	-15.1	-0.9	19.6	25.9	28.5	26.9	8.3	9.3	9.8
Trade, accommodation	10.4	8.3	10.1	9.1	7.4	5.7	6.8	9.1	4.9
Transport and storage	8.1	8.6	8.0	7.5	4.2	7.5	3.2	1.1	4.3
Other commercial services	-0.4	3.1	0.6	1.5	3.0	0.8	5.8	4.0	7.2
Public services	0.8	0.9	1.7	-0.6	1.4	0.0	-3.2	-0.5	2.0
GDP	**3.6**	**5.7**	**6.6**	**5.7**	**7.0**	**5.2**	**5.2**	**5.1**	**3.6**

In 2012, rapid growth was observed in **agriculture and forestry** – an increase by 6.9%. The fast growth of the sector was fostered to a great extent by the high yield. Yet, in the 1st quarter of 2013, the volumes of agriculture and forestry sector remained at the level of the 1st quarter of the previous year.

Figure 3.19

Manufacturing changes in value added, seasonally adjusted data, 2006 Q4 = 100	**Construction** changes in value added, seasonally adjusted data, 2006 Q4 = 100	**Transport and storage** changes in value added, seasonally adjusted data, 2006 Q4 = 100

The **construction sector** keeps growing largely due to public contracts and the EU funds projects. In 2012, construction volumes increased by 14.6%, while in the 1st quarter of 2013 – by 9.8%. Although construction volumes have been growing quite fast over the past two years, currently they are considerably behind the pre-crisis level.

In 2012, the volumes of services provided in **the transport and storage** sector were by 4% higher than in 2011, which was mainly fostered by the increase in freight turnover in railroad and ports. In the 1st quarter of 2013, the volumes of the transport and storage sector have increased by 4.3%, compared to the 1st quarter of the previous year. The increase was mainly based in the rise in road transportation.

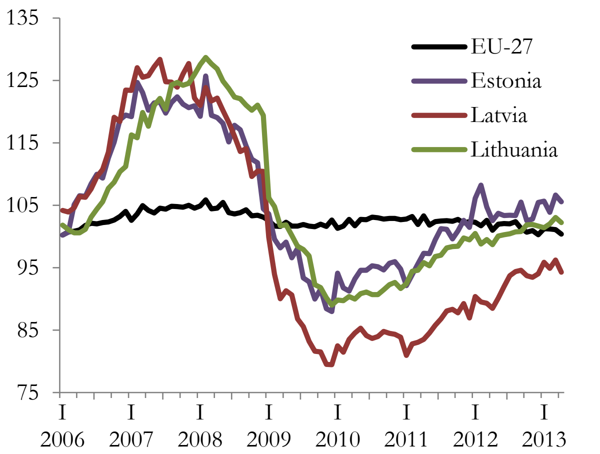
The contribution of domestic market-oriented sectors in the total growth of national economy is growing. The **trade** sector continues growing due to the increasing private consumption. In 2012, trade volumes have increased by 7.3% (together with accommodation and catering services), and considering the large share of the sector, the trade sector ensured over ¼ of the total economic growth in 2012. In the 1st quarter of 2013, the volumes of services provided in the trade sector were by 4.9% higher than a year ago.

As private consumption resumed growing, the retail trade turnover has been increasing since 2010. In 2012, it was by 7.3% higher than in 2011.

Figure 3.20

Retail trade turnover

(seasonally adjusted data, December 2005 = 100)



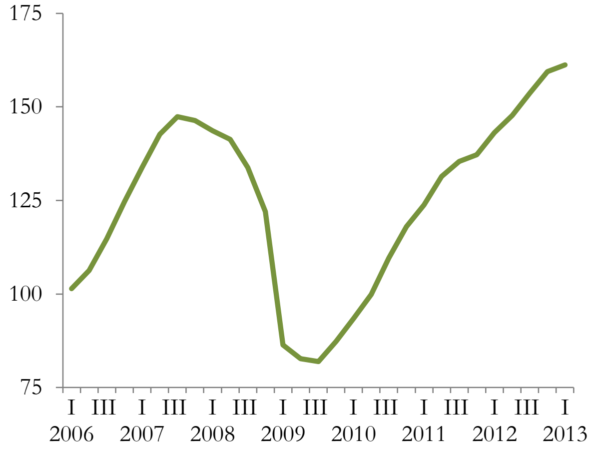
The increase in non-food retail trade turnover ensured almost 2/3 of the total increase in retail trade in 2012 (increase by 10.5%). Yet, retail trade turnover of food products in 2012 increased by 3.1%, while fuel retail trade – by 9.5 per cent.

Retail trade turnover keeps growing in 2013. In January-April 2013, compared to the corresponding period of the previous year, retail trade turnover has increased by 6%. The volumes of non-food retail trade in this period have increased by 6.6%, thus still ensuring the largest part of the total growth of retail trade.

Figure 3.21

Wholesale turnover

(seasonally adjusted data, 4th quarter of 2005 = 100)



Retail trade of food products constitutes one third of the total retail trade turnover; however, the retail trade turnover of food products is growing at a slower pace. In the four months of 2013, the retail trade turnover of food products was by 4.4% higher than a year ago. The dropping automotive fuel prices led to a notable increase in retail sale of automotive fuel in January-April 2013 – an increase by 10.9% compared to January-April 2012.

Since the mid-2009, wholesale volumes have been increasing rapidly along with the increasing economic activities. In 2012, the turnover of wholesale enterprises increased by nearly 15% (in current prices). Yet, in the 1st quarter of 2013, wholesale turnover exceeded the level of the 1st quarter of 2012 by 9 per cent.

In 2012, the amount of **commercial services** increased by 3.4%. The information and communications sector has been the most successful among commercial services sectors in 2012. In 2012, the amount of services provided in the given sector was by 8.9% higher than in 2011. At the same time, no increase in the amount of services in financial and insurance activities, as well as real estate activities has been observed in 2012, as compared to 2011.

In the 1st quarter of 2013, the growth of the sector remained steady; the amounts of commercial services exceeded the level of the 1st quarter of 2012 by 7.2%. The increase was to a great extent fostered by the growth of information and communication, art, entertainment and recreation service, as well as real estate sectors.

In 2012, the volumes in the **public service** sector remained at the level of the previous year. The sector kept growing at a moderate pace also in the 1st quarter of 2013. A more rapid growth is hindered by the fiscal policy targets set by the government.

Overall, most of the sectors of national economy are expected to grow in 2013. It will largely be based on the increase in domestic demand. At the same time external risks still exist in relation to further development in the EU.

3.2.2 Manufacturing

As the domestic and external demand shrank significantly due to the crisis, production volumes of manufacturing also experienced a considerable decrease and were on average by 23% lower in 2009 than before the crisis – in 2007.

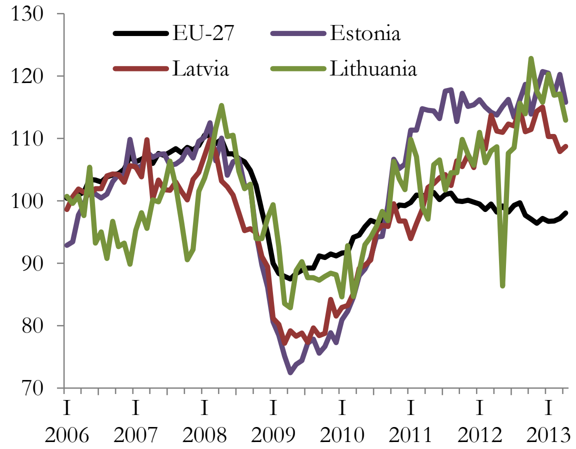
Competiveness of Latvian manufacturing is largely based on relatively cheap labour and low overall costs. In 2006 and 2007, the rise in labour costs and prices resulted in losing these advantages to a great extent. Yet, the overall wage level and prices in the domestic market dropped during the crisis thus improving the competiveness of Latvian producers.

Since the second half of 2009, production volumes have been growing in manufacturing. As economic growth resumed, manufacturing has been growing at a considerably faster pace than the overall national economy. Currently, manufacturing is the main driver of the national economic growth.

Figure 3.22

Manufacturing Production Volume

(seasonally adjusted data, December 2005 = 100)



Monthly production volumes of manufacturing were fluctuating considerably in 2012 – a rapid increase in one month was followed by a slight decline – in general the sector was growing steadily. Despite the strained economic situation and even obvious recession in several EU countries, Latvian manufacturing has been resistant to external occurrences.

In 2012, production volumes of manufacturing exceeded the level of 2011 by 9.3% and were by nearly 10% higher than in 2007. In 2012, metal processing has contributed the most to growth of manufacturing. The production volumes have increased also in manufacture of computers, electronic and optical equipment, as well as production of vehicles. A significant increase has been observed also in manufacture of machinery and equipment, as well as paper industry and publishing. It should be noted that production volumes in these sectors considerably exceed the pre-crisis level. Yet, production volumes in sectors like food industry and light industry have been increasing at a moderate pace in 2012.

Table 3.10

Structure of Manufacturing in 2012

per cent

	By turnover	By filled number of jobs	Share of exports in the sales of the sector
Manufacturing – total	**100**	**100**	**63.5**
Food and beverage industry	23.0	22.2	33.9
Light industry	4.0	11.2	84.2
Wood processing	21.5	19.5	73.2
Paper industry and publishing	4.0	3.9	58.3
Chemical industry and related industries	7.7	6.3	77.8
Production of other non-metallic minerals	6.0	4.1	46.3
Production of metals and metal articles	15.7	11.1	76.9
Production of electrical and optical equipment	5.5	3.6	89.3
Production of machinery and equipment	2.3	2.8	80.3
Production of vehicles	4.0	3.1	92.8
Other manufacturing industries	6.3	12.2	43.4

In 2012, turnover of manufacturing production increased steadily (an increase of 13.1%). The turnover grew mainly on the account of the increase in production volumes, while producer prices have been growing at a moderate pace. Due to the gradually growing demand in the domestic market, turnover of production sold in the domestic market in 2012 was by 5.5% higher than in 2011. Yet, turnover of exported production has increased by 18%, which is a proof of the still high demand for Latvian industrial production in foreign markets.

In early 2013, some sectors showed a weak output and overall, in the four months of the year manufacturing released by 2.9% less products than a year ago.

A more rapid growth of manufacturing is hindered by the low demand in foreign markets, as well as the significant decrease in production volumes of metal processing due to JSC "Liepājas metalurgs" which faced financial difficulties.

In the four months of 2013, production volumes have been behind the level of the corresponding period of the previous year in such subsectors of manufacturing as the chemical industry and production of vehicles. The growth rates slowed down in wood processing, which had been growing at a very fast pace since 2009 and last year, the volumes of the sector exceeded the pre-crisis level by 40 per cent.

Production volumes continue growing steadily in other manufacturing sectors – production of computers, electronic and optical equipment, production of electrical equipment, production of furniture, clothing and textiles. The volumes are increasing also in domestic demand-oriented sectors – food industry and production of non-metallic minerals.

Table 3.11

Changes of Production Volumes in Manufacturing
(% compared to the corresponding period of the previous period)

	2008	2009	2010	2011	2012	2013 I-IV
Manufacturing – total	**-3.4**	**-20.2**	**16.5**	**11.7**	**9.3**	**-2.9**
Food and beverage industry	-2.0	-16.1	-0.1	-0.2	2.5	4.6
Light industry	-12.2	-38.6	19.4	19.4	3.0	6.8
Wood processing	-12.1	1.6	33.0	12.6	5.4	-1.4
Paper industry and publishing	-3.9	-17.1	19.8	-0.5	10.1	6.1
Chemical industry and related industries	-2.0	-18.5	5.2	4.4	8.3	-12.4
Production of other non-metallic minerals	-14.4	-40.1	17.6	24.2	8.6	3.2
Production of metals and metal articles	1.4	-27.1	24.2	28.3	16.3	-11.4
Production of electrical and optical equipment	14.1	-34.8	33.2	29.6	19.9	13.1
Production of machinery and equipment	10.4	-35.5	17.8	37.1	8.7	-2.2
Production of vehicles	5.8	-49.7	59.0	37.0	15.8	-20.2
Other manufacturing industries	-5.5	-20.1	-4.9	9.5	26.1	-17.4

In the four months of 2013, the turnover of manufacturing was by 1.7% higher than a year ago. The turnover of products sold in the domestic market has increased by 0.6%, while that of exported products – by 2.3 per cent.

In the four months of 2013, compared to the corresponding period of the previous year, the turnover has increased in the food industry, wood processing, production of electrical and optical equipment, light industry, paper industry and publishing, production of non-metallic minerals, as well as production of machinery and equipment. These sectors all together constituted an increase in the turnover of manufacturing by 4.7 percentage points.

Narrowing production in metal processing, chemical industry, production of vehicles and other manufacturing industries affected the decrease in the total turnover of manufacturing by 3 percentage points.

In the four months of 2013, almost 65% of the total manufacturing production of the sector was exported. Over 1/3 is exported to the EU-15 markets. Around 30% of the exported production is sold in Lithuania and Estonia. Exports to the CIS countries constitute 15 per cent.

In the four months of 2013, compared to the corresponding period of 2012, the turnover has increased by more than 10% in production of electrical and optical equipment, light industry, food industry as well as paper industry and publishing.

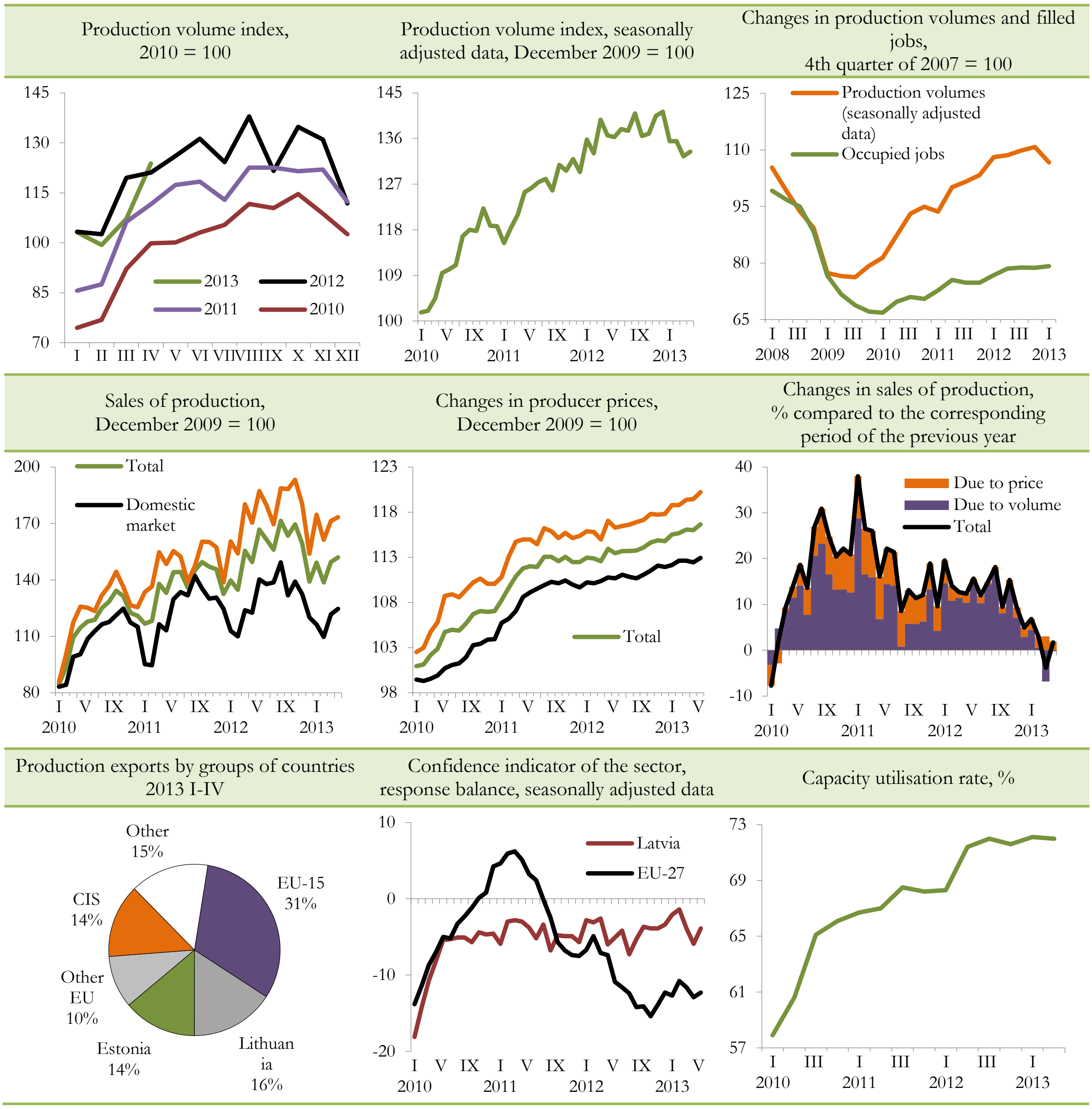
Producer prices in manufacturing keep growing at a moderate pace. In May 2013, producer prices were by 2.9% higher than a year ago. In this period, producer prices for exported products have increased by 3.4%, while those for products sold in the domestic market – by 2%. The dynamics of producer prices is a proof of the growing demand for Latvian industrial production in the domestic market and the remaining high demand for this production in foreign markets.

The rapid growth of manufacturing in the post-crisis period fosters an increase in labour demand. In 2012, compared to 2011, the number of filled jobs in manufacturing has increased by 5% or 5.5 thousand. Manufacturing has also contributed the most to creation of new jobs in national economy in general – the sector has ensured one fifth of all new jobs in 2012. At the same time it should be noted that the number of employed in manufacturing is growing considerably slower than the output, which is a proof of an increase in productivity.

The number of jobs kept growing also in 2013 – in the 1st quarter, there were by 3.1% more filled jobs in manufacturing than in the 1st quarter of 2012.

Figure 3.23

Indicators Characterising Manufacturing



The load of production capacity keeps increasing in manufacturing. In the 2nd quarter of 2013, the level of the load of production capacity in manufacturing was 72% – by 20 percentage points higher than at the hardest moment of the crisis at end of 2009. The load of production capacity in some subsectors has reached or is very close to the historically highest indicators.

The evaluation of Latvian producer confidence has essentially not changed over the past three years, besides it has been even better than the overall indicator in the EU-27 since 2010. The overall confidence indicator of manufacturing in Latvia in May 2013 was -3.9 points. The manufacturing confidence is still affected by uncertainty about development perspectives of the main trade partner countries.

The food and beverage industry is the largest manufacturing industry by both the output and the number of jobs. The sector is mainly oriented towards the domestic market – 2/3 of the total production is sold in the domestic market.

As the domestic demand narrowed during the crisis, production volumes of the industry also shrank significantly. Although the share of exports in turnover of the industry has increased over the past few years, the recovery of the food industry is rather slow due to the moderate increase of demand in the domestic market. In 2010 and 2011, production volumes of the food and beverage industry remained at the level of 2009. Yet, in 2012, production volumes of the industry slightly increased due to the expanding export possibilities and exceeded the level of 2011 by 2.5%. Production volumes of the industry continue growing also in 2013 along with the increasing demand in the domestic market – in the four months, production volumes were by 4.6% higher than a year ago.

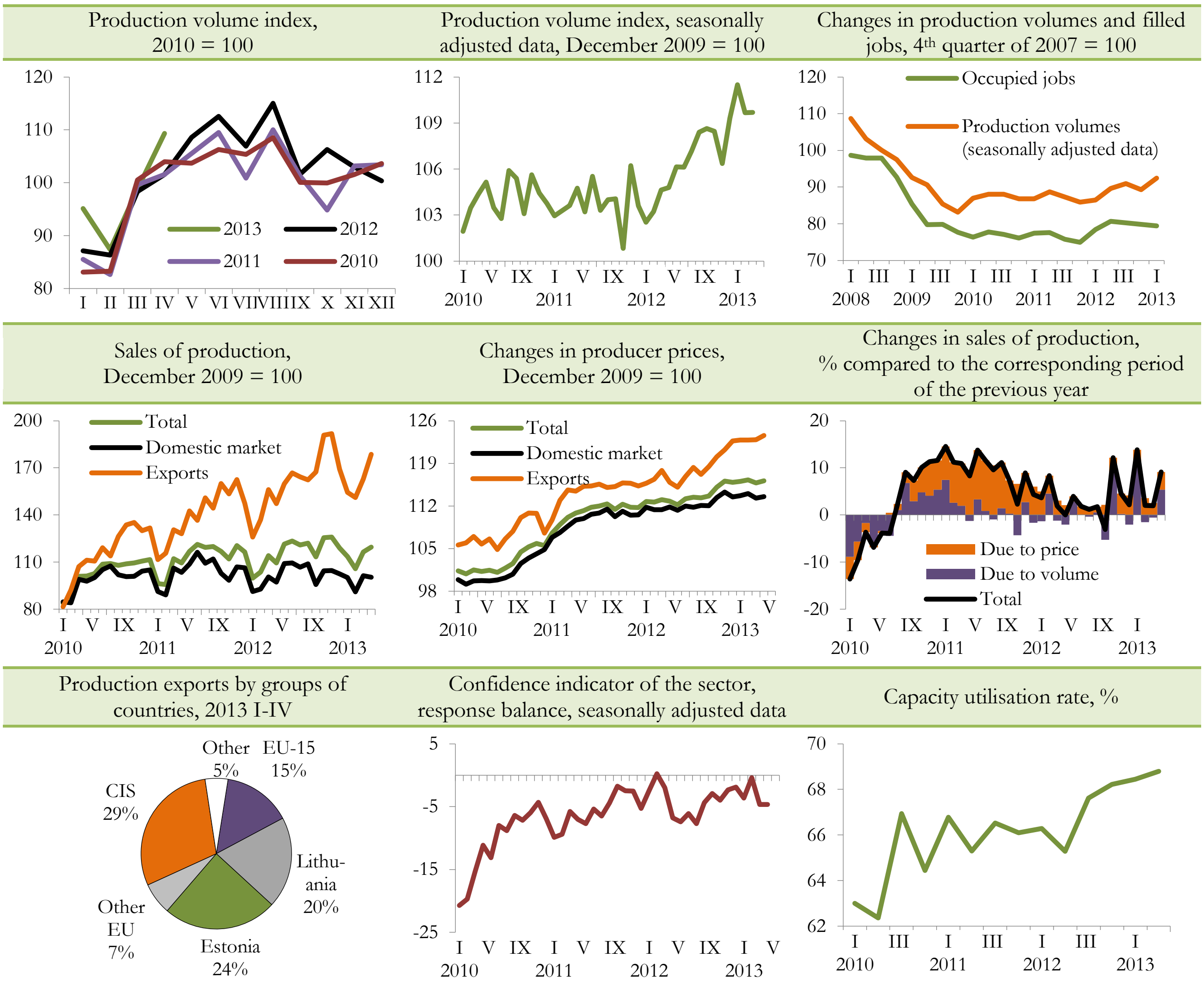
Revenues from sales in food industry are growing faster. In 2012, turnover of the industry was by 13.6% higher than in 2009. Also in 2013, revenues from sales continue increasing – in the four months, they exceeded the level of January-April 2012 by 6.6%. Turnover of exported production in this period has increased by more than 14%, while in the domestic market – by 3%. The increase was to a great extent fostered by the rise in producer prices (particularly for exported production) due to the rise in food prices worldwide in the previous years.

In April 2013, producer prices were by 3% higher than a year ago, which was mainly determined by the rise in producer prices for exported production (by 6.6%).

After the considerable drop in the number of jobs during the crisis, labour demand has been growing gradually. In the 1st quarter of 2013, there were over 25 thousand jobs in the food industry, which was by 1.2% more than a year ago.

Figure 3.24

Indicators Characterising Food and Beverage Industry



The ***light industry*** sector sells over 85% of the production in export markets – mainly the EU-15 countries.

The industry was hit more severely by the crisis than other manufacturing industries. Although in 2010 and 2011 production volumes in light industry increased by nearly 20% annually, they still were by 1/5 lower than before the crisis in 2007.

In 2012, production volumes were by 3% higher than a year ago. A slower increase was mainly determined by the deteriorating economic situation in the largest export markets. Yet, in January-April 2013, production volumes were by 6.8% higher than in the corresponding period of 2012.

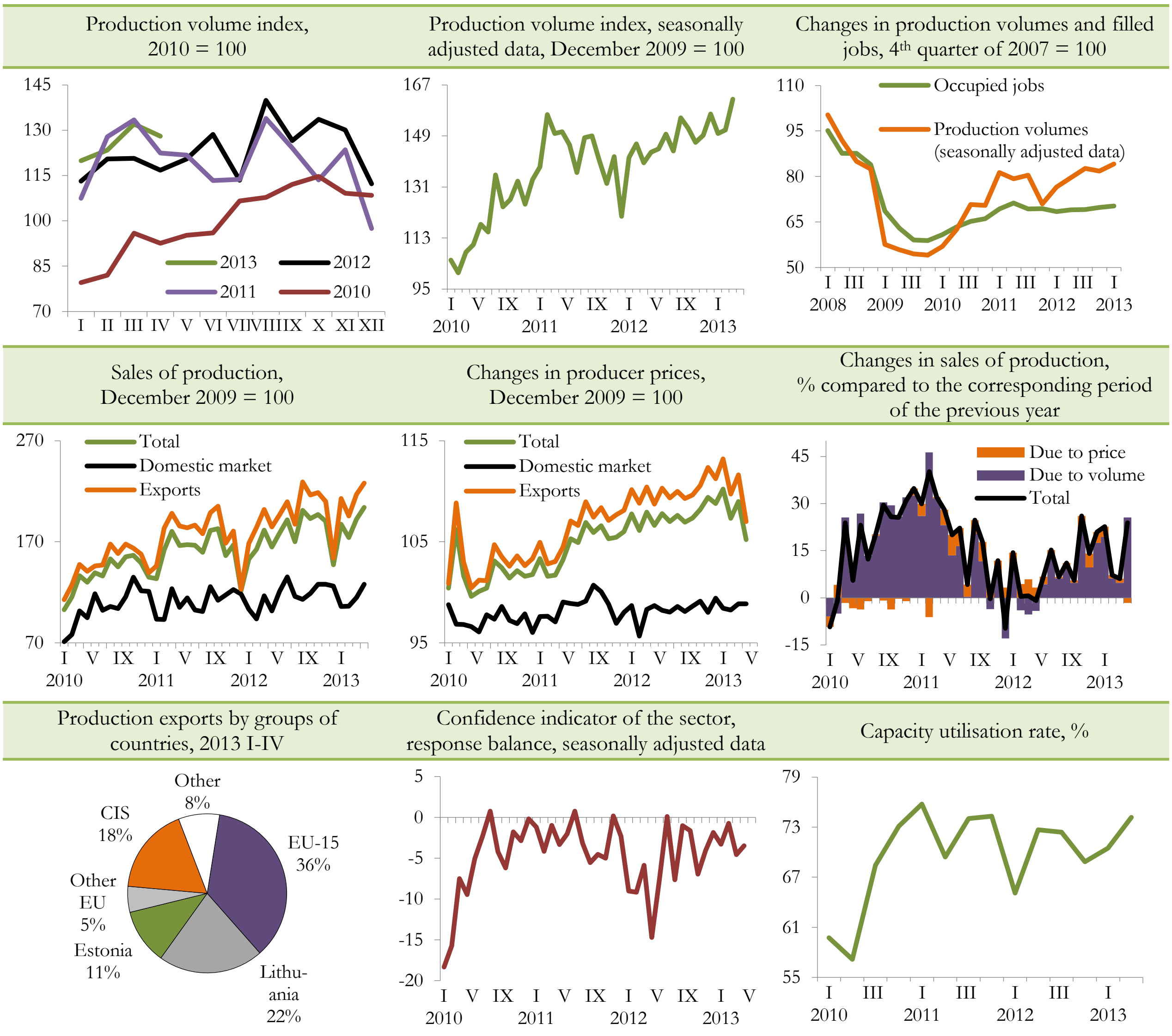
The sales volumes of the production in the industry have been growing steadily over the past few years along with the increasing output. In 2012, sales of the production increased by 9.6%, including the sales volumes of exported production – by 10.6%. Yet, revenues from goods sold in the domestic market have increased by 5.4% in 2012.

From 2010 to 2012 producer prices increased at a moderate pace in the light industry, which was mainly based on the rise in prices for exported production, while producer prices for products sold in the domestic market basically remained unchanged due to the still weak demand. Also in 2013, producer prices for products sold in the domestic market basically remain unchanged. Meanwhile, in April 2013, producer prices for exported production were by 1.6% lower than a year ago, which is mainly related to the weak demand in the largest sales markets.

The growth of the industry has been related to the increase in productivity in the past few years, since the number of filled jobs has been growing very slow after the considerable drop during the crisis.

Figure 3.25

Indicators Characterising Light Industry



Wood processing is one of the largest manufacturing sectors, and the sector constitutes 1/5 of the total output and all jobs in manufacturing. Wood processing was one of the first sectors to resume growth after the significant decrease in manufacturing. In 2012, production volumes of the sector continued increasing and were by 5.4% higher than in 2011. Production volumes of the sector already exceed the level of 2007 by 40 per cent.

About 3/4 of the total production in the sector is being exported, thus growth of wood processing is closely related to processes in foreign markets. In the first months of 2013, performance indicators of the sector have been slightly weaker than previously, mainly due to the economic situation in the EU countries that are the largest sales market of the sector. In the four months of 2013, production volumes were by 1.4% lower than a year ago.

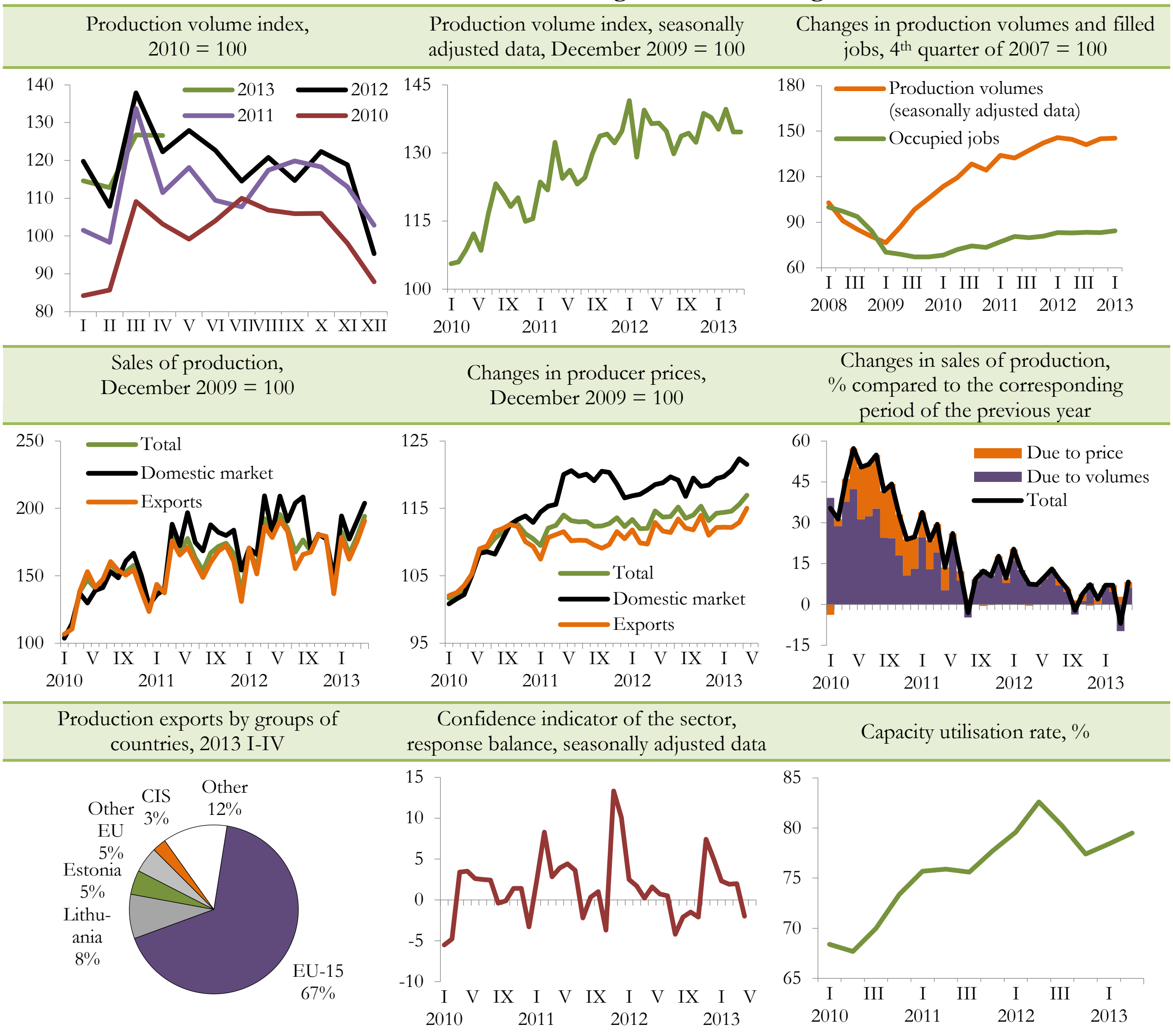
The turnover of wood processing production is also growing steadily for both exported production and for production sold in the domestic market. The demand for wood production is increasing also in the domestic market, fostered by gradually increasing activities in construction, and in the four months of 2013, the volumes of production sold in the domestic market were by 5.2% higher than a year ago. At the same time, the turnover of exported production has increased by 2.9 per cent.

Producer prices have been rising at a moderate pace over the past two years – in April 2013, producer prices were by 2% higher than in April 2012.

The significant increase in production volumes of the sector over the past few years has been based on an increase in productivity, while the number of jobs is growing at a moderate pace. In the 1st quarter of 2013, the number of filled jobs was by 1.5% higher than a year ago.

Figure 3.26

Indicators Characterising Wood Processing



The paper production and publishing industry is a rather small industry constituting on average 4% of both the total turnover and the number of employed in manufacturing. In the pre-crisis period, most of the production was sold in the domestic market, yet, the opening export opportunities made it possible for the industry to easily adapt itself to new conditions and gradually increase export volumes. Currently, about 60% of all production is exported mainly to neighbouring countries – Lithuania and Estonia.

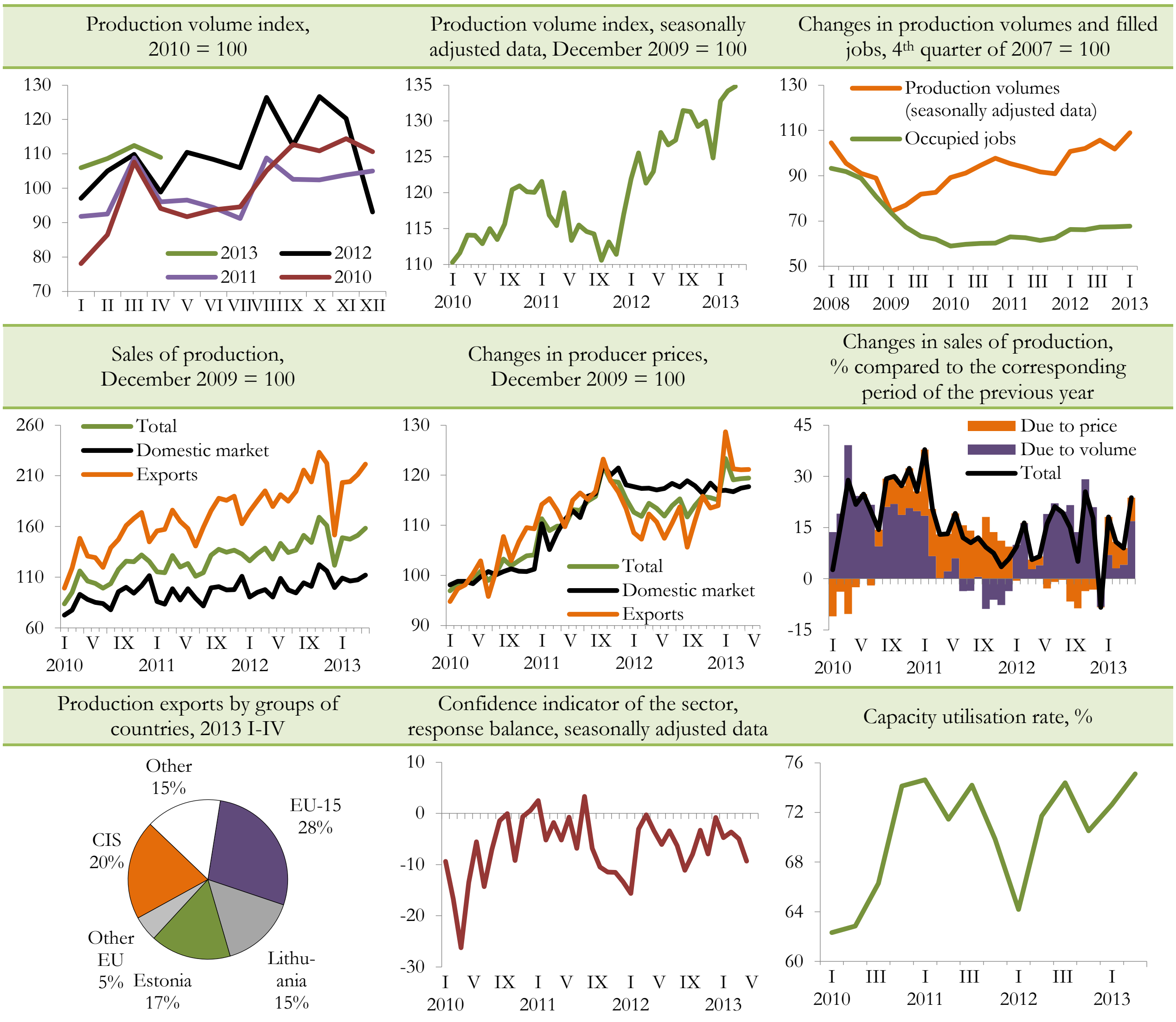
After weaker output indicators in 2011 when production volumes in manufacturing basically remained at the level of the previous years, a strong growth was already seen in 2012 – production volumes were by over 10% higher than in 2011 and reached the level of 2007. In the four months of 2013, the industry kept growing at a steady pace and production volumes were by 6% higher than a year ago.

The turnover of the industry is also growing steadily. In 2011, the rise in producer prices ensured a greater contribution, while recently the increase in the turnover has been mainly based on the increase in production volumes. In 2012, the turnover of the sector has increased by 12%, including that of exported production – by 15.8%. Also in early 2013, sales revenues of the industry continue growing fast – in the four months, the sales volumes were by 15% higher than a year ago. The increase in revenues was ensured not only by exports but also by the increase in turnover in the domestic market (by 16.5%).

Producer prices in the industry are characterized by explicit fluctuations. In 2011, the prices increased by nearly 11%, while in 2012, they even slightly dropped. In April 2013, producer prices were by 5.3% higher than a year ago, producer prices for exported production increased by 9.5% in this period.

Figure 3.27

Indicators Characterising Paper Production and Publishing Industry



The ***chemical industry*** and allied industries constitute nearly 7.7% of the total output of manufacturing and provide over 6% of jobs. Over ¾ of chemical industry products are exported.

Development tendencies differ among the chemical industry subsectors. In 2012, the total production volumes of the chemical industry increased by 8.3%, though they still were behind the pre-crisis level. The increase in volumes was fostered by production of chemical substances and products (increase by 17%), while production volumes of the pharmacy sector in 2012 remained at the level of 2011. Production of rubber and plastic products was growing at a moderate pace in 2012 (by 1.2%). In the four months of 2013, production volumes of chemical industry subsectors were 12.4% lower than in the four months of 2012.

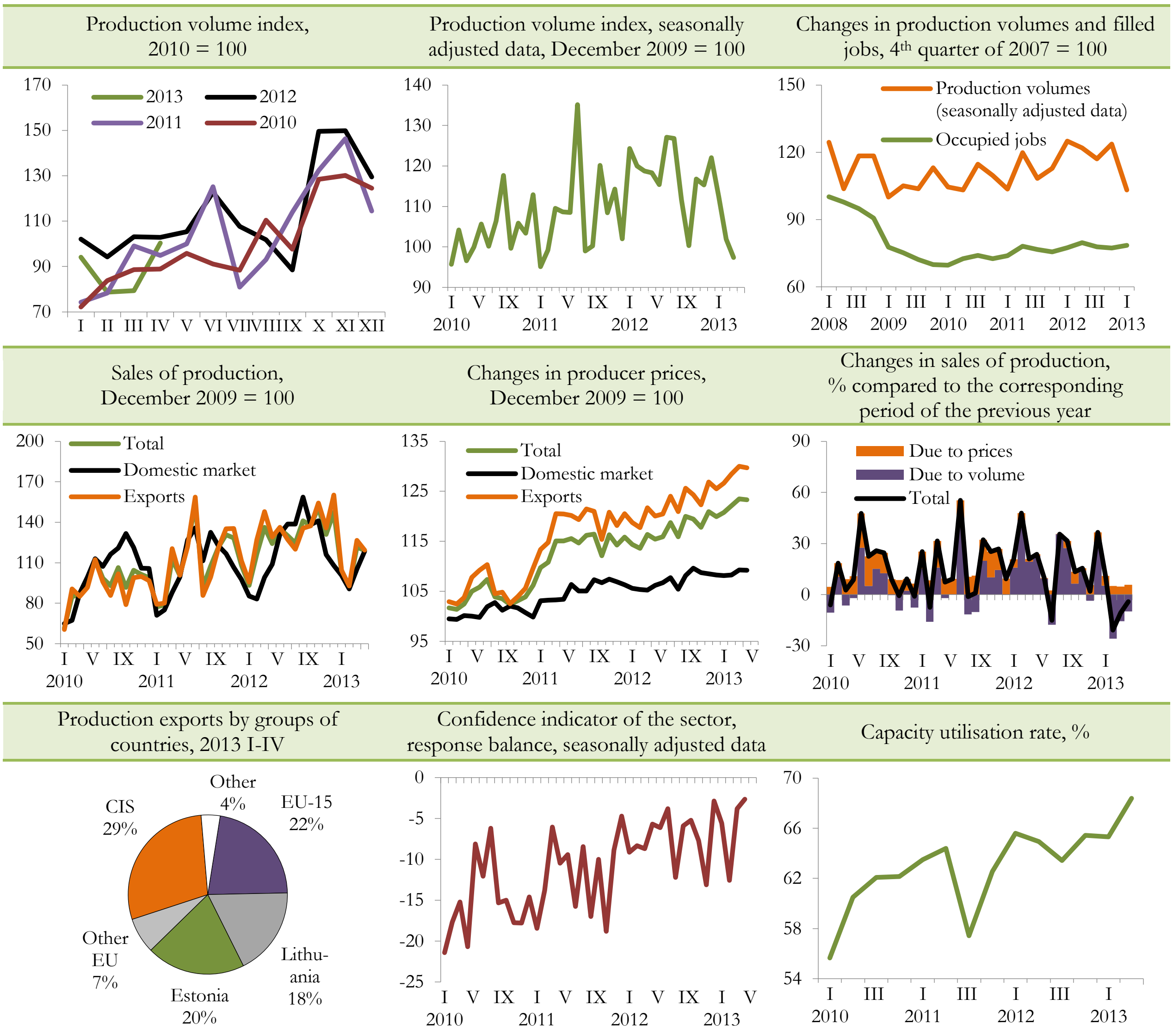
In 2012, the total turnover of the sector grew by 17.6% due to the increase in sales of exported production. Sales in the domestic market have increased by 12.7% due to the growing demand in the domestic market. In the four months of 2013, the turnover of the chemical industry was by 7.2% lower than a year ago. The drop was determined by the decrease in the turnover of exported production (by 11.3%), while the volumes of production sold in the domestic market were by 10% higher than a year ago.

After moderate price dynamics, producer prices have been growing faster since early 2012. In April 2013, producer prices were by 6.8% higher than in April 2012.

The number of filled jobs in the industry is growing gradually – in the 1st quarter of 2013, the number of filled jobs was by 1.5% higher than in the 1st quarter of 2012.

Figure 3.28

Indicators Characterising Chemical Industry



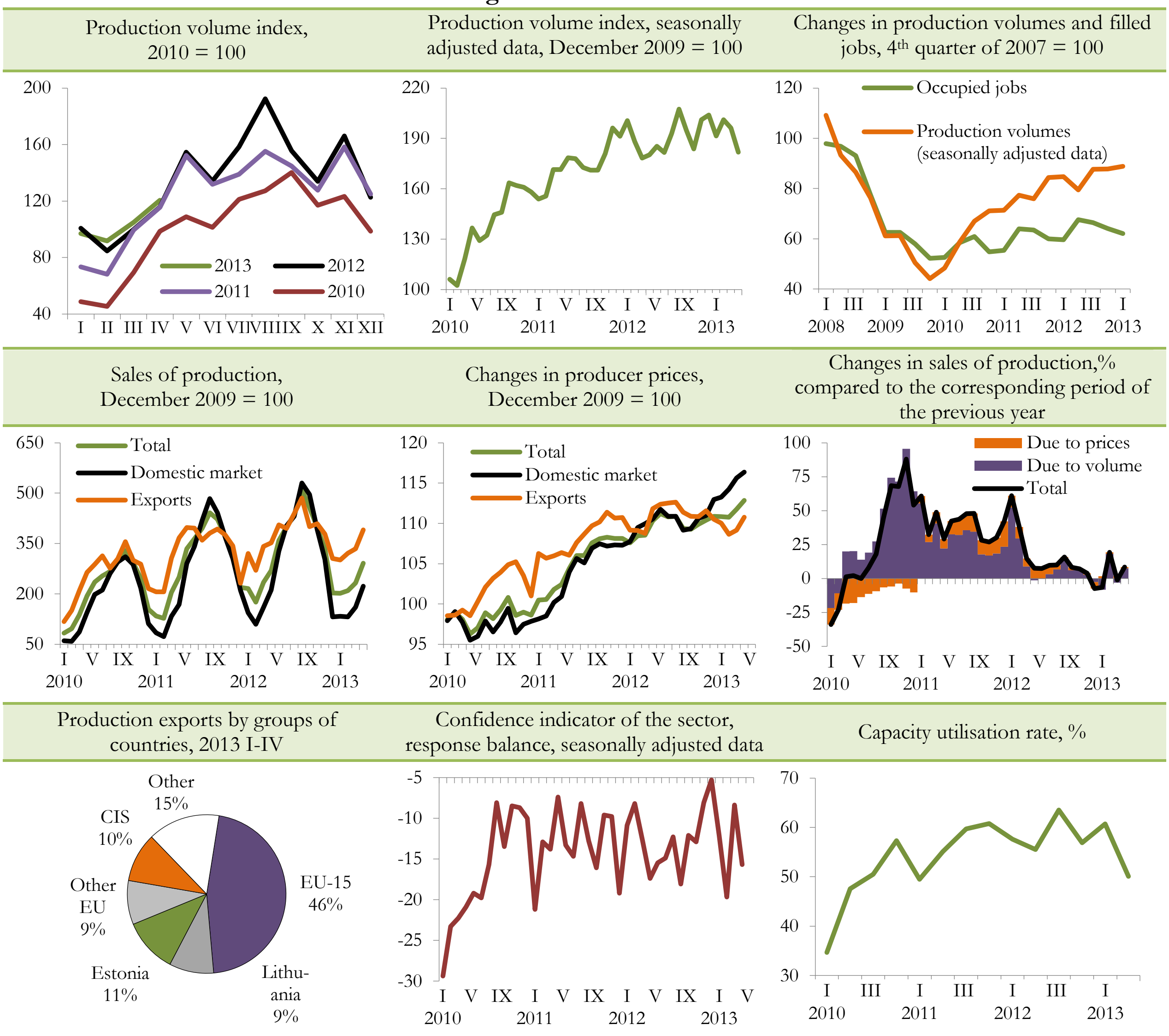
The growth of ***production of other non-metallic minerals*** during the pre-crisis period was to a great extent based on high demand for construction materials, therefore, during the economic crisis, when construction volumes significantly decreased, the production of non-metallic minerals decreased by a half. Production volumes have been increasing since 2010. The recovery of the sector after the crisis is mainly related to the ability to focus on foreign markets – mainly to the old EU Member States and owing to the gradually resuming activities in the domestic market. In 2012, production volumes increased by 8.6%, and the growth continues also in 2013 – in the four months, the volumes exceeded the level of the corresponding period of the previous year by 3.2 per cent.

The turnover of the industry has been growing over the past few years as well. The increase in sales revenues from exports has contributed greatly to the turnover – in 2012, the revenues were one and a half times higher than in 2009. The share of exported production has already reached 60% of the total turnover of the industry. As the economic situation gradually improved, the turnover in the domestic market also increases (in 2012 – by 9.5% and in January-April 2013 – by 3.7%). In the four months of 2013, the turnover of the industry was by 4.5% higher than a year ago.

After the considerable drop in producer prices in 2011, the price rise in production of non-metallic minerals, like the rest of manufacturing industries was moderate in 2012. Yet, in the first months of 2013, the increasing demand led to a rapid rise in producer prices for production sold in the domestic market. In April, the prices were by 5.3% higher than a year ago. At the same time, producer prices for exported production have dropped by 1 per cent.

Figure 3.29

Indicators Characterising Production of Other Non-Metallic Minerals



Production of metal and metal articles is the third largest manufacturing industry, mainly focused on foreign markets – 3/4 of the total production is exported.

Production volumes of the metal processing sector have been increasing rapidly since the mid-2009. Overall, despite the strained economic situation in the EU, Latvian metal processing industry kept growing fast in 2012 – production volumes exceeded the level of the previous year by 16.3%. Production volumes of the industry were by nearly 40% higher than before the crisis in 2007. The sector provided one of the greatest contributions to the total growth of manufacturing industry.

Yet, in 2013, the growth of the sector is significantly affected by JSC "Liepājas metalurgs" which is facing financial difficulties. The company ensures on average a half of the total turnover of the industry. In the four months of 2013, the total production volumes of the industry were by 11.4% lower than a year ago.

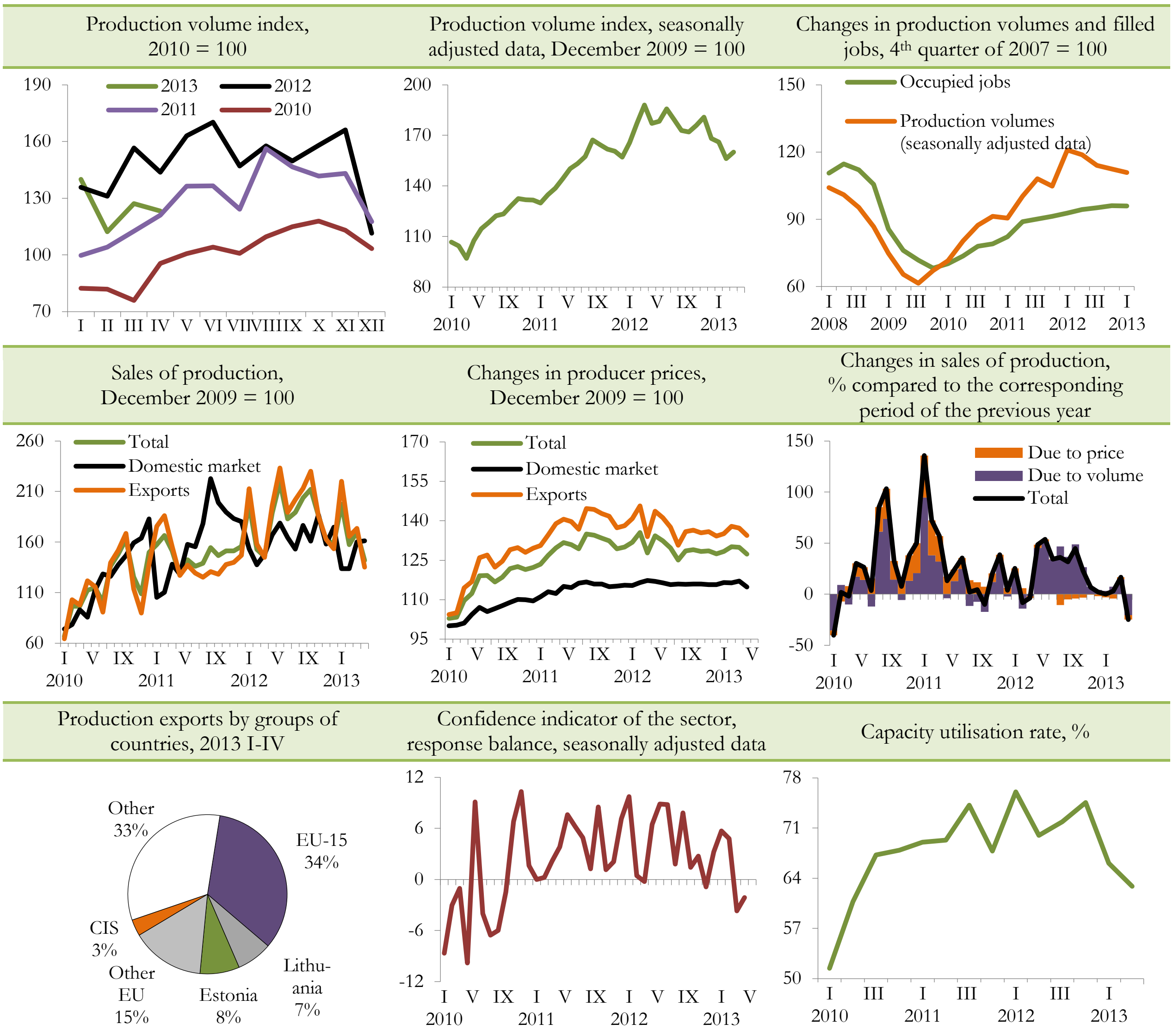
In 2012, the turnover of the industry was almost twice as high as in 2009. The increase in the turnover was fostered by both the increase in production volumes and the rise in producer prices observed in the previous years. Yet, in the four months of 2013, the total turnover of the industry was by 2.6% lower than a year ago.

The weak demand in the global market affects producer prices. In April 2013, they were by 5.2% lower than a year ago, while producer prices for exported production shrank even faster – by 6.4 per cent.

In the 1st quarter of 2013, there were by 40% more filled jobs in the industry than in late 2009. The industry employs 11% of all people working in manufacturing.

Figure 3.30

Characterising Production of Metals and Metal Articles



Production of electrical and optical equipment is developing rather successfully after the decrease in production volumes during the economic crisis and is one of the fast growing manufacturing industries in Latvia.

In 2012, production volumes increased by nearly 20%, compared to 2011, exceeding the level of 2007 by more than 50%. The increase in production volumes of electronic equipment has contributed the most to the growth of the industry, but the production volumes of computer, electronic, and optical equipment are increasing slightly slower. Overall, rapid growth of the industry was observed also in 2013 – in the four months, the production volumes exceeded the level of the corresponding period of 2011 by 13 per cent.

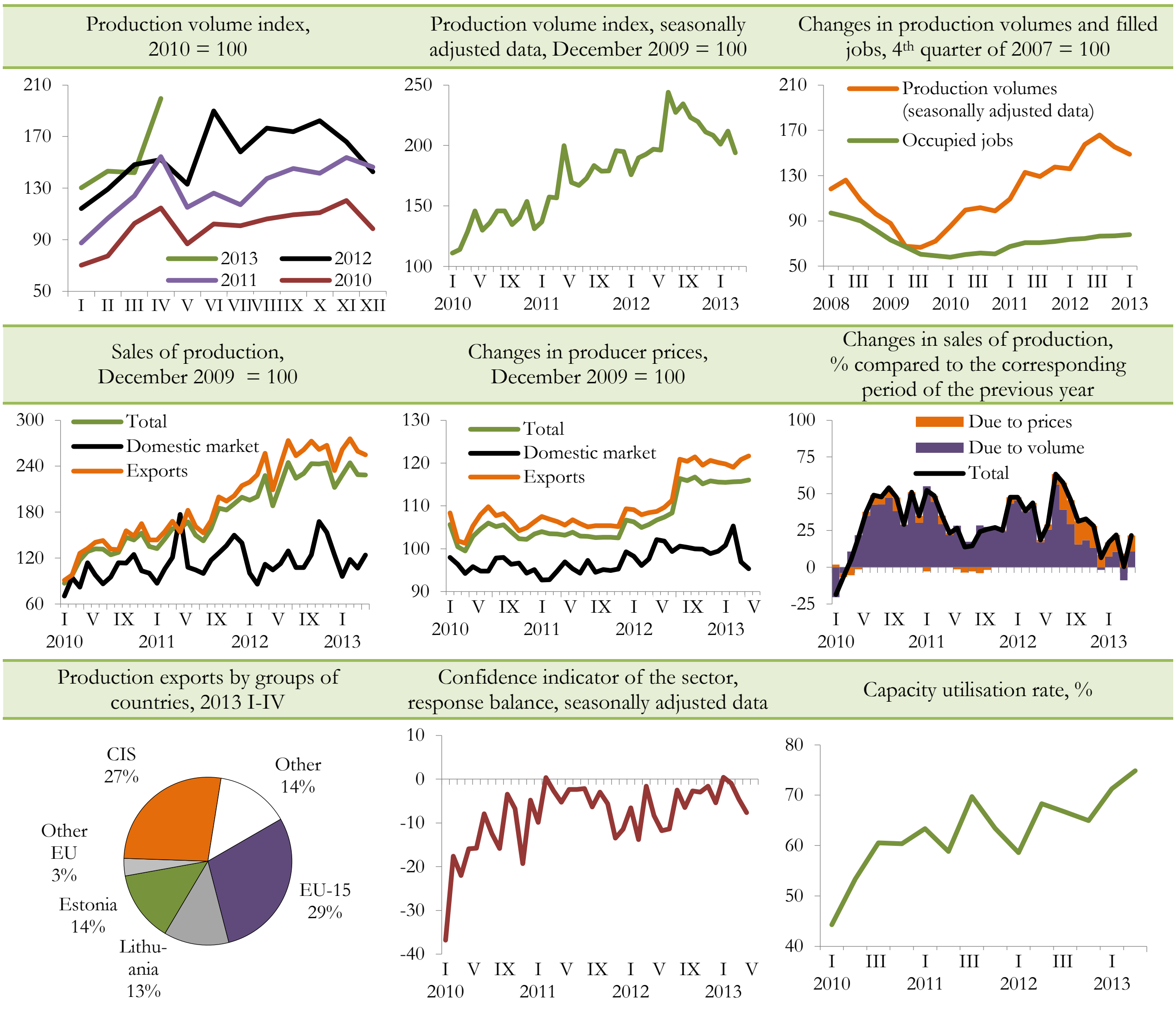
The sales revenues of the sector are increasing in line with the increase in production volumes. Since 2010, the turnover of exported production has been increasing by 30% annually. Overall, the industry exports almost 90% of manufactured production. In the four months of 2013, the turnover of exported production was by 15% higher than a year ago, while that of production sold in the domestic market – by 10.6 per cent.

Producer prices did not increase in production of electrical and optical equipment in 2010 and 2011. Yet, producer prices for exported production considerably increased in the second half of 2012. In April 2013, producer prices for exported production were by nearly 12% higher than in April 2012. At the same time, producer prices for production sold in the domestic market have shrunk by 6.7 per cent.

Considering the fast growth of the industry over the past few years, the number of jobs has also been increasing gradually. In the 1st quarter of 2013, there were by 5.6% more filled jobs in the industry than a year ago.

Figure 3.31

Indicators Characterising Production of Electrical and Optical Equipment



The industry of ***production of machinery and equipment*** is recovering from the crisis rather successfully – production volumes of the industry have been growing faster than average in manufacturing. The growth of the industry relies on export possibilities. Over 80% of all production manufactured in the industry is sold in foreign markets – Lithuania, Estonia, and other EU Member States.

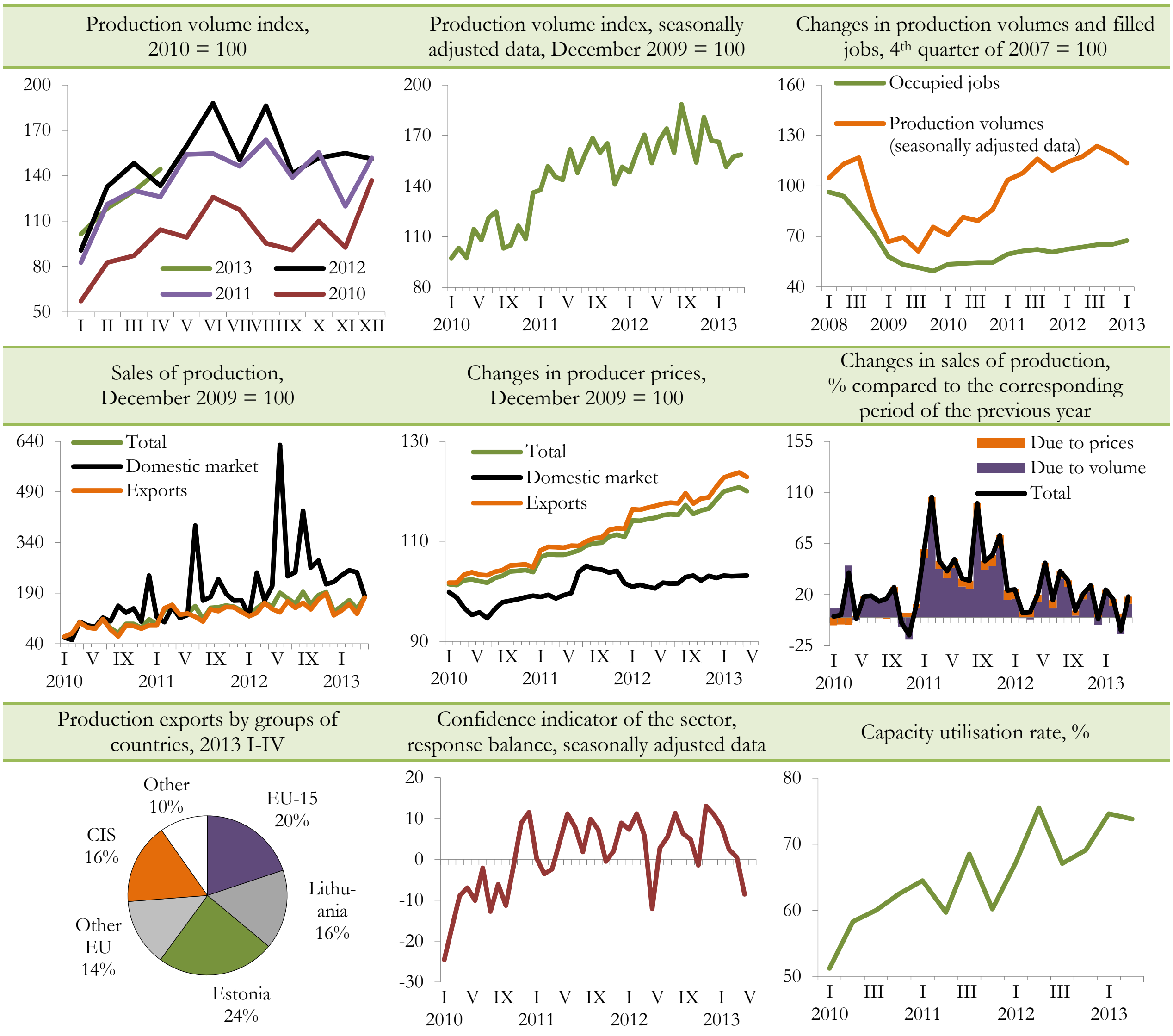
The production output of machinery and equipment in 2012 was by 8.7% higher than in 2011 and exceeded the pre-crisis level by 25%. In early 2013, the growth of the industry is affected by a deteriorating economic situation in a number of trade partner countries. In January-April 2013, production volumes were by 2.2% behind the level of the corresponding period of 2012.

The turnover of the industry is growing steadily. In 2012, it increased by 19.4%. The turnover of both exported production and that of production sold in the domestic market has been significantly increasing since 2009. Since the industry is a supplier of capital goods and common technologies to other industries of national economy, the increasing economic activities have a boosting effect on the demand for the industry products. In the four months of 2013, there were by 24% more sold products in the domestic market than a year ago. The turnover of exported production has also slightly increased in the four months of 2013.

The increase in the turnover is fostered by the rise in producer prices. Prices for exported production have been rising gradually since 2010 and in April 2013, they were by 5% higher than a year ago. Yet, the dynamics of prices in the domestic market is more moderate – producer prices for production sold in the domestic market have increased by 2.5% in a year.

Figure 3.32

Indicators Characterising Production of Machinery and Equipment



Production of transport vehicles constitutes 4% of the total output of manufacturing. The industry is characterised by explicit fluctuations of production volumes since it mainly deals with new orders. As approximately 90% of production is exported, fluctuations in external demand have a significant impact on development of the industry.

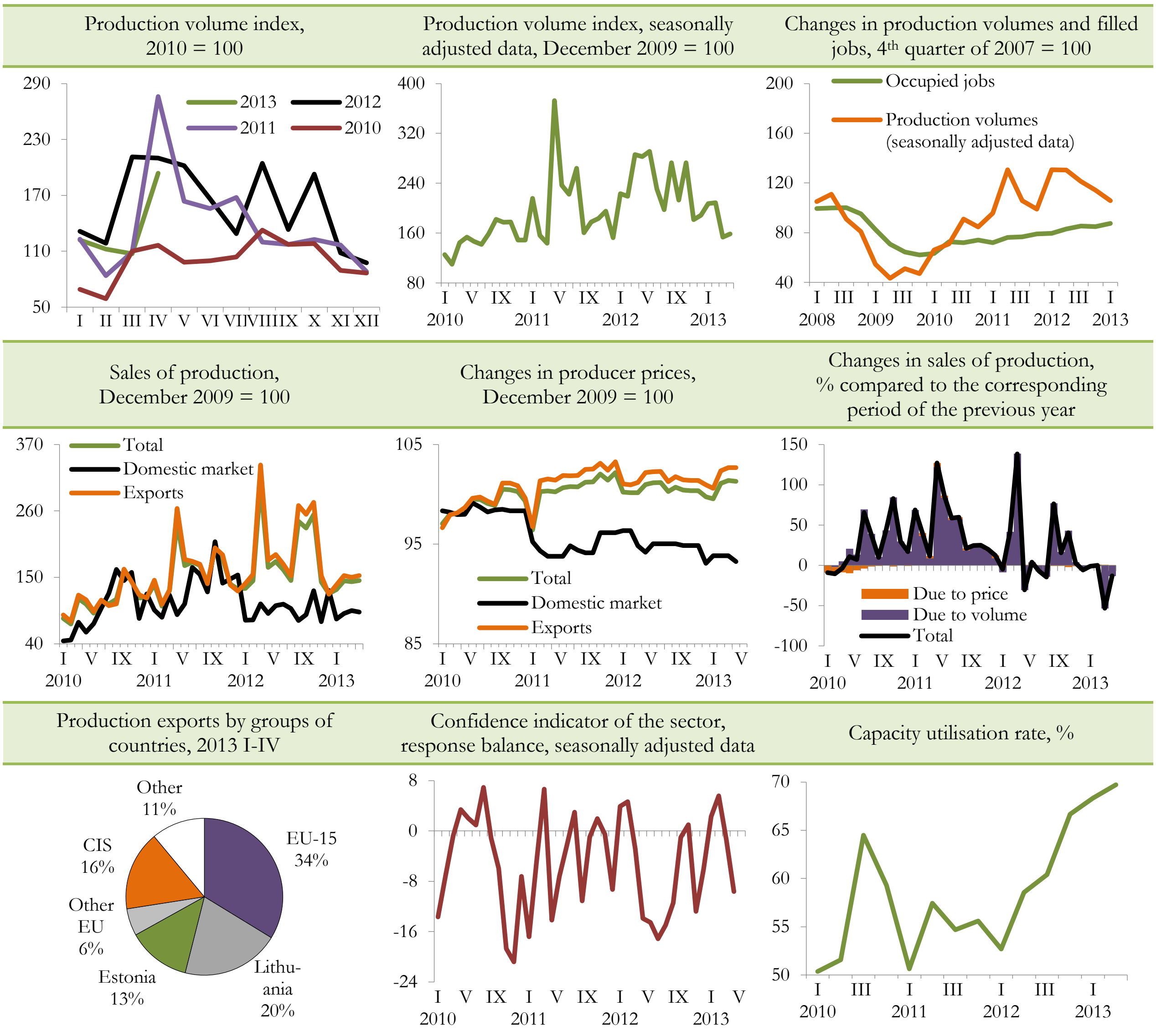
The volumes of new orders in the domestic market and foreign markets and production volumes increased rapidly in the post-crisis period. The growth continued also in 2012, when production volumes increased by 15.8% and were by 34% higher than in 2007. The orders finished in the previous years and the weak demand in foreign markets affected the development of the industry in 2013 – in the four months, production volumes in the industry were by 20% lower than a year ago.

Sales revenues of the industry are changing in line with the dynamics of production volumes. In 2012, the turnover of exported production more than doubled compared to 2009, while that of production sold in the domestic market increased by just 7%. In the four months of 2013, the turnover of exported production was by 26.7% lower than a year ago due to the shrinking demand in foreign markets. At the same time, the turnover of production sold in the domestic market has slightly increased.

Although the demand for production of the industry has been considerably fluctuating over the past few years, the dynamics of producer prices has been rather moderate. In April 2013, producer prices for exported production have increased by 0.5%, while prices for production sold in the domestic market have dropped by 1%, compared to April 2012.

Figure 3.33

Indicators Characterising Production of Transport Vehicles



3.3 Forecasts

The Ministry of Economics has prepared medium-term forecasts for economic development until 2020. The basic assumptions of the more rapid and slower development forecasts are based on various global economic recovery scenarios in a medium-term and on the ability of Latvian producers to further maintain competitiveness restored during the crisis.

Forecasts of the EC, as well as of the IMF have been used for preparing forecasts of the Ministry of Economics in the analysis of external markets and evaluation of global economic development tendencies.

Economic Development in 2013 and 2014

In the first half of 2013, national economy of Latvia continued growing and the increase of GDP still was one of the fastest in the EU.

As forecasted previously, the low demand in foreign markets affected the export dynamics of Latvian goods and services – the growth rates have slowed down. The narrowing export possibilities have affected certain manufacturing industries. At the same time, demand has provided greater contribution to the growth. Stable growth rates have been observed in such large sectors of national economy as construction, trade and commercial services.

In 2013 and 2014, growth of national economy of Latvia will still be closely related to the export possibilities, and therefore the highest risk to the growth of Latvia is related to global economic development. The IMF and the EC forecast that growth of global economy in 2013 may be slower than in 2012. In 2013, growth of Europe will be rather weak and recovery – gradual. The remaining weak demand in external markets is expected to lead to a more moderate growth of export volumes of Latvian goods and services than in the previous years. The ability to improve competiveness and find new market niches will become significant due to the remaining low demand for Latvian goods.

Domestic demand is expected to provide an increasing contribution to the growth. As the situation in the labour market improves, private consumption is also expected to grow. At the same time, a more rapid increase in consumption will be still limited by a relatively high unemployment rate and indebtedness of households. Investments of the private sector will be influenced by the awaiting behaviour of entrepreneurs regarding future perspectives and cautious crediting policy of commercial banks.

All main sectors of the national economy are likely to grow in 2013 and 2014, though in some industries the growth will be slightly slower than in 2012.

The weak demand in foreign markets will affect the growth of manufacturing, as well as the growth of transport and storage sectors. At the same time, the low demand in these sectors will be partially compensated by the increase in economic activities in the domestic market.

The contribution of domestic market-oriented services sectors to the growth also rises along with the increasing private consumption. After several years of stagnation, a moderate increase is expected also in public services sectors.

The Ministry of Economics forecasts a more moderate growth of Latvian economy in 2013 and in 2014 than in the past two years, and the increase in GDP might grow up to 4.5% in a year. At the same time, no improvements in the global economic situation might lead to a slower increase in GDP of Latvia in 2014.

Development Perspectives in 2015-2020

The medium-term growth of the economy will mainly depend on the economic situation in Europe and the structural policy implemented by the Latvian government for improvement of competitiveness.

A transition to a sustainable economic model is taking place in the economy of Latvia, in which exports are the key driver of growth. One of the key issues related to the change of economic paradigm is the opportunities of manufacturing industries that depend on the ability to introduce structural changes in the industry. It is a necessary precondition for strengthening the competitive positions of Latvia in the global markets, at the same time increasing the profitability of total exports.

Figure 3.34

Forecast of Latvian GDP
(2007 = 100)

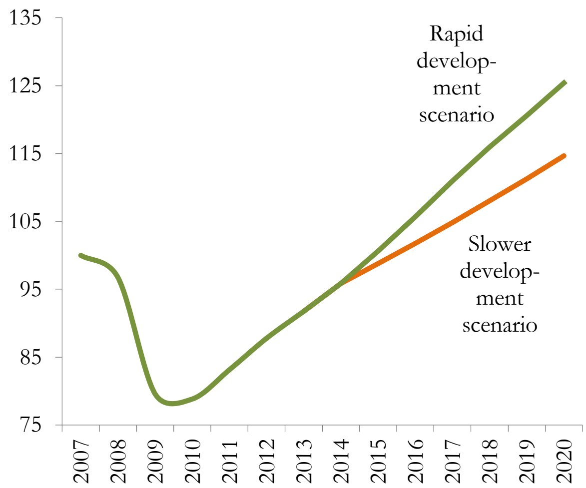


Table 3.12

Forecast of Latvian GDP by Expenditure Items

	2012 fact	2013	2014	2015-2020 (average annually)*
	growth rates, % over the previous year			
Gross domestic product	**5.6**	**4.5**	**4.5**	**3.0 .. 4.6**
Private consumption	5.4	5.0	5.0	3.0 .. 4.6
Public consumption	-0.2	0.6	1.4	2.0 .. 3.8
Gross fixed capital formation	12.3	-0.5	3.6	3.3 .. 5.8
Exports	8.3	3.0	4.0	3.1 .. 4.3
Imports	2.9	4.6	3.6	3.0 .. 4.7
	structure, %			
Gross domestic product	**100**	**100**	**100**	**100**
Private consumption	62.1	61.9	62.2	61.7 .. 61.8
Public consumption	15.3	16.0	15.6	16.2 .. 16.4
Gross fixed capital formation	23.5	23.0	23.1	23.6 .. 24.9
Changes in inventories	2.4	2.5	2.5	2.2 .. 2.4
Exports	61.1	61.6	61.9	60.7 .. 59.4
Imports	64.4	64.9	65.4	64.4 .. 64.9
Export-import balance	-3.3	-3.3	-3.4	-3.7 .. -5.5

* structure at the end of the period

The main medium-term objectives of the structural policy of Latvia are related to certain structural changes in allocating resources of the economy in favour of production of higher value added goods and services, export-oriented sectors, higher investments in new technologies, innovation and ICT, as well as improvements in the education system and supporting science. Implementation of these measures will strengthen economic growth potential, thus boosting industrial growth and increasing productivity of the economy.

Table 3.13

Forecast of Latvian GDP by Sectors

(real growth, % in comparison with the previous year)

	2012 fact	2013	2014	2015-2020 (average annually)
Gross domestic product	**5.6**	**4.5**	**4.5**	**3.0 .. 4.6**
Agriculture, forestry	6.9	1.0	3.9	1.7 .. 2.4
Manufacturing	9.3	2.2	4.7	3.6 .. 5.5
Other industry	-2.0	1.4	3.4	1.9 .. 2.9
Construction	14.6	4.9	4.5	3.6 .. 6.9
Trade, accommodation	7.3	6.9	5.5	3.2 .. 4.8
Transport and storage	4.0	5.4	5.0	2.7 .. 3.6
Other commercial services	3.4	5.1	4.3	3.4 .. 4.8
Public services	-0.6	1.4	2.6	1.7 .. 3.3

In the post-crisis period, the flexible labour market in Latvia has been a crucial factor for ensuring the current growth. It was characterized by reducing wages and employment in line with the narrowing output, thus allowing improving competiveness of the national economy with respect to internal devaluation measures during the crisis. However, further growth can no longer rely on such drastic measures and an increasing emphasis will be placed on qualitative improvements of the labour market in order to address the main challenges to the national economic growth – demography (migration and ageing labourforce) and increasing labour costs. Considering the negative demographic trends, the issues regarding access to labour are going to become increasingly topical in Latvia along with the growing economy in the coming years (see Chapter 5.3). The lack of labour might become a factor hindering growth in the future.

The more rapid development scenario foresees stable medium-term growth and economic development of the EU and the 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 foresees that growth rates of manufacturing (and respectively also of exports) will remain comparatively high, based mainly on both the increased competitiveness of Latvian producers and on the stable external demand.

The weaker development scenario is based on an assumption that the global economy will develop unevenly and the EU will recover slowly from the crisis. Yet, the national economy of Latvia will gradually lose the competitive advantages in low-cost segments.

4. Macroeconomic Stability

4.1 Public Finances

4.1.1 Fiscal Policy and Public Debt

Deterioration of the economic situation in 2008 and 2009 affected by the global financial crisis has considerably worsened the Latvian fiscal position (see Table 4.1). In order to prevent the situation in the financial sector from going out of control, Latvia carried out comprehensive budget consolidation. Overall, from 2008 to 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 while 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 implemented by the government, the budget deficit in 2010 and 2011 decreased to 8.1% and 3.6% of GDP, respectively. In 2012, it continued dropping and was 1.2% of GDP.

Table 4.1

General Government Budget

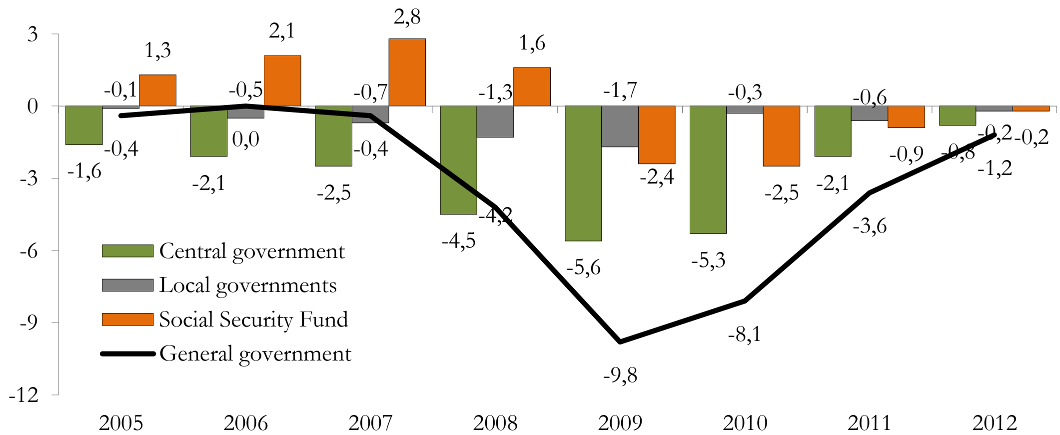
	2006	2007	2008	2009	2010	2011	2012
Revenues (million LVL)	4208.0	5235.5	5605.8	4442.6	4512.8	4978.3	5468.1
(% of GDP)	37.8	35.6	34.9	34.0	35.3	34.9	35.2
Expenditures (million LVL)	4263.2	5292.3	6286.9	5712.8	5549.6	5488.1	5661.7
(% of GDP)	38.3	36.0	39.1	43.7	43.4	38.4	36.5
Balance (million LVL)	-55.1	-56.8	-681.0	-1270.1	-1036.9	-509.8	-193.6
(% of GDP)	-0.5	-0.4	-4.2	-9.7	-8.1	-3.6	-1.2

Since the general government budget deficit in 2012 was considerably below the Maastricht criterion of 3%, EC has abrogated the *Decision 2009/591/EC on the existence of an excessive deficit in Latvia.* Structural deficit has reached 0.5% level, thus meeting the national medium-term objective of a balanced budget in structural terms budget balance or the MTO. Thus, the task of the upcoming years no longer is reduction of structural deficit, it is now keeping the MTO to the given level, allowing only deviations that comply with the *Stability and Growth Pact.*

Figure 4.1

General Government Budget Balance by Sub-Sectors

(% 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 (see Figure 4.1). Until 2008, the social insurance budget had a surplus; however, deficit has appeared over the last years.

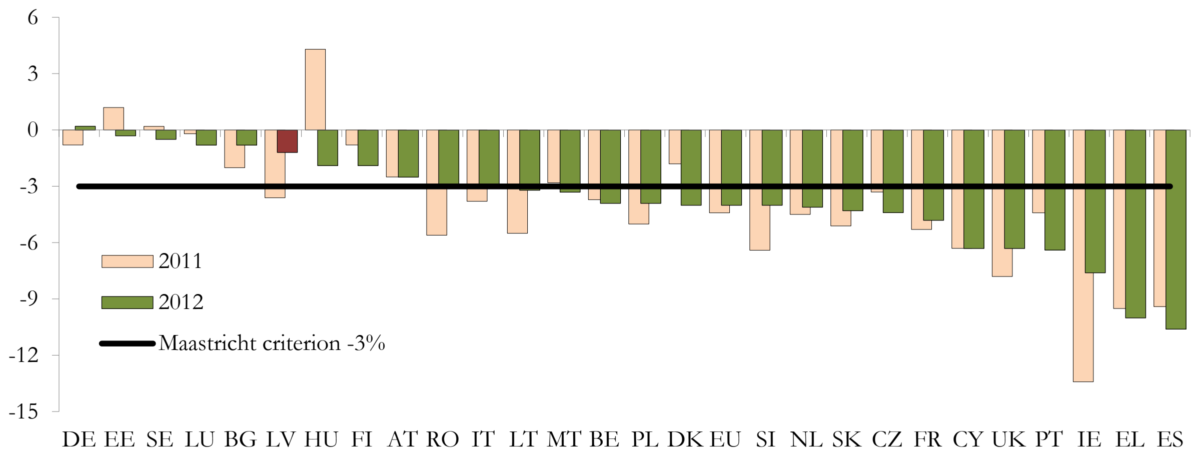
The level of the average budget deficit of the EU Member States in 2012 was 4% of GDP (in 2011 – 4.4% of GDP, in 2010 – 6.5% of GDP). The budget condition of 13 EU Member States has improved in 2012, while in 2 it remained the same and in 12 – deteriorated. Spain and Greece had the highest general government budget deficit against GDP in 2012. The budget deficit in these countries exceeded 10% of GDP. Only Germany had a budget surplus.

According to the forecasts of the European Commission published in spring 2013, the budget situation in the EU Member States is expected to continue improving both in 2013 and 2014. In 2013, the level of the average budget deficit of the EU Member States is forecasted to be in the amount of 3.4% of GDP, while in 2013 – in the amount of 3.2% of GDP. In 2013, the highest budget deficit that could exceed 6% of GDP is expected in Ireland, Spain, Cyprus, and the United Kingdom.

Figure 4.2

General Government Budget Balance in the EU Member States in 2011 and 2012

(% of GDP)



The Saeima approved the government budget for 2013 with a deficit of 1.4% of GDP. The priorities of the government budget for 2013 are economic growth, improvement of the demographic situation, and rise in wages for certain categories of workers employed in the public sector.

Along with the approval of the government budget for 2012, the Saeima approved also the *Medium-Term Budget Framework for 2013-2015*. The national fiscal policy in the period from 2013 to 2015 is based on four main factors:

- Commitment under the government declaration to move towards a balanced budget over the economic cycle;
- Obligations to comply with requirements for fiscal policy under the EU Stability and Growth Pact;
- The necessity to improve preconditions for national economic growth;
- Being in the post-crisis period.

According to the forecasts of the Ministry of Finance, maintaining the same government policy, the general government budget deficit is expected to be 1.1% of GDP in 2013. The general government deficit is expected to be below 0.9% of GDP in 2014 and 2015.

In order to ensure development of sustainable and counter-cyclical fiscal policy, the Saeima has adopted the *Fiscal Discipline Law* (FDL) which entered into force on March 6, 2013. The Law stipulates binding fiscal conditions for the annual government budget and the medium-term budget. The FDL covers the requirements of the *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union,* thus ensuring full compliance of Latvian system with the EU level requirements.

In order for these systemic new approaches towards development of fiscal policy and observing discipline to be sustainable without being constantly amended or even cancelled, amendments to the Constitution (*Satversme*) have been prepared. *The Amendments to the Constitution (Satversme)* are still being considered by the Saeima commissions. On January 17, 2012, they were considered by the Saeima Legal Affairs Committee; as a result, forwarding the *Amendments to the Constitution (Satversme)* was postponed until the working group of the Saeima Legal Affairs

Committee finishes its work on developing alternative draft amendments to the fundamental law.

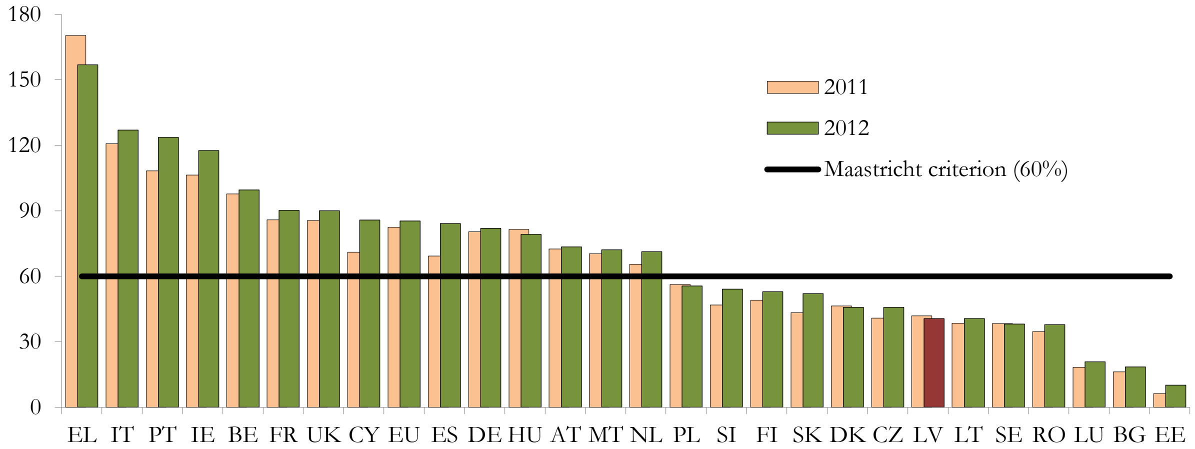
The level of **the general government debt** in Latvia is still one of the lowest in the EU (see Figure 4.3).

In 2012, the EU average level of the public debt was 85.3% of GDP (82.5% of GDP in 2011, 80% of GDP in 2010).The public debt exceeded the Maastricht criterion that is 60% of GDP in 14 EU Member States in 2012. In 2012, the highest public debt against GDP was observed in Greece, Italy, Portugal, Ireland, and Belgium, while the lowest general government debt against GDP was registered in Estonia, Bulgaria, and Luxembourg. According to the EC forecasts published in spring 2013, the average level of the general government debt in the EU will reach 89.8% of GDP in 2013 and continue increasing also in 2014.

Figure 4.3

General Government Debt in the EU Member States in 2011 and 2012

(% of GDP)



The general government debt in Latvia has moderately increased until 2007. Since 2008, it has been growing rapidly to guarantee the financial obligations of the government and reached LVL 5682.1 million or 44.4% of GDP at the end of 2010 (see Figure 4.4). At the end of 2011 general government debt was LVL 5974.4 million or 41.9% of GDP, while LVL 6309.2 million or 40.7% of GDP at the end of 2012. The level of the general government debt is mainly influenced by the central government debt, constituting LVL 6190.3 million at the end of 2012.

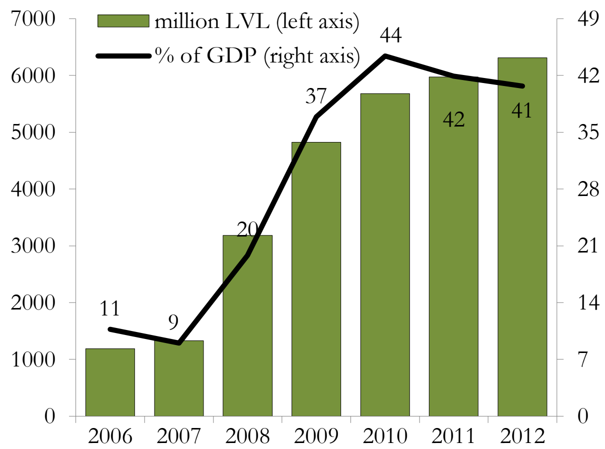
It should be noted that the three-year international loan programme was successfully completed at the end of 2011. The programme earmarked a loan of EUR 7.5 billion to Latvia. Taking into account that the economic situation and financial condition of Latvia had improved, Latvia did not need the full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

In June 2011 and February 2012, Latvia successfully returned to the international financial markets by issuing 10-year bonds worth USD 500 million and 5-year bonds worth USD 1 billion. These bonds prove Latvia's ability to finance its budget needs independently and lay a strong foundation for successful refinancing of loans in public financial and capital markets over the coming years.

In December 2012, Latvia successfully issued 7-year bonds in external financial markets in the amount of USD 1.25 billion thus continuing refinancing of the international loan programme and strengthening the foreign investor base in external markets.

Figure 4.4

General Government Consolidated Gross Debt by Nominal Value at the End of the Year



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

Taking into consideration the planned borrowing strategy, the debt level of the general government in the medium term is not likely to exceed 60% of GDP, which is the criterion under the *Maastricht Treaty*.

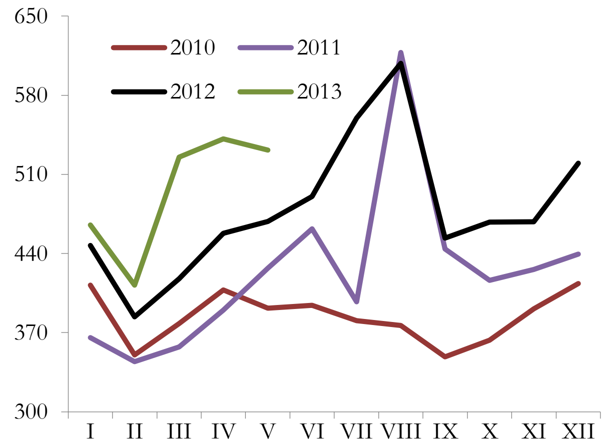
4.1.2 Budget Revenues[1]

After the decrease in revenues of the general government consolidated budget during the economic downturn in 2009 and 2010, budget revenues started to increase again as the economic activities gradually resumed in 2011. Budget revenues constituted LVL 5087.3 million in 2011 which was by LVL 480 million or 10.4% higher than a year ago.[1] Revenues of the general government consolidated budget have increased also in 2012 along with the growing economy and in 2012 they were by LVL 5742.8 million or 12.9% higher than in 2011.

In the five months of 2013, revenues of the general government budget were LVL 2475.6 million, which is an increase of 13.8%, compared to the five months of 2012.

Figure 4.5

General Government Consolidated Budget Revenues by month
(million LVL)



GDP in Current Prices and General Government Consolidated Budget Revenues
(2006 Q4 = 100)

Almost ¾ of all tax revenues consist of tax collections. The rest of budget revenues consist of non-tax revenues and income from foreign financial assistance. In 2012, income from foreign financial assistance increased significantly, compared to 2011, due to repayment of the European Union fund resources to the government budget as planned before.

In 2012, tax revenues constituted LVL 4289 million – by LVL 410.7 million or 10.6% more than in 2011. The increase in employment taxes fostered by the rise in employment and wages provided the most considerable contribution in 2012 – revenues from mandatory state social insurance contributions and personal income tax increased, as well as improving indicators of retail trade turnover ensured the increase in revenues from the value added. The SRS tax administration measures also played an important role in the increase in tax revenues.

In the five months of 2013, tax revenues increased by 7.1% and constituted LVL 185 million, compared to the corresponding period of 2012.

As of January 1, 2013, amendments to the *Law on Taxes and Fees* came into force regarding limitations on use of cash and transfer pricing.

In 2012, revenues from **employment tax** increased by 8.6% along with the continuously increasing number of employed and wages, compared to 2011.

[1] According to official data of monthly reports of the Treasury

Table 4.2

Budget Revenues
(% of GDP)

	2008	2009	2010	2011	2012
General government consolidated budget revenues	**35.6**	**36.2**	**36.0**	**35.6**	**37.0**
I Tax revenues	**29.4**	**26.9**	**26.7**	**27.2**	**27.6**
1. Indirect taxes	*10.5*	*10.1*	*10.2*	*10.2*	*10.5*
– value added tax	6.9	6.1	6.5	6.7	7.2
– excise tax	3.4	3.9	3.6	3.4	3.2
– customs duty	0.2	0.1	0.1	0.1	0.1
2. Income taxes and property taxes	*10.0*	*7.6*	*7.8*	*7.7*	*7.9*
– corporate income tax	3.1	1.5	0.9	1.4	1.6
– personal income tax	6.4	5.6	6.2	5.5	5.6
– real estate tax	0.4	0.6	0.7	0.8	0.8
3. Social insurance contributions	*8.7*	*8.9*	*8.6*	*8.6*	*8.5*
4. Other taxes	*0.3*	*0.2*	*0.2*	*0.6*	*0.6*
II Other revenues	**6.2**	**9.3**	**9.3**	**8.5**	**9.4**

In 2012, revenues from employment tax continue increasing and in the five months they were by 8.3% higher than in the five months of 2012. Employment taxes constituted a half of all tax revenues.

In 2012, revenues from personal income tax were LVL 871.6 million, which is by 10% more than in 2011.

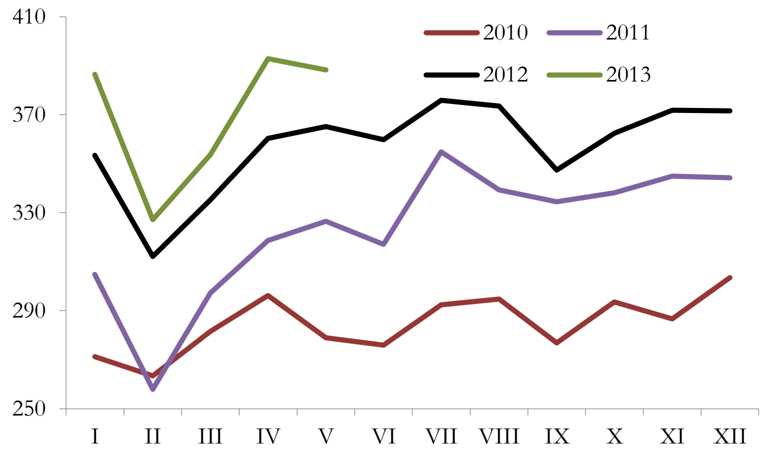
In the five months of 2013, revenues from personal income tax were LVL 381.4 million, which was by LVL 33.5 million or 9.6% more than in the five months of 2012.

As of January 1, 2013, the standard rate of personal income tax is reduced from 25% to 24%. Yet, as of July 1, 2013 the rate of personal income tax relief for dependants is expected to be increased from the current LVL 70 to LVL 80 per month. The employment tax reform is aimed at reaching employment tax rates equal to those in Estonia and Lithuania in terms of costs for the purpose of keeping Latvia competitive among the Baltic States with regard to investments and jobs. The reduced overall tax burden will reduce also the risk of poverty and structural unemployment, as well as shadow economy and motivation to avoid paying taxes.

In 2012, revenues from mandatory state social insurance contributions amounted to LVL 1324 million or 7.7% more than in 2011.

Figure 4.6

Total Tax Revenues by Months
(million LVL)



In the five months of 2013, revenues from mandatory state social insurance contributions continued increasing and were LVL 561.7 million, which is by 7.4% more, compared to the corresponding period of 2012.

Figure 4.7

Tax Revenues by Months
(million LVL)

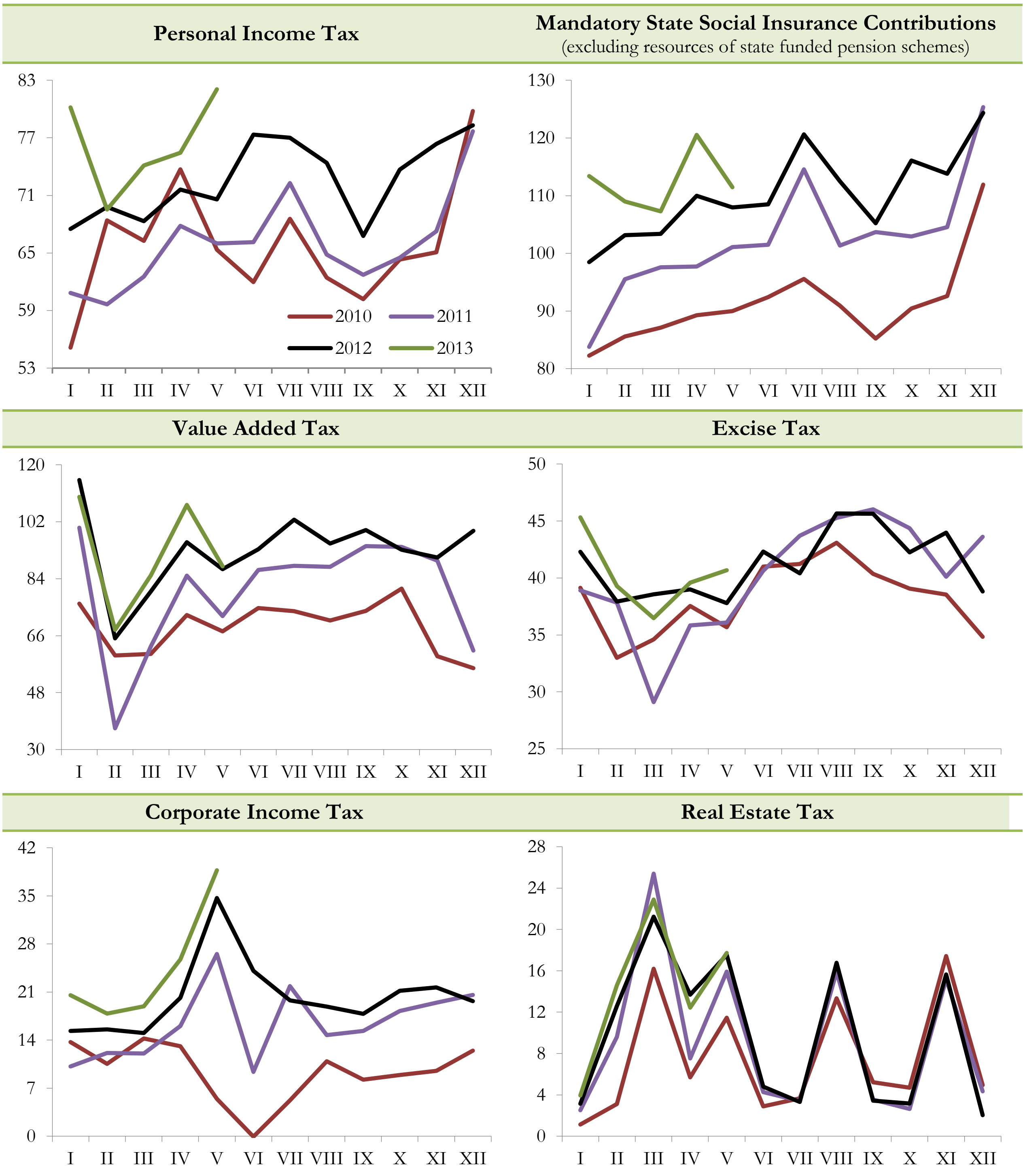
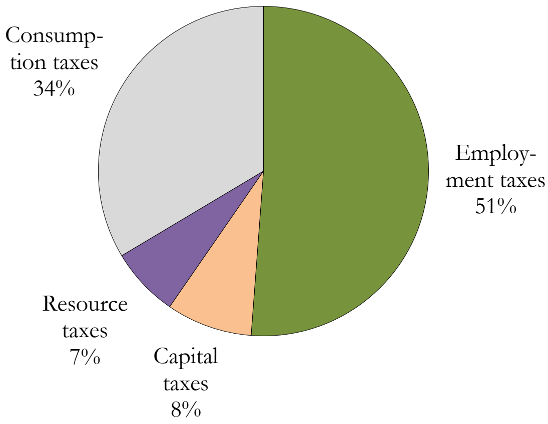


Figure 4.8

General Government Consolidated Budget Tax Revenues by Tax Groups in 2012

(per cent)



Revenues from **consumption taxes** constitute 1/3 of all tax revenues. The increase in private turnover and thus the increase in retail trade turnover in 2012 allowed collecting by 13.3% more consumption taxes in the government budget than in 2011.

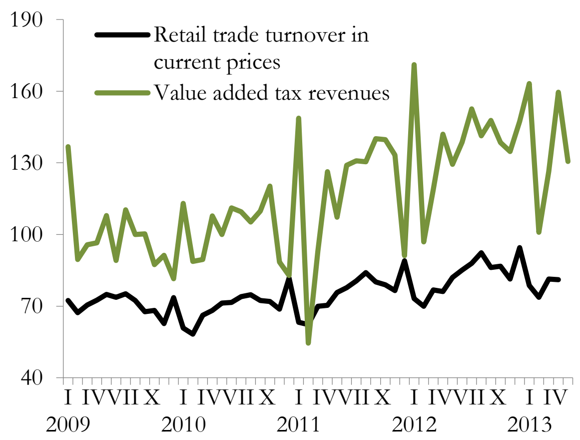
In the five months of 2013, revenues from consumptions taxes were by 4.4% higher than in the corresponding period of 2012.

In 2012, revenues from value added tax amounted to LVL 1116.6 million, which is by 16.5% more than in 2011.

Figure 4.9

Retail Trade Turnover in Current Prices and Revenues from Value Added Tax

(December 2008 = 100)



In the five months of 2013, revenues from the value added tax were LVL 458.1 million, which is by 3.4% higher than in the corresponding period of 2012.

As of July 1, 2012, the value added tax standard rate is reduced from 22% to 21% to improve competiveness and lessen the inflation pressure, as well as bring Latvia closer to the effective rates in other Baltic States (in Lithuania – 21%, in Estonia – 20%).

The new *Law on Value Added Tax* came into force on January 1, 2013. The new law envisages no significant changes and the application of the value added tax basically remains the same. Changes in the law are mainly editorial adjustments of the effective provisions of the *Law on Value Added Tax,* specifying or explaining the terminology used in the law, preventing any possible interpretations, and specifying administrative procedures. The rules of the Directives of the European Council have also been introduced with an aim to change the current conditions on issuing VAT invoices and determining locations of vehicle rental. The law envisages introduction of a number of taxpayer-friendly VAT application rules, for example, an opportunity to choose whether or not to apply VAT on used real property operations, the right not to perform corrections of input tax in case of disposal or theft of property, as well as the right of a customer or service recipient itself to make out a VAT invoice for gifts of small value or sample goods presented within the framework economic activity, and to raise the value of consignments of goods exempted from the VAT to EUR 22, etc.

The excise duty revenues from consumption were growing at a slower pace in 2012 (alcoholic beverages, tobacco and other excise goods). In 2012, tax revenues amounted to LVL 215 million which is by LVL 1.6 million or 0.8% more than in the corresponding period of 2011.

In the five months of 2013, the excise duty revenues from consumption increased by 7.1%, compared to the corresponding period of the previous year.

In 2013, a number of amendments are expected to be made in the *Excise Duties Law* in relation to the planned introduction of the euro as of January 1, 2014. Some of the provisions of the law will be specified, thus preventing certain misunderstandings in their application.

The share of **capital taxes** in the total tax revenues in 2012 was 8.4%. Capital tax levy has increased the most among the tax groups in 2012. Overall, in 2012, capital tax levy was by 17.8% higher than in 2011.

In the five months of 2013, capital tax levy has increased by 14.5%, compared to the corresponding period of 2012.

The fast increase in capital tax levy may be explained by the low base effect. The significantly narrowing business activities and the increasing number of insolvent enterprises during the crisis led to a considerable drop in corporate income tax levy. The increase in real estate tax within budget consolidation, on the other hand, had a relatively lesser impact because of the small share of this tax.

In 2012, revenues from corporate income tax have increased by LVL 47.4 million or 24.1%, compared to 2011. Revenues from real estate tax, on the other hand, have increased by LVL 7.2 million or 6.5% amounting to LVL 117.4 million in 2012, compared to 2011.

In the five months of 2013, revenues from corporate income tax amounted to LVL 121.8 million, which is by 20.9% more than in the corresponding period of 2012, while revenues from real estate tax increased by 5%, amounting to LVL 71.6 million in the five months of 2013, compared to the five months of 2012.

The amendments to *Corporate Income Tax Law* envisages that as of January 1, 2013, dividends paid out to non-residents (capital companies) and dividends received from non-residents are not a subject to corporate income tax. This provision does not apply to payments from low-tax and tax-free. As of January 1, 2013, interest payments to non-residents and payments for use of intellectual property are not a subject to corporate income tax. It will be possible to cover losses of taxation period incurred starting from 2008 for indefinite period of time.

The *Law on Real Property Tax* has been amended with an aim to grant local governments the right to define a tax rate in the amount of 0.2 to 3% of real property cadastral value by binding regulations. Tax rate may exceed the 1.5% only if the real property is failed to be managed in accordance with the procedure specified in legislation.

The resource tax group is the smallest tax group constituting 6.8% of all tax revenues in 2012. In 2012, resource tax revenues have increased slower than those of other groups – by 4.8%, compared to 2011.

In the five months of 2013, resource tax revenues have remained at the level of the corresponding period of 2012.

In 2012, revenues from the excise duty for oil products and natural gas were LVL 279.7 million – by 4.3% more than in 2013. However in the same period revenues from the natural resources tax increased by 18.4 per cent.

In the five months of 2013, revenues from the excise duty for oil products and natural gas have remained at the level of the corresponding period of 2012, while revenues from the natural resources tax have increased by 9.9%, compared to the corresponding period of 2012.

In 2013, a number of amendments are expected to be made in oil products- and natural gas-related excise duties laws in relation to the introduction of the euro. The *Law On Car and Motorcycle Tax, Electricity Tax Law* and the Cabinet Regulations *Regarding the Procedure for Application of the Exemption of Electricity Tax* are expected to be amended in 2013.

4.1.3 Budget Expenditures

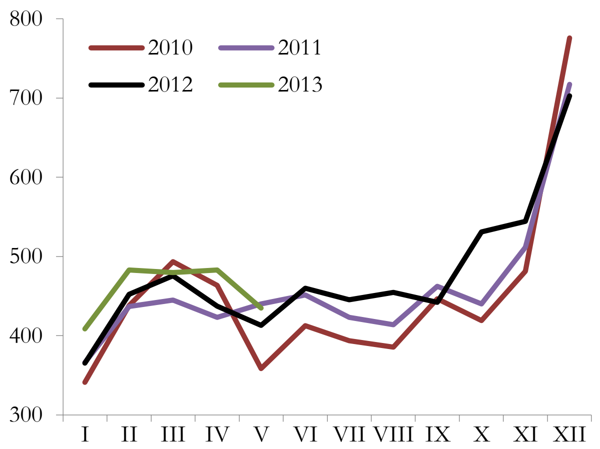
After the sharp cut in expenditures during the economic crisis, the government's **consolidated budget expenditures** slightly increased in 2011 (by 2.3%). It was mainly based on the increased capital expenditures in both government and local government budgets in relation to active implementation of the EU funds.

The government consolidated budget expenditures continued growing also in 2012, though considerably slower than revenues. In the eleven months of 2012, the government consolidated budget expenditures amounted to LVL 5723.6 million which is by LVL 191.4 million or 3.5% higher than in 2011.

In the five months of 2013, expenditures of the government consolidated budget continue increasing, and have increased by 6.8%, compared to the corresponding period of 2012.

Figure 4.10

General Government Consolidated Budget Expenditures by Months
(million LVL)



In 2012, in comparison with 2011, the **expenditures for subsidies and grants** increased by 4 per cent.

It should be noted that the expenditures for subsidies and grants increased also during the economic crisis. It was to a great extent related to the increasing number of the unemployed and paid unemployment benefits, costs of severance pays to dismissed workers in the public sector, as well as social benefits. The expenditures for subsidies and grants just increased in 2012 (by 6.7%) along with stabilizing economic situation.

Overall, in 2012, the expenditures for subsidies and grants constituted 45.3% of all budget expenditures which is by 7.6 percentage points more than in 2008.

In the five months of 2013, the expenditures for subsidies and grants have increased by 5.3 per cent, compared to the corresponding period of 2012.

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 also in 2009 and 2010. Since 2011 capital expenditures have been increasing due to active implementation of the EU funds. In 2012, capital expenditures were by 1.2% higher than in 2011.

Despite the increase over the past few years, the share of capital expenditure in the total expenditure has not been considerably changed, compared to 2008 – in 2012 they constituted average 10% of the total government budget expenditures.

In the five months of 2013, capital expenditures have decreased by 1.3 per cent, compared to the corresponding period of the previous year.

Current expenditures were reduced the most during the crisis. In order to cut the government consolidated budget expenditures, public administration and certain sectors went through optimization by reducing the number of employees in ministries, as well as the number of public agencies and hospitals. In 2008, current expenditures constituted more than a half of all budget expenditures, while in 2012 the share thereof constituted just 43.7 per cent.

It should be noted that the current expenditures have not been significantly increased in 2011 and 2012.

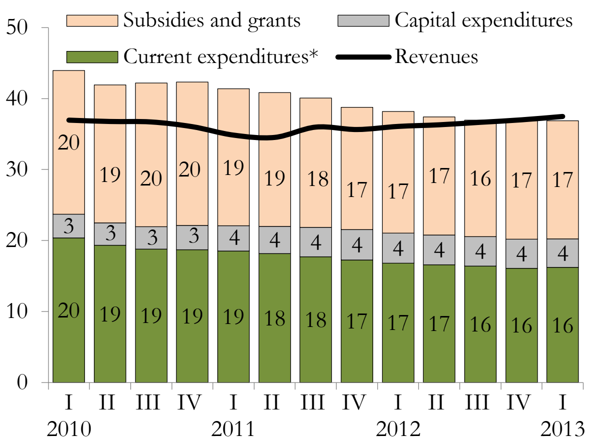
In the five months of 2013, current expenditures have increased by 7.5%, compared to the corresponding period of the previous year.

According to the expenditures by functional categories, the highest share in 2012 was for social protection – 28.2% of all expenditures, economic affairs – 18.6%, education – 16.67% and expenditures for general government services – 13.3%. However, the lowest share of all expenditures was for defence – 2% and environmental protection – 2.3 per cent.

Figure 4.11

General Government Consolidated Budget Revenues and Expenditures

(moving average of 4 quarters, % of GDP)



* including payments for loans and credits, as well as payments to the EU

Comparing the current structure of expenditures with the structure in 2008, only the share of expenditures in social protection area has increased (by nearly 9 percentage points). The share of expenditures by the rest of functional categories in the total government consolidated budget expenditures has been decreased.

Table 4.3

Expenditures of the General Government Consolidated Budget by Functions

(per cent)

	Structure				Against GDP			
	2009	2010	2011	2012	2009	2010	2011	2012
Expenditures – total	**100**	**100**	**100**	**100**	**43.0**	**42.3**	**38.8**	**36.9**
General public services	14.8	13.4	12.1	13.3	6.4	5.7	4.7	4.9
Defence	2.4	2.0	2.3	2.1	1.0	0.8	0.9	0.8
Public order and safety	4.5	4.4	4.4	4.5	1.9	1.8	1.7	1.7
Economic affairs	15.7	16.0	19.0	18.6	6.7	6.8	7.4	6.9
Environmental protection	2.2	1.1	2.5	2.3	0.9	0.5	1.0	0.9
Management of municipal territories and housing	2.1	2.5	3.0	3.0	0.9	1.1	1.2	1.1
Health	7.5	7.2	7.8	7.8	3.2	3.1	3.0	2.9
Recreation, culture and religion	3.4	2.9	3.2	3.5	1.5	1.2	1.3	1.3
Education	19.6	16.7	17.1	16.6	8.4	7.1	6.6	6.1
Social security	27.9	33.8	28.5	28.2	12.0	14.3	11.0	10.4

The 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 investment, i.e. capital investments using the budget resources.

The public demand decreased most rapidly in 2009 (by 13.3%). A significant decrease was observed also in 2010, when the public demand decreased for almost more than 10%. However, in 2011, in comparison with 2010, the public demand increased by 6.2% mainly due to the increase in central government expenditures for the total fixed capital formation. However, in 2012, as the government continued limit the government budget expenditures, the public demand decreased by 1.7 per cent.

Table 4.4

Public Demand

	% of GDP				Changes in comparison with the previous year,%			
	2009	2010	2011	2012	2009	2010	2011	2012
Public demand	**23.8**	**22.1**	**22.0**	**19.2**	**-13.3**	**-9.7**	**6.2**	**-1.7**
Public consumption	19.6	18.4	17.7	15.3	-9.4	-7.9	1.1	-0.2
– central government*	10.5	10.7	10.0	8.5	-10.6	-0.5	-2.1	-1.1
– local governments	9.1	7.7	7.8	6.8	-8.0	-16.5	5.4	1.0
Gross fixed capital formation	4.3	3.7	4.3	3.9	-24.1	-15.8	24.9	-6.1
– central government*	1.5	1.2	1.8	1.7	-25.4	-26.1	68.5	-3.2
– local governments	2.7	2.5	2.4	2.2	-23.3	-10.0	4.6	-8.2

* including Social Security Fund

4.2. Prices

4.2.1. Consumer Prices

In 2012, despite the growth in Latvia that has been the fastest among the EU Member states, consumer prices kept growing at a moderate pace, close to the level of seasonal fluctuations. In 2012 consumer prices increased by 1.6% and the rise was 2.5 times slower than in 2011. The rise in prices in 2012 was mainly based on the increase in administratively regulated prices, food prices and fuel costs.

Also in early 2013, the prices increased at a moderate pace. In the five months of 2013, the consumer prices increased by 0.3%, which was seven times slower than in the same period a year ago. Yet, in May 2013, a deflation was observed, compared to May 2012.

Figure 4.12

Private Consumption and Consumer Price Index

(2005 Q4 = 100)

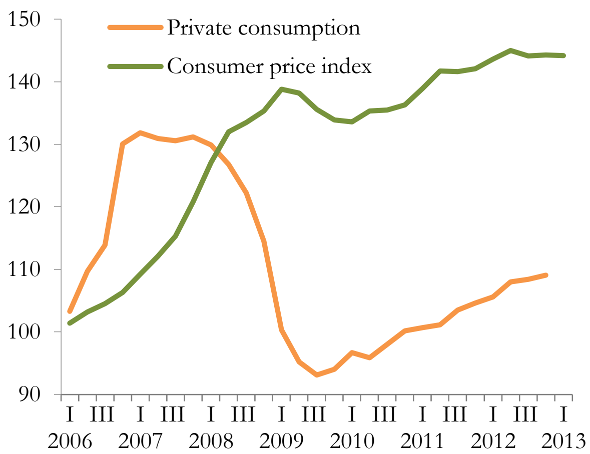


Table 4.5

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
2012	January	0.8	3.6	4.4
	February	0.1	3.4	4.3
	March	0.6	3.3	4.2
	April	0.6	2.8	4.1
	May	-0.2	2.2	3.8
	June	-0.1	1.9	3.6
	July	-0.5	1.7	3.4
	August	-0.3	1.7	3.1
	September	0.5	1.8	2.9
	October	0.0	1.6	2.7
	November	-0.1	1.6	2.5
	December	0.0	1.6	2.3
2013	January	-0.2	0.6	2.0
	February	-0.1	0.3	1.8
	March	0.5	0.2	1.5
	April	0.0	-0.4	1.2
	May	0.1	-0.1	1.0

Factors influencing prices in the 5 months of 2013:

– prices for food products increased by 1.4% in the five months of 2013, thus rising total price level by 0.3 percentage points. These changes depend mainly on world price fluctuations. It should be noted that world prices for food products slightly increased in the five months of this year, which was influenced by a sharp rise in the prices for dairy products in March and April in relation to the rise in prices in New Zealand that is world's largest exporter of these products. Since Latvia does not buy dairy products from this country, it has no impact on the prices for dairy products in Latvia. In May 2013, the world prices for food products were by 2% higher than in December 2012;

– The rise in prices for clothes and footwear in this period was one of the highest in the past decade (the highest rise has been observed in the five months of 2011). In the five months of 2013, prices for clothes and footwear increased by 4.2%, thus causing the total price level to rise by 0.2 percentage points. It is based to a great extent on the increasing private consumption and rise in prices for raw materials. The world prices for cotton increased nearly by 11% in the five months of this year, while the rise in prices for wool was among the lowest over the past five years;

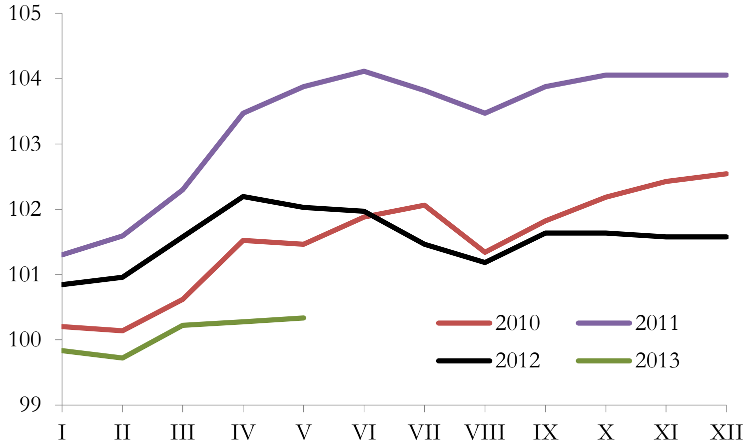
– prices for alcoholic beverages and tobacco experienced the highest rise since 2009. In the five months of 2013, prices for alcoholic beverages and tobacco increased by 2.3%, thus causing the total price level to rise by 0.2 percentage points;

– the drop in the world price for oil products in March-April was faster than the rise in prices and affected significantly the dynamics of fuel prices in Latvia. In January-February, fuel prices increased by 1.8% altogether in both months; however, they dropped by 5.4% in March-May. Since December 2012 fuel prices have decreased by 3.7%, thus reducing the total price level by 0.2 percentage points. The world prices for oil products decreased almost by 1% in the five months of this year. Overall, prices in the transport group have dropped by 2.6% since December 2012, thus reducing the total price level by 0.4 percentage points;

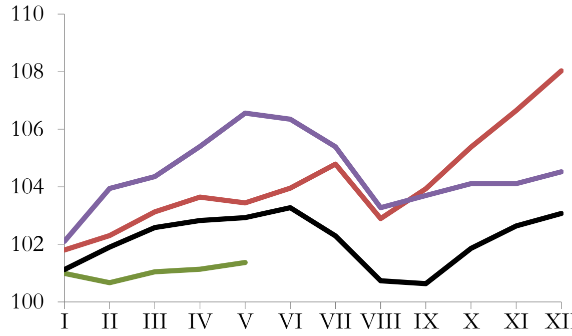
– since administratively regulated prices were not increased in January and April of this year, a drop has been observed in the prices related to housing maintenance by 0.9%, thus reducing the total price level by 0.2 percentage points. The drop in prices was influenced by the decrease in prices for natural gas, which led to a drop in prices for heat energy as well.

Figure 4.13

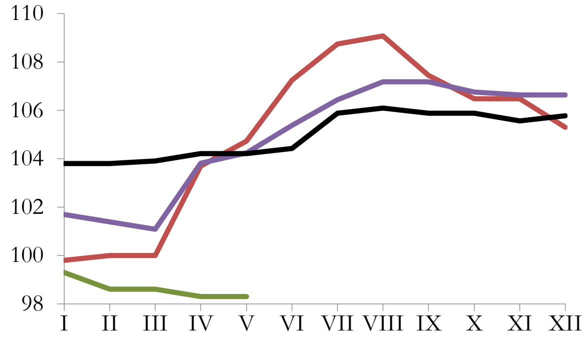
Consumer Price Index by Groups and Sub-Groups
(December of the previous year = 100)



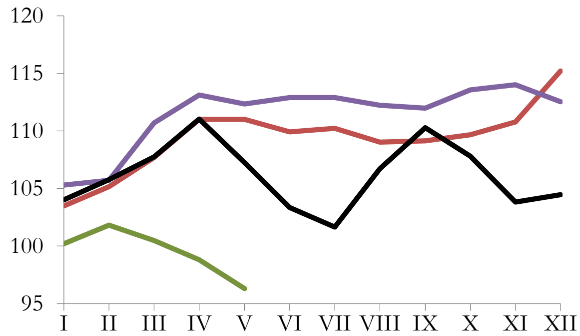
Food and non-alcoholic beverages



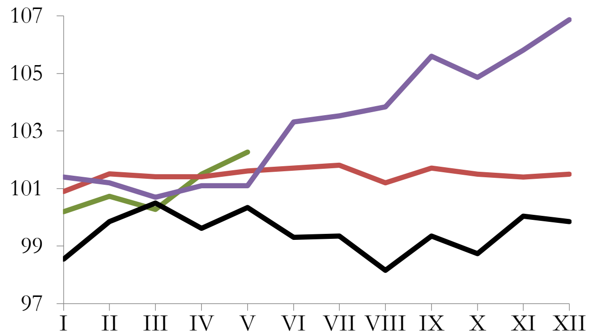
Administratively regulated prices



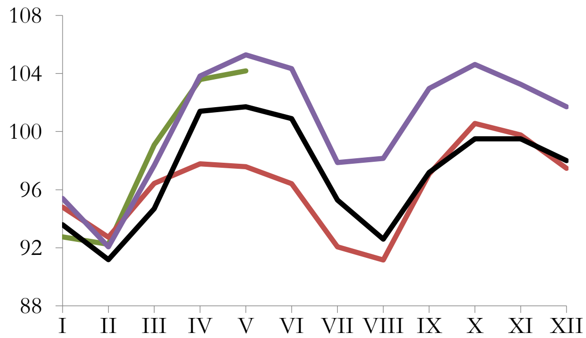
Fuel



Alcoholic drinks and tobacco



Clothing and footwear



Other product and services groups

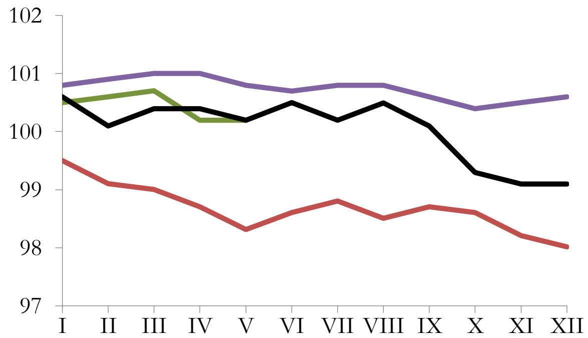
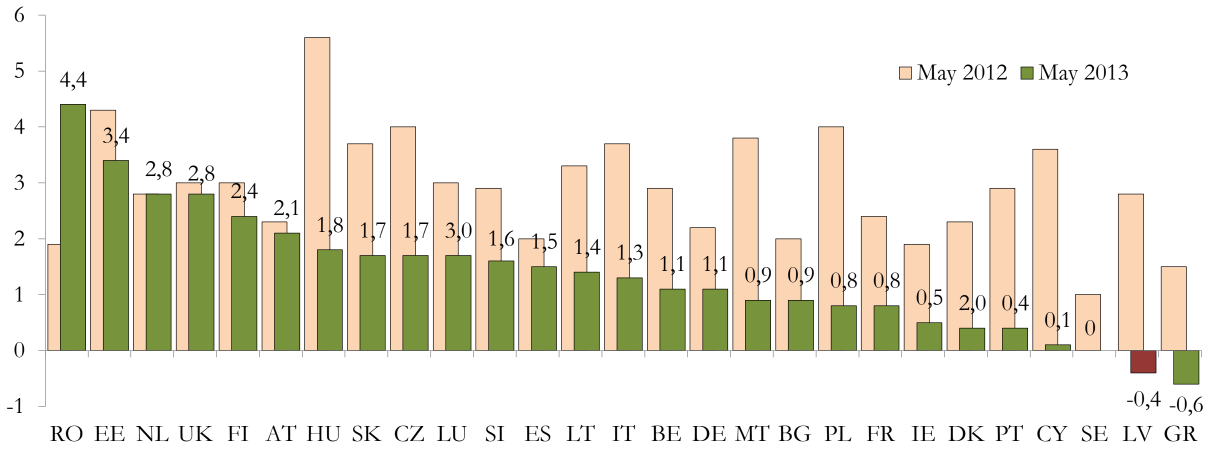


Figure 4.14

Changes of the Harmonised Consumer Prices in the EU Member States

(12-month inflation, %)



Source: *Eurostat*

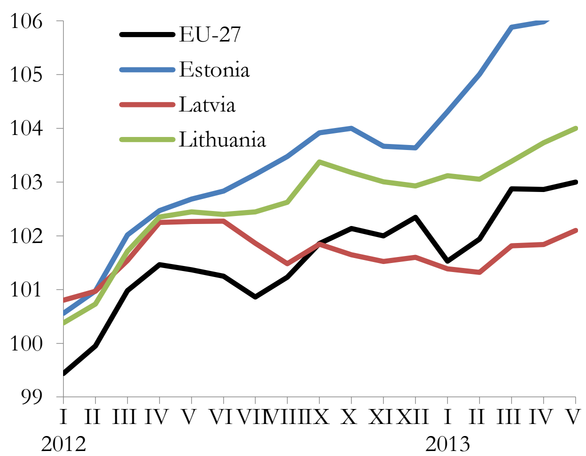
Further changes in consumer prices will to a great extent depend on price trends in the world. Although consumer prices have been dropping in the past few months, consumer inflation expectations are growing gradually in relation to the planned introduction of the euro. The Ministry of Economics forecasts a low inflation in 2013 on a condition that the current trends of world prices for food products and oil products remains stable and no rapid increase is expected.

In 2012, compared to 2011, the average price level in the EU has increased by 2.6%. Just like in Latvia, it was determined by the rise in prices for food products and energy.

Figure 4.15

Harmonised Consumer Prices Index

(December 2011 = 100)



In May 2013, compared to May 2012, the price level in the EU Member States increased faster than in Latvia – by 1.4%. The price inflation rose most rapidly in Romania, which was the only country with increasing inflation. Inflation dropped in other countries in May of this year, compared to May of the last year.

If comparing the Baltic States, the highest increase in consumer prices in May 2013, as compared to May 2012, was observed in Estonia (by 3.4%). In Lithuania consumer prices increased by 1.4%. Yet, in Latvia, consumer prices decreased by 0.4%. In May 2013, compared to May 2012, the consumer prices in the Baltic States continued increasing for the food product group, while the prices for the energy group increased only in Estonia. Considering the dynamics of prices for food products and energy worldwide, the rise in food prices continued growing at a moderate pace, while a drop in energy prices was observed in March-April after the rise in the first two months of the year.

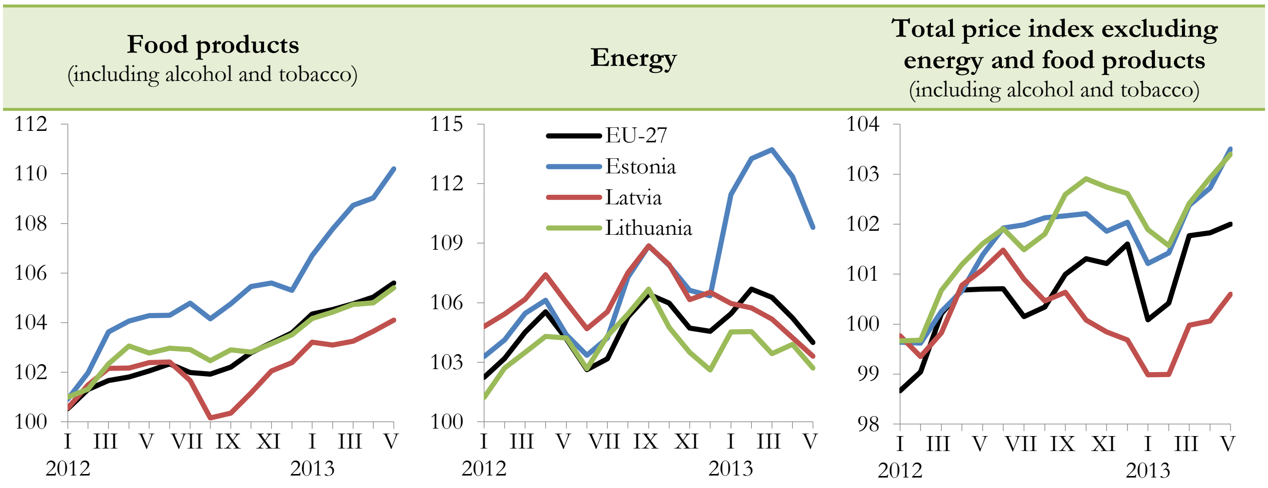
Prices for food product group among the Baltic States increased by 4.8% in Estonia, in Lithuania - by 1.7%, while the lowest increase was in Latvia – by 1.4%. Prices for energy rose only in Estonia – by 5.9%, in Lithuania the prices dropped by 0.4%, while Latvia experienced the sharpest drop – by 3%. The highest rise in administrative prices was observed in Lithuania – by 2.8%, they remained unchanged in Estonia but in Latvia the prices dropped by 0.7 per cent.

It should be noted that in May 2013, compared to May a year ago, prices in Estonia and Lithuania for the services group increased faster than in Latvia – by 2.7% and 2% (in Latvia, the prices dropped by 0.7%) respectively. In early 2013, prices in Latvia were mostly affected specifically by the increase in prices for the food product group and services group because apart from those two groups, a drop in prices was observed for the rest of the groups in May.

Figure 4.16

Harmonised Consumer Prices Index by components

(December 2011 = 100)



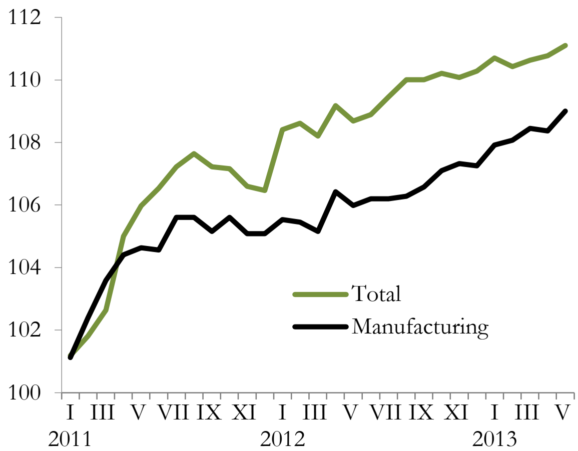
4.2.2. Producer Prices

After the rapid increase in 2010 and the first half of 2011, **producer prices** in general were moderate further on. In 2012, producer prices showed slight, though steady growth mainly due to the rising demand in the domestic market. In 2012, compared to 2011, prices have increased by 3.6%. Prices for products sold in the domestic market have increased by 4.2% within the year, and for exported products – by 2.9 per cent.

Figure 4.17

Producer Price Changes

(December 2010 = 100)

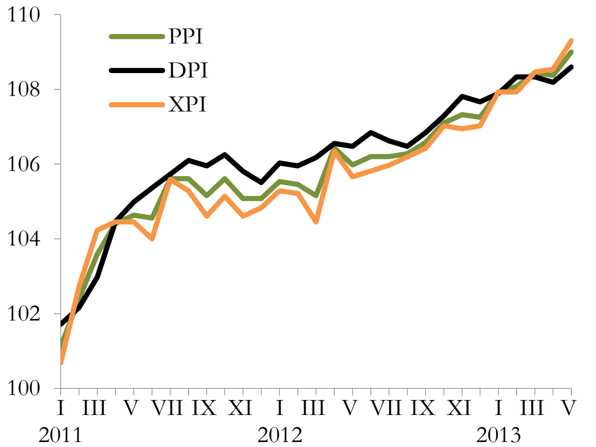


In May 2013, compared to May 2012, prices have increased by 2.2%. Prices for products sold in the domestic market have increased by 1.7% within a year, and for exported products – by 2.7%. The most significant increase in prices has been observed for production of food products (by 4.3%) and wood and timber products (by 4.2%). The decrease in production of metals (by 2.4%) had the biggest downward impact on the producer prices.

Figure 4.18

Dynamics of Producer Price Changes in Manufacturing

(December 2010 = 100)



PPI – producer price index,
DPI – producer price index for products sold in the domestic market,
XPI – producer price index for exported products.

Slightly over 60% of manufacturing products are exported therefore the overall dynamics of producer prices is to a great extent affected by fluctuations of producer prices for exported products. Yet, prices for exported products are mainly determined by the halt in the price increase in the world markets for the main export goods of Latvia, including wood and timber products, metal articles and food. The rise in prices for products sold in the domestic market was affected by the stabilising domestic demand.

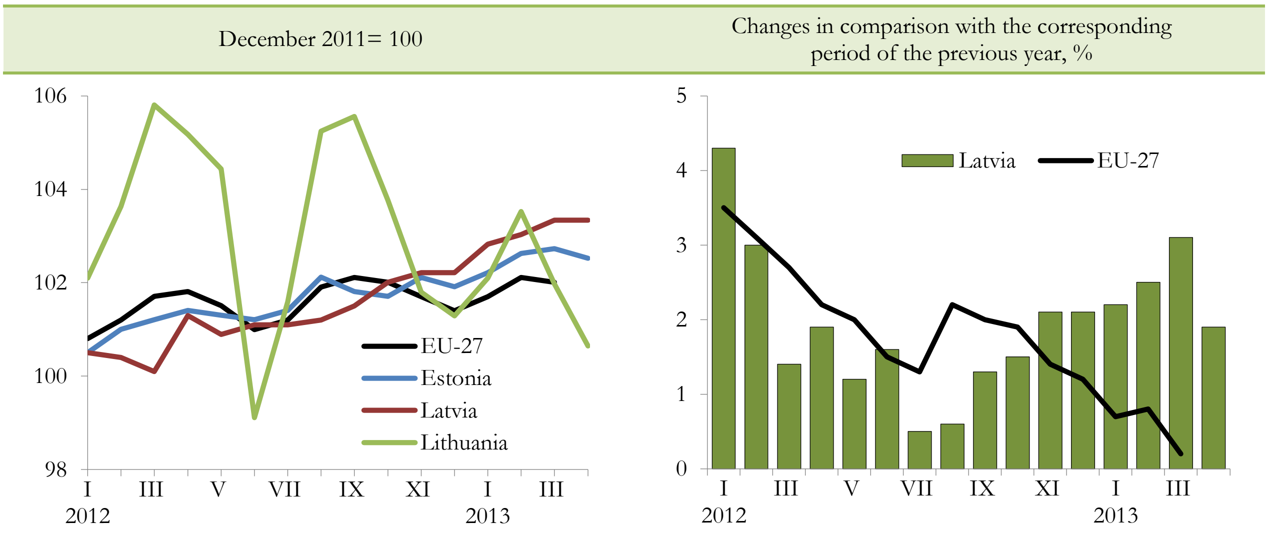
The overall producer price level in Latvian manufacturing in May 2013, as compared to May 2012, has increased by 2.9%. The manufacturing producer prices for exported products have increased by 3.4% in a year, while prices for products sold in the domestic market – by 2%. It should be noted that in May 2013, compared to May of the previous year, a significant drop in the world prices for manufacturing and agricultural raw materials, as well as energy prices was observed.

The fastest rise in producer prices in manufacturing by sectors in a year was for manufacture of computers, electronic and optical products (by 14.9%), printing and reproduction of recorded media (by 9.4%), as well as manufacture of food products (by 4.3%) and manufacture of wood and products of wood (by 4.2%). The rise in producer prices in these sectors was based on the rapid increase in producer prices for exported products.

Yet, producer prices in manufacturing dropped for manufacture of metals. It should be noted that the world prices for metal have decreased by nearly 10% in a year.

Figure 4.19

Producer Price Index in Manufacturing



The producer prices in the EU have been dropping since the mid-2011. It is mainly due to the decrease in agricultural prices and prices for raw materials, which to a certain extent was due to the decreasing demand worldwide in relation to the escalating debt crisis in the eurozone, worsening economic situation in other developed countries, as well as slowdown of the world trade growth rates, and uncertainty about expected fiscal consolidation in the majority of developed countries.

Also in early 2013, the producer prices in the EU continued dropping. If comparing the Baltic States, the most rapid increase in the producer price index in manufacturing in May 2013, as compared to May 2012 was observed in Latvia (by 2.9%), and a moderate increase – in Estonia (by 1.1%). Yet, in Lithuania, produce prices decreased by 4.2 per cent.

In the five months of 2013, an increase in manufacturing producer prices has been observed in Latvia (by 1.6%), while in Estonia, prices rose by 0.6% and in Lithuania – dropped by 0.6 per cent.

4.2.3 Foreign Trade Unit Value Indices

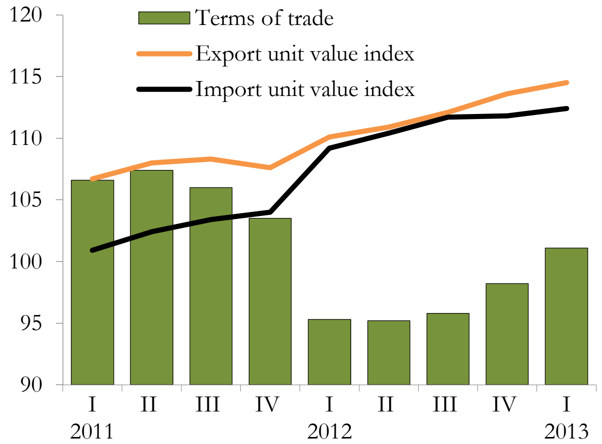
At the beginning of 2011, in comparison with the respective period of the previous year, the terms of trade improved considerably as import prices increased at almost half the speed of those of export. Taking into account the rapid increase in the unit value, since the beginning of 2012 the terms of trade have worsened and in the 4th quarter of 2012 compared to the respective period of 2011, the unit value for exported goods increased by 5.5% and that of imported goods – by 7.5 per cent.

At the beginning of 2013, trade condition have slightly improved, and in the 1st quarter of 2013, compared to the corresponding period of 2012, the unit value for exported goods has increased by 4%, while for imported goods – by 2.9%. The average export unit value level in the 1st quarter of 2013, compared to the 1st quarter of 2012, was mainly raised by the increase in the unit value for machinery and electric equipment, herbal products, products of the chemical and allied industries, transport vehicles and food products, as well as textile and textile articles. The unit value increase for transport vehicles, machinery and electric equipment, food products, mineral products, transport vehicles and herbal products had the greatest impact on the average unit value level.

Figure 4.20

Export and Import Unit Value Indices and Terms of Trade

(export and import unit value indices 4th quarter of 2010 = 100; terms of trade,% to the respective quarter of the previous year)

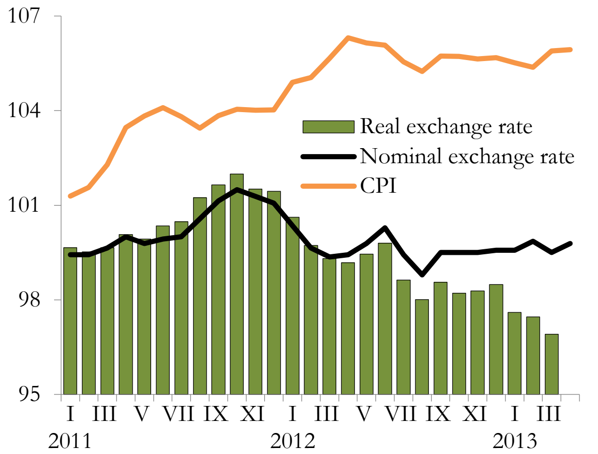


As competiveness of Latvian entrepreneurs improved, the real effective exchange rate of the Latvian lats continued decreasing in 2012. Despite the slight increase in the mid-2012, generally it is at a low level. The decrease of the real effective exchange rate of the lats has been determined by the low nominal effective exchange rate of the lats and the dropping growth rates of consumer prices. As the nominal effective exchange rate continues decreasing also in 2013, it can be concluded that competiveness of Latvian entrepreneurs is maintained.

Figure 4.21

Effective Exchange Rate of the Lats*

(December 2010 = 100)



* Effective exchange rate of the lats has been calculated in relation to the main trading partner countries. The real exchange rate has been calculated by applying the consumer price index.

4.3 Balance of Payments

4.3.1 Current Account

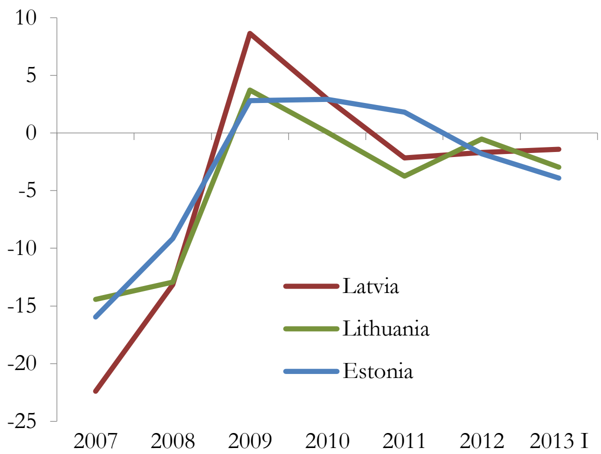
The current account has remained at a level of slight deficit over the past two years. In 2011, the deficit of the current account was 2.2% of GDP, while in 2012 – 1.7% of GDP. Also in the 1st quarter of 2013, the negative balance of the current account was 1.4% of GDP, proving external balance of Latvian economy.

Similar trends have been observed also in the dynamics of the current account of our neighbouring countries. Lithuania and Estonia, like Latvia, experienced major changes in the current account. As the capital inflow drained away and economic activities narrowed in the real sector due to the impact of the global financial crisis, the deficit of the current account first decreased rapidly, though there has been a *surplus* in the current account since 2009. As the economic situation stabilized, another change of direction of the current account has been seen in all three Baltic States and at the moment the balance of the current account is characterized by a moderate deficit.

Figure 4.22

Current Account Balance in the Baltic States

(% of GDP)



In 2012, the current account deficit reached 1.8% in Estonia, 0.5% in Lithuania and 1.7% of GDP in Latvia. Comparing to 2011, the deficit of the current account in Lithuania has decreased almost three times, while the balance of the current account significantly deteriorated in Estonia resulting in a deficit.

As the economy stabilized and growth resumed, the current account changes are mainly based on the export and import dynamics of goods.

Along with increasing economic activities, the dynamics of imports in Latvia are accelerating. In 2011, imports in current prices increased by 32.7%, compared to the previous year, but exports increased by 25.4%, while foreign trade deficit reached 10.8% of GDP, which was by 3.8 percentage points higher than a year ago, though considerably lower than before the crisis (in 2007 – 24%). In 2012, the dynamics of exports and imports was almost twice as moderate as a year ago. Comparing to the corresponding period of the previous year, export increased by 14.2% (in current prices), while import – by 11%. Yet, in the 1st quarter of 2013, the volume of export was by 7.7% higher than a year ago, while imports increased by 5% and foreign trade deficit reached 10.8% of GDP. It should be noted that in 2012, the volume of export of goods was 1.7 times higher than in 2007, while volume of imports of goods exceeded the volume of imports in 2007 by just 9 per cent.

Figure 4.23

Current Account, Investments, and Savings

(% of GDP)

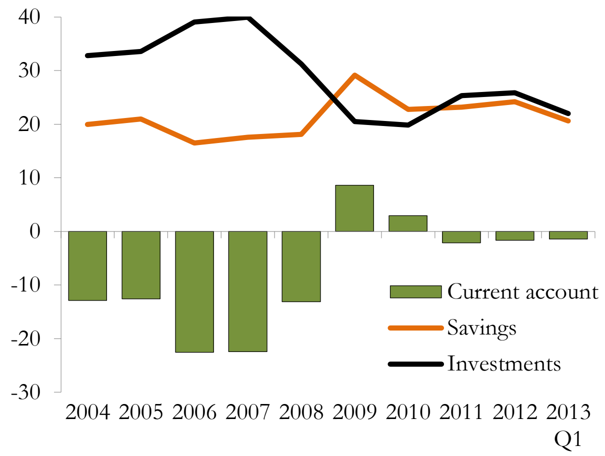


Table 4.6

Balance of Payments of Latvia

(% of GDP)

	2009	2010	2011	2012	2012 Q1	2013 Q1
A. Current account	**8.6**	**2.9**	**-2.2**	**-1.7**	**-3.1**	**-1.4**
Trade balance	-7.1	-7.1	-10.8	-9.8	-12.0	-10.8
Exports	*28.4*	*37.9*	*42.4*	*44.6*	*44.9*	*45.7*
Imports	*-35.5*	*-45.0*	*-53.3*	*-57.4*	*-56.9*	*-56.5*
Balance of services	6.0	6.2	6.5	6.8	7.4	7.7
Net revenues	6.3	0.2	-0.9	-1.5	-1.5	-0.9
Current transfers, net	3.4	3.6	3.1	2.9	3.0	2.5
B. Capital account	**2.4**	**1.9**	**2.1**	**3.0**	**0.0**	**2.5**
C. Financial account*	**-6.9**	**-2.1**	**-4.0**	**2.2**	**14.9**	**-2.1**
Direct investments	0.6	1.5	4.9	2.8	4.7	1.4
Abroad	*0.2*	*-0.1*	*-0.2*	*-0.7*	*-0.6*	*-1.3*
In Latvia	*0.4*	*1.6*	*5.1*	*3.5*	*5.3*	*2.7*
Portfolio investments**	2.3	-2.8	-1.8	4.8	-5.2	0.1
Assets	*3.2*	*-0.1*	*-1.0*	*-1.8*	*-8.1*	*1.2*
Liabilities	*-0.9*	*-2.7*	*-0.8*	*6.6*	*13.3*	*-1.1*
Other investments	-9.8	-0.8	-7.2	-5.4	5.1	-3.6
Assets	*-4.0*	*-3.3*	*-1.5*	*-1.7*	*-1.8*	*1.6*
Liabilities	*-5.8*	*2.5*	*-5.7*	*-3.7*	*6.9*	*-5.2*
D. Net errors and omissions	**0.8**	**1.2**	**-0.4**	**0.1**	**-2.0**	**2.5**
E. Reserve assets	**-5.0**	**-4.0**	**4.4**	**-3.6**	**-9.9**	**-1.5**

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

The positive balance of services is constantly growing. In 2012, surplus of balance of services was 6.8% of GDP, which was nearly two times higher than in 2007. Also, in early 2013, the volume of service exports is almost double the volume of service imports.

The income balance is mainly influenced by the changes in revenues from non-resident deposits. The balance was positive during the crisis largely due to the losses incurred by foreign investors. As the economic activities resumed, the income balance has been negative since the end of 2010. The increase in income balance deficit was related to the increase in non-resident investment income including an increase in the amount of dividends paid to non-residents. In 2012 and in the 1st quarter of 2013, the deficit of income balance was 1.5% and 0.9% of GDP respectively, which was influenced by the increase in non-resident investment income. It should be noted that non-resident income from investments in national economy of Latvia in 2012 was by 30% lower than in 2007, while non-resident income from dividends and distributed profit of branches reached 90% of the level of 2007.

The extensive deficit of the current account in 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 24.2% of GDP in 2012 (in 2007 – 17.6% of GDP), while the investment level in the national economy of Latvia dropped from 40% of GDP in 2007 to 25.9% of GDP in 2012. The moderate deficit of the current account is a proof of a balance between savings and domestic investments.

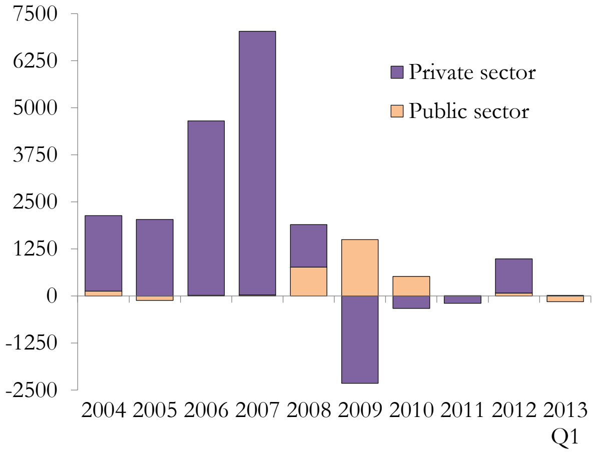
4.3.2 Financial Flows

The global 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) was 24.5% of GDP, while in 2009 the deficit of the financial account was negative being close to 7% of GDP. Although the financial account deficit has been dropping since 2010, the financial flows still are floating, showing explicit quarterly fluctuations.

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

Figure 4.24

Inflow of Foreign Investments in the Economy of Latvia
(million LVL)



During the previous years, foreign investments were mainly attracted by the private sector. Since 2004, the volume of foreign investments has grown rapidly and in 2007 compared to 2004 had increased almost 3.5 times. The unfavourable conditions in global financial markets weakened the intensity of the foreign investment flow. Volumes of private capital inflow decreased rapidly in 2008 (almost 7 times lower than in 2007), but since the 4th quarter of 2008, outflow of private foreign capital has been observed. Outflow of private foreign capital in 2009 intensified and was almost two times higher than the inflow in 2008.

In general, the decrease in liabilities of the financial account was more moderate in 2010 than it was in the previous two years, however, in the second half of 2010, for the first time since the end of 2008, capital inflow into the private sector was observed and it was influenced by the increase of reinvested profit and extensive investments in the banking sector.

In 2011, foreign private capital flows were negative mainly due to the decrease in liabilities of the banking sector. In general, the deficit of the financial account balance was 4% of GDP in 2011. In the 1st quarter of 2012, public debt commitments increased considerably, thus influencing the positive balance of the financial account (14.9% of GDP).

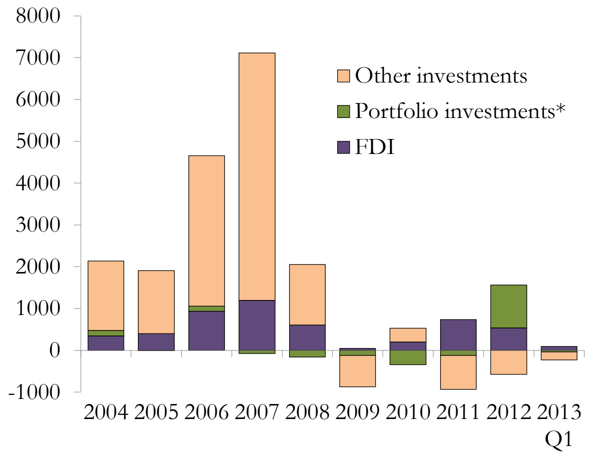
In the 2nd quarter of 2012, the financial account was negative (7.3% of GDP) due to the increase in assets and to the decrease in deposits in the banking sector. In the 3rd quarter of 2012, there was a slight financial account deficit as well (0.1% of GDP) due to positive net portfolio investment flows in the financial sector that partially compensated for the financial outflow caused by reducing debt commitments of the public sector. Overall, in 2012, the balance of the financial account was positive – 2.2% of GDP. In the

1st quarter of 2013, the financial account was at a deficit of 2.1% of GDP; it was mainly determined by the decrease in liabilities of the government and private non-financial sector.

With the change of the dynamics and direction of foreign capital flow, its structure is also changing.

Figure 4.25

Inflow of Foreign Investments in the Economy of Latvia by Types of Investments
(million LVL)



* portfolio investments and derivative financial instruments

During the period of 2005-2007, the foreign direct investments in the inflowing foreign capital structure on average constituted almost 20%. In comparison with 2004, the volume of FDI has tripled, but in 2008 compared to 2007, the FDI stock has decreased by almost a half and covered 30% of the negative current account balance. In 2009, the incoming FDI flows were only 7.8% of the indicator of the previous year.

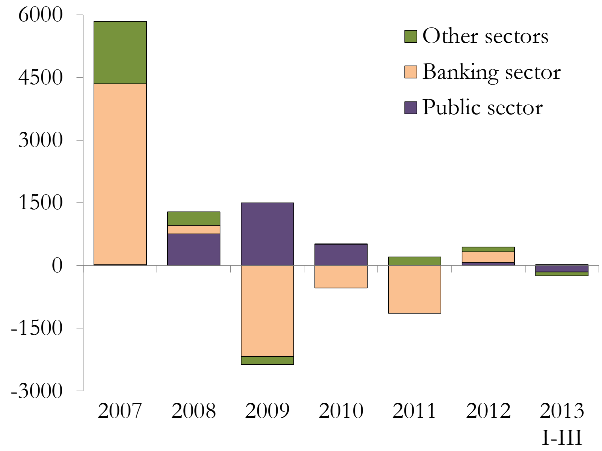
In 2010, the amount of incoming FDI flows was four times higher than in 2009 and constituted almost 1/3 of foreign investments attracted to the Latvian economy in 2010. In 2011, the volume of incoming FDI was almost four times higher than in 2010. In 2012, the amount of FDI was by 26.5% lower than a year ago. The drop in the amount of incoming FDI is largely related to negative net investment flows in the energy sector and real estate activities in the 2nd quarter of 2012.

The share of portfolio investments has not been exceeding 10% of incoming financial flows over the last three years. In 2012, there was a surplus of the balance of portfolio investments (4.5% of GDP), which was mainly due to the growing external indebtedness of the public sector. Fluctuations of portfolio investment flows are considerably influenced by the activities aimed at stabilizing the balance of the banking sector, as well as restructuring the external indebtedness. In the 1st quarter of 2013, the portfolio investment account was balanced.

Significant fluctuations are observed regarding other investments that until 2008 formed a large part of the total foreign investments. These are trade loans, loans and borrowings, cash and deposits, etc. As a result of the global financial crisis, a decrease of short-term flows was observed in 2008, but in 2009 flows of other investments were negative (-9.8% of GDP), mainly at the expense of the rapid decrease of foreign liabilities of the banking sector.

Figure 4.26

Incoming Foreign Investment Flows by Sectors*
(million LVL)



* excluding foreign direct investments

In 2010, the negative balance of other investments decreased and was only 0.8% of GDP determined by the decrease of long-term government loans and debt commitments of banks.

In 2011, the negative balance of other investments increased reaching 7.2% of GDP. The fluctuating indicator of the balance of other investments was mainly influenced by the decreasing deposits in the banking sector.

In the 1st quarter of 2012, the balance of other investments was positive at 5.1% of GDP, though it had a deficit further on (in the 2nd quarter – 1%, in the 3rd quarter – 5.2% and in the 4th quarter – 17.9% of GDP). Overall, in 2012, as well as in the 1st quarter of 2013, the balance of other investments was negative at 5.4% and 3.6% of GDP respectively. Fluctuations of the balance of other investments, like portfolio investments, are mainly related to the measures of stabilizing the financial sector and the restructuring policy of the public sector debts.

In general, incoming foreign investment flows still are fluctuating and are considerably lower than they were before the crisis. At the moment their fluctuations are mainly influenced by the measures to stabilize the financial sector.

The data of the international investment balance of Latvia shows that the government gross external debt was LVL 4927.3 million (31.4% of GDP) at the end of March 2013, i.e. by almost 1.3% lower than a year ago. Although the government gross external debt has decreased, the total gross external debt of Latvia has also increased by 3.2%, constituting 138.6% of GDP at the end of March 2013.

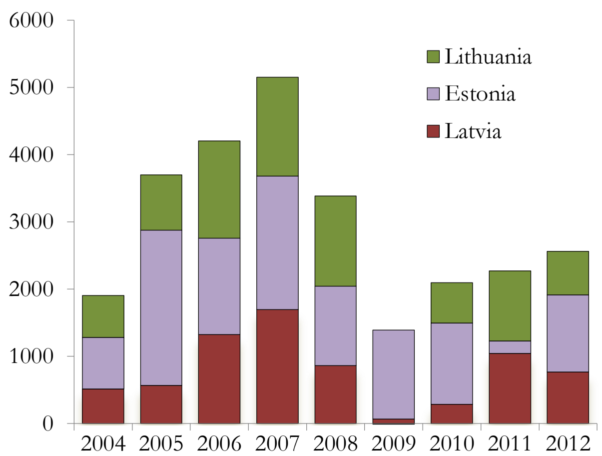
4.3.3 Foreign Direct Investment

The intensity of FDI flows had significantly decreased due to the global financial crisis, but had been growing in the past few years. At the same time, it should be noted that all in all FDI flows remained positive during the recession years, thus proving the trust of foreign investors in the implemented economic stabilization policy.

Figure 4.27

Inflow of FDI in the Baltic States

(million EUR)



In the first years of the crisis, a decrease of FDI inflow was observed in all Baltic States. In Estonia, the volume of incoming FDI in 2009 was only by 8.6% lower than in 2008, and it was due to the significant investments in the financial intermediation sector, while in Latvia they were only at the level of 7.8% from the FDI attracted within the previous year. FDI flows were negative in Lithuania. However, flows of incoming FDI have been growing since 2010. If compared to the previous year, the volume of FDI increased by 51.7% in all Baltic States, while in 2011 it was by 8.3% higher than in 2010. It should be noted that in 2011 Latvia attracted almost a half of the incoming FDI in the Baltic States.

The total amount of incoming FDI in the Baltic States constituted EUR 2562.7 million in 2012 which is by 12.8% higher than a year ago. Although incoming FDI flows have increased in general in the Baltic States, each country experienced differing changes in the amount of FDI. In Latvia and Lithuania the attracted FDI flows decreased correspondingly by 26.4% and 37.5% in this period, while Estonia experienced a sixfold increase.

During the period from 2010 until 2012, Estonia attracted about 37% of all FDI in the Baltic States, Lithuania – 33%, but Latvia – 30%. Comparing to the pre-crisis period, Latvia has slightly improved its position.

It should be noted that strong fluctuations of FDI flows have been observed in all Baltic States over the past few years, which was mainly influenced by the activities aimed at stabilizing the financial sector. (drop in FDI flows in Lithuania was mainly determined by the large investments in the oil refining sector in relation to reconstruction of *Mažeikiai oil* refinery company).

The activities of Latvian investors abroad have been increasing since 2010. Direct investments of Latvian entrepreneurs abroad have been almost three times higher in 2011, compared to 2010, but in 2012, FDI of Latvia 3.3 times exceeded the amounts of the previous year.

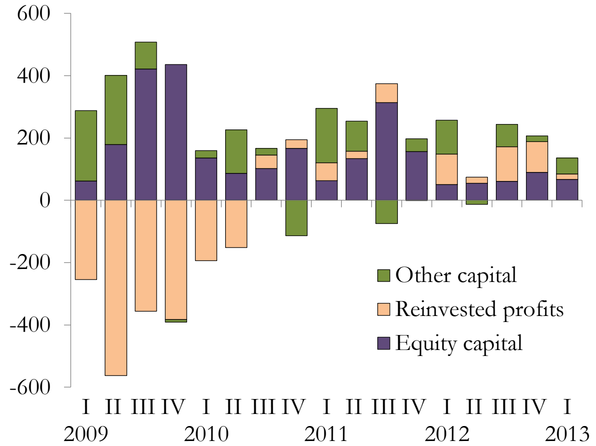
The structure of the incoming FDI by types of investments shows that since the 4th quarter of 2008 until the 2nd quarter of 2010, direct investment enterprises have been operating with losses. In 2009, the losses reached LVL 1094.5 million (EUR 1542 million). Losses of the foreign direct investment enterprises were fully compensated by great investments in equity capital and other capital, therefore the incoming FDI flows were positive in 2009 (LVL 47.5 million).

FDI flows experienced a rapid increase along with the economic recovery. The amount of incoming FDI in 2010 was fourfold the FDI in 2009, while in 2011, FDI flows exceeded the indicator of the previous year almost four times and reached 5.2% of GDP. In 2012 and in the 1st quarter of 2013, the amount of attracted FDI was slightly more moderate than a year ago and reached correspondingly 3.5% and 2.7% of GDP.

According to the international investment balance of Latvia, the FDI stock in the economy of Latvia reached LVL 7706.3 million (EUR 10 965.1 million) at the end of March 2013, which is by 16.3% more than at the end of March 2012. The share of FDI in the structure of foreign capital stock constituted 28.3 per cent.

Figure 4.28

Foreign Direct Investments in Latvia
(received during the quarter, million EUR)



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 March 2013, the FDI of the EU Member States constituted 70% of all FDI stock, a fourth of them are investments of the new EU Member States, and almost a half of them are investments of the euro zone countries.

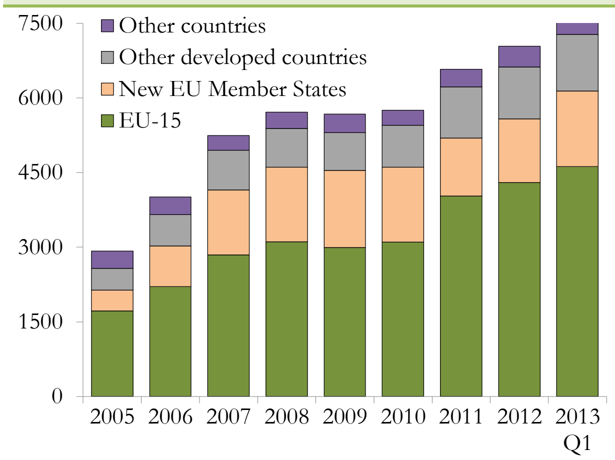
Sweden is the biggest investor country in the economy of Latvia. At the end of March 2013, investments of Sweden entrepreneurs constituted almost 22% of the total FDI stock. Mainly they are investments in financial intermediation (85% of all FDI stock in the sector). Since the end of the 1st quarter of 2012, direct investments of Sweden have increased by 4.2%, and these investments have almost doubled in comparison with late 2010, which is mainly related to transactions in the banking sector between Estonia and Sweden. Therefore, the FDI stock of Estonian entrepreneurs has decreased by almost a half constituting 5.8% of the total FDI stock at the end of March 2013 (at the end of 2010 – 14.1%).

Extensive investments have been made also by entrepreneurs from Denmark, the Netherlands, Estonia, Germany, Norway, Finland, Russia and Cyprus. Investment volumes of these countries at the end of March 2013 constituted almost 42% of the total FDI stock in the economy of Latvia.

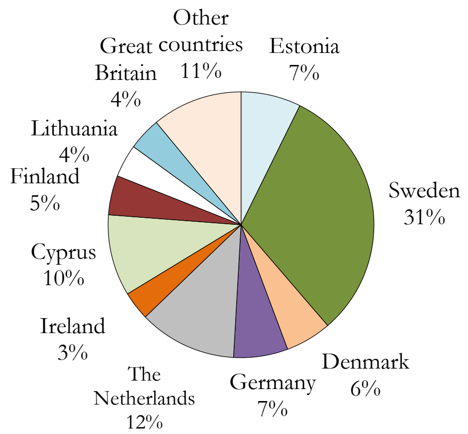
Figure 4.29

FDI Stock

By Groups of Countries
(million LVL, at the end of the period)



FDI of EU Member States
(per cent, at the end of March 2013)



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 service sector was by almost 4 times higher than in manufacturing. During the economic downturn (2008-2009), the amount of annual incoming FDI flows decreased almost three times, they were negative in trade, but the decrease in investment intensity in real estate was dropped by a half. Overall, the amount of annual FDI flows in services sectors shrunk by 72.8%. Yet, the amount of annual incoming FDI flows in manufacturing industries decreased by just 15% compared to the annual FDI flows in 2005-2007.

Since 2010, the structure of incoming FDI flows has become more even, without any explicit dominance of the financial sector. It should be noted that the average annual investments in service sectors have been exceeding the investments in manufacturing industries by nearly five times over the past three years. In the 1st quarter of 2013, the amount of attracted FDI in services and manufacturing industries were nearly the same.

At the end of March 2013, the FDI stock in services sectors constituted 75.7% of the total FDI stock in the national economy of Latvia, i.e. by 0.5 percentage points lower than at the end of 2007. Financial intermediation and real estate sectors constitute almost a half of the FDI stock in services sectors.

At the end of March 2013, the FDI stock in goods production constituted 24.3% of the total FDI stock in the national economy of Latvia. Compared to the end of 2007, they have increased by 50 per cent.

Table 4.7

FDI Stock by Sectors
(million LVL)

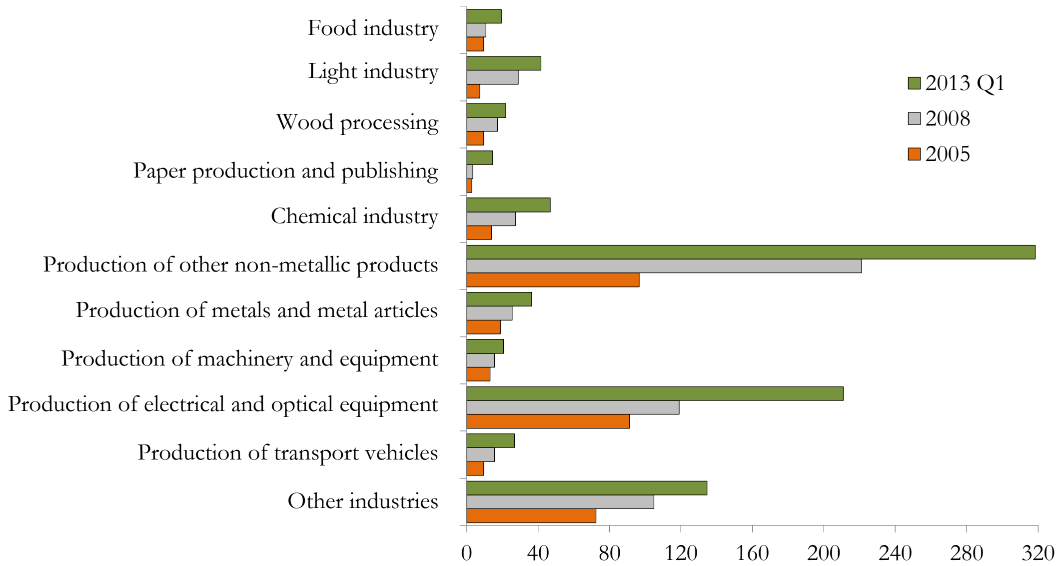
	Balance (at the end of the period)			**Flows** (average per year)			
	2005	**2007**	**2013***	**2005-2007**	**2008-2009**	**2010-2011**	**2012**
Agriculture	45.3	91.7	215.0	11.9	19.6	13.3	2.8
Manufacturing	345.0	489.2	892.1	63.5	85.5	59.9	40.9
Other industries	383.1	308.5	389.4	24.6	13.9	9.4	50.6
Construction	123.2	360.9	377.2	69.8	25.3	0.3	12.9
Trade and accommodation	405.4	704.7	1048.2	108.4	-2.7	52.4	70.9
Transport and storage	180.6	198.2	323.5	11.9	5.8	14.8	35.0
Financial intermediation	747.0	1751.4	1921.1	347.5	126.8	107.0	150.7
Real estate operations	198.9	465.6	978.4	78.3	36.1	171.7	74.6
Other services	494.5	877.2	1561.4	125.5	17.0	39.3	101.7

* At the end of March 2013

A particularly rapid increase of the FDI stock in industry was observed in manufacturing from the end of 2007 until the end of March 2013 – by 82%. The increase of the FDI stock in manufacturing to a great extent was influenced by substantial investments in manufacture of construction materials (increase by 118.5%) and wood processing (increase by 78%). The share of sectors mentioned above in the FDI stock constituted 60% in manufacturing at the end of March 2013 (at the end of 2007 – 54%).

Figure 4.30

FDI stock in manufacturing
(at the end of period, million LVL)

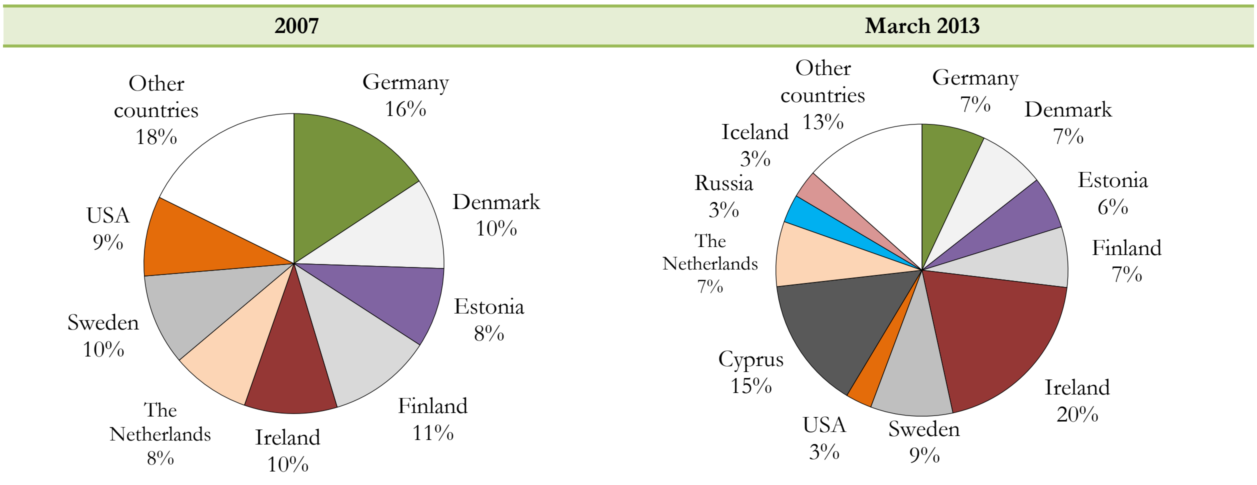


In general, having evaluated the FDI structure in manufacturing, it can be concluded that it is constantly changing. In some sectors, like the light industry, the FDI have been decreasing already since 2005, and the main reason for that was loss of competitiveness in foreign markets. Similar tendencies have been observed in several EU Member States. It should be noted that the FDI in this sector has been growing since the 3rd quarter of 2010. At the end of March 2013, the FDI stock in the light industry increased by 68 per cent.

The FDI in food industry decreased during the rapid downturn that was mainly influenced by the low domestic demand. However, as the economic situation has improved in the past few years, the FDI stock has increased and at the end of March 2013 it constituted 15.1% of the FDI stock in manufacturing (at the end of 2010 – 13%). The FDI in manufacture of electrical and optical equipment has been increasing since 2010; they increased 2.3 times at the end of March 2013 compared to the end of 2010.

Figure 4.31

Structure of the FDI Stock in Manufacturing by Countries
(at the end of the period, per cent)



Foreign investments in manufacture of vehicles also increased. At the end of the 1st quarter of 2013, the level of FDI stock in this sector exceeded the level of 2010 by 24.6%. Overall, it can be concluded that the level of FDI stock at the end of March 2013 exceeds the level of 2010 almost in all manufacturing sectors.

By evaluating the change in the structure of the FDI stock in manufacturing qualitatively, it can be concluded that the share of low technology industries is decreasing in favour of medium-low-technology and medium-high-technology industries.

The largest investments in manufacturing have been made by investors from Denmark, Finland, Germany, Sweden, Ireland, Estonia, the Netherlands, and Cyprus. Investments from the abovementioned countries constituted 80% of the FDI stock in manufacturing. It should be noted that by the end of 2007, none of the countries held the leading position in the structure of the FDI stock in manufacturing. Due to the financial crisis, the situation has changed significantly. At the end of March 2013, the capital of Ireland was dominating in the structure of the FDI stock constituting more than a fifth of the FDI stock in manufacturing, which was greatly influenced by the rapid increase of investments from this country. Entrepreneurs from Cyprus and the Netherlands have also made large investments in manufacturing. Comparing to late 2007, the FDI stock of Cyprus entrepreneurs in manufacturing has increased 8 times, while that of the Netherlands – 2 times. The amount of FDI stock of Germany and USA has decreased correspondingly by 22.2% and 42%. At the same time, at the end of March 2013, investment stock by Russian businessmen in manufacturing increased almost six times, when compared to the end of 2007 and was 3.1% of FDI stock in manufacturing.

Although FDI flows in Latvian manufacturing 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. From the end of 2010 until the end of 2012, Lithuania has attracted 31% of all incoming FDI in manufacturing in the Baltic States, Estonia – 47.6% but Latvia – only 21.4%. This means that foreign investors find manufacturing in Latvia less attractive than in neighbouring countries when comparing the Baltic States.

The Investment and Development Agency of Latvia (IDAL) plays a significant role in attracting foreign investment in Latvia. The investment attraction strategy of the IDAL is focused on proper maintenance of incoming investment projects and active operations related to attraction of investment projects, by addressing the potential investors.

The IDAL continues developing its range and supply of services on the basis of FDI market needs and ensuring a link between the IDAL and investors. Latvia can offer the investors a favourable geographic location, advantages of natural resources, advantages in the sphere of science, as well as assistance of the IDAL experts in the process of project implementation.

Overall, it should be noted that the interest about Latvia as a potential investment destination is increasing as the world recovers from the global economic and financial crisis.

The interest of foreign investors by submitted incoming investment projects to the IDAL: 29% of the projects have been submitted in metal processing and electronics sectors, while projects of global service centres (both shared services, and outsourcing projects) constitute almost 1/5 or 17% of projects. Thus, these two sectors account for the explicitly dominant share in incoming investment projects. In 2012, the number of incoming foreign investment projects at the IDAL which is still evaluating the investments in Latvia, has significantly increased in comparison with 2011.

Incoming investment projects have been successfully serviced. In 2012, 408 investment information requests have been processed which exceed the planned amount of the year, 130 investment offers have been prepared, the IDAL representations have organized visits to 100 potential investors, organized visits of 122 potential investors to Latvia, as well as continued active work on ex-*post monitoring of investors implementing their projects in Latvia* (23 projects).

As a result of the abovementioned activity, a decision on the implementation of 15 projects in Latvia has been made, including 11 new projects, while 4 exiting investor companies in Latvia expanded their activities. Complete project implementation is expected to attract investments in the amount of around LVL 23.6 million (EUR 33.6 million), thus creating 1249 new jobs.

Having assessed the interest of investors in the 1st quarter of 2013, by the number of investment requests processed, the trends of 2012 have basically remained unchanged by sectors – 28% of all potential projects have been submitted in metal processing and electronics sectors, while global business service centre projects constitute 18% of the projects.

In the 1st quarter of 2013, a decision on the implementation of 9 projects in Latvia has already been made for the total amount of about LVL 5.8 million (EUR 8.3 million). Complete project implementation is expected to create 478 new jobs (for example, investors from the Netherlands, Sweden, Switzerland and Germany will invest in mechanical engineering sector; an investor from the United Kingdom will invest in establishment of a machine service centre, an investor from Russia (Group of Companies "Cotton Club") will invest in manufacture of various hygiene textile products, etc.). It is important, that four of these projects are expansion projects.

The work with investment projects involves the regular analysis of the reasons why potential investors do not prefer Latvia on a regular basis. According to the collected information, the main reasons why investors have chosen other countries include the issue of access to labour, distance to target countries, inadequate infrastructure, including the lack of electrical capacity and roads, lack of investment incentives, as well as a range of other reasons, for example, access to finance, customs procedures, etc.

In order to improve the progress of local and foreign investment projects important for Latvia, the IDAL continues implementing investment attraction methodology *POLARIS process*, which envisages unified and coordinated action of ministries, municipalities, infrastructure enterprises and public institutions in implementation of strategically important local and foreign investment projects, as well as involvement of the private sector, universities and scientific institutions in this process.

In order to ensure coordinated inter-institutional cooperation for successful implementation of investment projects in Latvia in favour of the country, the Coordination Council for Large and Strategically Important Investment Projects established on August 10, 2010 continues working based on the investment attraction strategy *POLARIS process* developed by the IDAL (see also chapter 6.12).

4.4 Financial and Capital Markets

4.4.1 Monetary Policy and Exchange Rate

The main goal of the monetary policy of the Bank of Latvia is to maintain price stability in the country. The Bank of Latvia is independent in making and implementing its decisions, and it is not subordinated to the decisions or instructions of the government or governmental institutions. The Bank of Latvia is under the supervision of the Saeima.

Latvia has been a member of the European Central Bank (ECB) since joining the EU; yet, introduction of euro will make it a member of the *Eurosystem*. On June 5, the ECB published its *Convergence Report 2013* assessing the economic and legal convergence of Latvia, indicating, that all in all, Latvia is within the reference values of the convergence criteria. The Convergence Report on Latvia published by the European Commission also concludes that Latvia is ready to adopt euro in 2014. The final decision on accession of Latvia to the euro zone is expected to be adopted on July 9 by the EU Council. Since the euro is going to be introduced as of January 1, 2014, the government is already implementing different measures related to the euro introduction:

– On January 31, 2013, the Saeima adopted the *Law on the Procedure for Introduction of Euro* aimed at ensuring efficient and transparent introduction of the euro in Latvia;
– On April 4, 2013, the Cabinet of Ministers issued the Decree on Latvia's *National Euro Changeover Plan* aimed at defining the key tasks of the euro changeover project in Latvia, implementation stages and scope of accountability, as well as define the principles and scenario of euro changeover to ensure successful introduction of the euro in both private and public sectors;
– On May 1, 2013, the information campaign of introduction of the euro in Latvia was launched.

Until introduction of euro, Latvia will coordinate monetary policy instruments and procedures for monetary operations and will adapt the management of foreign currency reserves of the central bank to the ECB requirements. The Bank of Latvia is already using the same indirect monetary policy instruments based on free market principles as ECB, and after joining the European Monetary Union (EMU), it will be necessary only to review importance of separate instruments in implementation of the monetary policy and procedural elements. For Latvia being a member of the EMU means:

– Single currency with other EMU member states – the euro;
– Common 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.

In late 2012, the EU reached a political agreement on establishing a single supervisory mechanism (SSM) of credit institutions aimed at restoring confidence in the banking industry. The final voting on this issue might take place in September 2013 and the single supervisory system is going to be effective within a year after its approval. The SSM will be composed of the ECB and national supervisory authorities. After joining the eurozone, the three largest banks in Latvia might be subjected to direct supervision of the ECB. Out of all 6000 banks in the eurozone, about 200 will be subject to direct supervision of the ECB according to approved criteria.

Box 4.1

The fixed national currency exchange rate policy implemented by the Bank of Latvia

Since February 12, 1994, the Bank of Latvia has been implementing fixed national currency exchange rate policy by pegging the exchange rate of the lats (LVL) to the SDR currency basket (1 SDR = 0.7997 LVL). As of January 1, 2005, the peg of the lats to the SDR was replaced with the peg to the euro (1 EUR = 0.702804 LVL). The change of the lats peg was determined by the plans of Latvia to join the European Exchange Rate Mechanism II (ERM II) and after fulfilment of the required criteria to join the Economic and Monetary Union (EMS).

On May 2, 2005, Latvia joined the ERM II with the already existing exchange rate of the lats against euro. Within the framework of the ERM II standard fluctuations of the exchange rate in the amount of +/-15% around the central or peg rate are allowed. However, Latvia commits unilaterally to keep the exchange rate fluctuation margin within +/-1%, retaining the former range of fluctuation band of the lats, which was habitual to the financial market since 1994, when the lats was pegged to the SDR and was kept when the lats was re-pegged to the euro on January 1, 2005. The Bank of Latvia will continue implementing former policy of fixed exchange rate until the euro is introduced in Latvia. The operational objective of the Bank of Latvia is to ensure a constant peg of the exchange rate of the lats to the euro under conditions of fixed national currency exchange rate.

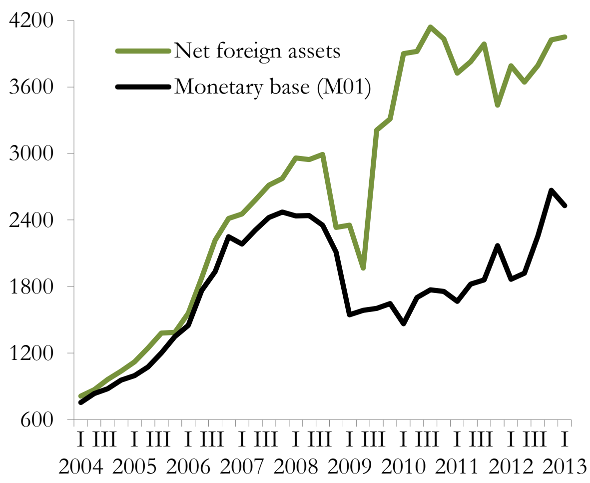
After making the single supervisory mechanism operational, it is expected to give the European Stability Mechanism an opportunity to directly recapitalize eurozone banks in difficulties, without burdening the eurozone countries with higher debt commitments. According to the proposal, the ECB will fully implement its supervisory duties on March 1, 2014 or 12 months after entering into force of the regulation.

In order to keep a fixed exchange rate, it is necessary to have a sufficient amount of foreign reserves. Net foreign reserves of the Bank of Latvia continuously cover the monetary base of Latvia (see Figure 4.31), and therefore it has been able to keep a stable exchange rate of lats even in situations of external collapses. Coverage of the monetary base (cash in circulation and deposits in the Bank of Latvia) with net foreign assets was 160% at the end of the 1st quarter of 2013.

Figure 4.32

Net Foreign Assets of the Bank of Latvia and Monetary Base, Quarterly Profile

(million LVL, at the end of the period)



Foreign reserves of the Bank of Latvia are administered according to the guidelines developed by the Council of the Bank of Latvia, investing them in safe and liquid financial instruments. Foreign reserves of the Bank of Latvia consist of gold reserves, foreign convertible currency and SDR. Foreign reserves of the Bank of Latvia (including gold reserves, foreign convertible currency, and SDR) at the end of April 2013 have increased by 1.1% constituting EUR 5735.5 million in comparison with the end of April 2012. The reserves consist mainly of foreign exchange, while gold reserves constitute EUR 280 million.

4.4.2 Market Structure and Development

At the end of the 1st quarter of 2013, 20 **banks** operated and 9 EU branches of foreign banks were registered in Latvia. 9 branches of Latvian banks are 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 early 2013, a number of Latvian banks continued structural changes:

– The commercial activity of JSC "Mortgage and Land Bank of Latvia" is being gradually terminated until the end of 2013 (see Section 6.8);
– The process of selling the shares of JSC "Citadele banka" (launched in the mid-2011), is suspended until the situation in international financial markets improves. JSC "Citadele banka" remains in possession of the current shareholders until further decisions of the shareholders. The decision on suspension of selling has no impact whatsoever on the operation of JSC "Citadele banka" and it continues implementing the restructuring plan;
– The sale of the loan portfolio of JSC "Latvijas Krājbanka" continues through implementing measures to attract potential investors. The loans of JSC "Latvijas Krājbanka" have been divided in five loan portfolios. The sale of loan portfolio is taking place according to pre-defined schedule. In June 2013, the bank's consumer loan portfolio was sold.

In the 1st quarter of 2013, performance indices of all Latvian banks complied with the regulatory requirements. Liquidity ratio of banks remained high at 58.9% (minimum regulatory requirement is 30%). Non-resident business oriented banks are subject to higher liquidity ratio and capital adequacy ratio requirements.

In the 1st quarter of 2013, the average banking sector capital adequacy ratio reached 18.3% (minimum regulatory requirement is 8%), which is the highest result over the past few years. Over the past few quarters, the return on assets (ROA)[1] and the return on equity (ROE)[2] of banks have increased and were 0.9% and 8.5%, respectively.

Banks' profitability has been improved and within the four months of 2013, profit of the banking sector has increased by 35%, compared to the corresponding period of the previous year. Thus, 17 Latvian banks and 4 foreign bank branches operated with profit of LVL 74.6 million. It was mainly influenced by the increase in revenue from commissions and commercial transactions of financial instruments, as well as lower reserves for bad debts.

The **insurance market** kept growing at a stable pace. In 2012, 9 insurance companies, 2 of which offered life insurance and 7 – non-life insurance, as

[1] ROA – ratio of profit/loss to assets.
[2] ROE – ratio of profit/loss to capital and reserves.

well as 13 branches of foreign insurance companies operated in Latvia.

In 2012, as compared to 2011, the amount of gross premiums signed by insurance companies has increased by 9.7% reaching LVL 248.9 million. The greatest increase in the amount of gross premiums signed was observed in the health insurance market, which was mainly influenced by the growing demand in the public sector. The amount of paid gross compensations has increased by 5.5% reaching LVL 131.8 million. In 2012, insurance companies operated with profit of LVL 10.2 million: life insurance companies – with nearly LVL 2.8 million profit, while non-life insurance companies – with profit of LVL 7.4 million.

Since the end of 2011, the situation in the **Latvian securities market** has significantly improved, and positive trends were observed also in 2012 as the total value of securities registered in the Latvian Central Depository increased by LVL 187 million, reaching LVL 1.8 billion at the end of the year. The majority of these securities have been listed on the stock exchange NASDAQ OMX Riga. A total of 162 different issues of securities have been registered in the Latvian Central Depository in late 2012. Comparing to the previous year, the number of issued corporative bonds has significantly increased. The market value of the stocks in exchange has also increased. In early 2013, situation in securities market continued improving and the OMX Baltic Benchmark index value was 609.7 points (data on May 20, 2013), which is by 11.4% higher than at the beginning of the year. The increase in NASDAQ OMX Tallinn and NASDAQ OMX Vilnius index value was within 11%. NASDAQ OMX Riga index value increased at a slower pace (by 4.2%).

In the 1st quarter of 2013, the amount of central government debt securities in bank assets has decreased by 2.6% compared to the corresponding period of 2012 mainly due to the decrease in the amount of foreign central government securities, whereas the amount of Latvian central government securities has slightly increased in this period. Out of other securities, the amount of issuer bonds and other fixed-yield debt securities with fixed income shares and other variable-yield securities experienced the most rapid increase (by 19.1%), while the amount of shares and other variable-yield securities dropped by 12 per cent.

4.4.3 Assets, Deposits and Loans

Bank assets of Latvia have been growing since the end of the second half of 2012, reaching LVL 20.2 billion at the end of the 1st quarter of 2013, which is by 0.2% higher than a year ago. Bank credits (58%) constitute the largest part of bank assets. The share thereof has been significantly reduced over the past few years (for comparison, in the 1st quarter of 2010, bank credits constituted 70% of bank assets), while the share of securities has increased.

As the confidence in the banking sector improves and the introduction of the euro approaches, the amount of currency in circulation is decreasing, constituting LVL 1011.8 million in circulation at the end of the 1st quarter of 2013, which is by 0.9% lower than in the corresponding period of 2012.

The balance of **deposits** attracted by banks continues increasing – at the end of the 1st quarter of 2013, non-bank deposits in banks have increased by 13.9%, reaching LVL 12.8 billion, compared to the corresponding period of the previous year. The balance of both resident and non-resident deposits increased, though the balance of non-resident deposits increased considerably faster. Within a year, the balance of non-resident deposits has increased by 17.7% or LVL 961.4 million, constituting a half of the total non-bank deposits. A half of the non-resident deposits are from the EU and the CIS countries. Regular market supervision and inspections in Latvian banks are carried out by the FCMC. Non-resident deposits are subject to a particularly strict supervision. Those banks dealing with non-resident deposits are subject to stricter requirements for liquidity and capital adequacy. The ECB in its *Convergence Report 2013* has referred to risks caused by the increasing amount of non-resident deposits in Latvia, emphasizing the growing need for a wide range of policy instruments in Latvia to prevent risks to financial stability, including those risks caused by the use of non-resident deposits as a source of funding in significant part of the banking sector.

In the 1st quarter of 2013, changes of the deposit currency structure continued. The amount of resident deposits in euro exceeds the amount of resident deposits in lats. Majority of non-resident deposits are in USD (64.8%) and the amount thereof keep growing.

The balance of bank **loans** granted still continues decreasing, although the loan portfolio is now decreasing at a slower pace. The balance of loans granted to residents' financial institutions, non-financial corporations and households decreased by 6.6% at the end of the 1st quarter of 2013 in comparison with the corresponding period of the previous year. The decrease in the balance of loans was mainly affected by the weak crediting and its slow recovery.

The following trends have been observed in lending sector:

– the number and amount of new loans issued is growing – in the 1st quarter of 2013, the banking sector has issued a total of 24 thousand new loans in the amount of LVL 543.2 million, which in terms of the amount is a half of the number issued in the corresponding period of the previous year. Almost a half of the new loans have been issued to non-residents. A number of banks are using the opportunity to earn profit abroad by issuing loans to non-residents. In 2012, the business model of 14 Latvian banks was oriented towards non-resident customers. Yet, the share of loans issued to non-residents constituted just 13% in the total loan portfolio of the banking sector;
– household lending still is limited. Overall, 9% or LVL 47.4 million of the total new loans have been issued to households, which is by 18% higher than in the 1st quarter of the previous year. The majority of new loans to households have been issued for the purchase of consumer goods, while in terms of amount the most of new loans have been granted for the purchase of housing; however, people still are too cautious to assume housing debt commitments. Overall, the amount of loans issued to households in the 1st quarter of 2013 was LVL 4511.1 million, which is by 9.4% less than in the corresponding period of the previous year and constituted 39% of the total loan portfolio of the banking sector;
– in the business sector lending is relatively stable. 24% or LVL 132.2 million of new loans have been issued for business development, while 22% to financial institutions. Most of the new loans have been granted to the agriculture and forestry companies, but in terms of amount, a half of all new loans have been granted to financial and insurance operations. The amount of new loans have been significantly increased also in one of the most important sectors of national economy – manufacturing. Overall, at the end of the 1st quarter of 2013, the amount of loans granted to residents in national economy constituted LVL 5477.3 million, which is by 4.5% less than in the corresponding period of 2012, and the share of these loans was nearly 45% of the total loan portfolio of the banking sector. By sectors of national economy, the balance of loans granted to construction decreased by almost one fifth.

Table 4.8

Monetary Indicators of the Latvian Banking System

	2007	2008	2009	2010	2011	2012	2013 Q1
at the end of the period, million LVL							
Net foreign assets	-4482.8	-5914.6	-3022.0	-1219.8	-224.8	613.7	660.8
Net domestic assets	10654.0	11846.1	8842.3	7609.8	6710.9	6161.7	5977.0
Domestic loans	13018.2	14279.7	12204.3	11215.1	11045.4	9593.3	9465.7
to the government (net)	-87.4	-370.0	-1474.6	-1430.8	-663.8	-903.8	-908.0
to companies and individuals	13105.6	14649.7	13678.9	12645.9	11709.2	10497.1	10373.7
Other assets (net)	-2364.2	-2433.6	-3362.0	-3605.3	-4334.5	-3 431.6	-3488.7
Broad money M2X	6171.3	5931.4	5820.3	6390.0	6486.1	6775.4	6637.7
Cash in circulation (without vault cash balance)	900.0	866.1	667.3	807.4	1040	1082.4	1011.8
Deposits of individuals and companies including:	5271.3	5065.3	5153.0	5582.7	5446.1	5693.0	5625.9
overnight deposits	2864.9	2308.0	2206.2	2782.1	3109.2	3586.6	3550.6
time deposits	2406.4	2757.3	2946.8	2800.6	2336.9	2106.4	2075.3
Changes in comparison with the corresponding period of the previous year,%							
Domestic loans (compared to 2012 Q1)	31.8	9.7	-14.5	-8.1	-1.5	-13.1	-6.0
including:							
to companies and individuals	34.0	11.8	-6.6	-7.6	-7.4	-10.3	-6.5
Broad money M2X	12.6	-3.9	-1.9	9.8	1.5	4.5	3.3
Cash in circulation (without vault cash balance)	-7.1	-3.8	-23.0	21.0	28.8	4.1	-0.9
Deposits of individuals and companies	16.9	-3.9	1.7	1.1	-2.5	4.5	4.1
GDP (at current prices)	**32.3**	**9.3**	**-18.7**	**-2.2**	**11.7**	**8.7**	**5.7**

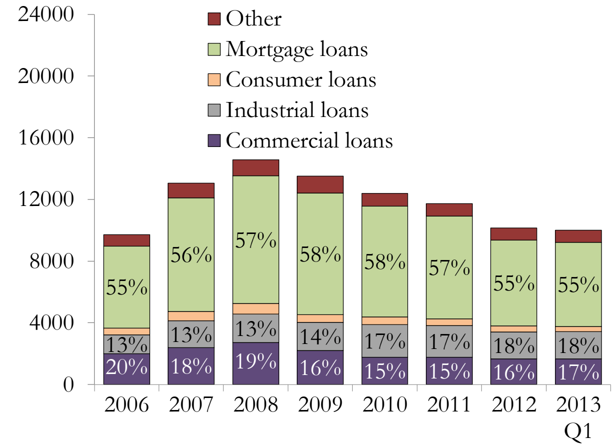
No significant changes in the structure of loans have been observed in the past few years. Mortgages still dominate in the structure of loans granted to domestic companies and individuals; the share of mortgages in the total loan structure has shrunk to 54.7%. The share of commercial credits and industrial credits in the total loan structure has increased to 34.2%, which is the highest indicator since 2006. Consumer crediting experienced the fastest drop (by 17.1%). The balance of mortgages continues dropping (by 9.1%), though at a slower pace.

Lending of commercial loans (for increasing current assets) is slowly resuming, while no significant changes have been observed in the balance of industrial loans (for acquisition of fixed assets) in the past few years.

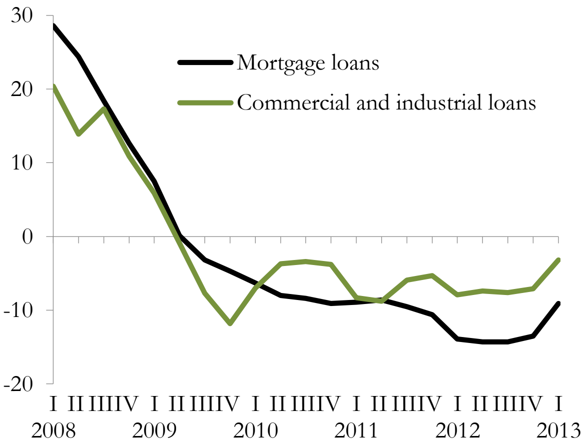
In the 1st quarter of 2013, the balance of industrial and commercial loans has decreased by 9.5%, compared to the corresponding period of the previous year.

Figure 4.33

Amount and Structure of Loans Granted to Resident Financial Institutions, Non-Financial Corporations and Households
(end of the period, million LVL)



Loans Granted to Resident Financial Institutions, Non-Financial Corporations and Households
(changes in comparison with the respective quarter of the previous year,%)

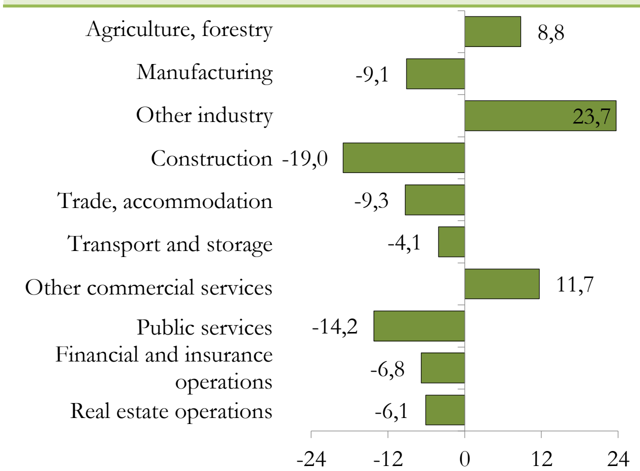


The largest share of loan balances is still related to real estate transactions (32% of the total loans granted to the sectors of the economy). A relatively high share of granted loans is also observed in manufacturing (14%), trade, accommodation and catering sectors (13%), as well as construction sector (7%).

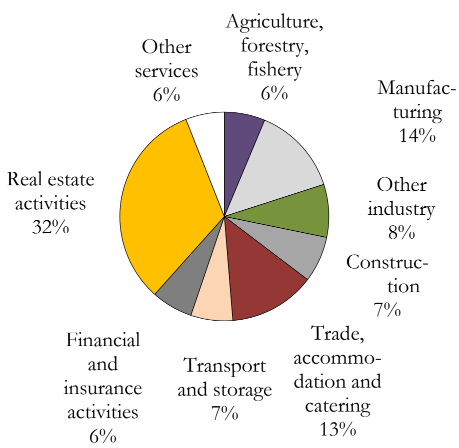
Figure 4.34

Loans to Residents by Sectors of Economy

Balance of Loans Granted
(at the end of the 2013 Q1 compared to the end of the 2012 Q1,%)



Structure of Balance of Loans Granted
(at the end of the 2013 Q1,%)

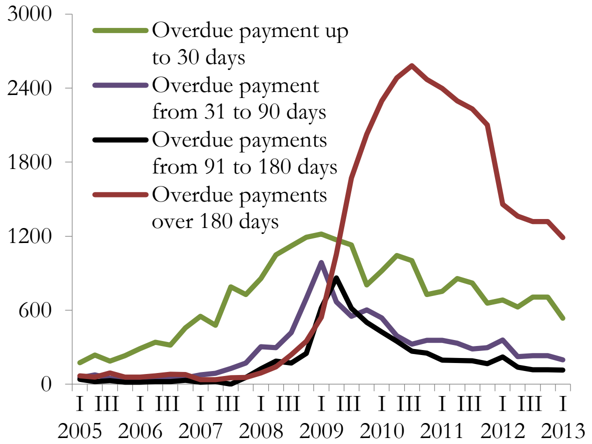


The quality of banks' loan portfolio continues improving, and the amount of **loans with overdue payments** in the total loan portfolio was 17.9% in the 1st quarter of 2013. Comparing to the corresponding quarter of the previous year, the amount of loans with overdue payments has significantly dropped (by 23.4%). It was mainly determined by the decrease in the amount of loans with overdue payments from 91 to 180 days and above 180 days by 27%, which is a positive trend considering that these loans constitute more than a half of all loans with overdue payments. The amount of the rest of loans with overdue payments also dropped in this period. The improving quality of banks' loan portfolio is mainly related to writing-off bad debts and improving solvency of enterprises. In the 1st quarter of 2013, the banking sector wrote off debts in the amount of LVL 73.9 million, which is by 25% higher than in the 1st quarter of 2012. Yet, it should be taken into account that the debt recovery continues also in case of writing-off the loan.

The quality of corporate loans has significantly improved along with recovering growth of the national economy. As regards loans with overdue payments, the loan portfolio or corporate customers is shrinking faster (14% delayed loans), while the quality of loans issued to households is improving slower (25% delayed debts).

Figure 4.35

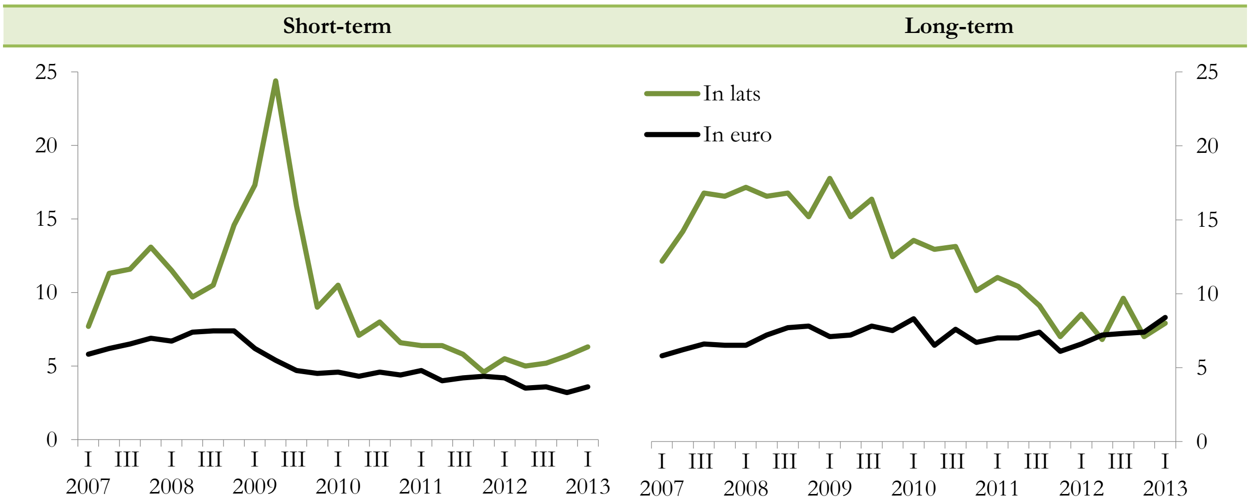
Loans with Overdue Payments
(million lats)



In 2013, the banks continued to cooperate with the clients facing difficulties to repay the loans. The share of restructured loans in the total banks' loan portfolio continues decreasing. At the end of the 1st quarter of 2013, restructured loans and loans currently being recovered constituted 21% of the total loan portfolio. The share of restructured loans in the total banks' loan portfolio decreased to 11.4%, while the share of loans currently being recovered – 9.7% of the total banks' loan portfolio.

Figure 4.36

Weighted Average Interest Rates for Loans Granted in Credit Institutions, Quarterly Profile
(per cent)



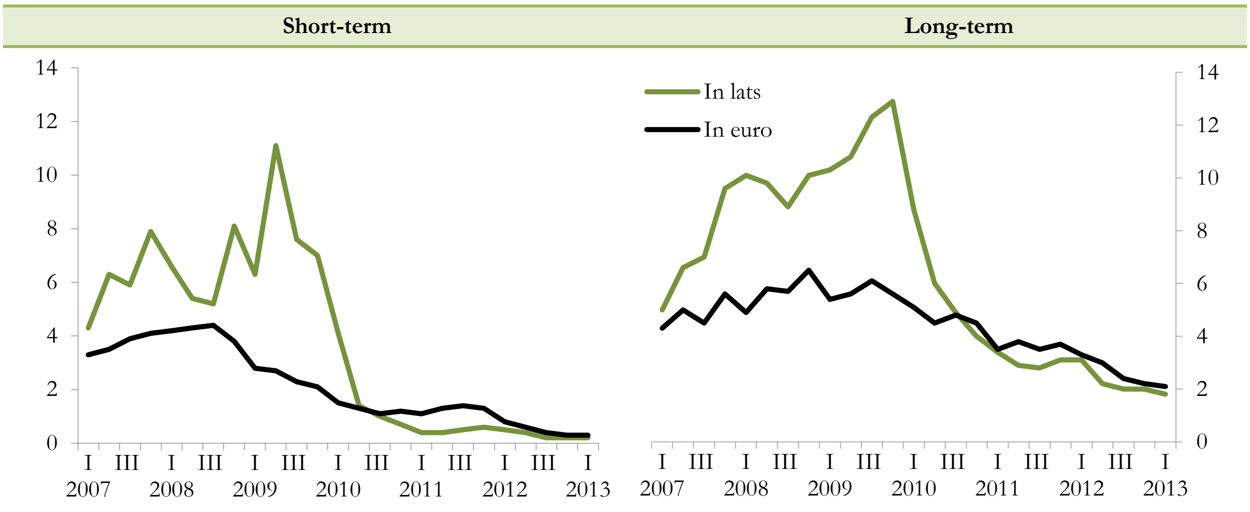
The weighted average **interest rates** on short-term loans granted in LVL to companies and individuals have been increasing since early 2012 and were 6.3% in the 1st quarter of 2013. Fluctuations of the weighted average interest rates on short-term loans granted in EUR were slight and reached 3.6 per cent.

Fluctuations of interest rates on long-term loans granted in LVL are more explicit and reached 8% in the 1st quarter of 2013. The weighted average interest rates on long-term loans granted in EUR increased, reaching the highest rate ever – 8.4 per cent at the end of the 1st quarter of 2012.

The interest rates on short-term deposits attracted in LVL and EUR in credit institutions have remained unchanged over the past few quarters and reached the lowest indicators within the past few years (accordingly 0.2% and 0.3%).

Figure 4.37

Weighted Average Interest Rates for Deposits Attracted by Credit Institutions, Quarterly Profile
(per cent)



5. LABOUR MARKET

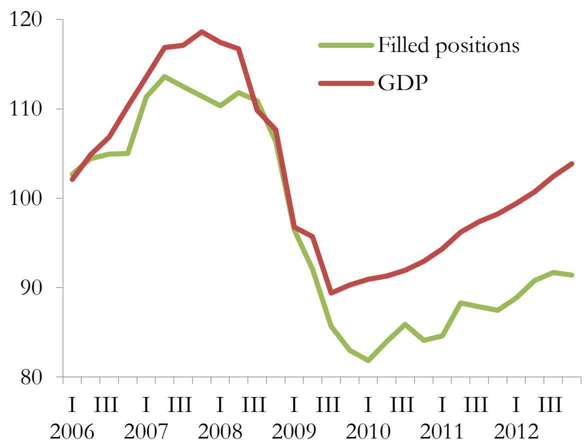
5.1 Employment and Unemployment

The gradual increase of economic activities has a positive impact on the labour market – the employment rate is growing and the high unemployment caused by the crisis is decreasing. At the same time, certain population groups, especially people of low level of education and qualification, older people, as well as the youth barely feel the improvement.

Figure 5.1

GDP and Filled Positions

2005 Q4 = 100



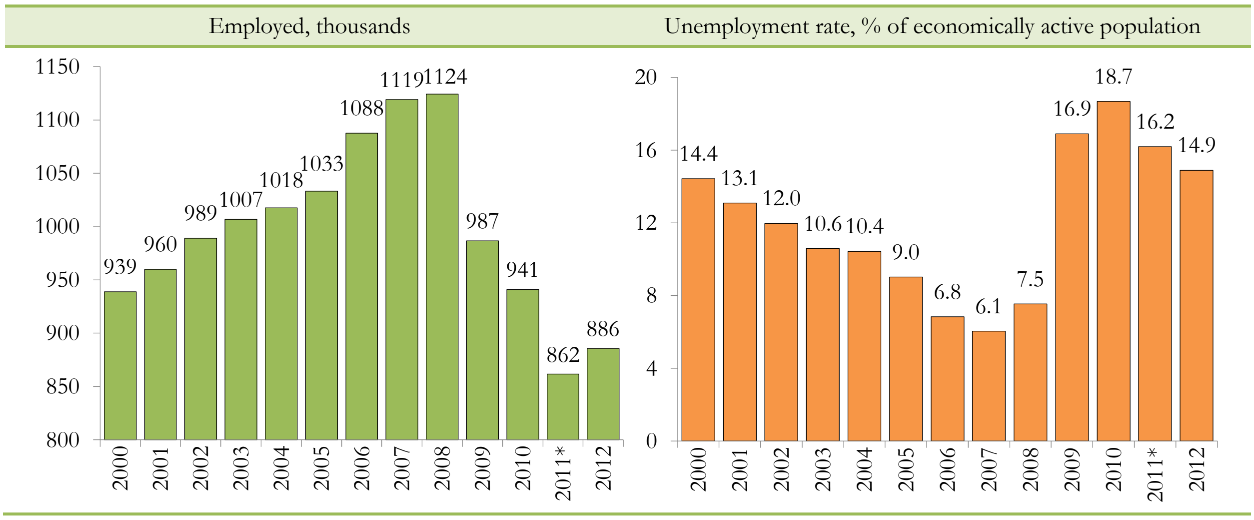
In 2011, the number of employed has increased by 2.5% compared to 2010. The unemployment rate has decreased significantly – in 2011 it was 16.2%, which was by 3 percentage points lower than in 2010.

The situation in the labour market kept improving in 2012 – employment and economic activity of the population increased, while unemployment gradually decreased. According to the Labour Force Survey data, the average number of employed people reached 885.6 thousand in 2012, which is by 2.8% or about 24 thousand more than in 2011. The employment rate in 2012 reached 56.3%, which is nearly by 3 percentage points higher than a year ago. At the same time, the number of economically active population has increased at a moderate pace (by 1.3%). A more rapid increase was hindered by negative demographic tendencies – a decreasing number of working-age population. The unemployment rate in 2012 was 14.9%, by 1.3 percentage points lower than a year ago.

At the end of December 2012, the registered unemployment rate reached the lowest point since April 2009 and was 10.5% – there were 104.1 thousand registered unemployed which is by 26.2 thousand less than in December 2011. The highest registered unemployment rate remains in Latgale region (21.1%), while the lowest – in Riga (6.4%).

Figure 5.2

Employment and Unemployment in Latvia from 2000 until 2012

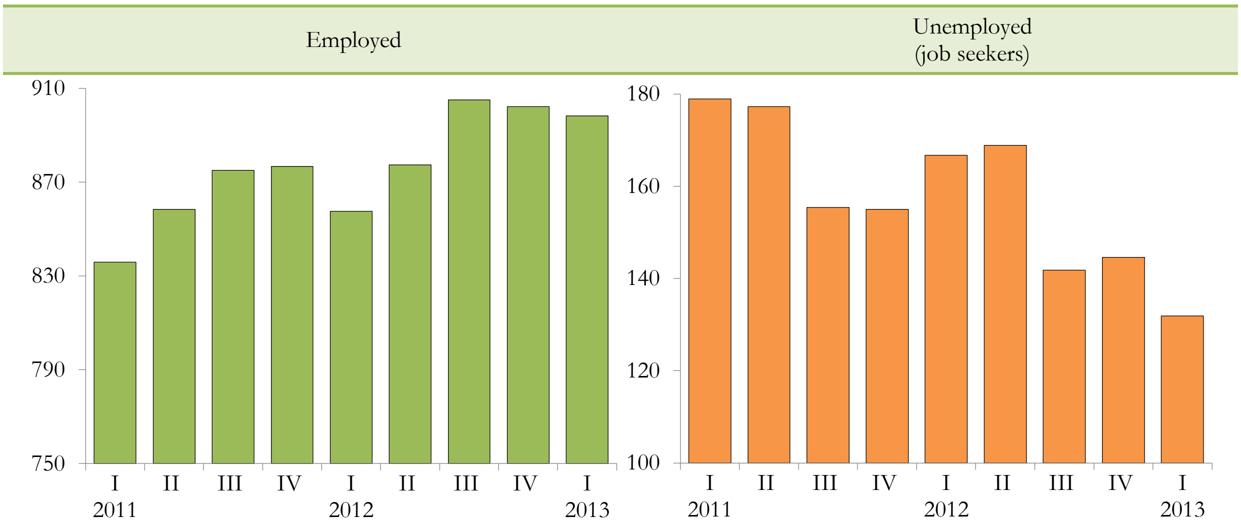


*according to the Population Census of 2011

In 2013, the situation in the labour market keeps improving. In the 1st quarter of 2013, the unemployment rate dropped to 12.4%. The number of economically active population has increased by 0.6% in the 1st quarter of 2013, compared to the 1st quarter of 2012. Yet the number of employed people, and their share in the total number of population has increased in the 1st quarter of 2013. A total of 893.3 thousand people of 57.1% of the population have been employed in this period.

Figure 5.3

Employment and Unemployment in Latvia
(thousands)

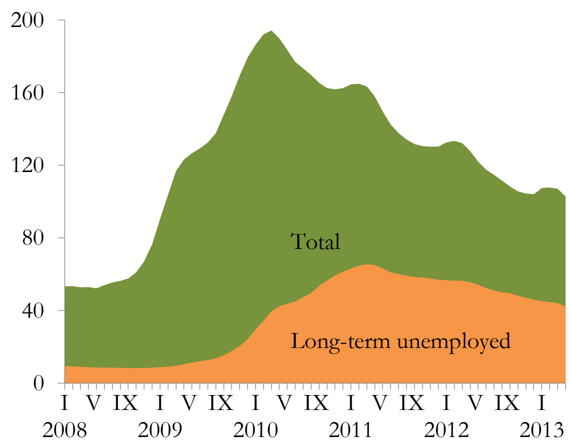


The current unemployment rate is mainly related to the cyclical unemployment, i.e. the significant drop in production volumes and services provided during the crisis. Therefore, all measures related to the promotion of economic activities and entrepreneurship foster an increase in the labour demand and employment growth. At the same time, there is a risk that some of the currently unemployed 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 may occur between the labour supply and demand – skills of job seekers fail to meet employers' requirements.

The number of long-term unemployed increased along with the overall unemployment rate during the crisis. The number of long-term unemployed is tended to drop along with the growing economic activity. At the end of 2012, there were 44.6 thousand long-term unemployed registered at the SEA, which was by 11 thousand or 20% less than in 2011. Although the situation is improving gradually, the share of long-term unemployed remains relatively high – 46% of the total number of registered unemployed in late 2012. It should be noted that high long-term unemployment may cause an increase in the structural unemployment, as the longer such people are jobless, the higher is the risk of losing working skills and competences.

Figure 5.4

Registered Unemployed
(thousands)



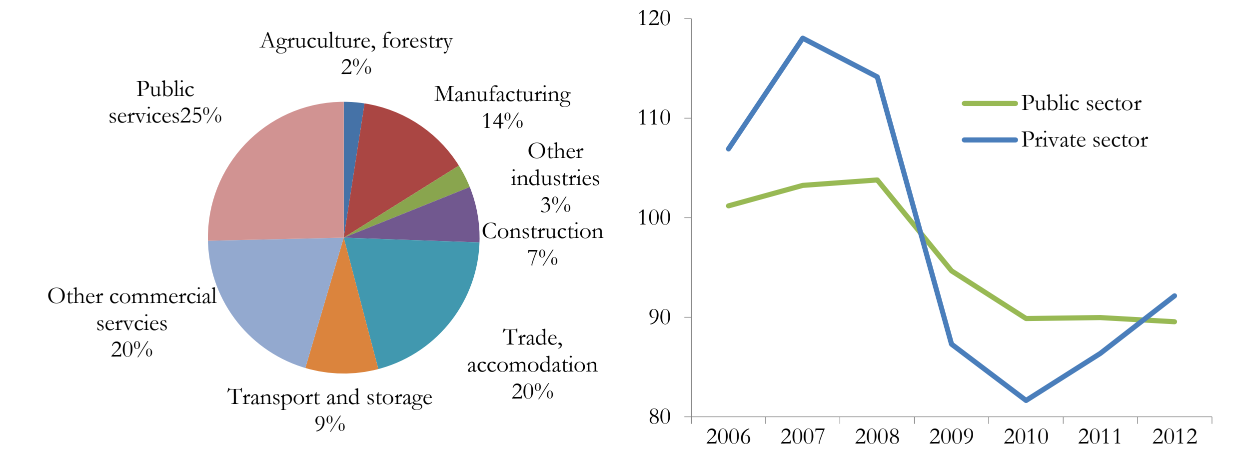
At the same time, the balance between the labour force demand and supply is influenced not only by labour force education and skills but also by wages, and therefore vacancies stay open even under high unemployment conditions.

The number of jobs has been growing at a steady pace since the mid-2010 along with the improving economic situation. According to the CSB data, the total number of jobs at the end of 2012 has increased by 36.5 thousand or 4.5% compared to 2011. At the same time the number of vacancies increased by 22.5% or approximately 0.6 thousand jobs.

Figure 5.5

Number of Jobs

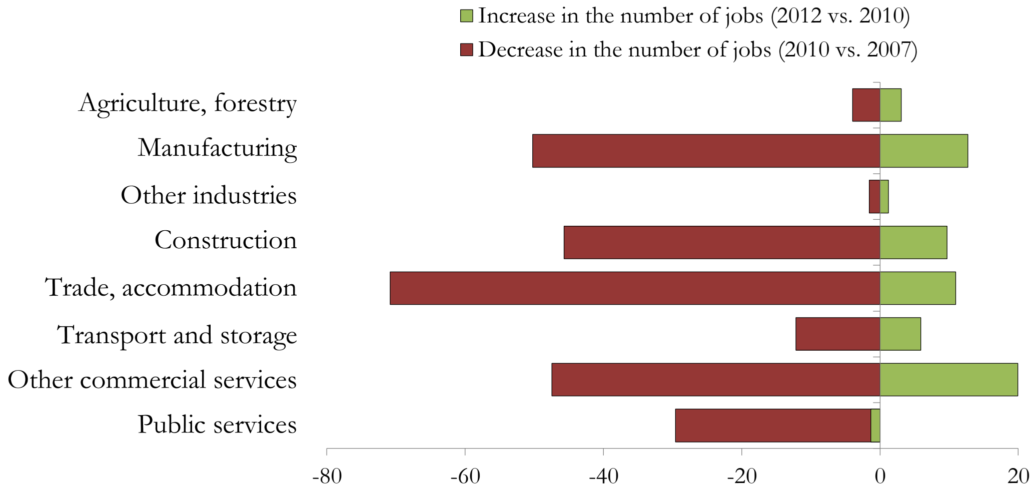
Structure by sectors of national economy in 2012, percentage | Private sector and public sector, 2005 = 100



In 2012, the number of filled positions increased in all sectors. The highest increase in the number of filled positions in 2012, compared to 2011, was in construction (by 9.4%), agriculture (by 8.5%). The number of filled positions in manufacturing has increased by 5%, while the lowest increase has been observed in other industries and trade. Yet, the number of filled positions in public services sector dropped by 1 per cent.

Figure 5.6

Changes in the Number of Jobs by Sectors of National Economy
(thousand, 2007-2012)



In last 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, it has increased by nearly 13% in 2012, compared to 2010. Yet, the number of jobs remains unchanged in the public sector.

Table 5.1

Key Indicators of Employment and Unemployment

	2011 (without correction)	**2011** (recalculated according to the results of the Population Census)	**2012**
Population thousand	2229.6	2074.6	2041.8
Economically active population aged 15-74 years, thousand	1147.0	1028.2	1041.1
Number of employed aged 15-74 years, thousand	970.5	861.6	885.6
Employment rate number of employed compared to the total population aged 15-74 years, %	55.3	53.4	56.3
Economic activity rate number of employed compared to the total population aged 15-74 years, %	65.4	63.7	66.1
Number of job-seekers aged 15-74 years, thousand	176.4	166.6	155.5
Unemployment rate the share of job seekers in the number of economically active population aged 15-74 years, %	15.4	16.2	14.9

* Data of 2011 according to the Population Census data. The preceding years have not been recalculated and are not comparable.

5.2 Labour Costs and Productivity

During the economic recession, not only the number of employed but also wages decreased. As the economic growth resumed, wages have started growing at a moderate pace since the end of 2010.

Wages continue growing along with the increase of economic activities also in 2012. The average gross wage in 2012 was LVL 481, which is by 3.7% higher than in 2011 and was by just 0.4% higher than in 2008.

In 2012, the average gross wage in the public sector was LVL 515, which was by 4.5% higher than in 2011, but by 8.5% lower than in 2008. It should be noted that the drop in wages in the public sector was considerably bigger than in the private sector during the crisis, mainly due to the necessity to limit state budget expenditures. The average gross wage in the private sector in 2012 was LVL 463, which was by 3.5% higher than in 2011 and exceeded the level of 2008 by 5.7 per cent.

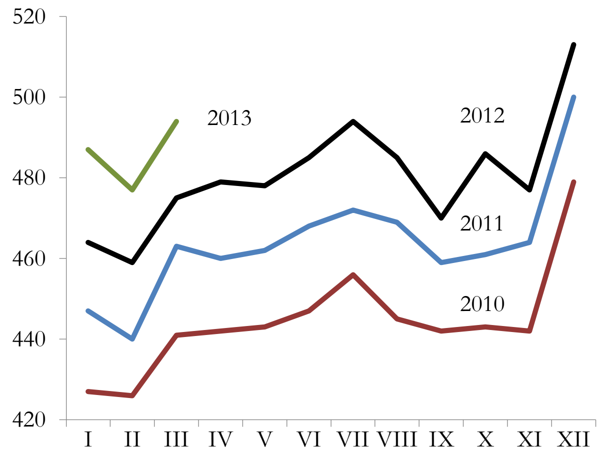
In 2012, the average gross wage in the private sector was by 11% lower than in the public sector, contrary to 2008, when the average gross wage in the public sector was by 28.8% lower.

In the 1st quarter of 2013, the average gross wage continued growing – compared to the 1st quarter of 2012, the gross wage has increased by 4.2%, amounting to LVL 486.

Figure 5.7

Average Gross Monthly Wage of the Employed

(in lats)

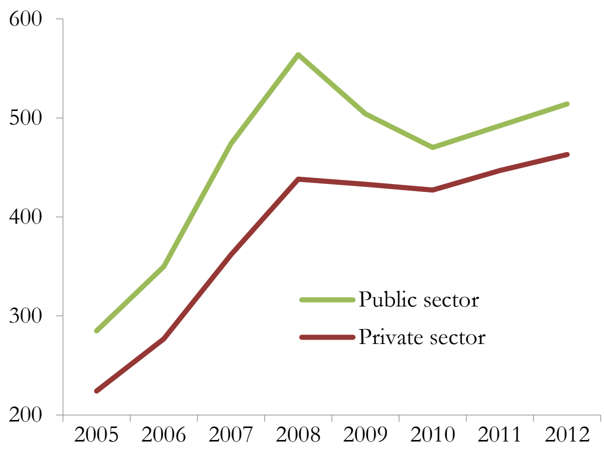


In the 1st quarter of 2013, the average gross wage increased equally fast in both the private sector (4.3%)

and the public sector (4.4%). At the same time, the average gross wage in the public sector in the 1st quarter of 2013 still was by 1.9% lower than in the 1st quarter of 2008, while in the private sector it already exceeded the level of the 1st quarter of 2008 by 11.8 per cent.

Figure 5.8

Average Gross Monthly Wage of Employed in Public and Private Sectors
(in lats)



The dynamics of wages in 2012 differed from one sector of national economy to another. Compared to 2011, the most rapid rise in wages in 2012 was observed in the transport sector, electricity and gas supply, trade and financial and insurance services sector. A more moderate rise in wages was observed in ICT, construction and health care sectors. Yet, wages even dropped slightly in some sectors, for example, mining.

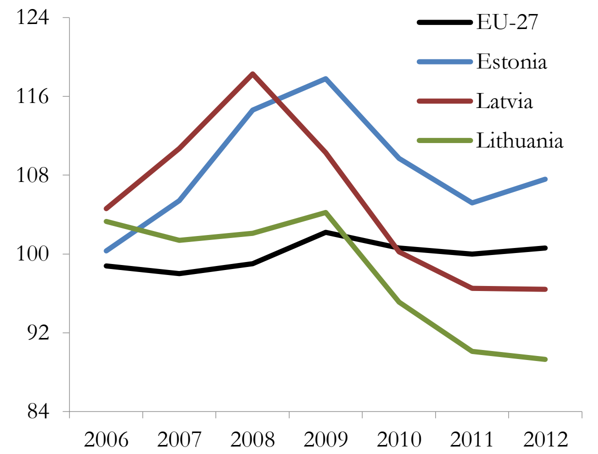
In 2012, the average gross wage in the key exports sector of Latvia – manufacturing increased by 4.6%, compared to 2011, and was by 8% higher than in 2008. Overall, the rise in manufacturing in 2012 was faster than the average in the national economy.

In the 1st quarter of 2013, the fastest rise in wages was in trade (6.5%), ICT (6.2%), construction (6%) and public administration (8%). The highest wage level remained in financial and insurance services sector – average LVL 1064 per month.

Adjustments in product and labour markets caused by the crisis eliminated the gap between productivity and labour costs resulting in gradual improvement of Latvia's competiveness in external markets as proved by the dynamics of the production unit labour costs (ULC)[1].

Figure 5.9

Changes of Real ULC in the EU and Baltic States
(2005 =100)



Unlike the years of rapid growth, the ULC dynamics since 2008 to a great extent are related to the cyclical factors or crisis consequences. It should be noted that product markets are much more sensitive to cyclical fluctuations than labour markets. In 2008, compared to 2007, GDP decreased by 3.3%, although the number of employed remained at the level of the previous year while wages increased. Labour costs continued growing in 2008 (by 15.7%) and productivity decreased by 4.2% resulting in an increase in nominal ULC by 20.7 per cent.

The significant adjustments in the labour market in 2009 affected the dynamics of both productivity and labour costs. If compared to 2008, productivity has decreased by 5.3%, as GDP decreased faster than the number of employed. However, labour costs in 2009 compared to 2008 decreased by 12.7%, which caused the decrease in nominal ULC by 7.9 per cent.

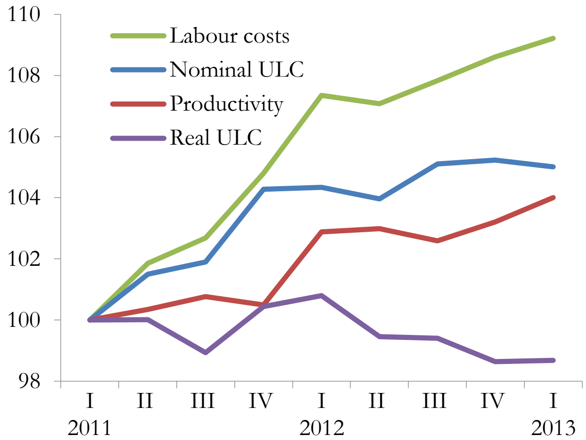
The dynamics of the ULC in 2010 were mainly determined by relative changes in the wages and the number of employed. The high unemployment rate and budget consolidation measures still put pressure on wages. However, taking into account the low competition of Latvia in the single EU labour market, the changes already were rather moderate. Therefore, the decrease in the ULC, as well as the increase in productivity was to a great extent based on changes in the number of employed. The nominal ULC in 2010 were by 10.4% lower than in 2009.

In 2011 and 2012, labour costs increased faster than productivity along with the resuming economic growth, thus nominal ULC in 2011 increased by 2% and in 2012 – by 2.8%. The dynamics of ULC and productivity over the past few years show that ULC will continue increasing along with the growing economic activities.

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

Figure 5.10

Changes of Labour Costs in Latvia
(2011 Q1 = 100)



The dynamics of nominal ULC in the medium-term is mainly affected by structural factors, while the influence of cyclical factors (for example, economic fluctuations in foreign trade countries) is expected to be lower. In 2012, labour costs per one employee in Latvia were 36% of the average EU level. Therefore, the equalization of wages (convergence) is an objective process to be taken into consideration in future, and the gap between productivity and the dynamics of wages is likely to remain in the coming years. A more rapid increase in wages might be related to the increase in the minimum wages, the wish of entrepreneurs to hire highly qualified employees, the dropping unemployment rate, etc. On the other hand, the increase in wages might cause a negative impact on competitiveness, giving a strong incentive for innovations and investments in new technologies to reduce the costs and increase productivity of production resources.

5.3 Labour Market Forecasts

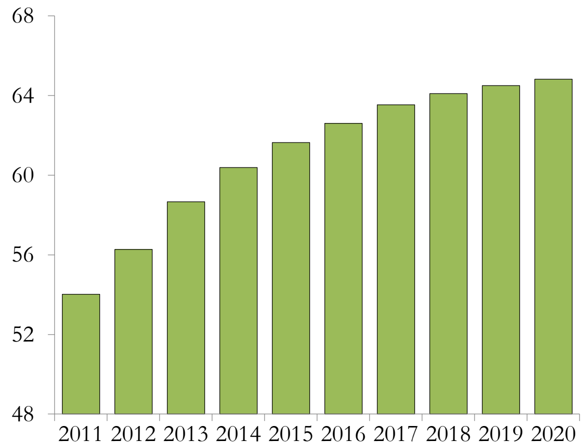
Labour market forecasts for the period until 2020 have been developed in line with economic development scenarios (see Chapter 3.3).

The situation in the labour market has been improving gradually along with the increasing economic activities. The positive trends are expected to continue – wages and job opportunities are going to increase.

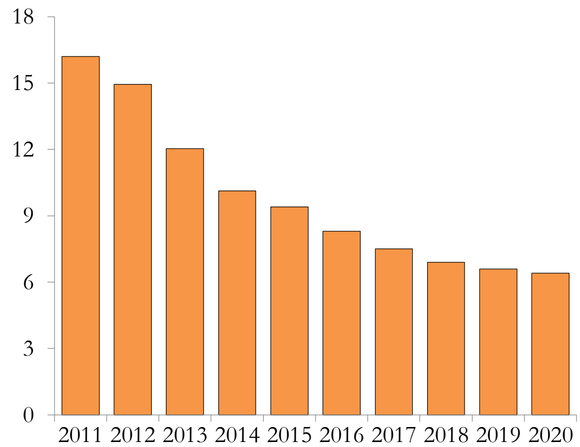
In 2013, the number of the employed might rise on average by 22 thousand or 2.4%, compared to 2012. The employment rate will increase respectively by 2.4 percentage points to 58.7%. Overall, the number of the employed will increase to 907 thousand in 2013.

Figure 5.11

Employment rate
(percent)



Unemployment rate*
(percent)



The number of jobseekers in 2013 might decrease by 20% (31 thousand) – to 124 thousand and the average annual unemployment rate will be 12 per cent.

According to the medium-term forecasts of the Ministry of Economics the labour demand will continue growing. At the same time, employment is likely to increase slower than growth, as the output will be mainly based on increase in productivity.

The number of the employed is expected to increase on average by 6% or approximately

50 thousand until 2020 compared to 2012. The most rapid increase in employment is expected until 2016, while employment growth rates will gradually slow down in the next couple of years mainly due to supply factors – negative demographic tendencies. In 2020, the number of the working population might reach 935 thousand and its share in the total population (aged 15-74 years) will approach 65 per cent.

Unemployment will also continue declining, though remaining high until 2014 – above 10%. The situation might considerably change starting from 2016 – the unemployment rate will be about 8% and shortage of labour will become a topical issue. In total, the unemployment rate might drop to approximately 6-7% by 2020.

In 2012, majority of economy sectors experienced fast growth that was reflected in the increase of employment. Similar tendencies are likely to be observed also in 2013.

The most rapid increase in the number of employed in 2013, compared to 2012, is expected in services sectors – commercial services sectors (by 8.3 thousand or 5%) and public services sectors (by 7.1 thousand or 3.5%), as well as manufacturing (by 4 thousand or 3.2%). A significant increase in employment is expected also in construction.

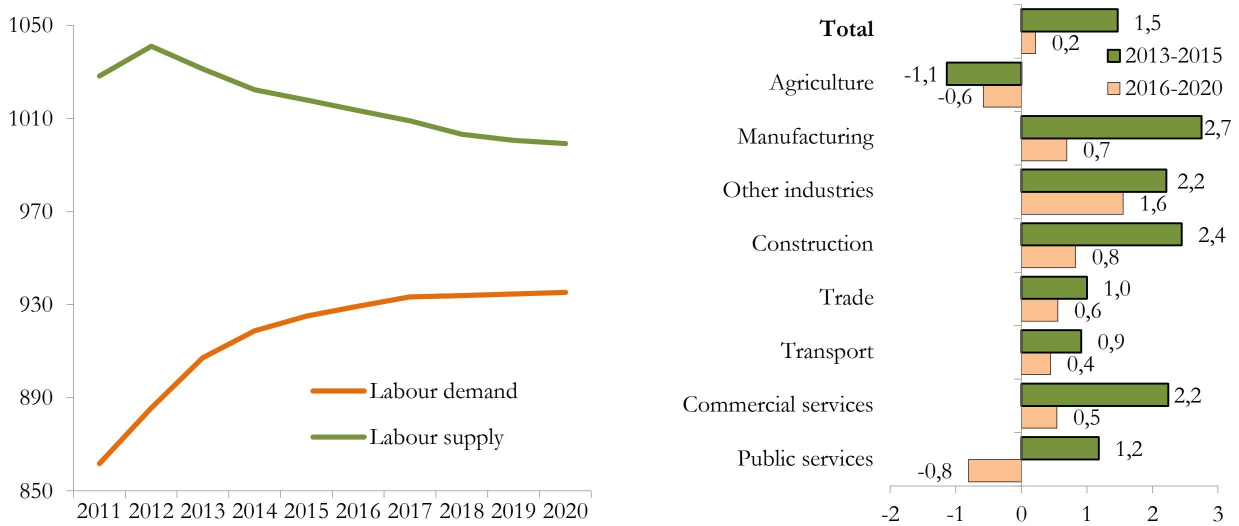
At the same time, the role of domestic demand-oriented sectors in the labour market might also increase. The growth of tradable sectors will be mainly based on the increase in productivity which is crucial for competiveness, and therefore employment might grow relatively slower in these sectors.

The number of the employed will increase in the majority of sectors by 2020. The most considerable increase in employment will be observed in manufacturing, commercial services sector, trade and construction.

Figure 5.12

Labour force demand and supply
(thousand)

Average annual increase in employment in sectors of national economy
(per cent)



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 improvement of the agriculture sector – formation of agricultural cooperatives and large farms, introduction of systemised production organisation, introduction of complex technological solutions in the production process.

Overall, the medium-term and long-term situation in the labour market will be determined by several important factors. The biggest uncertainty is related to further development of the European debt crisis. Although the situation in the euro zone has stabilized, a number of medium-term and long-term risks remain. The deteriorating situation in Europe might significantly influence the key export markets of Latvia that would later affect the growth of Latvia and also the situation in the labour market.

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

According to the estimates of the Ministry of Economics, the number of the working-age population (aged 15-74 years) will drop by about 7% until 2030 in comparison with 2012. At the same time, the demographic burden will increase by about 15%.

Significant changes are expected also in the structure of population age – the share of older people in the total number of population will increase in the future.

In general, these tendencies will escalate the problem of labour shortage until 2030 that might cause various disproportions in the labour market.

5.4 Employment Policy

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

The key elements of 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 Chapters 6.7 and 6.8);
– strengthening labour supply – improving competiveness of the unemployed and persons at risk of unemployment in the labour market, including improving skills according to the labour market demands, lifelong learning measures, consultations on business start-ups, etc.;
– fostering labour demand and labour supply matching, including improving the educational system, involving employers' organisations in improving education quality, forecasting 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 Chapter 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 facing lack of specialists. The future lack of labour 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 an country other than Latvia for various reasons but are willing to return to their home country to either live and work in Latvia or to develop business ties with Latvia, for example, to start own business (remigration policy).

In August 2012, a working group was created for development of a **remigration** support plan by the initiative of the Minister for Economics aimed at covering the wide range of return migration issues and promoting cooperation of institutions involved in the process, as well as identifying the existing measures and developing new ones to create favourable conditions for remigration. The working group involved representatives from state and local government authorities, trade unions, organizations of entrepreneurs and Latvians abroad.

The proposals of the working group for remigration support measures were passed on for public discussion held in November 2012 on the public online discussion platform *www.musuvalsts.lv*.

After evaluating all of the received proposals by the working group, the Ministry of Economic prepared the *Informative Report on Proposals for Remigration Support Measures* (approved by the CoM on January 29, 2013) reflecting the remigration support measures to create favourable conditions for remigration proposed by the working group.

In 2013, the Ministry of Economics in cooperation with the involved institutions continued working on specific remigration support measures incorporated in the *Remigration support measure plan for 2013-2016* (expected to be submitted to the CoM in July of this year).

The Plan is aimed at defining specific support measures for those nationals of Latvia living abroad and their families who are considering a 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 measures incorporated in the Plan according to the eight directions of support measures identified in the informative report:

– 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 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 demanded specialists/ vacancies in Latvia, etc.;

– attracting high-skilled workers – support for attracting high-skilled specialists (attractions of scientists and academic personnel living aboard, including to promote return if high-skilled youth having education acquired abroad, to revise requirements and list of professions where the state should repay study loans for persons working in these professions;
– 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;
– cooperation with diaspora (developing and maintaining business ties) – measures to inform 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 cooperation with diaspora, etc.;
– support to pupils returning/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 institutions;
– drawing attention of public authorities and capital companies to justification of requirements (for example, foreign languages) for job candidates and their suitability for the job duties, as well as providing opportunity for those living abroad to participate in job interviews (in public administration institutions) through *Web* communication options, for example, *Skype*;
– Expanding the range of persons eligible to apply for the status of a repatriate – so that persons who have left the country after May 4, 1990 and have been living abroad for at least 10 years would be eligible to obtain the status of a repatriate (draft *Repatriation Law* has been developed and submitted to the Saeima).

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

The remigration support measure plan proposes no solutions to all issues in the Latvian economy and society that have been neglected for years. It is aimed at providing practical support to persons who have emigrated from Latvia and their families but wish and are ready to return to Latvia.

In order to further reduce the economic factor-driven emigration of Latvian people, a wide range of measures should be implemented. The policy on improving economic and social situation in Latvia is included in a number of development planning documents – *Sustainable Development Strategy of Latvia until 2030*, *the National Development Plan for 2014-2020,* etc.

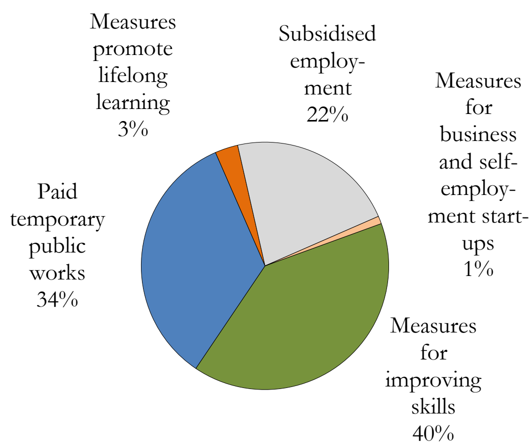
The State Employment Agency (SEA) is the institution implementing the state policy in the field of unemployment reduction and support to the unemployed and job seekers. For the purpose of influencing the labour market, it uses both active and preventive labour market measures, thus promoting competitiveness 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 person groups, overall, its activities are oriented towards providing service to the unemployed.

The dynamics of the registered unemployment rates complies with the economic development rates in the country. The number of unemployed registered at the SEA and the registered unemployment rate has been dropping steadily over the past few years.

Figure 5.13

Distribution of the Active Labour Market Policy Measures' Funding in 2012



Source: SEA

The total funding for active labour policy measures has been increasing rapidly over the past few years. In 2008, a total of LVL 11 million was used for these measures, in 2009 – LVL 32 million, in 2010 – LVL 64 million. As the number of the unemployed started to drop, the same trends have been observed also in relation to the funding for labour market measures. Yet, in 2011, the utilised funding has reached LVL 50 million, in 2012 – LVL 32 million, and most of it – about 4/5 is financing from the European Social Fund.

Considering the recent situation in the labour market, employment policy is now focused on training-oriented measures instead of socially-oriented measures. Most of the financing is granted for the measures for improving skills, which involve professional training, retraining, and promotion of qualification, measures to promote competitiveness and career consultations. A significant part of the financing has also been granted for paid temporary work and subsidized employment. Overall, more than 2/5 of the funding is spent on training-oriented measures – professional training, retraining 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 promotion of qualification;
– measures for specific groups of persons;
– measures to improve competitiveness;
– paid Temporary Public Work (in 2010 and 2011 this measure completely replaces the measure *Work practice with a grant*);
– measures for business or self-employment start-ups;
– complex support measures;
– training at the employer's workplace.

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. In 2009, a total of 244.3 thousand unemployed were involved in the active employment measures, but in 2010 – 299.2 thousand, while in 2011 – 249.6 thousand unemployed and in 2012 – 206.1 thousand unemployed (one unemployed person may participate in several activities).

The majority of the unemployed are involved in the measures to improve competitiveness (including information days). In 2012, the number of such unemployed was 122.5 thousand. The rest of the measures in this period were implemented to the following extent: 11.7 thousand unemployed were involved anew in professional training, retraining, and promotion of qualification, informal education – 18.8 thousand, measures for specific person groups – 2.3 thousand persons, paid temporary public work – 31.2 thousand, complex support measures – 18.5 thousand, measures for business or self-employment start-ups – 484 unemployed, the SEA inspector assistant training and practice – 143 persons, and 408 persons have started training at the employer.

Education programmes offered to the unemployed within the training measures are selected according to the proposals of 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 professions. Out of all implemented measures, the measure *Professional Training, Retraining, and Promotion of Qualification* can be used directly to reduce the mismatching labour market. Within the framework of the measure the unemployed have an opportunity to obtain new professional knowledge, thus acquiring or improving professional qualification. At the moment, the unemployed are offered to acquire knowledge for medium-level qualification.

The rest of training measures are support for obtaining additional knowledge to improve competitiveness in the labour market. Informal education programmes are targeted to both unemployed and job seekers. Yet, lifelong learning measures for employed persons are targeted towards employed people over the age of 25 years, except employees of the public civil service. Within the framework of the measures, existing qualification knowledge is improved by offering an opportunity to improve professional knowledge with necessary social and professional basic skills like computer skills, foreign languages and obtaining driving licence of certain category. Since implementation of the training at the employer's workplace revealed risks that may have a negative impact on the job, the measure has been temporarily suspended until improvement of the conditions.

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

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

In terms of the number of clients, to whom service has been provided, career consultations are the most important preventive unemployment reduction measure. In 2009, career consultation services were provided to 55.1 thousand people, in 2010 – 78.4 thousand, in 2011 – 47.7 thousand, while in 2012 – 67.1 thousand, 59.4 thousand of them were unemployed and job seekers.

A training-oriented measure *Training Programmes for Involvement of Adults in Lifelong Learning* was launched in 2010. The target group includes employed and self-employed persons (except employees of the public civil service) who have reached the age of 25, but have not reached the age for granting the state old age pension. In 2010, 5155 unemployed persons started the training, in 2011 – 15 638 persons (incl. 4715 transferred from 2010), and in 2012 – 7187 persons (incl. 4727 transferred from 2011).

In 2012, improvement of the active labour market policy measures was continued:

- improved conditions for implementation of the measure *Training at the employer's workplace*;
- launched development of the unemployed profile system for the work with the unemployed aimed at providing customized services to each unemployed;
- an improved job search system by preparing the legal basis for the new active employment measure *Launching job search support measures* aimed at encouraging the unemployed and job seekers to search for a job and get integrated in the labour market more actively;
- for the purpose of promoting regional mobility a legal basis for launching the measure *Promoting regional mobility of individuals employed by merchants* has been prepared in form of a pilot project in 2013, by supporting those unemployed who have found a job in another city/district during the initial working period;
- implementation of the measure *Work Practice with a grant*, which was introduced during the crisis period, was completed; since January 1, 2012 this measure is replaced by paid temporary public work.

Also in 2013, labour market measures are focused on specific target groups.

Since it is possible to involve a rather limited number of participants in the measure *Training Programmes for 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.

Since there are no sufficiently strict quality requirements defined for informal education, it is expected to consider a possibility to give up financing of informal education for the unemployed and job seekers in 2013 and replace it with short and flexible professional improvement programmes.

The **social dialogue** is important in implementing the employment policy. The institutions participating in the employment partnership – Employers' Confederation of Latvia, Free Trade Union Confederation of Latvia, local governments of Latvia, and Latvian Association of Local and Regional Governments – are involved in improving the social dialogue at both national and regional level.

An important aspect is **safety at work** ensuring conditions for safe and healthy work environment. The goal in the field of labour protection is by 2013 to improve the working conditions in enterprises and reduce the number of fatalities at work by 30% (per 100 thousand employed) compared to 2007.

In order to ensure gradual reduction in the number of fatal accidents at work, thus promoting safe and healthy working environment in enterprises, prolongation of working life and improvement of the entire public welfare level, the Cabinet of Ministers on April 20, 2011, approved the *Plan of Labour Protection Development for 2011-2013*. It sets several objectives: improving the labour protection policy planning, increasing 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.

In late 2012, the Cabinet of Ministers approved amendments to a number of occupational safety legislation documents to reduce the administrative burden on occupational safety. They envisage reducing the time required for occupational safety specialists and the minimum amount of basic training – 60 hours as of July 1, 2013. As of January 1, 2013 the enterprises of dangerous sectors with 6 to 10 employees will be subject to simplified requirements for occupational safety specialists.

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

The government has developed and approved directions of actions to reduce both undeclared employment and shadow economy and ensure fair competition for 2010-2013. The measures to reduce undeclared employment are implemented in the following key directions: improves efficiency of the control mechanism for the 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 the shadow economy and ensuring fair competition are tax policy, reducing the administrative burden, supporting the 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 the shadow economy in risk sectors.

The education system plays an important role in the context of labour market development, particularly emphasizing the significance of **lifelong learning**. Introduction of the lifelong learning principle is emphasized 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 public knowledge, skills, and competences providing the lifelong learning available to ensure that 15% of the population (aged 25-64 years) would be continuously involved in educational process in 2020.

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

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

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 March 3, 2010, the European Commission published a communication *Europe 2020: A Strategy for Smart, Sustainable and Inclusive Growth,* which outlines the European Commission's vision on the *Europe 2020* strategy.

On June 17, 2010, the European Council formally approved the *Europe 2020 strategy* and its key elements: EU-level headline targets for 2020, the *Integrated Guidelines* (developed according to the Articles 121 and 148 of the Treaty on the Functioning of the European Union, which set the main directions of economic and employment policies, as well as serve as the basis for development of the 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 with the *Integrated Guidelines* are being assessed), as well as fiscal surveillance (the *Stability* and *Convergence Programmes* of the EU Member States and their conformity with the *Stability and Growth Pact* are being assessed).

Since January 1, 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.

The *Europe 2020 strategy*, National Reform Programmes, *Stability* and *Convergence programmes* of the EU Member States are the core elements of the coordination and surveillance of the EU Member State's economic policy at the EU level within the European semester (see Figure 6.2). Multilateral surveillance of both programmes is being 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 targets set at the EU level. The National Reform Programmes are linked also to the EU budget as a part of the measures is co-financed from the EU budget.

Figure 6.1

Surveillance Mechanism of the National Reform Programmes, *Stability* and *Convergence Programmes* of the EU Member States

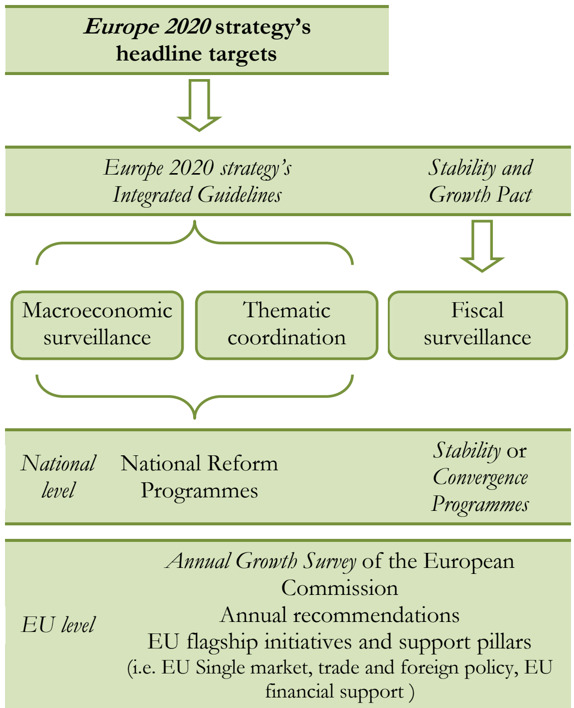
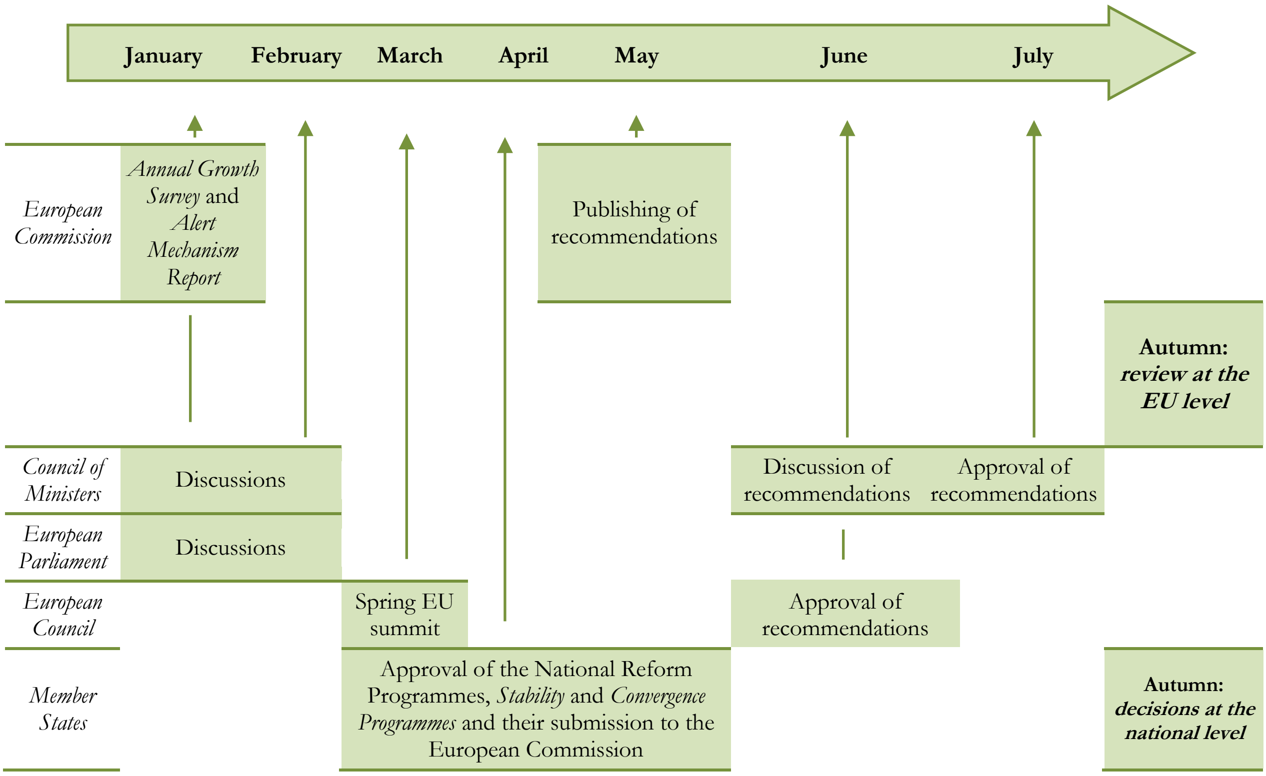


Figure 6.2

The European Semester and Surveillance of National Programmes of the EU Member States



Box 6.1

***Annual Growth Survey* 2013**

On November 28, 2012, the European Commission presented the *Annual Growth Survey 2013* along with other key documents, namely the *State of the Single Market Integration 2013*, the *Alert Mechanism Report*, as well as *A Blueprint for a Deep and Genuine Economic and Monetary Union.*

Taking into account the uncertain prospects of the EU economic development in the short-term, as well as the growing unemployment rate in the EU, the European Commission believes that the priorities identified in the *Annual Growth Survey 2012* have not lost the topicality therefore they should remain unchanged, namely:

– *pursuing differentiated, growth-friendly fiscal consolidation*: the expenditure side of government budgets of the EU Member States must foster investments in education, research, innovation and energy, while ensuring the efficiency of investments. The revenue side of government budgets of the EU Member States, on the other hand must implement growth-friendly tax reforms, for example, by shifting tax burden from labour to consumption and broadening the existing tax base instead of introducing new taxes, as well as improving tax administration;
– *restoring normal lending to the economy*: at the EU level it is required to achieve progress in the creation of the *Banking Union*, while at the national level, the Member States are required to promote new sources of capital, for example corporate bonds or venture capital, enhance repayments of public authorities to private sector, to strengthen the role of public banks in the financing of SMEs, as well as efficient spending of the EU and the European Investment Bank funding;
– *promoting growth and competitiveness for today and tomorrow*: at the national level, the Member States must improve education systems and overall skill levels, simplify laws regarding business start-ups, as well as tap the potential of the green economy to create more jobs, improve implementation of the *Services Directive* and modernize energy, broadband and transport networks;
– *tackling unemployment and the social consequences of the crisis*: it is necessary to improve and broaden the active labour market policy measures, boost public employment services, simplify the employment legislation and ensure an adequate rise in wages in line with the increase in productivity. Additional efforts are needed to promote social inclusion and to prevent poverty by strengthening social protection systems;
– *tackling unemployment and the social consequences of the crisis*: it is necessary to improve and broaden the active labour market policy measures, boost public employment services, simplify the employment legislation and ensure an adequate rise in wages in line with the increase in productivity. Additional efforts are needed to promote social inclusion and to prevent poverty by strengthening social protection systems;

Box 6.1 continued

- *modernising public administration*: at the national level, it is necessary to consider reorganization of local and central governments by reforming the payment system, the governance of state-owned enterprises, modernizing public procurement systems and increasing the number of online public services, as well as it is necessary to implement reforms in tax collection and health care, to speed up EU fund payments and improve quality, independence and efficiency of judicial systems.

The *Annual Growth Survey* of the European Commission is an important element of the European semester as publication of the survey launches the European semester with discussions at different levels of the EU Council (see Figure 6.2). As a result of these discussions, the EU Member States agreed 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 (so-called "six-pack") consisting of five regulations and a directive came into force on December 13, 2011. By adopting these new rules in the EU, in addition to the excessive deficit procedure, a macroeconomic imbalances procedure is established to identify timely (using scoreboard of the alert mechanism) and to 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 oriented towards implementation of key structural reforms, they help to eliminate timely excessive budget deficit and macroeconomic imbalances.

Box 6.2

Alert mechanism and scoreboard

The European Commission publishes annually the *Alert Mechanism Report*, which analyses the EU Member States according to certain indicators and thresholds (scoreboard):

- 3-year backward moving average of the current account balance as percent of GDP, with a threshold of +6% of GDP and -4% of GDP;
- net international investment position as percent of GDP, with a threshold of -35% of GDP;
- 5-year percentage change of export market shares measured in values, with a threshold of -6%;
- 3-year percentage change in nominal unit labour costs, with thresholds of +9% for euro-area countries and +12% for non-euro-area countries;
- 3-year percentage change of the real effective exchange rates based on HICP/CPI deflators, relative to 35 other industrial countries, with thresholds of -/+5% for euro-area countries and -/+11% for non-euro-area countries;
- private sector debt in % of GDP with a threshold of 160%;
- private sector credit flow in % of GDP with a threshold of 15%;
- year-on-year changes in house prices relative to the Eurostat consumption deflator, with a threshold of 6%;
- general government sector debt in % of GDP with a threshold of 60%;
- 3-year backward moving average of unemployment rate, with a threshold of 10%;
- annual changes in total liabilities of financial sector with a threshold of 16.5%.

In case, if any of the EU Member States violates the threshold of any of the indicators, the European Commission carries out an in-depth analysis and publishes it in the *In-Depth Review*.

In 2013, an in-depth review was carried out in 13 EU Member States and according to the findings of the *In-Depth Review* (published on April 10, 2013), macroeconomic imbalances exist in Belgium, Bulgaria, Denmark, Finland, France, Italy, Sweden, United Kingdom, Malta and the Netherlands, while Slovenia and Spain are experiencing excessive macroeconomic imbalances. Besides, in Slovenia there is a rapidly increasing negative tendency. In Slovenia, the risks for financial sector stability are stemming from corporate indebtedness and deleveraging, as well as from the public debt level. These risks are compounded by limited adjustment capacity in labour and capital markets in Slovenia and by an economic structure dominated by state-ownership. In Spain, the very high domestic and external debt levels continue posing serious risks for growth and financial stability. The dropping economic activity has led to a rise in the unemployment rate that has also imposed an additional burden on the government budget, and the country was forced to provide support to recapitalisation of banks due to the crisis.

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

The NRP of Latvia describes the medium-term macroeconomic scenario, reflects key macro-structural bottlenecks of the economy of Latvia and main measures to tackle them, as well as the targets of Latvia for 2020 in 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 GDP in the amount of 4-5% in the medium term and a high employment rate in the amount of 73% by 2020.

The NRP of Latvia reflects quantitative targets of Latvia for 2020 in the context of the *Europe 2020 strategy* (hereinafter – quantitative targets of Latvia). The quantitative targets have been defined based on the medium-term economic growth scenario, 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 (NDP2020)* approved by the Saeima on December 20, 2012.

According to the quantitative targets of Latvia, it is planned to achieve an employment rate of 73%, 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 13.4%, 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.

It should be noted that bilateral meetings are held between the EU Member States and the European Commission on a regular basis regarding implementation of the National Reform Programmes, Stability or Convergence Programmes and the EU Council Recommendations for the EU Member States. Prior to preparation of the *Progress Report on the Implementation of the National Reform Programme of Latvia within the "Europe 2020" Strategy* for 2013 (hereinafter – Progress Report on the Implementation of the NRP of Latvia) three bilateral meetings have been held between Latvia and the European Commission. Economic situation in Latvia, implementation of the EU Council recommendations for Latvia, the delivery of the 2013 European Semester and the priorities of the *Annual Growth Survey 2013* of the European Commission have been discussed during these meetings.

According to the European semester process, on April 29, 2013, the Cabinet of Ministers approved the second ***Progress Report on the Implementation of the National Reform Programme of Latvia*** and the updated *Convergence Programme of Latvia for 2013-2016*. Both abovementioned documents have been submitted to the European Commission.

The Progress Report on the Implementation of the NRP of Latvia contains the updated medium-term macroeconomic scenario described in the NRP of Latvia and evaluates the implementation progress of the NRP of Latvia, particularly emphasizing fulfilment of the Council recommendations and the *Euro Plus Pact* commitments, as well as it provides a detailed description of the NRP of Latvia policy directions, 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 in the current and in 2014-2020 planning period.

It should be noted that all in all a good progress has been achieved in the implementation of the NRP of Latvia within a year, which is shown also by statistical data. In 2012, the growth was more rapid than expected and GDP increased by 5.6% compared to 2011. Situation in the labour market is improving gradually. In 2012, the employment rate (population aged 20-64 years) reached 68.2%, which is by 2.8% more than in 2011. The share of job seekers constituted 14.9%, which is by 1.3 percentage points less than in 2011. The share of long-term unemployed in the total number of unemployed has also dropped by 2.6 percentage points, while the youth unemployment rate has shrunk by 2.7 percentage points in 2012 compared to 2011. The registered unemployment rate is also shrinking gradually, reaching 10.4% at the end of April 2013 (11.3% at the end of April 2012).

Good progress can be seen also in achievement of certain quantitative targets of Latvia within the *Europe 2020 strategy*. Apart from the abovementioned progress in the unemployment rate, the decrease in the share of early school leavers to 10.5% in 2012 should also be emphasized (11.6% a year ago), while the share of people having acquired tertiary education has risen to 37% (35.7% a year ago). The share of renewable energy resources is growing gradually in the total gross energy consumption, which was 33.1% in 2011 (32.5% in 2010).

A challenge for Latvia is still the achievement of the quantitative target regarding investments in R&D for 2020, which constituted only 0.7% of GDP in 2011 (0.6% of GDP in 2010). The restored growth in Latvia shows no sign of reducing social inequality since the share of persons at risk of poverty in 2011 has slightly increased, constituting 19.4% (19.1% in 2010).

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 May 29, 2013, the European Commission presented proposals for the **EU Council country-specific recommendations for the EU Member States**, including Latvia which are as follows:

- Reinforce the budgetary strategy to ensure that the deviation from the medium-term objective only reflects the incremental impact of the systemic pension reform. Within this strategy, reduce taxation of low-income earners by shifting taxation to areas such as excise duties,

recurrent property taxes and/or environmental taxes. Maintain efforts to improve tax compliance and combat the shadow economy. Continue strengthening the fiscal framework through effective implementation of the *Fiscal Discipline Law* and multi-annual budgeting;
- Continue to use micro and macro prudential policies to prevent possible vulnerabilities that could arise from future credit growth and non-resident banking activities;
- Tackle long-term and youth unemployment by increasing coverage and effectiveness of active labour market policies and targeted social services. Improve the employability of young people, for example through a *Youth Guarantee*, establish comprehensive career guidance, implement reforms in the field of vocational education and training, and improve the quality and accessibility of apprenticeships;
- Tackle high rates of poverty by reforming social assistance for better coverage, by improving benefit adequacy and activation measures for benefit recipients. Reinforce the delivery mechanisms to effectively reduce child poverty;
- Implement the planned reforms of higher education concerning, in particular, the establishment of a quality-rewarding financing model, reform of the accreditation system, consolidation of the institutions and promotion of internationalization. Take further steps to modernise research institutions based on the on-going independent assessment;
- Continue improving energy efficiency, especially of residential buildings and district heating networks, to provide incentives for reducing energy costs and shift consumption towards energy-efficient products. Improve connectivity with EU energy networks and take steps towards liberalisation of the natural gas market, including provision of clear rules for third-party access to storage capacities;
- Complete pending reforms to improve the efficiency and quality of the judiciary and reduce the backlog and length of proceedings, including as regards insolvency. Put in place a comprehensive human resources policy and take steps to implement the mediation laws and streamline the arbitration court system.

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

The Ministry of Economics will continue monitoring the implementation of the measures of the NRP of Latvia and the information on the progress will be included in the *Progress Report on the Implementation of the National Reform Programme of Latvia within the "Europe 2020" Strategy* for 2014.

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

6.2.1 Use of the European Union Structural Funds and Cohesion Fund

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

<u>Programming period 2007-2013</u>

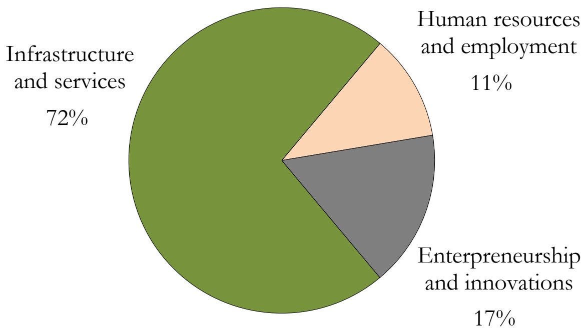
In the programming period of 2007-2013, the SF support is mainly directed towards education of inhabitants, technological excellence and flexibility of enterprises, as well as towards development of science and research in order to promote knowledge-based economy and strengthen other prerequisites for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

Programming of the SF and the CF resources is implemented on 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 allocation of 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 June 19, 2007. On September 20 of the same year, it was also approved by the EC.

Figure 6.3

Breakdown of Funding among OP's in the Programming Period 2007-2013
(per cent)



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 or LVL 3.18 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 million or LVL 409 million. With the amount of overcommitments EUR 711 million or LVL 500 million;
– 2. OP *Entrepreneurship and Innovations* (ERDF) – EUR 736 million or LVL 517 million. With the amount of overcommitments EUR 830 million or LVL 584 million;
– 3. OP *Infrastructure and Services* (ERDF+CF) – EUR 3.2 billion or LVL 2.25 billion. With the amount of overcommitments EUR 3.82 million or LVL 2.69 million.

Table 6.1

EU Fund Financial Progress in the Programming Period 2007-2013 till April 30, 2013

	Funding of the EU funds	Concluded contracts		Paid to the funding beneficiaries		Received EC's repayments (incl. advances)	
	million LVL	million LVL	%	million LVL	%	million LVL	%
ESF	409.8	427.6	104.4	337.7	82.4	346.0	84.4
ERDF	1692.0	1572.4	92.9	993.2	58.7	904.8	53.5
CF	1082.1	945.2	87.4	594.8	55.0	526.0	48.6
Total	**3184.0**	***2945.4***	**92.5**	**1925.8**	**60.5**	**1776.8**	**55.8**

As of October 31, 2012, projects for the amount of 92.5% of all financing of the EU funds available for Latvia within the given programming period have been approved, and contracts for a total of LVL 2945.4 million had been concluded. As of April 30, 2013, the funding beneficiaries have received LVL 2740.2 million.

Box 6.3

Activities under the responsibility of the Ministry of Economics

A total of LVL 524.8 million of the European Union 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* – LVL 35.7 million;
2. OP *Entrepreneurship and Innovations* – LVL 347.6 million;
3. OP *Infrastructures and Services* –LVL 141.4 million.

Contracts concluded until May 11, 2013 within the framework of activities under the responsibility of the Ministry of Economics:

– Within 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 LVL 20.5 million.
– Within activity *Support to Individually Organised Trainings for Entrepreneurs*, 84 contracts have been completed for the total contract sum of LVL 2 million.
– Within activity *Attraction of Highly Qualified Employees*, 3 contracts have been completed for the total contract sum of LVL 100.9 thousand.
– Within activity *Competence Centres* 6 contracts have been concluded for the total contract sum of LVL 37.3 million.

Box 6.3 continued

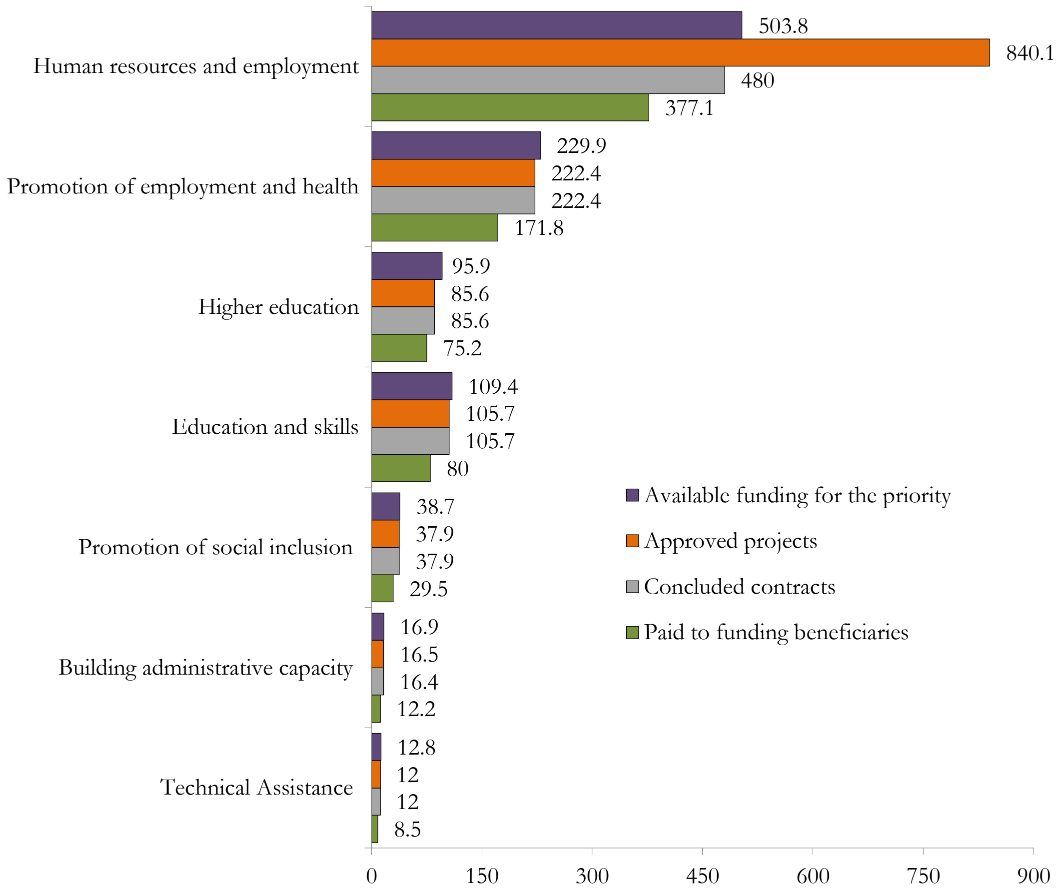
- Within activity *Technology Transfer Contact Points*, 8 contracts have been concluded for the total contract sum of LVL 1.8 million.
- Within activity *Development of New Products and Technologies*, 81 contracts have been concluded for the total contract sum of LVL 5.8 million.
- Within activity *Introduction of New Products and Technologies into Production*, 124 contracts have been concluded for the total contract sum of LVL 30 million.
- Within activity *Development of New Products and Technologies – Support to Strengthening Industrial Property*, 5 contracts have been concluded for the total contract sum of LVL 71.8 thousand.
- Within activity *High Value Added Investments*, 37 contracts have been concluded for the total contract sum of LVL 78.3 million.
- Within activity *Access to International Trade Markets – External Marketing*, 1318 contracts have been concluded for the total contract sum of LVL 5.8 million.
- Within activity *Development of External Markets – Strengthening International Competitiveness of Industry Sectors,* 2 contracts have been concluded for the total contract sum of LVL 6.6 million.
- Within activity *Support for Self-employment and Business Start-ups* 916 start-up projects for over LVL 8.3 million.
- The following results have been achieved within the financial instruments of the activity *Holding Fund*:
  (1) venture capital – on January 22, 2012, a contract on establishment of venture capital fund was concluded with *BaltCap Management Latvia*. In addition to the 20 million euro invested by the Holding Fund, *BaltCap Management Latvia* invested another 10 million euro of private investor co-funding. *BaltCap Management Latvia* has concluded 8 venture capital contracts for the total amount of LVL 6.72 million;
  (2) seed and start-up capital – on June 16, 2010, a contract on establishment of 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 7.26 million (On May 10, 2013 a contract on increase in the seed capital to EUR 6.4 million was concluded with *Imprimatur Capital Baltics*). By April 30, 2013 *Imprimatur Capital Baltics* has concluded 12 seed capital investment contracts for the amount of LVL 1.21 million and 3 start-up capital investments in the amount of LVL 878 thousand;
  (3) high risk loans – on March 26, 2010 contracts with *AS Swedbank* and *AS SEB Banka* were concluded. The programme was implemented until September 26, 2012. A total of 32 loan agreements for LVL 10.59 million have been signed within the programme
- Within activity *Guarantees for Improvement of Enterprise Competitiveness*, 333 credit guarantee contracts have been concluded for the total amount of LVL 81.4 million and 112 export guarantee contracts for the total amount of LVL 7.4 million.
- Within activity *Loans for Improving Enterprise Competiveness*, until April 30, 2013, 412 loans have been granted for the total amount of LVL 186.1 million, including 95 loan agreements have been granted for LVL 86.4 million within the ERDF part of the programme (out of them 73 loan agreements have been concluded for the amount of LVL 52.4 million).
- Within the activity *Measures to Encourage Innovations and Business Start-ups*, 1 contract has been concluded for the total contractual amount of LVL 2 million. Measures, seminars and competitions organized within the activity have involved 15 134 persons.
- Within activity *Business Incubators,* 9 contracts on providing business incubation services in regions of Latvia and 1 contract on providing business incubation services to creative industry enterprises in Riga have been concluded. 535 enterprises are supported within the activity. The given enterprises ensure (maintain) 1251 jobs.
- Within activity *Co-financing to the Investments in Micro, Small and Medium-sized Enterprises Operating in the Specially Assisted Areas*, 106 contracts have been concluded for the total contractual sum of LVL 5.6 million.
- Within 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 contractual sum of LVL 7.3 million (ERDF).
- Within sub-activity *Development of Cycling Tourism Product of National Importance*, 7 contracts have been concluded for the total contractual sum of LVL 3.9 million (ERDF).
- Within activity *Improvement of Heat Insulation of Multi-apartment Residential Buildings*, 744 contracts have been concluded for the total contractual sum of LVL 45.8 million (ERDF).
- Within activity *Improvement of Heat Insulation of Social Residential Buildings*, 56 contracts have been concluded for the total contractual sum of LVL 4 million (ERDF).
- Within activity *Measures for Raising Efficiency of Central Heat Supply Systems,* 90 contracts have been concluded for the total contractual sum of LVL 44 million (CF).
- Within activity *Development of Cogeneration Power Plants Using Renewable Energy Resources,* 10 contracts have been concluded for the total contractual sum of LVL 21.1 million (CF).

Financial acquisition of EU funds in operational programmes *Human Resources and Employment, Entrepreneurship and Innovations,* and *Infrastructure and Services*

The overall implementation progress of the Operational Programme *Human Resources and Employment* until April 30, 2013 has been good, reaching 104.5% due to the granted overcommitments of the government budget. Yet, the total amount of funding paid to funding beneficiaries has reached 82.1 per cent.

Figure 6.4

Financial Investments of the EU funds until March 31, 2013 in the OP *Human Resources and Employment*; Public Funding
(million LVL)



Until March 1, 2013 implementation of the OP *Entrepreneurship and Innovations* has been according to the plan, the payment objective to funding beneficiaries has been overachieved by 5.8%, the Ministry of Education and Science and the Ministry of Economics correspondingly 12.5% and 6%. The overall financial indicators of the OP *Entrepreneurship and Innovations* have been affected by the regression in the activities implemented by the Ministry of Education and Science and the Ministry of Economics within the priority *Science and Innovations*, as well as the slow implementation progress of the priority *Promotion of Entrepreneurship* hinders a little the implementation of the OP *Entrepreneurship and Innovations*.

Within the projects of the activity *Support for science and research* of the priority ***Science and innovations***, procurement procedures have been carried out for the purpose of preparing patent applications, thus approaching the finish line of the projects.

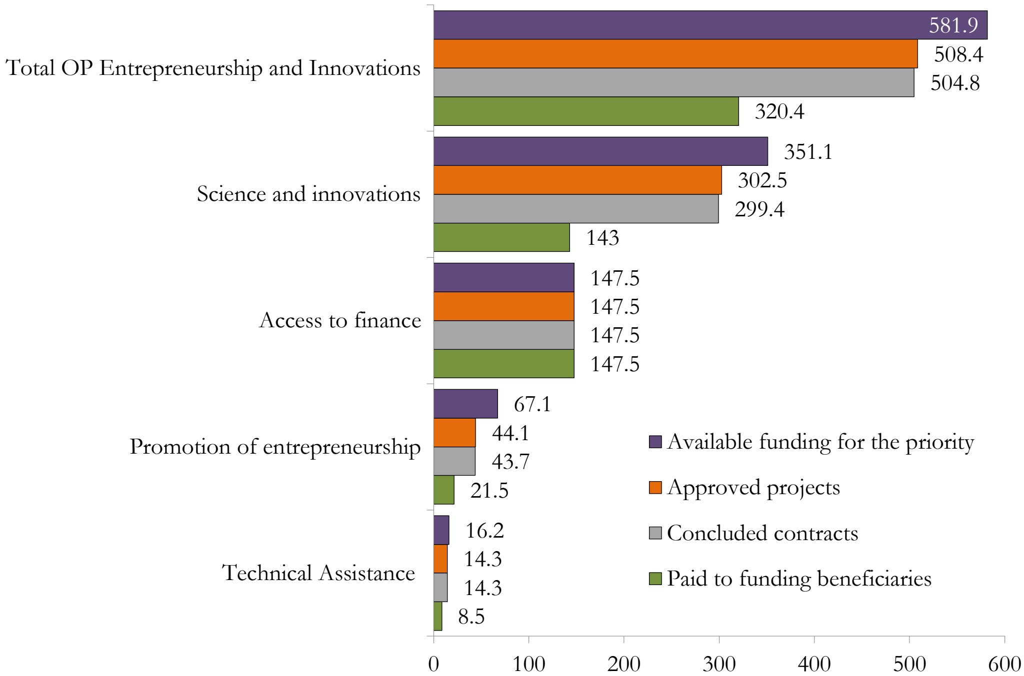
A regression has been observed in the amount of approved projects and concluded contracts within the measure *Innovations*, which can be explained by the introduction of amendments in the financial plans in the sub-activity *Development of new products and technologies – support for introduction of new products and technologies into production*, as well as termination of one financially intensive project within the activity *High value added investments* due to non-conformity occurred within the project.

Although the financial amount of the concluded contracts has decreased, projects are being actively implemented within the abovementioned activities, and the amount of payments to the funding beneficiaries is considered as good since the payment objective to the funding beneficiaries in the measure has been achieved by 133.1% at the end of the reporting period.

The amendments to the OP *Entrepreneurship and Innovations* are being coordinated with the European Commission and they are expected to be approved in the Cabinet of Ministers by July 1, 2013, thus an opportunity to implement additional projects in the field of innovations are planned to be given.

Figure 6.5

Financial Investments of the EU funds until March 31, 2013 in the OP *Entrepreneurship and Innovations*; Public Funding
(million LVL)



The priority ***Access to finance*** is oriented towards promotion of access to finance for business development through comprehensive financial instruments including guarantees, loans, venture capital, and other financial instruments implemented by the Mortgage and Land Bank of Latvia and the Investment and Development Agency of Latvia. Overall, implementation progress of financial instruments has been moderate, until March 31, 2013 2.7% more investments have been made, loans have been actually granted and guarantees provided than by the end of 2012, while the amount of granted mezzanine loans has increased by just 0.2%. In order to improve implementation of the activity, seminars on the opportunities of mezzanine loans to finance commercial activities have been organised (for example, DNB bank, UniCreditLeasing), a direct sales plan has been developed (including the LGA is discussing the obstacles for active use of the product with cooperation partners), in addition, an educational video on mezzanine loans will be prepared soon, and at the same time, a communication strategy where mezzanine loan is one of the elements is being developed.

Overall, within the priority ***Promotion of entrepreneurship***, the payment objective is achieved to an extent of 44.2%. Within the activity Business incubators the Investment and Development Agency of Latvia has improved internal procedures by implementing recommendations of the audit carried out by an audit authority.

Most of the projects within the OP *Infrastructure and Services* (about 58%) are still being implemented; besides, approval of new projects and conclusion of contracts still continues. Overall, slight progress of the approved projects has recently been observed within the OP *Infrastructure and Services*. Projects in the field of improvement of infrastructure in small ports and improvement of infrastructure in educational institutions are being implemented at a slower pace. As regards payments to the funding beneficiaries within the OP *Infrastructure and Services*, compared to the 4th quarter of 2012, the progress has been slower (2.3%) since largest payments are made at the end of the year. The largest payments have been made in such fields as improvement of regional roads and transit streets, as well as development of water management infrastructure in populated areas with up to 2000 residents.

The new programming period 2014-2020

On May 3, 2013, the Ministry of Finance forwarded the EU funds draft planning documents *Partnership Contract for the European Structural Funds and Investment Funds Programming Period 2014-2020* and the OP Growth and Employment for public discussion.

Since January 2013, the draft planning documents have been prepared by the Ministry of Finance as the leading authority of the EU funds in cooperation with the responsible line ministries, at the same time consulting with the European Commission. In order to ensure quality of the preparation for the EU funds investment period 2014-2020, a partnership platform – Temporary supervisory committee – has been established in September 2012.

The draft planning documents 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 achievement of certain results that will contribute the most to the economic growth and promote achievement of the Cohesion policy objectives.

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 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 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 information and communication technologies 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

Indicative Breakdown of the Funding and Total Investments of the EU Funds Planning Period 2014-2020

	Amount of the EU funding mln LVL	Structure of the EU funding per cent	Total amount of the funding mln LVL
Research, technology development and innovations	226.2	7.3	321.0
Information and communication technologies, e-government and service	159.8	5.2	223.6
SMEs competitiveness	264.1	8.5	392.5
Energy efficiency	265.2	8.6	470.7
Environmental protection and efficient use of resources	175.3	5.7	239.6
Sustainable transport growth	949.7	30.7	1132.7
Employment, labour mobility and social inclusion	380.8	12.3	720.2
Education, skills and lifelong learning	335.4	10.8	407.4
Urban development	338.8	10.9	398.5
Total	**3095.3**	**100**	**4306.1**

6.2.2 Foreign Trade Policy

In the first half of 2013, there were a number of important activities in the field of strengthening and deepening foreign economic relations. Namely, a decision on the *OECD* expansion was made during the *Organisation for Economic Co-operation and Development (OECD)* summit on May 30, 2013 (see Box 6.8), within the EU common trade policy it was decided to launch negotiations on the Trade and Investment Partnership Agreement with USA, while the annual *Baltic Development Forum Summit* was held in Riga on May 29-30 in the field of bilateral relations that outlined further cooperation priorities in the Baltic Sea Region.

Box 6.4

Latvia's progress towards joining the *OECD*

In 1996, Latvia and other Baltic States signed a declaration expressing future commitment to obtain the status of a member state of the *OECD*, which is one of the leading global economic forums. In 2004, the CM approved the *Guidelines for Cooperation Policy between Latvia and the OECD* defining Latvia's objective – to obtain the status of a member state of the *OECD*.

Considering the unique experience gained during the implementation of reforms and the rapid economic growth, Latvia is ready to become a full member of the *OECD*, it meets the criteria set by the organisation and is able to contribute to the work of the organisation. Membership in the organisation will promote economic competitiveness of Latvia. Implementation of the OECD standards in important sectors of Latvia will further promote economic growth.

As of March 5, 2013, Latvia has joined the *OECD Declaration on Green Growth,* while as of April 30, 2013 – the *OECD Declaration on Propriety, Integrity and Transparency in the Conduct of International Business and Finance* which sets out the political commitments in areas of competition, corporate governance, investment and responsible business conduct, tax co-operation, anticorruption, interaction between government and business, quality of regulation and financial literacy and consumer protection.

Latvia also has been successfully participating in various *OECD* working groups and committees, for example as a participant – in the Local Economic and Employment Development Programme, Investment Committee, etc., and as an observer – in the State Capital Management and Privatisation Practice Working Group, Competition Committee, etc.

Multilateral relations

The first half of 2013 has been remarkable for the World Trade Organization (WTO) since the number of its members rose to 159 countries[1], because of the accession of Laos and Tajikistan on February 2, 2013 and March 2, 2013 correspondingly. Yet, the ongoing negotiation process for the accession of Kazakhstan and Bosnia and Herzegovina to the WTO has reached the finish line and is expected to be completed in 2013. The negotiation process is mainly hindered by the unfinished bilateral negotiations regarding access to goods and services market.

Taking into account the accession of Russia to the WTO and its commitments, a tariff quota system with lower export tariffs has been applied to import of certain round coniferous timber (spruce and pine) from Russia to the EU since September 1, 2012. The defined quotas are based on the highest import indices of Russian timber in the history, considering the overall situation in global markets these indices will satisfy the import needs of the EU timber industry in the next few years.

Within the (WTO) Doha Round (DDA) negotiations commenced in November 2001, the member countries continue efforts to reduce the global trade barriers. Over the past months informal consultations of the WTO members are continued regarding proposals submitted by working groups of certain member countries and further progress of the DDA process. Yet, no significant progress has been achieved so far, though certain hopes of further progress are pinned on the planned WTO's 9th Ministerial Conference in December in Bali (Indonesia) on December 3-6, 2013.

Notwithstanding, the WTO members in various formats (bilaterally, regionally, multilaterally, etc.) are working on improving specific trade conditions that might promote further progress of multilateral trade conditions in the future. One of the latest initiatives is related to the intention of a number of countries[2] to sign Plurilateral Trade in Services Agreement *(TiSA)*, to expand liberalisation of mutual trade in services according to current WTO standards. Yet, in the field of public procurement and agreement on amendments to the WTO Agreement on Public procurements of 1994 has been reached to ensure clear and transparent conditions for contracting parties[3] in procurement procedures. The amendments are going to come into force as soon as the parties complete the necessary approval procedures.

Bilateral relationships within the framework of the EU Common Trade Policy

At the same time, the EU has concluded a number of **preferential agreements** prescribing mutually favourable trade conditions with such partners as Andorra, the Balkan countries [4], European Economic Area countries [5], San Marino, Switzerland, Chile, South Africa, South Korea [6], Mexico and Turkey.

In the first half of 2013, the key advancement of the EU bilateral relationships with third countries was the readiness of the EU and USA leaders expressed in February to launch the largest bilateral negotiations in the history on the *Transatlantic Trade and Investment Partnership* (see Box 6.9). Launch and first round of the EU-Japan *FTA* negotiations is also important, as well as the coming into force of the ES-Peru FTA as of March 1, 2013, possibly followed by coming into force

[1] At the moment, 26 candidate countries are continuing negotiations on accessing the WTO, including Azerbaijan, Belarus, Kazakhstan, and Serbia being the most important for Latvia.

[2] Australia, Canada, Columbia, Costa Rica, Chile, EU, Hong Kong, Iceland, Israel, Japan, Mexico, New Zealand, Norway, Pakistan, Panama, Peru, South Korea, Switzerland, Taiwan, Turkey and USA

[3] Armenia, Canada, EU, Hong Kong, Iceland, Israel, Japan, Korea, Lichtenstein, the Netherlands, Norway, Singapore, Switzerland, Taiwan and USA

[4] Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro and Serbia

[5] Iceland, Lichtenstein, and Norway

[6] Temporarily in force as of July 1, 2011 (until ratification is completed by all parties; Latvia completed the ratification on August 4, 2011)

of other agreements concluded in 2012, namely, Columbia and Central American countries[1].

Box 6.5

The EU-USA Trade and Investment Partnership Agreement

On February 13, 2013, the EU and the USA expressed readiness to launch negotiations on signing the Trade and Investment Partnership Agreement. Thus, on March 12, 2013, the European Commission published the EU Council proposal for the negotiating directives on opening of the respective negotiations. The EU Council provisionally plans to make the final decision on June 14, 2013.

Negotiations on the largest future free trade partnership are expected to be launched shortly after the decision making, i.e. in July 2013 and they are expected to be completed in two years. The decision on signing the bilateral trade and investment agreement was promoted by the lack of progress on the multilateral trade liberalisation negotiations launched in 2001. In the future, this agreement is expected to bring the WTO multilateral negotiations to the finish line and encourage other countries to aspire to better economic integration.

Latvia expects the upcoming trade and investment agreement to strengthen the commercial links historically established with the USA and hopes that the negotiations will result in signing deeper, comprehensive and ambitious agreement. Since the EU and the USA apply relatively low medium import tariffs to each other (4.8% – USA and 6.7% – the EU), Latvian businesses would benefit most from the decrease of the non-tariff barriers (for example, simplified customs procedures, harmonized technical regulations and standards, as well as sanitary and phytosanitary requirements) particularly in sectors like pharmacy, food industry and wood industry. The signing of such an agreement would be beneficial not only to the businesses directly exporting to the USA but also to the businesses producing and supplying raw materials and components to other EU companies subsequently exporting the finished goods to the USA.

The signing of the agreement would also reduce restrictions on services trade, provide better access to public procurement markets, etc. Most complicated issues to be agreed by the parties are the use of genetically modified food, agricultural subsidies and protection of patents.

Among the negotiations on active preferential trade agreements in the report period, significant are the EU-Canada *Comprehensive Economic and Trade Agreement* and the EU-Singapore FTA negotiations reaching the finish line. These will be the first agreements laying down conditions on the FDI protection (see Box 6.10). The active EU *FTA* negotiations and overall successful progress of negotiations with Armenia, Georgia, and Moldova which might be completely closed in the second half of 2013 should also be noted. The EU-Ukraine Association agreement initialized in April 2012 is also expected to be signed during the EU and Eastern partnership country summit planned to be held in November in Vilnius (Lithuania).

Box 6.6

Protection of the EU investments

Since the *Lisbon Treaty* came into force on December 1, 2009, FDI have been a part of the EU common trade policy. In 2010, the EC published a communication strategy *Towards a comprehensive European international investment policy* highlighting two key aspects of the EU investment policy – to improve the market and to promote legal certainty and transparency. On December 12, 2012 the *Regulation (EU) No 1219/2012 of the European Parliament and of the Council of 12 December 2012* establishing transitional arrangements for bilateral investment agreements between Member States and third countries came into force within the framework of which all Member States notified of all effective investment agreements with third countries (OV C 131, 08.05.2013) to continue applying them to conclusion of relevant EU level agreements.

The EC proposal for the regulation of the European Parliament and of the Council establishing a framework for managing financial responsibility linked to investor-state dispute settlement tribunals established by international agreements to which the European Union is party (COM(2012) 335, 21.06.2012.) and which lay down the framework for future division of financial responsibility between the EU and Members States in case of disputes between investors and a country is being actively discussed at the moment.

At the same time, the EU is holding *FTA* negotiations with India, Malaysia, Vietnam, Thailand and Mediterranean countries[2], as well as negotiations on the economic partnership agreement *(EPA)* with the majority of African, Caribbean and Pacific Group of States *(ACP)*. It is not expected to finish the negotiations in the near future with the Gulf Cooperation Council countries[3] *(GCC)* and the Common Market of the South[4] (*Mercosur*), considering the different positions of these countries regarding economic integration with the EU.

[1] Costa Rica, Guatemala, Honduras, Nicaragua, Panama and Salvador
[2] Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian Authority, Syria and Tunisia
[3] Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates
[4] Argentina, Brazil, Paraguay, Uruguay and Venezuela

Bilateral economic cooperation

In order to promote and deepen bilateral economic cooperation with the key trade partners, Latvia has signed bilateral economic cooperation agreements with Russia, China, Belarus, Ukraine, Kazakhstan, Azerbaijan, Georgia, Moldova, Uzbekistan, Kirgizstan, Turkmenistan, Tajikistan and Armenia. Within the framework of these agreements, Intergovernmental Commissions (IGC) on Economic, Scientific and Technical Cooperation Affairs and a Joint Committee (JC) have been established, ensuring supervision of validity of agreements and analysing opportunities for improvement of further cooperation.

It should be noted that in March 2013, Turkey's Ministry of Economy proposed establishment of Latvian-Turkish Joint Economic and Trade Committee at minister level. Latvia has approved this proposal and currently it is being established.

Box 6.7

Council for the Coordination of External Economic Policy

Based on *Memorandum of Understanding on cooperation between the Ministry of Foreign Affairs, the Ministry of Economics, the Investment and Development Agency of Latvia, the Latvian Chamber of Commerce and Industry and the Employers' Confederation of Latvia was signed on August 9, 2011,* the Council for the Coordination of External Economic Policy has been established as of May 2012. The purpose of the Council is to ensure coordinated cooperation of the parties in successful development and implementation of economic policy to increase competiveness of Latvian national economy.

Four Council meetings have been held so far, in the framework of which the guidelines were approved for the coordination of visits of high level state officials aimed at improving the preparation process for coordination of visits of state officials, prepared proposals for developing and implementing an indicator system for evaluating the economic performance of the Foreign Economic Missions and the Diplomatic and Consular Missions of Latvia, and reached an agreement on the economic cooperation target countries of Latvia for 2013-2014. A calendar of economic visits of high level state officials has been developed and available online, thus making it possible for entrepreneurs to timely obtain information about planned visits of officials open for business participation *(http://www.mfa.gov.lv/lv/Arpolitika/ekspertu-padomes/arejas-ekonomiskas-politikas-koordinacijas-padome/kalendars)*.

The homepage of the Latvian Institute is currently being improved *(www.latvia.eu)*. After developing an integrated information system, it will contain information about business environment, trade sectors, investments and export possibilities in Latvia.

In the first half of 2013, there have been a number of important activities in the field of bilateral economic cooperation of Latvia:

– On May 27, 2013, the meeting of co-chairs of **Latvian-Kazakhstan IGC** was held in Riga, It addressed a number of economic cooperation issues, including possibilities to expand economic cooperation in the transport sector (to develop transit freights and conclude transnational agreement in the field of aviation). Yet, on June 3-4, 2013, several bilateral meetings with high level official of Kazakhstan were held during the official visit of the President A. Bērziņš, as well as business forums in Astana and Almaty. Over 50 entrepreneurs participated in the visit representing such sectors as transport and logistics, food industry, mechanical engineering, metal processing, designing and architecture, tourism, agriculture, finance and legal consultations, etc.;
– Although Latvian-Moldavian trade volumes are quite small, there is a potential to further expand and deepen mutual economic and trade relationship. Latvian entrepreneurs showing an active interest in developing cooperation in road construction, manufacture of electric equipment, pharmacy and other sectors. Those and other Latvian-Moldavian economic cooperation issues were addressed in the second meeting of **Latvian-Moldavian IGC** on February 6, 2013 in Riga and during the visit of Prime Minister V. Dombrovskis on February 19-21, 2013. Along with the IGC, the Latvian-Moldavian business seminar was also held on February 6 in Riga. A delegation of over 20 Latvian entrepreneurs participated in both the business seminar and the Prime Minister's visit, representing such sectors as mechanical engineering and metal processing, electronics, construction and architecture, food industry, pharmacy, etc.;
– On April 24, 2013, the fifth meeting of **Latvian-Azerbaijan IGC** was held in Baku, addressing the possibilities to further promote bilateral economic cooperation in such areas of mutual interest as industry, energy, ICT, space services, science and education, agriculture, banking, culture and tourism, regional development and environmental protection, as well as health care. The IGC meeting was held within the framework of the official visit of the President A. Bērziņš and the Latvian-Azerbaijan business forum took place along with it, involving over 80 Latvian entrepreneurs, representing such sectors as finance and legal services, real property, health care, transport, logistics, telecommunications, food industry, mechanical engineering and metal processing, construction and architecture,

design, chemistry, pharmacy, tourism, agriculture, education, etc.;

- On March 14-25, 2013, the President A. Bērziņš was on a visit in Ukraine. The President was accompanied by a delegation of 49 Latvian entrepreneurs. During the visit Latvian entrepreneurs participated in bilateral meetings with Ukrainian entrepreneurs in Kiev and Odessa, thus establishing important contacts to further develop cooperation. During the meeting of the President with the high level officials of Ukraine a particular attention was paid to issues related to enhancing economic cooperation, as well as integration process of Ukraine and the EU, including readiness of Ukraine to sign the *Association Agreement* involving establishment of the Free Trade Area in the second half of 2013. The parties agreed to hold the next or 6th meeting of **Latvian-Ukraine IGC** in the second half of 2013 in Ukraine;
- Although **economic cooperation between Latvia and Turkmenistan** is rather recent, gradual increase has been observed in exports of Latvian goods and services and the interest of Latvian entrepreneurs in cooperation with this Central Asian country over the past few years. A major relationship-enhancing impulse was participation of Turkmenistan in the 18th International Textile, Clothing, Leather Garments and Production Equipment Exhibition *Fashion & Textile 2013* on April 17-21, 2013 in Riga, as well as the visit of the President A. Bērziņš to Turkmenistan on May 13-15, 2013. During the President visit the business forum of both countries was held involving representatives from 39 Latvian enterprises and institutions. This gave an opportunity to identify further cooperation possibilities in such sectors as finance and legal services, transport and logistics, IT and telecommunications, food industry, mechanical engineering and metal processing, manufacture of electric equipment, water supply and sewerage, planning and construction, chemical industry and pharmacy, agriculture and bioenergy, vehicles, education and postal services;
- On April 4-5, 2013, the Minister of Economics Mr. D.Pavļuts was on **a business visit in Moscow**. The purpose of the meeting was opening of Latvian Days *Appreciate Latvia (ОцениЛатвию)*, participation in the round table discussion of Russian-Latvian entrepreneurs and bilateral meeting of the minister and representatives from Russian government and business community. The Latvian Days was aimed at promoting the image of Latvia and introducing the best offers of Latvia. Yet, business meetings with Russian officials and entrepreneurs emphasised the need to develop economic cooperation with the regions of Russia, as well as to improve efficiency of border crossing;
- In order to deepen economic cooperation with the regions of Russia, thus giving more opportunities to expand economic and commercial cooperation between both countries, as well as promote mutual cooperation, agreements of economic cooperation with Yaroslavl Oblast and Kaluga Oblast have been prepared for revision in the first half of 2013. The agreement with Kaluga Oblast is expected to be signed in the third meeting of **Latvian-Russian IGC**, which is provisionally planned to be held in the second half of 2013 in Kaluga (Russia);
- On April 2-3, 2013, the **Latvian-Turkey business forum** took place within the framework of official visit of Turkey President Mr. Abdullah Güll. Latvia was represented by 146 entrepreneurs. During the forum the *Memorandum of Understanding Between the Turkish the MUSIAD – Independent Industrialists and Businessmen's Association and the LDDK* was signed, which is an important tool in addition to the Latvian-Turkey Business Council renewed in 2012;
- On May 29-30, 2013, the Baltic Development Forum Summit New Realities – New Opportunities. Competitiveness, investments and business development in the Baltic Sea Region was held in Riga, aimed at promoting further development of the Baltic Sea Region in terms of competitiveness, sustainable economic growth and infrastructure development, as well as other issues pursuant to the EU Strategy for the Baltic Sea Region. Along with the summit, a visit to Riga IT Demo Centre and the Baltic Business Arena (business matchmaking) took place, the Baltic Sea Region Award and Baltic Innovation Award ceremonies, etc. the annual reports on economic and political situation in the Baltic Sea Region were presented during the summit. The informal Baltic Council of Ministers and the annual meeting of Latvian high level officials and top level representatives from the Foreign Investors' Council in Latvia were also held during the summit. The summit involved 400 leading decision makers of the region from politics, business, and the academic community. The summit addressed such topics

as competitiveness, investments and business, transport, energy, cooperation of the Baltic Sea Region with Russia, ICT, "blue" economic growth of the Baltic Sea Region, research and innovations, the EU presidency of the Baltic States, etc.

Promotion of access to export markets in third countries

In the first half of 2013, within the EU Market Access Strategy, 12 working groups[1] and 33 market access teams[2] continued working on identification and targeted solving of specific trade restrictions in third countries. Latvian economic and diplomatic representatives in the USA, Israel, Japan, Kazakhstan, Russian, China, Turkey, and Ukraine are actively participating in these groups and teams.

Yet, as of 2011, in order to decide on the best measures to deal with trade barriers and protective measures at the EU political level, the European Council of March 14-15, 2013 approved the third annual *Trade and Investment Barriers Report*. It covers the latest trade restrictions important for the EU enterprises in different world countries, in particular the USA, Argentina, Brazil, India, Russia, and China, as well as provide information about the results of elimination of restrictions to promote market access of these countries.

The EU, like majority of the world countries dealing with the import of goods and raw materials from other countries, uses the *trade defence instrument (TDI) system* – antidumping, anti-subsidy[3] and safeguard measures of the domestic market[4].

Currently, the EU has applied a total of 107 anti-dumping measures and 11 anti-subsidy measures to various products of other countries. More than a half of the given measures have been applied to China, India, Indonesia, Russia, Taiwan, Thailand, and Ukraine. At the moment, the EU applies no safeguard measures of domestic market.

In anti-dumping inspections, Latvia supports open trade, access for producers and users to the necessary raw materials and intermediate consumer goods, as well as a variety of supply chains thereof. In the first half of 2013, among the TDI inspections important to Latvia are the antidumping inspection concerning import of biodiesel from Argentina and Indonesia, as well as the antidumping inspection concerning import of ceramic tableware and kitchenware from China.

Like the EU applies trade defence measures, other third countries may apply any of trade defence instruments to all EU exporters of certain products (for example, safeguard measures of the domestic market) and to exporters of certain products from a certain EU member country (for example, antidumping measures).

Economic interests of Latvia are greatly affected by the antidumping measures introduced by the USA in 2001 with respect to import of steel bars from the EU. Considering the fact that the WTO Disputes Settlement Institution has recognized the anti-dumping margin calculation method *(Zeroing)* used by the USA as unjustified and non-compliant with the WTO's norms, in May 2012 the USA recalculated the duty thus reducing the amount of duty applicable to Latvian enterprises. Despite that, the second review was initiated on July 2, 2012. The results of the second review regarding continued application of the duty for the next five years or complete cancelation of the duty are expected in June 2013.

In order to encourage small and medium-sized enterprises to get involved in TDI inspections, the SME Helpdesk has been established and guides on initiating anti-dumping and anti-subsidy inspections have been developed, as well as a guide on TDI[5] aimed at improving the understanding of the EU entrepreneurs about their rights and obligations in inspections carried out in third countries. In order to continue the public discussion launched in 2012, the work on the initiative on improving the TDI aimed at making the EC TDI inspections more transparent and simplifying participation of interested parties in the TDI inspection procedures continues also in 2013.

6.2.3 Internal Market of the European Union

The EU internal market currently comprises 30 countries (including the European Economic Area 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

[1] Established Working Groups in sector of the EU market access – SPS/Animal products; SPS/Vegetation products; Medical devices; Electronics and information and communication technologies; Tyres; Automotive; Postal services; Distribution services; Textiles; Wine and spirits; Leather; Chemistry sector

[2] EU Market Access Teams are operating in Algeria, Argentina, Australia, Brazil, Canada, Chile, China-Hong Kong and Macau, Colombia, Egypt, Iceland, India, Indonesia, Israel, Japan, Kazakhstan, Korea, Malaysia, Mexico, Morocco, New Zealand, Nigeria, Norway, Philippines, Russia, South Africa, Switzerland, Taiwan, Tunisia, Turkey, Ukraine, USA, Venezuela, Vietnam

[3] Antidumping and anti-subsidy measures are aimed at protecting the EU producers against losses caused by unfair competition of third country enterprises or granted subsidies by governments.

[4] Application of safeguard measures of the domestic market is mainly based on the increase in such import that caused losses to local producers, though it is not a sign of unfair competition

[5] *http://trade.ec.europa.eu/doclib/docs/2010/october/tradoc_146710.pdf*

the EU, a uniform formation of a set of rules has been achieved for operators of economic activity, border control has been cancelled, 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 provided to residents, an opportunity to introduce a single currency has been created, as well as many other benefits have been provided. However, the potential of the 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 Latvia, implementation of internal market directives is successfully progressing. Overall, 23 EU Member States have reached the transposition deficit of 1%, thus achieving the Lisbon objective of 2009 to transpose 99% of directive requirements or allow transposition deficit of 1%. Moreover, Ireland has managed to transpose all EU internal market-related directives. Latvia has been ranked 13th among those 13 Member States with a deficit of directive transposition below 0.5% (to be specific – 0.4%).

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 the freedoms in the EU internal market, *inter alia*, by assessing the current draft laws and regulations.

The procedure for submitting technical regulations (*Directives 98/34/EC* and *98/48/EC*), which prescribes the obligation of the EU Member States to submit draft technical regulations to the European Commission and to other EU Member States, as well as to the European Economic Area countries for further assessment, 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 social services. Any business, not only the responsible institutions of the 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 the 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/default.htm*. *TRIS* database is a free service, and the majority of the notified draft technical regulations are available in Latvian. In case an enterprise has any objection to draft technical regulations of other countries that might or do affect 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. A list of contact persons in responsible ministries 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 the sole legal instrument in the non-harmonised sphere of application of national technical regulations and standards for harmonisation of draft technical regulations pursuant to the procedures set by the *Directives 98/34/EC* and *98/48/EC* in order to ensure free movement of goods. In order to improve application of the principle of mutual recognition within the administrative practice of the national competent authorities, after a suggestion of the European Commission and with the support of the EU Member States, 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* was adopted and enforced on September 2, 2008. Thereby, a substantial step was taken towards introduction of a new legal instrument at the EU level. Application of the requirements of the Regulation in Latvia and other Member States is ensured as from May 13, 2009.

The aim of the Regulation is to prescribe the procedures, whereby the principle of mutual recognition must be observed in the work of public authorities by applying the national technical regulations to the goods manufactured or lawfully released into free circulation in the European Economic Area countries, distribution of rights and obligations among the national competent authorities and economic operators within the framework of the mutual recognition procedure, as well as for the purposes of simplification of applicable administrative procedures, the Regulation stipulates an obligation for the state to establish one or more product information points for the informative support of performers of economic activity. Currently, the functions of the product information contact point in Latvia are performed by the Ministry of Economics (e-mail: pcp@em.gov.lv). In 2012, the Product Information Contact Point has replied to requests for information on national requirements regarding various products received from merchants of 14 other European Union Member States.

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 the 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 cancelling 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. Procedures of extending the validity term of permits are also simplified, and the list and the number of documents to be submitted for receiving the permit is revised, requests for permits are replaced with requests for registration, procedures for re-certification of persons, as well as other administrative processes are simplified. 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 state and municipal service portal *www.latvija.lv*.

The principle of "silence means consent" is one of 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 by, for example, overlapping procedures or excessive bureaucracy in relation to submission of documents. The principle defines that in case a 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 service rendering. Many EU countries have already adopted the silence-means-consent mechanism thus trying to simplify public administration for the benefit of enterprises and population. Currently, the responsible institution of Latvia plans to make the necessary amendments to laws and regulations to apply the "silence-means-consent" principle to the issue of certain permits.

In order to ensure administrative cooperation among public administration authorities of the European Union, the European Commission has introduced the ***Internal Market Information (IMI)*** system. The *IMI system* allows fast and easy communication between the responsible institutions of EU Member States (also Norway, Iceland, and Lichtenstein) at national, regional, and local level. The *IMI system* provides an option to search the responsible institutions of other Member States for cooperation purposes and a set of prepared questions and answers to make the daily use of the *IMI system* easier for users. At the same time, the *IMI system* provides clarity of information exchange to its users, thus allowing efficient keeping up with information exchange in the system. Through the *IMI system,* the Member States can verify authenticity of documents issued in other Member States and submitted by legal entities and individuals and contact the issuing institution in case of any questions. Thus, the person submitting the documents is released from additional bureaucratic barriers to solve various issues in the Internal Market of the European Union. Currently, the *IMI system* is available in the field of the *Service Directive (2006/123/EC)*, the *Professional Qualification Directive (2005/36/EC)* and the *Posting of Workers Directive (96/71/EC)* (still a pilot project). 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, 54 responsible institutions of Latvia accounting for information exchange of one or several fields are registered. At the moment, 44 responsible institutions registered in the *IMI system* are involved, 14 – in the sphere of professional qualification and 6 – in the sphere of employee secondment (one institution can be involved in several spheres), the *Warning mechanism* has involved 6 supervisory institutions - the Consumer Rights Protection Centre, the State Environmental Service, the Health Inspectorate, Criminal Investigation Department of the State police and 2 ministries – the Ministry of Health and the Ministry of Economics as the *Warning message* coordinators. The Ministry of Economics is the national *IMI system* coordinator in Latvia.

Since January 2012, the *IMI system* in Latvia has registered 224 requests for information: 13 – in the field of services, 33 – in the field of employee secondment, 178 – in the field of professional qualification.

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 coordination 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 before bringing a court action in situations when a citizen or 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). Since January 2012, the SOLVIT coordination centre in Latvia has received 34 complaints. In order to lodge a complaint with the *SOLVIT coordination centre,* the case must comply with 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 of people regarding the issue of residence permits, entrepreneurs – restrictions of free movement of services and recognition of professional qualification.

6.3 Industrial Policy

The economy of Latvia has gone through important macroeconomic adjustments. The economic model, which fostered an increase in domestic demand due to the inflow of foreign capital, thus being the main driver of growth, no longer exists. It was not a sustainable model and consequently led to a deep economic crisis due to substantial macroeconomic imbalances (high inflation, high current account deficit of the balance of payments, etc.).

At the same time, a transition to a sustainable economic model is taking place in the economy of Latvia, in which export is the key driver of growth along with the ability to compete in the domestic and external product markets and the ability to be competitive in attracting capital to increase the productive potential of Latvia.

Along with the change of the common economic paradigm, there is a growing need for efficient *National Industrial Policy* (NIP) in Latvia focused on development of export-oriented sectors and change of structure in favour of these sectors. This policy should improve competiveness of tradable sectors and exports profitability, thus fostering an increase in the total revenues of the country. Therefore, the NIP is aimed at assisting/ ensuring/ supporting – encouraging entrepreneurs in developing and managing competitive advantage towards higher productivity.

Guidelines on National Industrial policy of Latvia was approved by the Cabinet of Ministers on May 28, 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 industry and services and export sophistication.

The guidelines are closely linked to long-term planning documents – *Sustainable Development Strategy of Latvia until 2030 (Latvia 2030), the National Reform Programme of Latvia for the Implementation of the EU 2020 strategy, the National Development Plan, the Guidelines for Promoting Latvian Goods and Services Exports and Attracting Foreign Investments for 2013-2019, the Guidelines for Research, Technology Development and Innovation for 2014-2020.*

In order to reach the defined aim set within the framework of the *National Industrial Policy of Latvia* the following expected results are determined:

- the share of manufacturing shall reach 20% of the gross domestic product by 2020;
- the increase in the productivity of manufacturing shall reach 40% by 2020 compared to 2011;
- the growth of manufacturing shall reach 60% by 2020 compared to 2011;
- investments in research and development shall reach 1.5% of GDP.

The NIP is based on modern, updated, and latest scientific concepts developed by economic theorists. The concept of a new industrial policy is among the most modern economic concepts in the scientific literature in the field of economics. One of its defined founding principles instead of “picking winner” is a process comprised of a dialogue between the public and the private sector aimed at revealing obstacles hindering new economic activities and proposing solutions to eliminate or overcome them.

Understanding global challenges affecting the growth of the sector is not the only key element of industrial policy. It is also important to clearly identify **economic advantages of the country and functional obstacles of products, finance and labour market** hindering sustainable industrial growth. Elimination of functional obstacles is aimed at improving market forces by increasing their ability to adapt to changing conditions and stimulate economic subjects to carry out a relevant structural transition to improve competiveness. Improved functional activity of the market allows eliminating market failures and at the same time minimizing the need for state intervention.

In order to identify market and state failures, structural transformation needs to be considered. Therefore, potential of export-capable niches and products and services with higher value added was identified, as well as in-depth analyses of producers were carried out based on the findings of an in-depth study *Analysis of Product Space and Possibilities of Structural Transformation in Latvia* within the *Latvian Competiveness Report 2011*.

The study of the Latvian Competiveness Report is based on the methodology developed by Mr. R. Hausmann and Mr. B. Klinger (2006), as well as Mr. R. Hausmann, Mr. J. Hwang and Mr. D. Rodrik (2005). Compared to other methodologies, its key advantage is the possibility to assess diversification potential of Latvian production and possibility to switch to manufacturing of products with higher value added according to current exports structure and comparative advantages of production without any need for extensive estimates of other indicators of competiveness.

In order to identify the current market and government failures at business level, in 2012 the Ministry of Economics conducted structured in-depth interviews based on conclusions from theoretical concepts of Mr. M. Porter's five forces model and strategic advantages. The interviews resulted in identifying several advantages and failures (challenges) that basically are similar in all interviewed enterprises regardless of size evaluating by the number of employees, represented the sector or type of product (intermediate product or end product) (see Box 6.8).

Box 6.8

Main Advantages and Challenges of Latvia

Structured in-depth interviews revealed the following results.

Main advantages:

– price advantage;
– quality advantage;
– activity in production of niche products and products with high adaptability rate;
– flexibility;
– timely delivery of orders;
– highly qualified specialists;
– brand "made in the EU".

Main challenges:

– **Availability and knowledge of labour force** – availability of employment and qualified workers is an obstacle that has been identified at the moment but is of long-term nature. Availability of specialists of higher professional qualification is particularly critical. Entrepreneurs have drawn attention to some professions, which are not possible to obtain in the higher education system of Latvia and in which as of now mainly employees in pre-retirement age or retirement age are working;
– **Management skills and knowledge** – further growth of enterprises, particularly, motivation to shift to production of new products with higher value added or achieving new development stage of enterprises require improvement of such skills as selling, risk and quality management, financial planning and management, and particularly management and optimization of production process;
– **Limited access to finance** – according to information provided by respondents, the current range of services mismatches the actual needs or the enterprise in question is subject to an increased risk interest rate resulting in raised charges for financial resources or declined bank financing because the financial institution is unable to assess the financial state and development prospects of the enterprise due to the influence of too many variations of analysis;
– **Limited availability of industrial areas and premises** – primarily outside the Riga agglomeration territory. Respondents have emphasized the difficulty of finding suitable industrial premises outside Riga agglomeration territory. At the same time, respondents from regions outside the area of former industrial objects and direct national or regional development centre usually face the issue of quality industrial infrastructure, including access roads, electricity, gas, communication and other services;
– **Costs of entering new markets** – identification of cooperation partners by participating in exhibitions, individual business trips, state official visits requires relatively huge financial resources with questionable return, and therefore, there is the identified challenge with respect to and failure to take the risk of increasing costs of entering new markets preventing enterprises with existing potential from expanding the volume of economic export;
– **Administrative burden in export markets** – customers in export markets, particularly those of third countries, set requirements for product registration and quality assurance specific to each export market in relation to regulated product groups thus increasing the costs related to new products entering the market, as well as current production costs where costs of quality control and laboratory quality tests play an increasingly important role;
– **Rise in costs, particularly energy costs** – according to information provided by respondents, the risk of maintaining the price advantage is a critical medium-term obstacle on a condition that costs of different resources are expected to increase;
– **Cooperation with the science sector in developing products** – according to information provided by respondents, the majority of products are developed in own laboratories of enterprises and cooperation with scientific organizations and institutions is generally weak and occasional or caused by chance.

Upon summarizing the analysis, it can be concluded that the main challenges to the National industrial policy requiring active state action are the following:

– 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 *National industrial policy* are directed towards:

– **Issues related to access to and skills of labour force** such as: further implementing reforms of 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 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 industrial premises and spaces in centres of international, national and regional significance;
– **Issues related to access to finance** such as: providing 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 current CIT reliefs for research and development costs with new relief in the CIT Law envisaging a threefold writing-off of certain research and development costs; developing 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 has been developed according to the proposed directions (Annex 4 to the NIP, envisaging a number of activities for each direction of action, appointing the responsible institutions for the activities and defining the expected performance results.

The most substantial institutional solution element of the industrial policy is the **promotion of the modernization of sectors**, as a result of which the activities mentioned in this chapter occur – in cooperation with the organisations represented in the National Economy Council, a wide analysis of the abilities and skills of the sectors has been carried out within the framework of a new, improved dialogue (Dialogue 2.0), including an analysis of government failures, for example, an analysis of national priority sectors at the level of enterprises (micro) and the economy (macro), as well as an examination of the existing support instruments towards the identified market failures in order to promote the support for increased sophistication of export products. Within the framework of the dialogue, an agreement on a supervision mechanism shall be reached to analyse the efficiency of the existing industrial support policy by evaluating advantages, disadvantages and mistakes on a regular basis.

Clearly, the National industrial policy is not a time-limited issue and development of the Guidelines in the National industrial policy and approval thereof at the Cabinet of Ministers is not the closure of implementation of the policy in Latvia. Besides, according to conclusions of Mr. D. Rodrik, industrial policy is a continuous consultation process with constant adjustments to policy actions.

6.4 Energy Policy

The main approaches to the energy policy are directed at increasing security of the country's energy supply by encouraging diversification of supplies of primary energy resources and by creating conditions for increasing subsistence of electric energy generation, as well as by preventing isolation of the regional electric energy market through new interconnections. Creation of competition conditions for promoting the use of renewable and local energy resources and environmental protection also plays a substantial role.

On June 27, 2006, the Cabinet of Ministers approved the *Energy Development Guidelines for 2007-2016*. The Guidelines contain the government policy, development objectives and priorities in the energy field both in the medium-term and long-term period. Taking into consideration policy priorities and significant changes in the Latvian economy, a long-term policy guidance draft document of the energy sector development – *Long-term Energy Strategy 2030-competitive energy for society* – has been developed and approved in the meeting of the Cabinet of Ministers on May 28, 2013. The key objective of the *Energy Strategy 2030* is a positive impact of the energy sector on national economy of Latvia, at the same time pursuing two sub-objectives – safe and sustainable energy supply.

Box 6.9

Energy Sector in Latvia

Both the imported (natural gas, electricity, oil products, coal, coke, etc.) and local (hydropower, firewood, charcoal, straw, biogas, bioethanol, biodiesel, peat, used tyres, municipal waste for heating, wind energy) energy resources are used in Latvia to supply fuel, electric energy and heat to sectors of economy, commercial consumers and residents.

A part of electricity is generated by Latvian HPPs, CHPs, biogas and wind power plants, whereas the rest is imported. Mainly, the imported fuels – natural gas and heavy fuel oil and local fuels – firewood – are used in heating energy generation.

In 2012, energy resource generation and recycled products in Latvia reached 91.7 PJ, but import of energy resources was 172.2 PJ, out of which 57.8 PJ was the import of natural gas.

In 2012, the total consumption of primary energy resources in Latvia amounted to 182.9 PJ, what was by 1% higher than in 2011. Self-security in the total consumption of primary energy resources was 35.8%. In the total consumption of primary energy sources, firewood with its total consumption forming 46.5 PJ was the most widely used local energy resource, electricity generated in hydropower stations and wind power stations constituted 13.7 PJ.

The draft *Energy Strategy 2030* sets the following objectives of the energy policy:

– Competitive economy – balanced, efficient, economically, socially, and ecologically justified energy policy based on market principles ensuring further development of the economy, its competitiveness in the region and the world;
– 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;
– Secure supply – stable energy supply and developed infrastructure provided to energy users.

According to the protocol decision of the CoM meeting, the Ministry of Economics has to develop new energy policy guidelines for 2014-2020 by May 1, 2014 based on the energy policy development directions laid down in the *Energy Strategy 2030*.

Electric energy market

More than 90% of electric energy generated in Latvia is generated by the JSC "Latvenergo", which also ensures electric energy imports and supply to the consumers. Currently, 46 traders have received licences for electric energy trade. At the moment, six traders, who have signed a contract on use of the system with JSC "Sadales tīkls", are operating actively in the electric energy market.

Until April 1, 2012 households and enterprises with the annual turnover or total balance sheet below LVL 7 million and the number of paid employees below 50 had right to electricity at a regulated price. About 1700 electricity users (energy-intensive and large enterprises) purchased electricity at the agreed price on such conditions thus constituting approximately 35% of the annual electricity consumption in Latvia.

By narrowing the range of associated electricity users in Latvia, users with connection voltage exceeding 400 V and the nominal current of the input protection appliance exceeding 100 A, namely, the medium-larger electricity users have entered the market since April 1, 2012. About 4800 users with the average consumption of 200 MWh/per year have been involved in the market thus increasing the free share of the electricity market in Latvia to approximately 66 per cent.

Taking into consideration the successful opening and conditions of the market in the past, on

August 28, 2012, the Cabinet of Ministers approved the amendments to the *Regulations Regarding the Trade and Use of Electricity* granting only users consuming electricity for household needs the rights to receive electricity at a regulated price as of November 1, 2012. Such regulation involved another 18 500 users in the electricity market, which constitutes 2.3% of all users consuming about 9% of the total consumed electricity in Latvia, thus the open electricity market share in Latvia reaches 75% of the total consumption.

On November 20, 2012, the Cabinet of Ministers approved the proposals provided in the *Informative Report on Full Latvian Electricity Market Opening* regarding further activities for full opening of electricity market. The CoM supported the proposal to complete opening of Latvian electricity market by September 1, 2013. On February 18, 2013, the CoM committee approved the amendments to the *Electricity Market Law* envisaging opening market to households on the specified date. Yet, since there are some concerns about an increase in tariffs for households after the market liberalisation, particularly due to the increase in the mandatory procurement component, the Ministry of Economics made a decision to suspend the planned full electricity market opening until a range of measures to limit the rise in prices and minimise consequences thereof will be implemented. For instance, implementation of the action plan to directly minimise the risks of the overall rise in the mandatory procurement component in the overall electricity price, introduction of the social instrument (the apartment benefit), thus replacing the current start tariff and *Latvenergo* gift cards since the regulated tariff would be the best way to protect households from increased costs for electricity in current situation.

Since September 1, 2005, the operator's functions for the electric energy transmission system are performed by the JSC "Augstsprieguma tīkls", which has become an independent transmission system operator as of January 1, 2012. Since July 1, 2007, the operator's functions of the electric energy distribution system are performed by the JSC "Sadales tīkls".

Table 6.3

Consumption of Primary Energy Resources in Latvia, PJ

	2000	2005	2008	2009	2010	2011	2012
Total consumption* including:	**163.8**	**191.9**	**196.5**	**189.0**	**200.5**	**184.7**	**182.9**
coal and coke	3.1	3.3	4.4	3.5	4.5	5.0	3.6
peat	2.5	0.1	0.1	0.0	0.1	0.0	0.0
petroleum products	56.4	61.9	69.3	62.4	64.6	59.6	58.4
natural gas	45.6	56.9	55.8	51.4	61.3	54.0	50.8
firewood	39.7	49.4	46.0	52.6	51.4	46.9	46.5
electricity**	16.6	19.9	20.5	18.6	16.0	15.1	18.4
other energy resources***	-	0.5	0.5	0.5	2.7	4.1	5.3

* All energy resources have been calculated based on the lowest calorific value
** Hydropower, wind energy and electric energy net imports
*** Used tyres, municipal waste for heating, charcoal, straw, biogas, bioethanol, biodiesel

A well-operating domestic electric energy market has to provide the producers with proper stimuli to invest in new types of energy production, among all electricity production from renewable energy sources. According to the provisions set in the EU *Third Internal Market Liberalization Energy Package*, without separating network services from production and trading activities (efficient separation), there is not only the risk of facing discrimination in network management, but also the risk that vertically integrated enterprises lose motivation to make proper investments in networks. Separation of ownership at the transmission level is considered as the most efficient way to foster non-discriminating investments in infrastructure, fair access to the network for new participants and transparency in the market.

By implementing separation of ownership of the transmission system operator, the transmission system (networks) remains a part of the vertically integrated company JSC "Latvenergo", but activities related to performing the functions of a transmission system operator (transmission service rendering, operative management of the transmission system and its connected generating units, balancing, dispatching electric energy flows, management of cross-border electric energy trade, sustainable transmission system planning, participation in the European Network of Transmission System Operators ENTSO-E, etc.) are going to be separated from the JSC "Latvenergo". As a result, on April 1, 2011, JSC "Latvijas elektriskie tīkli" – the owner of the JSC "Latvenergo" subsidiary company's transmission system assets – started operating, but the JSC "Augstsprieguma tīkls" began its operations on January 1, 2012 as an independent company outside the JSC "Latvenergo" group. The electricity market of Latvia, just like the whole Baltic energy market, is currently connected to the European energy market only through the underwater cable *Estlink* between Estonia and Finland, though its transmission capacity is insufficient. Since such a situation considerably reduces security of energy supply, the EU has identified eliminating isolation of the Baltic energy as one of the priorities.

Box 6.10

Electricity and Centralized Heat in Latvia

The volume of **electricity** generation depends on the flow rate in the Daugava River. After closing the Ignalina NPP at the end of 2009, the situation in the electric energy market in the Baltic States has changed. Latvia is no longer the only state in this region with insufficient amount of electric energy generated in its power plants. At the moment, Lithuania is also importing electric energy. Therefore, basically the suppliers from Estonia and Russia compete for supplying electric energy to Latvia.

In 2012, the total supply of electricity was 7459 GWh, which is by 1.6% more than in 2011. JSC "Latvenergo" generated 68% of the total electricity supply, it purchased 15% from small electricity energy producers and net imports of electric energy constituted 17 per cent.

The consumption structure of **centralized heat supply** has remained the same over the past years, with central heating comprising 65-70% and hot water supply – 30-35%. Since 2012, 1.2% of the total generated heat energy has been supplied to the industrial sector, 72% – to households, 26.8% – to other consumers. However, the breakdown of heat energy distributed by regions is the following: Riga region – 51.7%, Pieriga region – 11.6%, Vidzeme – 6.1%, Kurzeme – 10.5%, Zemgale – 8.1% and Latgale – 12 per cent.

In 2012, heat energy for sale was produced in 663 boiler houses and 132 cogeneration plants having generated 7.46 TWh of heat energy for sale.

In 2011, natural gas was the main resource for generating heat energy and electric energy. The share of heat energy produced using natural gas as fuel was 78.4%, woodchips – 14.2%, firewood – 2.2%, heavy fuel oil – 1.1% and other types of fuel – 4.1 per cent.

On July 17, 2009, the protocol of intent ***Baltic Energy Market Interconnection Plan*** (BEMIP) was concluded between the European Commission and a number of Member States including the Republic of Latvia.

Table 6.4

Electricity Supply in Latvia, TWh

	2000	2005	2008	2009	2010	2011	2012
Total electricity supply	**5922**	**7054**	**7794**	**7223**	**7500**	**7340**	**7459**
Gross electricity generation including:	**4136**	**4906**	**5274**	**5569**	**6627**	**6095**	**6164**
from renewable energy resources:	2824	3414	3213	3555	3635	3078	4105
large HPPs *	2794	3263	3038	3391	3445	2823	3627
small HPPs	25	62	71	66	75	64	79
biomass and biogas power stations	-	42	45	48	66	120	287
wind power stations	5	47	59	50	49	71	112
from fossil energy resources:	1312	1492	2061	2014	2992	3017	2059
large CHPs **	1163	1278	1524	1476	2402	2425	1409
other CHPs	149	214	537	538	590	592	650
Net electricity imports	**1786**	**2148**	**2520**	**1654**	**873**	**1245**	**1295**

* Daugava cascade – Riga HPP, Ķegums HPP and Pļaviņas HPP
** Riga CHP-1 and Riga CHP-2

The BEMIP identifies measures to be implemented for development of an efficient joint Baltic electric energy market and its integration into the electric energy market of the Nordic states. Development of an operating regional market is considered as a prerequisite for further integration of the Baltic region into the Nordic electric energy exchange *Nord Pool* region by simultaneously taking over also *Nord Pool* operating principles. 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.

In order to develop cross-border trade and achieve competitive electricity prices, the BEMIP action plan envisages that the necessary measures are carried out by the countries to ensure that electricity exchange could start operating in the Baltics, including Latvia. The common Baltic day-ahead electricity trade within the trading platform *JSC Nord Pool Spot*, electric energy trade within the framework of the current day, as well as market principle-based management of network jams and overload organized by the *Nord Pool Spot* and organization of indirect auctions have to be implemented within time period from 2011 until 2013.

On June 3, 2013, *Nord Pool Spot* opened Latvian price zone within the exchange.

On January 1, 2012, the Cabinet *Regulations on the Requirements for Public Electricity Network Voltage* came into force stipulating that the overtaken EU standard LVS EN 50160:2010 *Voltage Characteristics of Electricity Supplied by Public Electricity Networks* is mandatorily applicable in Latvia.

Natural gas market

Currently, the JSC "Latvijas Gāze", which according to the *Privatisation Agreement* signed in 1997 has the exclusive rights to carry out transmission, distribution, storage and trade of natural gas, is the only enterprise operating in the Latvian natural gas market.

In 2012, natural gas consumption was 1508 million m3 or by 6% lower than in 2011. The biggest consumers of natural gas in 2011 were CHP and heat supply enterprises of JSC "Latvenergo" – 63.9%, manufacturing – 15%, other consumers – 18.2%. The Riga region consumes about 65% of natural gas used in Latvia.

The Latvian gas supply system is not connected to the European Union common gas supply system. Latvia receives natural gas only from Russia, as most of gas is supplied to Latvia by the Russian enterprise JSC "Gazprom" and a small amount by LLC "Itera Latvija" which is controlled by JSC "Gazprom". The gas supply business environment in the region and the effective gas supply agreements practically exclude third parties except a regional transmission system operator and access to Inčukalns underground gas storage. The capacity of the gas pipeline Valday-Pskov is not sufficient to ensure gas supply to the Baltic States and to the Northwest region of Russia during winter. Consequently, at the moment, the gas market in Latvia may only be open formally.

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*.

Currently, Latvia is a subject to two different exemptions from the requirements of 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 2003/73/EC*) exemption of "the new market" which applies until April 4, 2014 – 10 years after the first commercial natural gas supply under the first long-term contract, and the exemption of "isolated market" which is applied until Latvia constructs an interconnection with any of the EU Member States, except Estonia, Lithuania, and Finland, or the market share of dominant supplier is below 75 per cent.

Currently, the Ministry of Economics is working on implementation of the *Directive 2003/73/EC* in two stages pursuant to the CoM assignment and developing amendments to the *Procedure for Entering into Force of Some Sections of the Energy Law* and the *Energy Law* separating and specifying provisions to be effective as of April 4, 2014 from those provisions implementation of which may be further suspended.

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 constructing an interconnection with any of the EU Member States, except those of the isolated region – Estonia, Lithuania, and Finland, as well as by developing a **regional liquefied natural gas (LNG) terminal**. The LNG terminal has been under discussion for several years, yet the Baltic region countries have not been able to agree on the best location of the terminal, therefore in March 2012, the European Commission launched an independent research, by involving Italian advisors Booz&Co. The research was competed at the end of November 2012 and its conclusions show that the most optimal location for regional LNG terminal, considering the willingness of Finland to participate in the LNG terminal project, would be Estonia or Finland. Since they have not been able to agree on the location, in May 2013, Estonia and Finland agreed to ask the European Commission to provide an independent assessment of the best location of the new regional LNG terminal within the Gulf of Finland. It should be noted that either way the *Inčukalns Underground* Gas Storage Facility plays an important role in functioning of the natural gas market of the East Baltic States. In case Estonia and Finland fail to agree on the location of the new LNG terminal by the end of June, 2013, the project might not receive EU financing within this financing stage and the financing will be available again only in 2016.

In order to strengthen the security of natural gas supply in the EU, the *Regulation (EU) No 994/2010 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 approved on October 20, 2010. Among other things the *Regulation 994/2010* imposes an obligation on the competent authority of the Member States (in case of Latvia – the Ministry of Economics) to develop the *Preventive Action Plan* and the *Emergency Plan*.

The *Preventive Action Plan* contain 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 Plan* contains the measures to be taken to eliminate or mitigate the impact of a gas supply disruption if it cannot be removed by the measures specified in the *Preventive Action Plan*, and the 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 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 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, measure 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 emergency situation, as well as mechanisms used to cooperate with other Member States.

The *Preventive Action Plan* and the *Emergency Plan of Latvia* has been approved by the Decree No 98 of May 23, 2013 of the State Secretary of the Ministry of Economics, and it is available to the public on website of the Ministry of Economics (*http://www.em.gov.lv/em/2nd/?cat=30177*).

Renewable energy resources

Latvia, similar to other EU Member States, has committed to achieve 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 efficiency of the existing heat supply systems and use energy resources more efficiently, thus greatly contributing to the reduction of greenhouse gas emissions.

Not only contribution of the existing tools but also the chosen support measures for energy produced from renewable energy resources in the coming years will be crucial until 2020, so that Latvia can contribute to preventing climate change and reduce imports of fossil energy resources particularly focusing on the heat supply sector. Therefore, development of economically unfavourable projects should be limited when implementing new support measures for renewable energy, and it can be ensured, for example, by applying a technologically neutral additional payment thus reducing consumer expenses.

Box 6.11

Renewable Energy in Latvia

In 2012, the electricity production volume reached 6164 GWh, which is by 1.1% more than in 2011. 66.6% (4105 GWh) of the total produced electricity volume was generated from renewable energy (HPPs, wind, biogas, biomass, etc.). While the total installed capacity for electricity production from renewable energy in 2012 increased by 65 MW, constituting 1707 MW in comparison with 2011.

Contribution of electricity produced from renewable energy sources to transport was small in 2012: a total of 1 million tonnes of fuel have been sold and used for own consumption in Latvia in 2011, including pure biofuel or mixture of fossil fuel and biofuel – 24.5 thousand tonnes. In 2012, the final energy consumption consisted of bioethanol – 279 TJ (in 2011 – 318 TJ) and biodiesel fuel – 526 TJ, experiencing a decrease (in 2011 – 616 TJ).

Box 6.11 continued

The Cabinet of Ministers considered and accepted for information the informative report *Action Plant to Limit the Risk of Rose in the Overall Electricity Price* in the meeting on April 9, 2013. The Report is available on website of the Ministry of Economics: *http://www.em.gov.lv/em/2nd/?cat=30168*. The action plan contains measures to be taken to limit the increase in the mandatory procurement component (MPC).

The action plan envisages a range of solutions to be implemented in 2013 for audit and control of the decisions of the Ministry of Economics on granting the right to sell electricity within the framework of mandatory procurement or receive guaranteed payment for installed capacity projects that have not been implemented yet. The action plan also includes measures for enhanced surveillance of already implemented projects to ensure that undertakings and power stations in their possession meets all applicable requirements, including the requirements for efficient use of heat energy. The action plan also envisages analysis of costs for energy production depending on the type of energy resources, as well as impact assessment of changes in aid intensity for cogeneration plants on heating tariffs that might result in possible revising calculation formula of mandatory procurement prices, thus reducing the impact on the MPC.

Since the increase in the total electricity price would have a great impact on the economy of Latvia and its further development, the Ministry of Economics believes that it is crucial to make changes in the energy policy as soon as possible to ensure balance between related policies, so that Latvia would be able to achieve the binding objectives laid down in the *Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC* and also successfully improve economic competitiveness and prevent worsening of the quality of life.

The Cabinet of Ministers considered and accepted for information the informative report *Regarding Situation in the Field of Biofuel Production* in the meeting on April 23, 2013 and entrusted the Ministry of Economic with the task to develop a draft amendments to legislation regarding conformity assessment of fuel and diesel and legislation regarding biofuel quality requirements, conformity assessment, market surveillance and procedure for consumer information in three months with an aim to ensure determining the mandatory 6.5-7% biofuel addition (by volume) to diesel as of April 1, 2014, as well as in cooperation with the Ministry of Transport, the ministry of Environmental Protection and Regional Development and the Latvian Association of Local and Regional Governments to develop proposals for possibilities to include conditions on granting additional evaluation points in tenders for providing public transport services and state and local government procurements of vehicles in case of offering vehicles that use pure biofuel or fossil fuel and mix of biofuels (biofuel contents over 10%) as fuel. The proposals have to be developed within three months.

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.

Energy efficiency

The Energy Efficiency Monitoring Report for 2010-2011 shows that in 2011 services and manufacturing sectors have failed to achieve significant energy savings, while the household sector has achieved considerable energy savings (1700 GWh) as the sector is experiencing successful implementation of energy efficiency measures in multi-apartment residential buildings with the support of the EU Structural Funds.

In order to promote energy savings in manufacturing, the CoM approved the *Regulations Regarding Industrial Energy Audit* on March 12, 2013. The regulations establish the procedure for conducting industrial energy audit, as well as the requirements for energy auditors. The conditions on accreditation of energy auditors come into force as of August 1, 2013.

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* came into force on December 4, 2012, laying down new challenging requirements for energy efficiency, among all the Member States are required to define national indicative energy saving targets for 2020, involve energy distributors and retail energy sales companies in implementing measures to improve energy efficiency of energy end-users, promote development of energy service and set mandatory requirements for renovation of buildings in possession and use of the government. In May 2013, Latvia announced the indicative energy saving target to the European Commission – to save 0.67 Mtoe of primary energy consumption by 2020. The requirements of the *Directive 2012/27/EU* have to be transposed into national law by June 5, 2014.

Energy efficiency of energy-consuming products

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 during their lifetime. Over 20 EC regulations on eco-design and energy labelling have been adopted since 2008, setting stricter 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 electric products, lighting, household appliances, heating and cooling equipment, industrial and commercial equipment, etc. (a full list of adopted eco-design regulations is available on the website of the Ministry of Economics at *http://www.em.gov.lv/em/2nd/?cat=30641*). New eco-design regulations are expected to be adopted for another 27 product groups within the upcoming two years.

Investments in the energy sector

Currently, several infrastructure development projects included in the *BEMIP* are being implemented which will ensure successful integration of the Nordic and Baltic electricity markets.

Within the framework of *Trans-European Energy Network (TEN-E) programme,* the project *Environmental Impact Assessment and Route Investigation of* ***Kurzeme Circle*** is being implemented. The total expenses of the project amount to EUR 0.65 million, deadline – June 2012. The work is carried out in 3 stages: Grobiņa-Ventspils, Ventspils-Tume and Tume-Riga.

On August 6, 2010, the EC adopted a decision to financially support the construction of electric power transmission infrastructure in Latvia by granting co-financing for the project *Kurzeme Circle* within the framework of a single *Nord Balt project*. EC is planning to invest EUR 131 million in the construction of the Lithuania-Sweden interconnection, furthermore EUR 44 million are granted for improving the network infrastructure in Latvia within the framework of the project *Kurzeme Circle*. The total expenses of the first and second stage of the project *Kurzeme Circle* amount to EUR 88 million, and the deadline is 2014. At the moment, the third stage of the projects is planned to be constructed – 330 kV transmission line Ventspils-Dundaga-Tume-Imanta, the deadline is 2018. This project is expected to attract the European Union co-funding from the new Connecting Europe Facility (CEF) to be established within the European Union budget for 2014-2020. Latvia has applied 4 projects for entering the list of Common interest projects aimed at preventing the isolation of CEF energy markets within the given financial instrument – *third stage of the project Kurzeme circle* and *Latvian-Estonian third interconnection* to electricity, as well as *Modernization and Extension of Inčukalns underground gas storage (UGS)* and construction of *the Baltic regional liquefied natural gas (LNG) terminal* in the gas sector.

At the moment, the largest project for the development of natural gas infrastructure and improvement of regional supply safety is the ***Increase of Two-Way Gas Flow between Latvia and Lithuania***, within the framework of which a new gas transmission line under the Daugava River is being constructed, 15 drill holes in Inčukalns underground gas storage are being reconstructed, and a new treatment and intellectual piston chamber for pipeline diagnostics is created. By implementing the project, gas supply safety will be improved in both directions and a possibility will be created to supply natural gas from Lithuania to Latvian consumers. The option to supply natural gas from Lithuania will be available in case of insufficient natural gas supply through gas pipeline from Riga to Bauska during the winter season. The project had been completed in 2011 however its deadline had been extended to 2012 for additional works, because the whole granted financing had not been used for the main activities.

After closing the Ignalina nuclear power plant at the end of 2009, the new ***Visagina nuclear power plant project*** is one of the most topical issues in the context of the Baltic energy policy. Latvia supports the *Visagina NPP project* based on the regional solidarity principle, as well as on the economic benefits of the project. However, until some material questions are not answered, it is too soon to decide on involvement of the Latvian energy company "Latvenergo". Besides, after the elections of Lithuanian Seimas in October 2012 and the referendum on Visagina NPP where the majority of electorate voted against the construction of a nuclear power plant, the future project development is uncertain in the project developer country. It should also be kept in mind that future decisions on the reconstruction of the Narva oil shale thermal power plant blocks in Estonia will have a significant impact on the entire Baltic energy market and the overall energy supply safety in Latvia.

In order to improve heat energy production efficiency, reduce heat energy losses in the transmission and distribution system and to foster replacement of fossil fuel types with renewable fuel, several projects are being implemented within the Cohesion Fund (CF). A total of 58 project applications for the CF's financing in the amount of LVL 34.2 million have been approved till October 25 within the first and the second selection stage of project applications of the activity 3.5.2.1 ***Measures Regarding the Increase of Efficiency of Centralised Heat Supply Systems*** of the supplement to the Operational Programme *Infrastructure and Services*, and among them 15 projects for the CF's financing in the amount of LVL 7.7 million have been finished.

In order to significantly increase the production of electricity and heat energy from renewable resources, diversify primary energy resource supply and to 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 CF's financing in the amount of LVL 21.4 million.

6.5 Construction and Housing Policy

The policy for development of a sustainable and competitive **construction sector** is developed taking into account principles that influence favourable and competitive business environment by reducing administrative barriers, ensuring effective exchange of construction-related information and increasing productivity of construction service providers. The regulatory framework for building contractors is just as important as access to an adequate infrastructure and support.

The Saeima continues considering the approved second reading of the new **Construction Law**, which envisages a simplified construction administrative process by excluding multiple interim decisions. The Saeima Committee for Economic, Agricultural, Environmental and Regional Policy has established a working group, which is currently considering and evaluating all proposals submitted for the third reading of the *Draft Construction Law*.

The new *Draft Construction Law* is aimed mainly at significant simplification of the construction process and promotion of its transparency, as well as at facilitation of development of the construction market and of the whole economy. The Draft Law contains the following principles that have to be observed within the construction process:

- The principle of architectonic quality – buildings are planned by balancing the functional, aesthetic, social, cultural heritage, technological and economic aspects of construction, as well as the interests of the customer and the society, by highlighting the individual identity of natural or urban landscape and easily integrating in the cultural environment, thus enriching it and creating qualitative living space;
- The principle of engineering quality – an engineering solution of a building is safe for using, as well as economically and technologically efficient;
- The principle of openness according to which the construction process is open and the society is informed about the planned construction and the decisions made in relation to it;
- The principle of sustainable construction – the construction process creates the quality aspect of living environment for the present and further generations, inter alia, by increasing the usage of renewable resources and promoting efficient usage of other natural resources;
- The principle of accessible environment – environment that is suitable for people to get around conveniently and use the buildings according to their function is created in the construction process.

A number of **amendments** have been made to **the effective *Construction Law***, envisaging shorter appealing procedure for construction permits and changes in the public information procedure. The amendments to the *Construction Law* will simplify and promote investments of both local and foreign enterprises in Latvia; the construction process itself will be simpler, more transparent and will impose no risk of terminating investment projects already launched and losing the investments already made.

As of June 1, 2013, the appeal period for construction permits is one month in any case. A special regulation in construction stipulates that an authority must consider an administrative case within a month, and if an additional assessment is needs, the period may be extended by a time period not exceeding the total period for consideration – two months.

In case the person, upon appealing a construction permit, fails to ask the court to suspend the construction permit, it shall be renewed on the day when the constructor receives a notification of it. Yet, in case the court receives such a request, the judges shall assess the need to suspend the construction permit along with initiation of a case. The construction permit shall remain valid if the court rejects the person's request to suspend it.

The public information procedure is also expected to be changed, stipulating that further on the party commissioning construction shall notify the owners of real property whose property is next to the land planned for construction about the obtained construction permit within three business days by sending the notification with registered mail to the declared domicile or legal address, as well as by placing an information site board on the land. Yet, the local government has an obligation to publish information on the submitted application for construction on its website within three business days.

Box 6.12

Data Characterising the Construction Sector

Data of the Central Statistical Bureau show that in the 1st quarter of 2013 the construction production volumes in current prices were LVL 142.8 million.

In the 1st quarter of 2013, the construction production volumes according to the seasonally adjusted data in comparable prices have increased by 1.4%, compared to the 4th quarter of 2012. Out of this, the construction of buildings has increased by 4%, while construction of civil engineering structures decreased by 2.4 per cent.

In the 1st quarter of 2013, the construction production volumes according to the calendar adjusted data in comparable prices have increased by 9.8%, compared to the 1st quarter of 2012. The construction of buildings has increased by 16.1%, including construction of residential buildings, which increase more than twice. The construction of civil engineering structures increased by 2.2% due to a notable rise in the volume of construction of main pipelines, communication and electricity lines (2.6 times).

In the 1st quarter of 2013, 313 building permits were granted for the construction, capital repairs, reconstruction and restoration of single-dwelling houses with total floor space 78.0 thousand m^2 (in the 1st quarter of 2012 – 304 building permits and 66.7 thousand m^2, respectively), of which 185 permits were issued for the construction of new single-dwelling buildings with total floor space 42.5 thousand m^2. In comparison with the corresponding period of the previous year, the number of building permits issued for the construction of single-dwelling houses did not change, while the total floor space increased by 8.7 per cent.

Moreover, 74 building permits were granted for the construction of industrial production buildings and warehouses with the total floor space of 163.5 thousand m^2, of which 38 permits were issued for the construction of new industrial production buildings and warehouses with the total floor space of 58.2 thousand m^2. While a year ago, 80 building permits were granted for the total floor space of 93.2 thousand m^2, of which 49 permits were issued for the construction of new industrial production buildings and warehouses with the total floor space of 41.3 thousand m^2.

In the 1st quarter of 2013, the volume of construction work (in current prices) performed by Latvian builders abroad was LVL 12.3 million, compared to the 1st quarter of 2012 (LVL 12.9 million), the volume of performed construction works has decreased by LVL 0.6 million. yet, in the 1st quarter of 2013, foreign builders in Latvia have performed construction works in the amount of LVL 2045.6 thousand, which is by LVL 333.3 thousand less than in the 1st quarter of 2012 (LVL 2378.9 thousand).

In the 1st quarter of 2013, the construction costs have increased on average by 5.2%, compared to the 1st quarter of 2012. Wages of workers have increase by 13.7%, while the costs for machinery and maintenance and use of machines increased by 3.7% and the costs for construction materials – by 1.3 per cent.

As regards the **housing policy**, the development of the *Draft Law on Residential Tenancy* continues according to the effective legal framework by balancing the rights and obligations of the tenant and the lessor, improving record-keeping of rental agreements, specifying the rights and obligations of the tenant and his/her family members, as well as observing the principles of free rental market operations.

Since the economic downturn, debts of tenants for heat supply have become a topical issue in multi-apartment buildings. Having analysed the reasons for debts, it has been concluded that the main reasons are insufficient or reduced financial resources of residents, lack of payment discipline, lack of cooperation between the service provider or manager and the debtor (including failure to permanently initiate debt recovery), differing approaches to development of social support policy-making (including setting apartment benefits) in local governments.

In order to solve the problem, the Ministry of Economics has developed and the Saeima has adopted draft amendments to the *Law on Administration of Residential Houses* in the first reading on May 24, 2012. The draft law has been developed to:

– Divide the information to be entered in the register of residential building managers into information to be made available to the public and information not to be made available to the public;
– Impose an obligation on the manager to control payments of apartment owners for the use of apartment property.

Box 6.13

Projects Announced by the SSM

On October 4, 2012, draft regulations of the Cabinet of Ministers *Amendments to the Regulations of the Cabinet of Ministers of December 9, 2008 No 1013 Procedures by which an Apartment Owner in a Residential Apartment House shall Pay for Services, which are Related to Use of the Residential Property* were announced in the State Secretaries Meeting. The draft regulations have been developed with an aim to avoid a situation when unreasonably high difference in water consumption is quite often calculated in multi-apartment residential buildings in addition to water readings of the meters installed in apartment property. The draft regulations envisage changes in the calculation procedure for several services related to use of residential property.

Based on the abovementioned draft regulations of the Cabinet of Ministers, on February 28, 2013, the draft regulations of the Cabinet of Ministers *Amendments to the Regulations of the Cabinet of Ministers of December 12, 2006 No. 999 Procedures by which Tenants and Lessors of Residential Space Settle Accounts with Service Providers for Services that are Associated with the Use of a Residential Space* were announced in the State Secretaries Meeting to avoid a situation when a different charge is calculated for services related to the use of residential space and applied to owners of privatised and non-privatised apartments.

On January 10, 2013, the draft law Amendments to the Law on residential Property was announced in the State Secretaries Meeting laying down conditions for alienation of apartment property in order to promote debt payment for management services and services related to use of apartment properties, as well as alienation of apartment property in case of a specified date on which the acquirer of an apartment property shall start to pay for management services and services related to use of apartment property if the apartment property is alienated through a compulsory auction.

On March 21, 2013 the amendments to the *Law on Privatisation of State and Local Government Residential Houses* came into force, envisaging a number of changes in the privatisation process of residential buildings in relation to dealing with premises acquired before commencing privatisation of a residential building, extending the term for commencement of privatisation of a residential building, as well as management issues of residential buildings after completion of privatisation of apartments. The amendments envisage extending the term until December 31, 2014 for decision-making regarding the commencement of privatisation of residential buildings. In order to promote transfer of residential buildings into management of apartment properties, the law imposes an obligation on owners of apartments to take over management rights of those residential buildings where all privatisation objects have been privatised within six months after the convocation of the general meeting of apartment owners. Once the term expires, the possessor of residential building or local government no longer have an obligation to manage and administer the residential building; the manager or the local government shall notify public utility service providers of the fact; in case the apartment owners have failed to sign the acceptance-delivery certificate of the residential building, the possessor or the local government shall keep the file of the residential building.

As regards apartment, artist's workshop or non-residential space acquired by a person before privatisation of a residential building and the person has failed to conclude a purchase contract within the time period specified in the notification of conclusion of purchase contracts, the law prohibits any dealing with the property after March 15, 2013 until privatisation of the residential building. The amendments to the law impose an obligation on the owners of a privatised object to pay a rent for undivided shares of the state or local government-owned land to be privatised, starting from April 1, 2013, if the owner fails to conclude the agreement on acquisition of the undivided share of the land without payment within the time period specified in the invitation.

In order to promote competiveness in the residential building management market and quality management of residential buildings, the Register of Residential Building Managers developed in 2012 continues operating in the Ministry of Economics. Currently, 455 managers have been registered in the Register. The main task of this register is to provide the latest information about persons operating or willing to operate in the residential building management market and conformity to the criteria of performing management activities as defined by the *Law on Administration of Residential Houses*.

On January 9, 2013, the *Law on the Energy Performance of Buildings* came into force, which based on the previously effective regulation by adding the updates introduced to the revised *Directive 2010/31/EU* of the European Parliament and of the Council of May 19, 2010 on the energy performance of buildings. In order to completely transpose the *Directive 2010/31/EU* of May 19, 2010, it is necessary adopt the regulations of the Cabinet of Ministers delegated in the *Law on the Energy Performance of Buildings*: 1) *Regulations Regarding Independent Experts in the Field of Energy Performance of Buildings* (the project was announced in the State Secretaries Meeting on March 28, 2013, VSS-291), 2) *Methodology for Calculating the Energy Performance of Buildings* (the project was announced in the State Secretaries Meeting on May 2, 2013, VSS-424), 3) *Regulations Regarding Energy Certification of Buildings* (the project is expected to be announced by the end of May 2013), as well as a range of construction regulations should be developed by the end of 2013, laying down the minimum requirements for energy performance of buildings according to Article 5 of the *Directive 2010/31/EU* and the *EU Regulation 244/2012*[1].

The Ministry of Economics has prepared a report On Financial Solutions to Renovation of Buildings. The informative report has been prepared to implement the objectives laid down in the national energy efficiency policy documents and to promote renovation of the building sector, particularly the housing sector in accordance with the requirements for energy performance of buildings. In addition, the report contains information about tasks arising out of the EU directives on state and local government buildings. The report is aimed at evaluating the possible financial models for renovation of buildings and to identify the tasks to be fulfilled. On May 13, 2013 the informative report was sent to the State Chancellery.

Implementation continues for the activity 3.4.4.1 ***Improvement of Heat Insulation of Multi-Apartment Residential Buildings*** of the European Regional Fund Operational Programme *Infrastructure and Services*.

Since launching implementation of the activity 3.4.4.1 *Improvement of Heat Insulation of Multi-Apartment Residential Buildings* in April 2009 until May 23, 2013, 1324 project applications have been considered, 208 of which have been completed; contracts on implementation of 550 projects have been concluded with the IDAL. 51 project applications have been approved (to be launched after signing the contract), while 62 project applications are under evaluation.

The most active region is Kurzeme with 356 submitted projects, followed by the Vidzeme region with 299 project applications. Two regions have maintained average activity – the Riga region with 279 project applications, while the Zemgale region has submitted 215 project applications. The lowest number of projects has been submitted from Latgale – 53 project applications. Considering the large number of population and housing, the activity in the Riga city with 122 submitted projects is still rather low.

The total funding available within the activity 3.4.4.1 is LVL 62.75 million. As of May 23, 2013, LVL 54.75 million (87%) have been distributed or reserved, the remaining available amount is LVL 8 million (13%).

The average heat energy savings gained as a result of implementing the renovations measures range from 30% up to 57%, thus the implementation of the activity results in significantly improved energy performance of multi-apartment residential buildings. Moreover, the housing facilities are improved and that would not be possible without such support.

The housing renovation process has also significantly influenced establishment of associations of apartment owners and corporate societies of apartment owners because most frequently, when agreeing on launching renovation, the residents of the buildings want to deal with building management issues on their own. According to the estimates of the Ministry of Economics, taking into account the total costs of finished projects and of projects to be implemented under concluded contracts, the construction sector has so far received about LVL 100 million from the implementation of this activity.

6.6 Tourism Policy

The tourism policy in Latvia is intended to promote development of local and international tourism, thus improving competitiveness of 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.

In order to promote development of the tourism sector, the following economic objectives have been set for the time period to 2015:

– increasing the share of foreign tourists staying for 3 and more days;
– increasing the export of tourism services in comparable prices by 5-10% every year compared to the previous year;
– ensuring tendency of percentage growth in local tourism services to outpace the total percentage growth in export of tourism services.

[1] *COMMISSION DELEGATED REGULATION (EU) No 244/2012* (*16 January 2012*) supplementing *Directive 2010/31/EU* of the European Parliament and of the Council on the energy performance of buildings by establishing a comparative methodology framework for calculating cost-optimal levels of minimum energy performance requirements for buildings and building elements

Box 6.14

Tourism Development Indicators

According to the data of the UN World Tourism Organization (UNWTO), the number of international tourists in 2012 has grown by 4%, reaching 1.035 billion. Asia and Oceania achieved the best results (+7%) among regions, while Southeast Asia and North Africa were the first (each +9%) among sub-regions, as well as Central and Eastern Europe (+8%).

The tourism sector is also a significant source of export income providing a considerable contribution to the national gross domestic product. The added value of tourism-related sectors (hotels and restaurants, passenger rail transport and road transport, water transport, air transport, ancillary transport services, vehicle rental, activities of tourism operators and travel agencies, recreational, cultural and sport services) in 2010 reached 5.3 per cent.

In 2012, the tourism flow remained at the level of 2011. In 2012, the number of border crossings by foreign tourists in Latvia reached 5.6 million (in 2011 – 5.5 million border crossings), spending LVL 383.6 million in our country or by 1.1% more than a year ago. 1.44 million or 26% of the total number of foreign tourists were overnight travellers who stayed here on average 4 days.

At the end of 2012, there were 632 hotels and other tourist campsites – 9 less than at the end of 2011. Despite that, the number of persons served in campsites increased by 4% (1.6 million) in 2012. It should be noted that the majority or 67% of the total number of served guests were foreign tourists.

The key priorities of the LTDA which is subordinated to the Ministry of Economics is related promotion of development of quality tourism infrastructure and single tourism information system, raising awareness about the Latvian tourism image and promotion of Latvia as a tourism destination, conduct of marketing surveys on local and international tourism market, improvement of tourism service quality, as well as development of local tourism and implementation of international cooperation.

In order to ensure constant involvement of sectoral partners in implementation of the tourism policy, the Advisory Council of the LTDA has been established and continues its activity, 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 6.15

Activities of the LTDA in the First Half of 2013

In the first half of 2013, the LTDA organized marketing activities in foreign target markets and ensured measures to develop tourism products and promote local tourism:

- in cooperation with the Latvian tourism sector, participation of the Latvian national stand in 7 international tourism exhibitions (in Russia, Finland, Germany, Sweden, Estonia, Lithuania, and USA) has been organised, ensured participation of Latvian national stand in specialised camping exhibition *Caravan Fair* in Finland and participation in the international tourism exhibition *Balttour* in Latvia;
- within the framework of international tourism exhibitions, the LTDA organized a range of measures for professionals of the sector – work seminar for journalists and tourism professionals in Helsinki, Baltic press conference in Berlin, seminar and business matchmaking for tourism companies and a press conference for mass media in Moscow, participated in tourism forum *Balttour Forum. Focus – CIS countries* in Riga;
- launched advertising campaigns in German and Russian, Lithuanian, Estonian, Finnish and Swedish internet media, thus raising awareness about Latvia and fostering demand of Latvian tourism products during the active tourism season;
- issued informative materials of Latvian tourism – Latvian tourism rout brochures, Culture tourism brochure, a map *Recreation for families with children*, tourism maps of Kurzeme, Latgale, Vidzeme and Zemgale, tourism maps of Riga and its surrounding territories, a Latvian tourism map, a brochure *Top 10 Latvian tourism destinations of Latvian tourism*, Baltic tourism maps;
- organized work seminars and Latvian tourism presentations in Russia (Saint Petersburg, Pskov, Kaliningrad, and Moscow), Latvian tourism presentation in Hamburg, organised foreign tourism operator and mass media visits to Latvia;
- implemented publicity and marketing activities in Finnish, Swedish, Russian, and German tourism markets by implementing publicity measures for a professional audience in target markets, adapting news of tourism newsletters for target markets, providing support for the LTDA advertising activities, communicating with national and regional mass media of target markets;
- ensured development of the Latvian tourism portal *www.latvia.travel* according to the demand of the target markets by ensuring the content of the portal in 9 languages and mobile applications of the tourism portal *www.latvia.travel* for IPhone and Android smart phones in 4 languages;
- launched information measure for local society about topical tourism issues in cooperation with Latvian mass media (newspapers, radio, television);
- monthly issue of the Latvian tourism newsletter in English, Russian, and German, distributing it to 12 500 foreign tourism professionals and journalists;
- granted Quality labels of the Latvian tourism service quality system *Q-Latvia* to t tourism enterprises to increase the quality level of tourism services provided by Latvian tourism enterprises;

Box 6.15 continued

- organized training measures for Latvian tourism sector for creating tourism products and developing tourism destinations according to the target market requirements;
- launched local tourism promotion campaign *Rediscover Latvia! (Atklāj Latviju no jauna!*), by encouraging people to travel around Latvia and preparing recreation offers for families with children;
- implemented the project *European Destinations of Excellence*. In 2013, its theme is *Accessible tourism*. The winner of the Latvian competition was awarded in an international conference in Riga – Liepāja ensures the most accessible range of tourism services in Latvia.

In 2013, the LTDA continues working on the priorities defined last year. The priorities are related to tourism marketing in local and foreign markets (development of tourism portal and distribution of tourism information on the internet, participation of Latvian national stand in international tourism exhibitions, organisation of advertising campaigns in high priority tourism markets – Russia, Germany, Finland, Sweden, Estonia, and Lithuania), development of tourism products and local tourism, training and increasing competence of tourism service providers, as well as cooperation with the Baltic States for implementation of joint projects and Baltic marketing activities in distant markets.

Support measures

The annual state budget funding for 2011-2013 that is envisaged for promoting tourism development is earmarked as state co-funding for implementation of the Sub-activity 2.3.1.1.2 *Access to International Trade Markets – Strengthening International Competitiveness of Industry Sectors* of the Activity 2.3.1.1 *Access to International Trade Markets* of the supplement to the Operational Programme *Entrepreneurship and Innovations* of the European Regional Development Fund (ERDF). Within the framework of the Sub-activity, the following activities are supported:

- 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 cooperation partners.

In 2013, the total amount of funding (state budget funding and the ERDF co-funding, as well as funding for implementation of the project *EDEN VI*) for tourism marketing is LVL 1.47 million.

Improvement of the legal framework

On December 18, 2012, the government approved the *Procedure for Granting and Annulling the Resort Status*. It establishes the procedure by which local governments shall submit an application for granting the resort status and information to be included in the application, as well as the procedure by which local governments shall provide a report on development of resort and environmental quality indicators under spatial development planning documents. In early 2013, the Ministry of Economics in cooperation with experts from the Ministry of Health and the Ministry of Environmental Protection and Regional Development has launched considering the application for granting the resort status to the Jurmala city submitted by the Jurmala city council.

The *By-law of the Latvian Tourism Development Agency* came into force on January 1, 2013 specifying the LTDA status pursuant to the effective *State Administration Structure Law* and the *Law on Public Agencies* by changing the status of a state agency to a public institution.

In order to ensure efficient enforcement of the European Council Directive of June 13, 1990 on package travel, package holidays and package tours, informing the consumers and other interested people 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.gov.lv)*. Overall, 553 entrepreneurs were registered in the database by May 20, 2013, 40 of them were registered as tourism operators, 149 – as tourism agents and operators, but 364 – as tourism agents. Every interested person can access the information contained in the database.

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* came into force on February 8, 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) to registration of activity of tourism agents and operators in the *Database of Tourism Agents and Tourism Operators (TATO)*.

International cooperation in the field of tourism

In 2013, Latvia continues developing closer cooperation 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 cooperation in the field of tourism are regularly included on the agenda of foreign visits of intergovernmental commissions and chief state officials.

Cooperation in the field of tourism at the national tourism administration level of Latvia, Lithuania and Estonia is based on the *Agreement Between the Government of the Republic of Latvia, the Republic of Estonia and the Republic of Lithuania on Cooperation in the Field of Tourism* signed on June 26, 2002. Considering the significant changes at national and international level in the signatory countries since the conclusion of the agreement, Latvia, Lithuania and Estonia have recognised the need to update the given agreement. Having regard to the agreement, the Ministry of Economics has developed draft amendments to the agreement which are currently being coordinated with the national tourism administrations of Lithuania and Estonia.

The Joint Tourism Committee (JTC) and the Baltic Marketing Council have been established and are working successfully. The annual JTC meeting was held on May 14-15, 2013 in Vilnius, in the framework of which the latest cooperation projects of the Baltic States were discussed: work seminar *Baltic Connecting 2013*, activities in distant markets – USA, Japan and China, local tourism promotion campaign *The Great Baltic Travel* and other activities.

Representation of Latvian interests in the tourism sector at an international level basically is 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 a member of the European Travel Commission, which deals with raising awareness about European, including Latvian, tourism destinations.

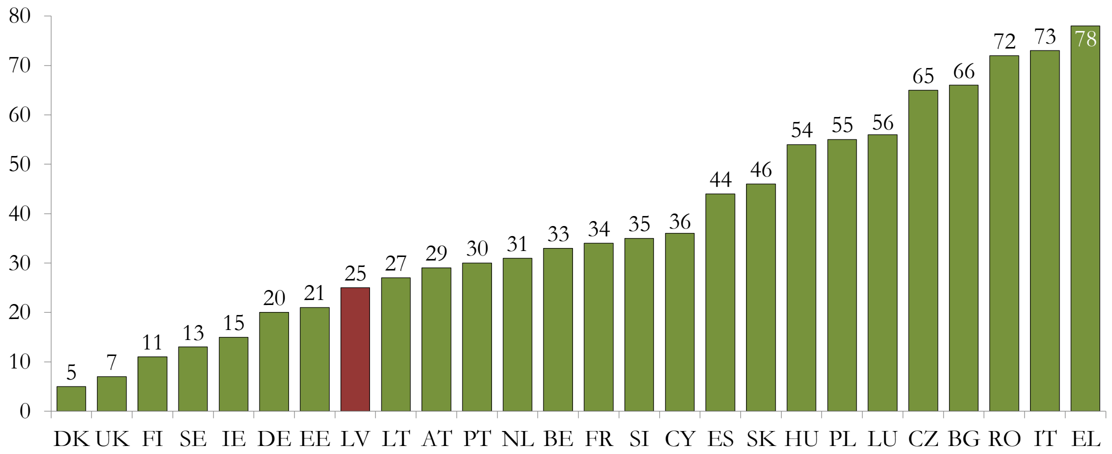
6.7 Improvement of Business Environment

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.*

Figure 6.6

Rank of Latvia and Other EU Member States in the World Bank's Research *Doing Business* in 2013

(business environment in general)



The World Bank research *Doing Business 2013* which covers the reporting period from June 2, 2011 to June 1, 2012 has ranked Latvia 25th among 185 countries (the study of 2012 ranked Latvia 21st). Latvia is ranked 8th among European Union member states in the ease of doing business which is by 1 position lower than a year ago. If compared to neighbouring countries, Estonia has lost its position by 2 places (from 19th place to 21st place) while Lithuania has kept its position unchanged (27th place).

Table 6.5

Benchmarks of Latvia in the World Bank's Research *Doing Business* in 2012 and 2013

	2012	2013	Changes
Starting a Business	50	59	-9
Dealing with Construction Permits	109	113	-4
Employing Workers	-	-	-
Getting Electricity	83	83	0
Registering Property	32	31	+1
Getting Credit	4	4	0
Protecting Investors	66	70	-4
Paying Taxes	62	52	+10
Trading Across Borders	17	16	+1
Enforcing Contracts	16	24	-8
Closing a Business	33	33	0

According to the study *Doing Business 2012*, Latvia has considerably improved its rating in the area of paying taxes and registering property, while the main problems are still related to efficient functioning of the legal system and the construction process.

Measures to improve the business environment in Latvia have been planned since 1999 when the Ministry of Economics prepared the first *Action Plan to Improve the Business Environment.* Every year, the plan is updated and approved by the government together with a wide range of organizations representing entrepreneurs which get involved more and more actively.

The objective of ***The Action Plan to Improve Business Environment for 2012*** is "simple and qualitative services in entrepreneurship: more e-services" and it includes 30 measures to be carried out; the following are the most important.

Starting a business – as of November 21, 2012, electronic registration of new enterprises has been introduced in the Commercial Register via the website *www.latvija.lv*, thus significantly simplifying the procedure for starting a business by reducing the time and costs needed for entrepreneurs to start a business. In addition, a reduced stamp duty in the amount of 10% is defined for an applicant, who submits applications to the Register of Enterprises electronically. The reduced stamp duty was introduced on May 1, 2013.

In addition, the new *Law on Added Value Tax* (VAT) entered into force on January 1, 2013 envisaging registration of VAT taxable persons at the State Revenue Service (SRS) within 5 days (in 2011, the procedure took 7 days).

In **Construction process**,- the 2nd reading of the *Draft Construction Law* has been approved in Saeima envisaging reduced number of procedures for obtaining construction permits and simplified harmonization procedures. The *Draft Construction Law* is expected to be approved by the end of 2013 and it will enter into force as of 2014. Along with the approval of the 2nd reading of the *Draft Construction Law*, the amendments to the Cabinet regulations related to the *Draft Construction Law* are currently being developed to ensure complete improvement of construction process. It is also expected to start operating the *Construction Information System* (CIS) by the end of 2013.

Protecting investor rights – the amendments to the *Commercial Law,* the *Financial Instrument Market Law* and the *Annual Accounts Law* entered into force on July 10, 2012 for the purpose of protecting the rights of investors – specified the decision making process in an enterprise in case of a conflict of interest between members thus ensuring transparency of transactions of entrepreneurs, which are members of the board in respective enterprises. The amendments to the *Commercial Law* envisage prevention of the conflict of interest of the board and council members in conclusion of transactions.

Registering immovable property – the *Amendments to the Immovable Property State Cadastre Law, the Amendments to the Land Register Law and the Amendments to the Law on Recording of Immovable Property* have been approved at the Cabinet meeting on April 16, 2013 envisaging introduction of the one stop shop principle to registration of property data and corroboration of the title. The respective draft laws have been submitted to the Saeima for consideration.

Paying taxes – as of January 1, 2013 the new *VAT Law* sets the VAT rate – 21%, as well as envisages simplified application procedure of this tax. Functionality of the SRS electronic declaration system (EDS) has also been improved in 2012 thus making it easier for entrepreneurs to fill in the declarations.

Enforcing contracts – in 2012, amendments to the *Civil Procedure Law* have been developed envisaging reduced number of the instances (courts) needed to consider commercial disputes. On February 14, 2013, the Saeima approved the 3rd reading of the amendments to the *Civil Procedure Law* envisaging a special procedure for legal proceedings concerning matters related to commercial activities and combating raiderism. However, the draft law has not been announced yet and on February 22, 2013, the President returned it to the Saeima for s second revision.

E-service development – *eKase* (*eCash*) has been introduced since May 18, 2012 – entrepreneurs no longer need to submit a statement as confirmation of paid chargeable services, state fees and tax payments. a centralised e-application for institutions has been introduced to the website *www.latvija.lv* – for easier communication enterprises may submit applications to state and local government authorities electronically on the given website by authorising via online banking or using e-signature authentication.

Continuing improving business environment, preparation of the draft ***Action Plan to Improve Business Environment for 2013-2014*** was approved on April 24, 2013 by the Cabinet Decree No. 165. The Plan includes 31 measures to be carried out; the following are the most important:

- **Starting a business** – to consider a possibility to streamline the registration process of employees of enterprises (including microenterprises), to reduce the fee for enterprise registration in case of using electronic registration, to expand functionality of e-signature for enterprise registration on the website *www.latvija.lv*;
- in **Construction process** – adoption of the *Draft Construction Law* in urgent and to develop the amendments to the Cabinet regulations related to the *Draft Construction Law* (to ensure complete improvement of construction process), as well as to launch the BIS project by the end of 2013;
- **Protecting investor rights** – to introduce the new RE service – sending notification of the announced changes in the subjects registered in the RE registers;
- **Paying taxes** – to introduce electronic personal payroll tax booklet, ensure exchange of warning information within the EDS on ceased economic activities of taxpayer's business partners;
- **Registering immovable property –** to implement electronic registration of real properly by developing functionality of the *State Unified Computerised Land Register* for electronic forms of requests for corroboration;
- **Enforcing contracts –** to adopt the *Draft Law on Arbitration Courts*, to take measures to attract additional judges to balance the caseloads and to speed up consideration of the existing cases, to prepare amendments to procedural laws in order to ensure gradual implementation of electronic exchange of documents and e-services in court institutions (for example, publications of court practice and free access on the internet).

Representatives of both line ministries and their subordinated institutions and cooperation partners from the LCCI, LDDK and the Foreign Investors Council in Latvia were involved in preparation of the *Action Plan to Improve Business Environment for 2013-2014*.

Information on the implementation progress of the *Action Plan to Improve Business Environment* is available on the website of the Ministry of Economics: *http://www.em. gov.lv/em/2nd/?cat=30209*.

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 GDP building and employment.

Box 6.16

The Number of Small and Medium-sized Enterprises in Latvia

According to the CSB preliminary data, there were 80 484 economically active individual merchants and commercial companies in Latvia in 2011 (excluding farms, and fish farms and self-employed persons, who perform economic activity), 99.53% of which belonged to the category of SMEs. The distribution of economically active SMEs in Latvia is the following: micro-enterprises – 84.72%, small enterprises – 12.29%, medium-sized enterprises – 2.52%, large enterprises – 0.47%. An important indicator characterizing economic activity is the number of economically active merchants and commercial companies per 1000 inhabitants. This indicator in Latvia has grown constantly over the last 10 years from 17 in 2001 to 38 in 2011.

However, it is equally important to emphasize the number of performers of individual work (self-employed persons) in 2011 – 47 878 (23 per 1000 inhabitants), as well as the number of farms and fish farms in 2011 – 13 192 thousand (6 per 1000 inhabitants). Taking into account the fact that there is no single methodological practice among the EU Member States for calculating such an indicator characterizing 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 responsible EU institutions shows that 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 2011 in Latvia there were 69 performers of economic activity per 1000 inhabitants.

Box 6.16 continued

According to the statistics of the *Register of Enterprises* in the year 2011, 19 942 subjects were registered and 4041 subjects were liquidated in the registers of the Register of Enterprises. Yet, in 2012, 18 574 subjects were registered and 4443 subjects were excluded from the registers of the Register of Enterprises

Definition of SMEs

Definition of SMEs is stipulated in the *Law on Control of Aid for Commercial Activity,* Regulations of the Cabinet of Ministers of November 25, 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.

In order to foster development of small and medium-sized enterprises and the overall business environment, the policy is formed and implemented in three directions:

- development of support measures to promote micro-enterprise establishment and development;
- development of measures to promote business start-ups (*Business incubator programme*, *Mortgage and Land Bank of Latvia, etc.*);
- providing enterprises with access to finance (*Mortgage and Land Bank of Latvia, Latvian Guarantee Agency).*

Box 6.17

Activities of the EU in Promoting Entrepreneurship

Small Business Act for Europe

On June 25, 2008, the European Commission approved the review of the *Small Business Act for Europe (Act)*, 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 development of small and medium-sized enterprises, and helping to eliminate obstacles preventing their development. The Act includes proposals for 10 politically binding guidelines and several specific proposals for regulations of normative enactments.

European Entrepreneurship 2020 Action Plan

In order to continue implementing the guidelines laid down in the *Small Business Act for Europe,* on January 9, 2013, the European Commission published the *Entrepreneurship 2020 Action Plan*: *Reigniting the entrepreneurial spirit in Europe,* which includes entrepreneurship activities at European level to bring Europe back to growth and higher levels of employment, emphasising the need to support SMEs and particularly new enterprises. The document sets 3 priority directions of action:

- Pillar I – *Entrepreneurial education and training*

The European Commission points out that the entrepreneurial mind-set helps entrepreneurs transform ideas into action and also significantly increases employability. Therefore, the European Commission asks the EU and Member States to focus actively on ensuring entrepreneurial education to students through curricula, thus providing practical knowledge and communication with representatives of entrepreneurs, as well as promoting entrepreneurship orientation in higher education institutions.

- Pillar II – *Create an Environment where entrepreneurs can flourish and grow*

The European Commission points out that access to finance and misleading marketing practices constitute one of the most significant constraints on successful growth of SMEs. Therefore, the European Commission asks the EU and Member States to jointly remove barriers the Single Market, provide comprehensive information to entrepreneurs, thus creating single contact points (incl., information on the use of digital options), provide support and facilitate growth of new enterprises at different stages of their development, minimise administrative burden and set clearer and simpler requirements arising out of legislations, thus reducing the tax-related expenses, improve the process of business transfers and insolvency procedures.

- Pillar III – *Role models and reaching out to specific groups*

The European Commission points out that Europe has a limited number of known entrepreneurial success stories and entrepreneurship has not been celebrated as a preferred career path. Therefore, the European Commission asks the EU and Member States to promote entrepreneurial mind-set, by informing the public about entrepreneurial success, particularly paying attention to such groups of population as young people, women, disabled persons and migrants.

Box 6.17 continued

European Small- and Medium-Sized Enterprises Week

In order to achieve the objectives of the Act, in 2012 already for the fourth year, the European Commission plans to organize a 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 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.

Regional and thematic seminars on such issues as protection of intellectual property rights, internet marketing strategy, collaboration of sectors, international marketing, consultations and solutions to promote exportability, current support programmes for enterprises, etc. were held in September and October in Latvia within the framework of the *SME week 2012*. The *EU Single Market Forum* was held in October 2012 as the main event of the *SME week 2012 in Latvia* to educate entrepreneurs and help them understand the legal framework of the EU single market and provided opportunities, identify challenges and learn success stories of entrepreneurs, as well as offer business matchmaking for further business growth. Overall, more than 12 informative events for entrepreneurs were organized within the *SME week 2012 in Latvia* involving over 1000 entrepreneurs.

Elaboration of support measures to promote micro-enterprise establishment and development

On October 30, 2009, the Cabinet of Ministers approved the *Concept of Micro-enterprise Support Measures* with an aim of creating the necessary preconditions to encourage unemployed people to start business activity, to create 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 it is proved by the key accomplishments in business improvement.

Amendments to the *Commercial Law* of May 2010 significantly reduced the costs required to start a business, envisaging that a **limited liability company may be founded with reduced equity capital** (from LVL 1). At the same time, the state dues for registration of such a limited liability company were reduced. On January 29, 2013, the Cabinet *Regulations Regarding Official Publications* was approved, reducing the fee for publication of announcing a record of a new LLC in the *Commercial Register* to LVL 19 (instead of current LVL 24). According to the data of the Register of Enterprises, 47 428 limited liability companies were registered within the time period from May 1, 2010 until May 1, 2012, 67% or 31 787 of them were limited liability companies with reduced equity capital.

Since September 1, 2010, legal and natural persons **can obtain the status of a micro-enterprise taxpayer,** if they meet certain criteria (members are natural entities, turnover does not exceed LVL 70 000 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. Over 28 268 micro-enterprise tax payers were registered at the State Revenue Service from September 1, 2010 until May 1, 2012 (incl., 67% of them are new companies). The micro enterprises employ over 50 000 employees. These micro enterprises are subject to simplified SRS formalities (declarations 4 times a year).

In 2012, amendments to the *Micro-enterprise Tax Law* were developed, envisaging a specified term for losing the status of a micro-enterprise taxpayer and the applicable micro-enterprise tax rate in case of updating information on the previous taxation period provided in the micro-enterprise tax declaration, the responsibility of a micro-enterprise taxpayer fro notifying employees of changes in taxation regime as of the next taxation period, as well as ensuring compliance with the requirements of the *Labour Law* regarding wages of employees of a micro-enterprise taxpayer. The draft law was approved by the Cabinet of Ministers on December 18, 2012 and on May 1, 2013, it is being considered by the Saeima in the 2nd reading. The amendments to the *Micro-enterprise Tax Law* are expected to come into force by the end of 2013.

As of January 1, 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 6020 applications for patent fees have been submitted to the State Revenue Service from January 1, 2010 until May 1, 2013. The number of the patent fee payers on average is 350 patent fee payers per month. Typically patent fee payers are persons performing such economic activity as gathering gifts of nature – berries, mushrooms, wild herbs –, photographers, hair stylists, nail care specialists, dressmakers.

On September 24, 2012, the Cabinet of Ministers conceptually supported the concept *On Consolidation and Simplification of Small Enterprise Taxpaying System*. The Concept envisages reducing the number of simplified tax regimes and increasing the number of economic activity operators by achieving that unregistered economic activity operators legalize their activity, and developing a mechanism for encouraging small enterprises not to hide their growth and become a part of the overall tax system, as well as increasing long-term social guarantees of employees of small enterprises and micro-enterprises. The Concept envisages the following main measures:

- revising the amount of the monthly income limit of employees under the *Micro-enterprise Tax Law* in connection with the overall rise in wages in the country and applying no additional tax rate when exceeding the turnover threshold of micro-enterprises if the taxpayer has presented a steady growth of turnover in its declarations over the past three taxations years;
- giving up the fixed income tax regime that overlaps to a certain extent the micro-enterprise tax system and setting a two-year transition period;
- maintaining a patent fee system and expanding it with other types of economic activities as necessary, as well as revising the amount of patent fees on a regular basis (once a year) and updating them as necessary;
- introducing general anti-evasion rules in the *Law on Taxes and Fees* by applying the given rule to general regimes and simplified regimes;
- developing a *Tax regime map*, publishing it on the SRS website under the section for persons planning to start an economic activity and providing access to paper format Tax regime maps;
- the Ministry of Welfare shall prepare annual information on the actual amount of SMSIC paid by small economic operators – self-employed persons and patent fee payers and possibilities to provide state social insurance services.

The required amendments to the relevant laws are going to be forwarded in the package of draft laws on the government budget for 2014.

Measures to promote business start-ups

In order to foster establishment and development of micro, small, and medium-sized enterprises, IDAL implements the project **Business Incubators**[1] co-financed by the ERDF. The aim of the activity is to foster establishment and development of new, viable, and competitive enterprises in the regions of Latvia by ensuring the environment and consultancy services necessary for business activity. A business incubator is a combination of infrastructure and personnel aimed at aiding new and small enterprises to develop, by supporting them in their early stage of development with infrastructure, day-to-day consultations, and services concerning basic business development issues.

By the end of April 2013, 570 micro-, small-, and medium-sized enterprises providing (maintaining) 1096 jobs have received services at ten business incubators. In the 1st quarter of 2013, 42 new enterprises have been admitted to the business incubators. The total available funding within the programme is LVL 20.2 million and the activity is expected to be implemented until October 31, 2014.

A programme providing complex support to business start-ups and new enterprises has been launched since 2009. The programme ***Supporting self-employment and entrepreneurship*** is implemented at the **Mortgage and Land Bank of Latvia** (see information about the programme and other programmes provide by the bank – in the section below).

Providing access for enterprises to financing

The Mortgage and Land Bank of Latvia (the Mortgage Bank) is 100% state-owned bank and performs the functions characteristic for a development bank.

Box 6.18

Transformation of the Mortgage Bank into a Development Bank

In December 2009, the Cabinet of Ministers accepted the concept *Transformation of the State Joint Stock Company "The Mortgage and Land Bank of Latvia" into Development Bank*. The aim of the concept was to select the optimal options for transformation of the Mortgage Bank into a development bank, by reducing the number of transactions of a commercial bank and focusing the work of the bank on directions currently crucial to the national economy**.** The 1st model of the concept was supported envisaging establishment of a development bank on the basis of the Mortgage Bank and gradual discontinuation of commercial bank's functions no later than by December 31, 2013.

[1] A business incubator is a combination of infrastructure and personnel aimed at aiding new and small enterprises to develop, by supporting them in their early stage of development with infrastructure, day-to-day consultations, and services concerning basic business development issues

Box 6.18 continued

In November 2011, the Cabinet of Ministers adopted a decision on the sales strategy of Mortgage Bank's commercial part envisaging the sale of the commercial part in 6 packages, thus selling both assets and liabilities. Contracts of sale of commercial parts in 4 packages of the Mortgage Bank were signed in June 2012. Swedbank purchased packages of commercial parts of the Mortgage Bank containing commercial loans of private persons and legal entities, payment and deposit services, while LLC "Swedbanklīzings" purchased LLC "Hipolīzings". "SEB Wealth Management", for its part, purchased the management package of the 2nd level pension plans. In May 2013, the Cabinet of Ministers heard out informative reports on implementation progress of the sales strategy of Mortgage Bank's commercial part and approved the sale of the remaining commercial part packages. According to the assessment and recommendations of a consultant, a package containing loans granted to real estate developers is going to be sold to JSC "Rietumu Banka", whose proposal was recognised as conformant to the market situation. The transaction and customer transfer is expected to take place within a month after approval of the Financial and Capital Market Commission. Since private investors proposed inadequate price, i.e. too low price for the remaining commercial parts, the government took note of transferring the capital shares of LLC "Hipotēku bankas nekustamo īpašumu aģentūra"(HipoNIA) to SJSC "Privatisation Agency", which is an alternative solution to a transfer of assets to the private sector. It is planned to grant HipoNIA a loan from the Treasury pursuant to the Law on Government Budget to repay HipoNIA commitments to the Mortgage Bank. The government also took note of the sale of 51.31% of the shares of JSC "Ieguldījumu pārvaldes sabiedrība „Hipo Fondi"" owned by the subsidiary LLC "Risku investīciju sabiedrība" of the Mortgage Bank to LLC "Biznesa Sistēmas". The sales process of the Mortgage Bank's commercial part will be completed after conclusion of the contracts and completion of transactions.

In November 2012, the data of the commercial customers of the Mortgage Bank were successfully transferred to JSC "Swedbank", thus these customers are now attended by JSC "Swedbank". Overall, the Mortgage Bank has transferred customer deposits or commitments in the amount of LVL 147.7 million to JSC "Swedbank"; moreover JSC "Swedbank" has taken over about 7 thousand loans of the commercial sector in the amount of LVL 86.5 million. Over 70 thousand customer accounts have been transferred from the Mortgage Bank to JSC "Swedbank" within the sale of commercial parts, out of which about 95% are private accounts and 5% – accounts of legal entities.

The Mortgage Bank continues providing service to customers of state aid programmes and issuing state aid loans. The bank also continues servicing accounts of privatization certificates, land purchase contracts and securities accounts.

The transformation of the Mortgage Bank is aimed at establishing a development institution to implement state aid programmes through efficient use of the Mortgage Bank's infrastructure, intellectual and financial potential, by transforming the bank in a way that is advantageous to the state and at the same time ensuring continuity of the implementation of state aid programmes. During the transformation process activities of the Mortgage Bank are focused on important economic directions - financing of small and medium-size enterprises, promotion of new enterprises, development of infrastructure and other national development projects within the framework of CoM approved programmes.

In October 2012, the Cabinet of Ministers approved the *Informative Report on Establishing a Single Development Financial Institution* (DFI). The DFI is expected to implement state aid programmes in form of financial instruments that have been implemented so far by the Mortgage Bank, the Latvian Guarantee Agency, the Rural Development Fund and the Latvian Environmental Investment Fund, thus ensuring continuous implementation of existing programmes, launching new ones, at the same time being able to fulfil the existing commitments. The DFI is also expected to promote one-stop-shop agency state aid services, ensure more efficient monitoring of invested resources and optimizing costs. On April 2, 2013, the CoM decided to establish the single DFI as a new commercial company operating as a holding company, involving three institutions – the Mortgage Bank, the Latvian Guarantee Agency, and the Rural Development Fund. The Mortgage Bank will be one of the subsidiary companies of this commercial company. The Mortgage Bank is expected to operate without a credit institution licence within the single DFI, accordingly reorganising its activities. The Ministry of Finance will be the shareholder of the new commercial company. A board will be established for management of the institutions composed of representatives from the Ministry of Economics, the Ministry of Environmental Protection and Regional Development and the Ministry of Agriculture. The DFI is expected to be established by the end of 2013.

In 2013, the Mortgage Bank continues implementation of the following support 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.*

Currently, the most significant support programme in terms of the amount of loans implemented by the Mortgage Bank is the ***Support Programme for Improvement of Competitiveness of the Enterprises*** approved by the Cabinet of Ministers 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 the increased risks. Within the programme, investment loans (up to LVL 1 million) and current assets loans (up to LVL 500 thousand). In case the loan is expected to exceed LVL 350 thousand, the customer should, prior to receiving the loan at the Mortgage Bank, obtain an approval from his commercial bank if the customer has commitments at the bank. The Mortgage Bank is expected to grant loans until December 2013 to enterprises for improvement of competitiveness in the amount of LVL 210 million[1]. Within the Support Programme for Improvement of Competitiveness of the Enterprises, since its launch until the end of April 2013, a total of 409 loans in the amount of LVL 176.9 million have been granted, including loans in the amount of LVL 120.2 million have been issued. A total of 96 loans in the amount of LVL 87.4 million, including loans in the amount of LVL 46.4 million have been granted from the part of the programme co-financed by the ERDF[2]. 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 Cabinet of Ministers 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 LVL 54 thousand) and grants[3] for starting an economic activity. 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 3 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 on a condition that they establish a new enterprise for this purpose. The amount envisaged in a business plan may not exceed LVL 60 thousand, and at the same time co-financing 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 LVL 5 thousand for the implementation of the business plan.

The total funding of the programme is LVL 23 million, including funding from the ESF and the state budget – LVL 14 million, and co-financing of the Mortgage Bank in the amount of LVL 9 million. Within the total funding of the programme, LVL 16.5 million is envisaged for loans, while LVL 6 million – for grants, training, and consultations. It is planned that during implementation of the programme, 1200 start-ups will be trained by the end of 2013, while funding (loans and grants) will be granted to 800 persons.

The practical implementation of the programme was launched in August 2009. Since then, cooperation agreements with 3421 interested entrepreneurs have been concluded, 1878 clients have submitted business plans, including 971 start-up projects that have already been supported for the total loan amount of LVL 11 million. In cases of 863 projects, also grants have been awarded for the total amount of LVL 3.6 million.

Since January 2010, within the scope of the programme, training is available throughout the territory of Latvia for those programme participants whose theoretical and practical knowledge is insufficient to carry out commercial activity and to prepare a business plan[4]. Training according to the modular approach is available in such modules as basics of business activity (small business organization), management basics, legal regulation of entrepreneurship, finance management of the enterprise, accounting and taxes of economic activity, and basics of marketing. By the end of April 2013, 1300 programme participants have been trained.

In September 2009, the Cabinet of Ministers adopted regulations *On Loans for Promotion of Development of Small (Micro), and Medium-Sized Enterprises and Agricultural Service Cooperatives*. In accordance with these regulations, in February 2010, the Mortgage Bank launched implementation of the ***SME Growth Loan Programme.*** The programme is aimed at improving access for economic activity operators registered in Latvia to financing, thus promoting development of national economy. It is envisaged that until December 2013, loans for liquid assets and investments in the amount of LVL 140 million will be available within the framework of the programme for promotion of development of small (micro), and medium-sized enterprises and agricultural service cooperatives. The maximum amount for investment loans for one economic activity operator is LVL 300 thousand, farmers – LVL 2 million; the maximum loan amount for liquid assets is LVL 200 thousand. Besides, according to the conditions of the programme, the maximum amount of a loan within this programme per one micro-entrepreneur operating in service industry may not exceed LVL 30 thousand. By the end of April 2013, 764 loans in the amount of LVL 35 million, including

[1] Currently, the total amount of programme resources amounts to LVL 140.2 million. Programme funding comprises resources of the Northern Investment Bank (NIB) (LVL 70.3 million) and ERDF (LVL 43.3 million), as well as funding of the Mortgage Bank (LVL 26.6 million).

[2] Information in this case and in case of other described programmes is given according to the situation as of April 30, 2013.

[3] A grant for starting an economic activity (up to LVL 3.6 thousand, but not exceeding 35% of the loan amount); a grant for repayment of a loan up to LVL 2 thousand (but not exceeding 20% of the loan amount).

[4] Training in Riga region is provided by an association of companies "Accounting and Finance College" and "Business Complex"; in Vidzeme and Latgale regions – association of LLC "Education and Consultation Centre ABC" and LLC "Mensarius"; in Kurzeme and Zemgale regions – LLC "Stockholm School of Economics in Riga".

loans for LVL 30 million have been granted within the framework of the programme.

In May 2010, the Mortgage Bank launched the ***Programme of Liquid Assets Loans for Producers of Agricultural Produce.*** Producers of agricultural produce, as well as groups of fruit and vegetable producers may receive liquid assets loans from LVL 5 thousand up to LVL 700 thousand with a term of up to 2 years, while the maximum loan for agricultural service cooperatives can reach LVL 2 million. Guarantees of the Rural Development Fund may be attracted for these loans. By the end of April 2013, 844 loans in the amount of LVL 27.5 million, including loans in the amount of LVL 26.4 million have been granted within the framework of the programme.

In September 2011, the Cabinet of Ministers 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 LVL 5.1 million[1], including LVL 4.6 million that are earmarked for micro-loans for investments and liquid assets of up to LVL 10 thousand, as well as LVL 436 thousand – for grants to repay the loans[2]. The programme will function until June 2015. So far, micro-loans have been granted to 683 micro-enterprises in the amount of LVL 3.6 million including granted loans in the amount of LVL 3.6 million. Moreover, in case of 565 loans grants in the amount of LVL 385 thousand have been granted as well.

In May 2012, the Cabinet of Ministers approved the regulations of the ***Crediting Programme for Purchasing Agricultural Land.*** Up to LVL 100 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. The total budget of the programme is LVL 10 million and loans within the programme are going to be granted by the end of 2013. According to the Cabinet regulations, the Mortgage Bank is responsible for accepting, assessing the applications and issuing and administering the loans within the programme, while the decision on granting the loan is adopted by SJSC "Rural Development Fund" based on the bank's recommendations. Practical implementation of the programme was launched in July 2012, and 108 loans in the amount of LVL 3.6 million have been granted by the end of April 2013.

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 financing for 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 financing for development and first marketing of entrepreneurs' products. This instrument is implemented by Imprimatur Capital within the Holding Fund administered by the LGA;
- venture capital investments aimed at providing financing for 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;
- commercial loans. This instrument is implemented by SEB banka and Swedbank within the Holding Fund administered by the LGA. The programme was completed on September 26, 2012, because it begun to overlap lending activities of private commercial banks.

[1] 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 the Switzerland to an extent of 80% and the Mortgage Bank – to an extent of 20%. Yet, 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.

[2] The amount of the grant in Riga, its local governments and major cities is LVL 500, while the amount of the grant in the rest of Latvia is LVL 750.

A number of other instruments are being developed.

On March 10, 2009, the Cabinet of Ministers adopted Regulations on ***activity 2.2.1.3 "Guarantees for 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 development of commercial activities and for implementation of the EU funds projects 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 competitiveness of Latvian enterprises, to promote absorption of new markets and consolidation in the existing ones.

In April 2009, the LGA launched implementation of the activity ***Guarantees for improving enterprise competitiveness***. At the moment, the ERDF financing available within the activity is LVL 11.3 million.

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.

Guarantees issued within the framework of the ***Loan Guarantee Programme*** since launching the activity until the end of April 2013:

- the number of issued guarantees – 333 guarantees for 227 enterprises;
- the amount of issued guarantees – LVL 81.4 million;
- the amount of guaranteed loans – LVL 185.8 million.

In May 2009, the Cabinet of Ministers adopted regulations *On Short-term Export Credit* establishing coverage and beneficiaries of ***short-term export credit guarantees,*** as well as the procedure for granting guarantees and the procedure under which the guarantor covers the loss. The LGA export credit 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.

Within the framework of the ***Export Credit Guarantee Programme*** since launching the activity until the end of April 2013:

- the number of applications – 210 applications from 57 enterprises;
- the number of issued guarantees – 112 guarantees for 31 enterprises;
- the amount of guaranteed loans – LVL 7.4 million.

Most of the companies (94%) that have concluded contracts represent manufacturing (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%) and Belarus (27%), as well as countries like Kazakhstan (18%), Brazil (6%), Nigeria (3%), Ukraine (2%), Germany (2%), etc.

In August 2011, the Cabinet of Ministers 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 competitiveness of economic operators. The maximum amount of a mezzanine loan is LVL 700 thousand. The amount of a loan does not exceed 40% of the total costs of an investment project. The total amount of the loans is LVL 17.7 million.

By the end of April 2013, a total of 3 mezzanine loans in the amount of LVL 1038.3 thousand have been granted and 5 applications for mezzanine loans have been submitted. The purpose of the mezzanine loan is to issue long-term loans to Latvian merchants in addition to loans issued by banks to cover 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 guarantee, 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, until the end of April 2013, a total of 32 loan agreements for LVL 10.6 million have been concluded, while within the framework of venture capital instruments, a total of 24 different stage venture capital investment agreements in the amount of LVL 9.3 million have been concluded.

Considering the total amount of the fund (EUR 91.5 million) and the present progress of financing absorption within the activity, the LGA plans to implement additional financial instruments – growth capital fund (funds) with the expected budget in the amount of EUR 30-40 million and a microloan fund with expected budget in the amount of EUR 5 million. On May 10, 2013, a contract was signed with *Imprimatur Capital* on granting another EUR 1.8 million to the seed capital fund for the purpose of financing early stage investments up to EUR 50 thousand, particularly focusing on supporting those who complete the acceleration programme. In 2012, these financial instruments were developed and launched for growth capital funds, while implementation for both of the new instruments is expected to be finished and start providing financing to merchants in 2013.

On May 29, 2012 the Cabinet of Ministers approved implementation of a new venture capital state support programme – the ***growth capital funds*** to continue providing access for Latvian small and medium-sized enterprises to venture capital financing for business start-up and development, as well as improve competiveness 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.

The growth 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 LVL 1 million to provide financing for 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 high growth potential. The growth capital funds will be funded by 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 European Union structural funds. The total amount of investments of the growth capital funds in Latvian enterprises is expected to reach EUR 40 million (about LVL 28 million).

On September 26, 2012, a contract on establishment of the *Baltic Innovation Fund* (BIF) was signed between the Baltic States and the European Union. The available BIF funding might amount up to EUR 200 million, out of which EUR 100 million are expected to be public resources, while remaining EUR 100 million are planned to be attracted from private investors. The LGA is the contracting party from Latvia. The BIF will make it easier for Baltic micro-, small- and medium-sized enterprises wishing to expand activities in the Baltic region and internationally to access the finance, by attracting venture capital investments for one enterprise up to EUR 15 million, thus creating new jobs and promoting knowledge-based economy in the Baltic States. The BIF also promotes development of venture capital sector and attractiveness of markets in the Baltic States to investors. Latvia will provide the co-financing in the amount of EUR 20 million necessary for establishment of the BIF from the resources available to the LGA.

6.9 Innovation and New Technologies

The European Commission's annual research *Innovation Union Scoreboard 2013* has ranked Latvia 25th among 27 member states of the EU (Estonia – 14th, Lithuania – 23rd), outpacing Bulgaria and Romania in the score. It must be noted that the average rise in the indicators of the research over the last five years in Latvia is 4.4% that is considerably higher than the average indicator of the EU member states – 1.6%. According to the research, Latvia has achieved rather strong results in the area of human resources and financing and support. Lower results are achieved in the area of research environment, collaboration and business and economic effects. In 2012, compared to the previous year, Latvia has improved the indicators of innovative enterprises and intellectual property, achieving the highest percentage results in such areas as Community trademarks and Community designs.

According to the *Eurostat* data, during the time period from 2008-2010, about 29.9% of the enterprises in Latvia were innovative, while in the EU countries this indicator was 52.9 per cent.

The share of products of high technologies in total exports is rather small. In 2012, this indicator was 12.4% (in 2011 – 12.8%). The share of products of medium-high technologies in the total exports was 19.9% in 2012 (in 2011 – 20.4%); however, the total share of export of high and medium-high technology products was 32.3% of the total export structure in 2012 (in 2011 – 33.2%).

The key activities to improve the Latvian innovation system are as follows:

- developing scientific activity potential;
- establishing a long-term platform for cooperation between enterprises and scientists;
- supporting development of innovative enterprises.

In 2013, several measures to develop **scientific activity potential** are being implemented with an aim to increase the number of the employed in science and research, establish competitive scientific institutions with state-of-the-art material supply by consolidating the state scientific institutions and strengthening their infrastructure.

In 2013, the Ministry of Education and Science continues to support 5 *State Research Programmes* for cross-sectoral scientific research commissioned by the state within five priority scientific directions approved by the CoM. Implementation of the existing state research programmes will be completed in 2013. And financing in the amount of LVL 4 million has been earmarked for implementation of the programmes in 2013.

In order to improve scientific and research equipment in the leading research centres of national importance, the EU Structural Funds activity *Development of Science Infrastructure* is being implemented with the total public financing in the amount of LVL 103.7 million. Implementation of 9 projects is being supported within the first selection stage, thereby modernising and properly equipping 9 research centres of national importance for the total co-financing of the EU Structural Funds in the amount of LVL 56.3 million. In 2012, 11 projects of enterprises have been approved for the total co-financing of the EU Structural Funds in the amount of 46.3 million within the second selection stage, granting financing for development of a research infrastructure that fosters development of research in the private sector and research service rendering to the private sector.

The EU Structural Funds activity *Support to Research and Development* provides support for implementation of practical research projects in the state priority science directions. Implementation of 122 project contracts approved last year was continued in 2013 for the total EU funds financing in the amount of LVL 33.5 million. So far, 289 internationally recognized publications have been issued and 24 international patents have been applied within the projects.

The state support programmes *Competence Centres* and *Technology Transfer Contact Points* are being implemented for the purpose of **fostering long-term cooperation between enterprises and scientists** by supporting projects oriented towards commercialization of research results.

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 is planned to be implemented until 2015 and its total public funding is LVL 37.4 million and additional co-funding in the amount of LVL 22 million is expected to be attracted from the private sector. A total of 72 enterprises and 17 scientific institutions are involved in the Competence Centres.

Technology Transfer Contact Points[1] are operating at the University of Latvia, Riga Technical University, Latvia University of Agriculture, Riga Stradins University, Ventspils University College, Rezekne Higher Education Institution, Daugavpils University, and Art Academy of Latvia. The total EU structural funds financing available for the programme until 2013 constitutes LVL 1.9 million. As a result of activity of the eight Technology transfer contact points, in the time period from 2008 to the first quarter of 2013, commercialization offers of 364 research projects have been prepared, 190 patent applications for registration in Latvia and 22 international patent applications have been submitted, as well as 228 agreements on cooperation of enterprises and researchers were signed on carrying out commissioned researches, providing scientific services, and sale of industrial property or the right to use it.

Implementation of the *Cluster Programme* co-funded by the EU funds is continued. In September 2012, 11 contracts were signed with the heads of different industry clusters of national economy within the framework of the programme. The *Cluster Programme* is aimed at promoting collaboration between mutually unrelated enterprises, research, educational and other institutions to improve competiveness of sectors and enterprises, export volumes, promote innovation and new products.

The following clusters are being supported within the programme:

- Latvian Information technology cluster project *IT CEAP – Information technology cluster's embassies, academy, platforms*;
- Latvian Electrical engineering and electronics industry association project *Latvian Electrical engineering and electronics industry cluster*;
- The *Latvian Federation* of *Food* Enterprises project *Food product quality cluster*;
- Latvian Timber construction cluster project *Improvement of Exports and Competitiveness of Latvian Timber construction*;

[1] Technology transfer contact points are structural units established by higher education institutions supporting and promoting the activity of knowledge and technology transfer, gathering information upon request of entrepreneurs regarding research results, identifying the potential of higher education institutions or scientific institutes to render research or product development services according to the needs of entrepreneurs.

- Association of Mechanical Engineering and Metalworking Industries project *Development of Metal industry cluster*;
- The Association of Latvian Chemical and pharmaceutical industry project *Promoting collaboration of the Pharmacy and associated sector cluster members for the purpose of improving productivity and developing exportability by applying the combined strategic planning, cooperative logistics and marketing and specialised scientific-technological infrastructure approach*;
- Project of "Passive House Latvia" *Industrial energy efficiency cluster*;
- Project of the Ventspils High Technology Park *Development of Space technology and service industry cluster for 2012-2015*;
- Project of the Latvian Biotechnology Association *Clean technology cluster*;
- Project of the Sigulda Region Tourism Association *Development of Gauja National Park tourism cluster*;
- Project of the Association of Latvian Travel Agents and Operators *Latvian sustainable tourism cluster*.

The *Cluster Programme* involves at least 300 enterprises, 22 educational and research institutions, as well as several non-governmental organisations and local governments. The total financing of the EU Structural Funds until 2015 is LVL 3.4 million, granting maximum LVL 300 thousand to one cluster.

In order to **raise innovation capacity of enterprises**, the IDAL continues providing financing to implementation of projects approved within the first selection stage of project application of the programme *Development of New Products and Technologies* and the first and second selection stage of project application of the programme *Introduction of New Products and Technologies into Production* aimed at developing new or significantly improved products, technologies or technological processes. At the same time, the IDAL continues supporting the programme *Development of New Products and Technologies – Support for Securing Industrial Property Rights*. Within all of the three programmes, 210 contracts for the total amount of LVL 36.8 million have been concluded, and 167 projects for the total amount of LVL 21.7 million have been completed by May 2013.

Implementation of projects approved within the second selection stage of project applications in the state aid programme *High Added Valued Investments Programme* organized in 2012 for the total available EU Structural Funds financing in the amount of LVL 26 million is continued. During the second selection stage of project applications, project applications submitted by 17 enterprises for the requested amount of LVL 33.9 million were supported. At the same time, implementation of 21 projects is continued in 2013 for the total financing of LVL 45.8 million approved within the first selection stage of project application. Until May 2013, 10 projects have been completed for the total financing in the amount of LVL 22.9 million within both stages of the programme. The programme aims at increasing the potential of Latvian production enterprises to invest in knowledge or technology-based projects, including attraction of foreign investments to high added value sectors, by supporting purchase of production equipment, construction or modernization of production plants with aim to promote new jobs.

In late 2012, the IDAL started accepting project applications for an open tender within the activity *Development Programme of New Products and Technologies of Micro-, Small and Medium-Sized Enterprises*. The activity aims at promoting activities aimed at developing innovations, new products or technologies and strengthening technology transfer competiveness of micro-, small- and medium-sized enterprises. The total EU structural funds financing available within the programme is LVL 2 million. The financing per one beneficiary is LVL 10 thousand with maximum aid intensity – 60%. Two project applications for the requested amount of LVL 18 thousand have been approved until May 2013, while another 5 project applications for the requested amount of LVL 43 thousand have been submitted for consideration. The programme is expected to support at least 200 micro, small- and medium-sized enterprises, by attracting co-financing in the amount of LVL 1.2 million from the private sector.

A new aid programme *"Green" Industry Innovation* for enterprises is expected to be launched in 2013 – grants and subsidised services for development of environmentally-friendly and knowledge-intensive manufacturing and the total expected financing of the Norwegian Financial Mechanism is LVL 8.8 million. A *Green Technology Incubator* will be established within the framework of the programme providing support to enterprises for development of environmentally-friendly innovative products and technologies in the amount of LVL 1.6 million. The support within the activity will be provided until 2017.

For the purpose of educating the society and raising public awareness of innovation and entrepreneurship, as well as encouraging people to start a business and focus on creation and application of innovative ideas and solutions and further development thereof, the IDAL continues implementing the EU Structural Funds programme *Measures to Encourage Innovations and Business Start-ups*. In the first half of 2013, new entrepreneurs are being supported within the mentoring programme, and the season 2 of a business show *Firmas noslēpums (Trade*

Secret) for new entrepreneurs aired on TV. In 2013, a range of informative and educational measures will be implemented, for example, the innovative business idea competition *Idea Cup 2013,* series of seminars for authors of innovative business ideas and seminars on commercialization of technologies, as well as training course *Become an Entrepreneur in 5 days* have been organised. The total EU structural funds financing available for the programme until 2013 is LVL 2.11 million.

Currently, the draft ***Guidelines on Science, Technological Development and Innovations for 2014-2020*** are being developed. The guidelines include also the *Smart Specialization Strategy of Latvia*, which are a precondition for investments of the EU funds in research and innovation planning for 2014-2020. The *Smart Specialization Strategy* will identify the areas on which the limited resources should be focused to achieve the required critical mass, accomplish significant results and develop competitive advantages.

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 society, and of the level of individual skills and knowledge. As a result of development of information and telecommunication technologies[1] (ICT), information and knowledge are more increasingly used in work and labour relations, education and everyday life (see Box 6.19).

Box 6.19

The Role of the ICT Sector

According to the CSB data, in 2011, the share of the ICT sector in GDP constituted 3.3%. In 2011, 3370 companies operated in the ICT sector in Latvia, employing more than 18.3 thousand persons, the companies' turnover reached LVL 1.6 billion, staff costs – LVL 141 million. The value added to the ICT production reached LVL 30 million, provision of the ICT services – LVL 350 million. The foreign trade balance of the ICT was negative: -LVL 87.9 million, because imports amounting to LVL 410.6 million exceeded exports with LVL 322.7 million. It should be noted that in 2011 imports of the ICT products increased by 10.7% while exports – by 19.3% in comparison with 2010.

According to the data of the CSB survey *Computer and Internet Usage in Households,* 70% of all households had computers, but internet connection – 69% of households in 2012 (households with at least one person in the age group of 16-74 years). The best situation with accessibility to computers and internet was for households in the Riga region (computers – 77%, internet – 76%), Zemgale region (computers – 72%, internet – 71%) and in the Pieriga (vicinity of Riga) region (computers – 71%, internet – 70%), while in other regions, the situation was not as good – in the Latgale region (computers – 64%, internet – 61%), Vidzeme region (computers – 63%, internet – 62%), and Kurzeme region (computers – 60%, internet – 60%). 71% of inhabitants in the age group of 16-74 years used a computer and 70% used internet on a regular basis (at least once a week). 67% of all households had a broadband internet connection.

In 2012, 95% of all companies having 10 and more employees had computers, 91% of such companies had an internet connection, and 53% of enterprises had their own website. In 2011, 98% of companies having 10 and more employees used internet for cooperation with the public and local government institutions. In 2012, 39% of all employees of enterprises used a computer connected to the internet.

At the beginning of the academic year 2012/2013, general education schools used 33.6 thousand computers in learning process, which is about 1 computer per 6 students. 563 or 67.7% out of 831 schools with internet connection had their own homepage on internet.

Development of information society in Latvia is prescribed by the *Information Society Development Guidelines for 2006-2013* approved by the Decree of the Cabinet of Ministers of July 19, 2006. Since the next planning period of the EU structural funds is approaching, the *Draft Guidelines on Information Society Development for 2014-2020* have been developed to analyse the achieved results and define priorities for 2020.

Among the key policy results achieved is the high number of regular internet users, relatively high share of households with broadband internet connection, the high number of employees using computer and

[1] The ICT sector is defined in accordance with the OECD definition which specifies inclusion of the following economic activities (NACE 2nd rev.): production of ICT (production of electronic components; production of electronic boards; production of computers and peripheral equipment; production of communication equipment; production of consumer electronic equipment; production of magnetic and optical data carriers), ICT wholesale (wholesale of computers, their peripheral equipment and software; wholesale of electronic equipment, telecommunications equipment and its components), and provision of ICT services (software publishing; telecommunications; computer programming, consulting and other related activities; data processing, hosting and other related activities, web portals; repairs of computers, their peripheral equipment and communication equipment).

internet on a daily basis, as well as relatively high share of population using distance learning services. As regards the results not achieved, the main ones are the share of ICT sector in GDP that has not been achieved, the low number of people purchasing over the Internet and the low turnover of companies from online sales.

Box 6.20

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 interoperability of ICT-based tools and services, building trust and security of users, fast and ultrafast internet access, research and innovation, enhancing digital literacy, skills and inclusion, ICT-enabled benefits for EU society, like, climate changes, health care and ageing population. The programme areas include 101 measures, among them 31 legislative initiatives and 23 measures to be implemented in the EU Member States.

The Action Plan emphasizes the following areas as particularly supported:

– *Fast and ultrafast internet access*. In order to ensure equal access to electronic communication services all 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 Chapter "Broadband internet") and implement a European radio spectrum policy programme;
– *Enhancing digital literacy, skills and inclusion*. In order to promote development of information society by giving Latvian population an opportunity to obtain e-skills according to their education and professional activity level: to implement long-term policy for e-skills and use of digital tools and properly encourage SMEs and disadvantaged groups; to implement the 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 use of internet: to join and use the European scale *Network of Computer Emergency Response Teams* (*CERT network*); carry out a large scale attack simulation and test mitigation strategies; implement hotlines for reporting offensive or harmful online content, 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*: 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*: 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 double the annual total public spending on ICT by attracting equal private funding, and 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*: implement smart meters and agree on their additional functionalities, include specifications for total lifetime costs for all public procurement of lighting installations; improve interoperability of e-government; ensure conformity of single contact point of the *Services Directive*; 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 from June 2012 until May 2013 within the *Digital Agenda for Europe (*along with the "to-do" list updated in late 2012), the European Commission has prepared the third progress report *Digital Agenda Scoreboard*. It analyses the progress of 132 policy measures and 13 targets. Overall, measures are being implemented successfully. 70 measures have already been implemented, 54 are being implemented according to the time schedule, while 8 measures are at a risk of delay. All in all, the EU has made good progress with respect to the increase in the number of regular internet users. Internet users have purchased and used e-government services online more. The amendments to the legislation have allowed considerably reducing the prices for mobile phone roaming. Basic broadband coverage in the EU is nearly 100%, although fixed communication lines are not available everywhere. *LED lighting* is expanding rapidly. Thus, it was concluded that the targets might be achieved in all areas by 2020.

The progress report assesses the progress of the EU Member States. Latvia has made a significant progress both in broadband penetration (at least 30 Mbit/s) and ultra-fast broadband penetration (at least 100 Mbit/s), exceeding the average EU levels. However, broadband internet is mainly concentrated in cities. Also communication land-line coverage in Latvia is one of the lowest in the EU. The report also highlights the rapid progress in buying online cross-border that previously was at a very low level, and the rapid increase in the share of population using internet in communication with public administration authorities that previously was low. The report also emphasises the high use of internet outside work and home in Latvia (one of the highest in Latvia, and at the same time the low share of enterprises providing their staff with portable devices for accessing the internet (one of the lowest in the EU.

Considering the results of the previous planning period, the guidelines set the following objectives for the new planning period:

– to increase 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 internet (by increasing the number of households having access to internet);
– to ensure easy access to services in electronic environment (by increasing the share of people

and companies using internet for cooperation 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).

While solving sectoral issues in the coming years, the ministries have prepared guidelines setting out the overall goals, expected results, possible solutions, and planned financial sources, for example, the concept *Organisational Model for Management of State Information and Communication Technologies, Concept for Improvement of Public Services System, Policy Guidelines of Electronic Communication Sector of the Republic of Latvia for 2011-2016,* etc., as well as implementation programmes and action plans of these guidelines were developed, for example, the *Electronic Government Development Plan for 2011-2013*, etc.

In the course of solving issues occurring during implementation of certain information systems and looking for possibilities to cut maintenance costs of information systems and improve their security, several informative reports have been prepared, for example, *Informative report "On Proposals for Ensuring Broader Use of Electronic Signature", Informative report "On Implemented State Information Development Projects and Proposals for Development of State Information Systems", Informative report "On the Progress of Concept "Broadband Development Strategy for 2006-2012"", Informative report "On Implemented Activities in Development Projects of State Information Systems in 2012", Informative report on Implementation Progress of the Concept for Electronic Procurement System in 2012,* etc.

The NGOs of sectors also actively participate in building information society. The Latvian Information and Communications Technology Association (LIKTA) has developed the ICT Sector Priority Charter. The charter is aimed at defining clear and measurable tasks for developing information society in Latvia for the next 5 years setting 6 key directions: a society educated in the field of ICT and equipped with the e-environment infrastructure, up-to-date e-government, ICTS-based competitive business environment, active welfare (e-health, lifelong learning) and easily accessible cultural heritage. The charter was signed on June 13, 2012. The charter was signed by several ministries, the NGOs of sectors, employers' organizations, leading higher education institutions, enterprises of sectors and other organizations.

Along with Latvia's accession to the EU, the EU initiatives related to development of the information society have become binding to Latvia.

A new aim has been set in the European Commission's communication *A Digital Agenda for Europe* adopted on August 26, 2010 – in relation to the *Europe 2020 Strategy* to gain economic and social benefit from the digital single market based on fast and particularly fast internet.

On May 22, 2012, the meeting of the Cabinet of Ministers considered the *Informative report "On Coordination of Implementation of the Flagship Initiative 'A Digital Agenda for Europe' of the Europe 2020 Strategy in Latvia"*, which sets an action plan for implementation of the programme (see Box 6.20). The Ministry of Environmental Protection and Regional Development was appointed the responsible institution for coordination of the programme.

On December 18, 2012, the European Commission assessed the progress of *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 6.21).

Box 6.21

Communication of the European Commission *"Digital 'to-do' List: New Digital Priorities for 2013-2014*

On December 18, 2012, the European Commission defined an urgent 'to-do' list in digital area setting 7 main priorities for 2013-2014:
- Create a new and stable broadband regulatory environment;
- New public digital service infrastructures through Connecting Europe Facility;
- Launch Grand Coalition on Digital Skills and Jobs;
- Propose EU cyber-security strategy and Directive;
- Update EU's Copyright Framework;
- Accelerate cloud computing through public sector resources;
- Launch new electronics industrial strategy.

Yet, the *Memorandum* of *cooperation* on "*E-skills partnership*" was signed during the E-skills week in 2013 (from March 18 until 24). It was signed by the public sector, representatives of ICT sector and the NGOs in response to the European Union initiative *The Grand Coalition for digital jobs creation*.

The financing from the EU structural funds, as well as from the state and local government budget is used for development of electronic government and information society.

According to the information of the Ministry of Environmental Protection and Regional Development the total financing available for development of information systems and electronic services was LVL 99.3 million at the end of August 2012, out of which the most part was from ERDF financing. Project implementation is expected to result in providing about 280 services in electronic form and improving about 70 information systems.

According to the information summarized in late 2012 regarding 45 projects at different development stages, in 2012, 24 projects have been completed and LVL 9.6 million have been absorbed (including the ERDF funding in the amount of LVL 6.6 million).

Electronic services

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 total, information about almost 2120 services is available in the public services catalogue.

Information on e-procurement and development of e-services is available on the website of the State Regional Development Agency (*www.vraa.gov.lv*), while the 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 2012, the public and local government institutions have purchased goods in the *Electronic Procurement System* for about LVL 18.3 million (in 2011 – LVL 13.4 million thus achieving savings in the amount of about LVL 4.1 million on the account of reduced prices and administrative costs). The majority were procurements of computer technologies, medicaments, printing equipment and office supplies.

According to *Eurostat* data, in 2012, 18% of Latvian enterprises (except the financial sector) with 10 and more employees used internet to offer goods and services on the Latvian Electronic Procurement System (average in the EU – 11%) and 8% in other EU countries (average in the EU – 2%).

On April 2, 2012, issuing of the electronic identification cards (eID) was launched. 106 190 electronic identification cards have been issued till the end of year. The card is a person's identification document equal to passport, as well as the carrier of a secure e-signature (it includes 120 free of charge timestamps for signing documents with a secure electronic signature).

Broadband internet

According to the *Eurostat* data, the number of broadband internet access lines in Latvia in January 2013 reached 23.1 (the EU average – 28.8) per 100 inhabitants (a broadband internet access line is a line, in which the data transfer rate is higher or equal to 144 kbit/s). In 2012, already 98% of all internet connections ensured broadband internet speed. Besides, 43.4% of all broadband connections had speed above 30 Mbit/s (average in the EU – 14.8%) and 20% even had speed above 100 Mbit/s (average in the EU – 3.4%).

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 June 2013, Latvia with the download speed of 26.5 Mbit/s is ranked 18th and upload speed of 17.7 Mbit/s is ranked 9th among 184 world countries.

On November 9, 2011, the European Commission pursuant to the EU state support conditions approved the support scheme for LVL 71.5 million aimed at providing ultrafast broadband internet network all over Latvia.

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 financing in the amount of LVL 16.2 million and private financing in the amount of LVL 2.4 million. The project will be implemented by the SJSC "Latvia State Radio and Television Centre", establishing about 165 internet access points and installing optical cable lines of 1900 km in length, thus providing quality internet with a speed from 30 to 100 Mbit/s to the citizens and enterprises and eliminating the gap between urban and rural areas. Yet, 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 LVL 55.3 million (including the EU structural funds).

In order to identify development directions of next-generation electronic communication networks, on December 7, 2012, the Cabinet of Minister 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 unit), attracting new electronic communication companies to network development, state aid programmes for establishing local loops (last mile connections) and other measures.

On May 21, 2013, the Cabinet of Ministers approved the draft decree of the Ministry of Economics on granting the CIT allowance to LLC "Latvijas Mobilais Telefons" for implementation of the investment project "Development of Next Generation Mobile Communication Network in Less Densely Populated Territories". Within the project LLC "Latvijas Mobilais Telefons" will provide faster access to the newest generation 4G broadband internet for people in less densely populated areas through investments in the amount of LVL 29.01 million. Yet, by this decree the Ministry of Transport has been entrusted with a task to assess the planned investments and correspondingly adjust the broadband infrastructure development plans.

On June 18, 2013, the Cabinet of Ministers approved the amendments to the legislation that envisage an opportunity to locate access points to electronic communication optical networks free of charge in real property of private persons within the framework of the state support programme project *Next Generation Networks in Rural Territories*. Such a decision makes it possible not to raise the price for internet access services, thus ensuring the same prices in rural territories as in cities and towns.

Combating computer piracy

According to the data of the international software copyright protection organisation "Business Software Alliance", the level of computer piracy in Latvia in 2011 decreased by 2% and reached 54% compared to 2010. The losses to the Latvian economy caused by piracy have constituted LVL 16 million.

E-commerce

According to the *Eurostat* data, 27% of Latvian population in 2012 have ordered goods or services online (the EU average – 45%), while 13% of the Latvian population ordered goods or services online from other EU countries (the EU average – 11%).

In 2012, 23% of all enterprises (except the financial sector) with 10 and more employees had purchased goods or services over the internet or other computer networks (the EU average – 34%). However, 9% of all enterprises (except the financial sector) with 10 and more employees had sold goods or services over the internet or other computer networks in 2012 (the EU average – 16%). The turnover of e-commerce constituted 7% of the total turnover of these enterprises (the EU average – 15%).

6.11 Competition Policy and Regulation of Public Utilities

6.11.1 Competition Policy

The Competition Council (CC) is responsible for implementation of the competition policy in Latvia ensuring protection of competition by promoting reduction of administrative obstacles, liberalisation of markets and enterprise activities under conditions of strong competition, to ensure that consumers can choose various high quality goods and services. In order to raise the overall public awareness about the positive impact of fair competition on public welfare, to enable the society to identify violations of competition rights and to become intolerant with respect to such violations, the CC carries out public information measures and other measures promoting competition.

The work of the CC is performed in compliance with the *Competition Law*, other regulatory acts, and the operational plan of the institution covering such significant activity directions as:

– protection of competition;
– promotion of competition.

Protection of competition

Protection of competition comprises activities directed against the following violations of the *Competition Law*: prohibited agreements and abuse of dominant position. The CC also controls mergers of enterprises.

The priority of the CC is identification and prevention of the most severe breaches of the *Competition Law* – prohibited agreements and dominant position abuse.

The *Competition Law* defines several areas, where an agreement between market participants is prohibited, because its purpose or consequences hinder, restrict, or distort the competition, including – direct or indirect price or tariff fixing in any manner, or conditions for formation thereof, as well as exchange of information regarding prices or sales conditions. The CC initiated an investigation of a possible breach of this particular norm against three largest fuel retailers in Latvia – LLC "Statoil Fuel&Retail Latvia", LLC "Neste Latvija" and LLC "Lukoil Baltija R" (see Box 6.22).

Box 6.22

The CC Completes Fuel Market Inquiry

On March 18, 2013, the CC completed fuel retail market inquiry – within the inquiry the CC has carried out the most comprehensive data analysis since its inception, leading to a conclusion that fuel activities of retailers complies with the market conditions and there is no prohibited agreement between them.

In spring 2010, the CC initiated a case of possible prohibited agreement between the three largest fuel retailers in Latvia – LLC "Statoil Fuel&Retail Latvia", LLC "Neste Latvija", and LLC "Lukoil Baltija R". Concerns about a possible prohibited agreement were raised by the implemented price changes made by the enterprises in similar time periods and for a similar interval – although such behaviour itself is not a violation, possible parallel pricing that eliminates competition and misleads consumers was investigated within the case.

During the investigation, the CC performed econometric analysis of costs, pricing principles and price fluctuations, as well as cyber technical analysis of data obtained from the enterprises by a court decree during an unannounced inspection. The analysis allowed the CC to conclude that the large fuel retailers are characterised by mutual observation and parallel behaviour or what is known as intelligent adjustment; however, the enterprises have fixed prices independently and they are competing with each other. Thus, the prices have been affected by the balance of market forces – demand and supply – and not by an agreement on the price level between competing enterprises.

Considering the important role of fuel prices in expenses of households and enterprises, the CC will continue monitoring the processes in this market. In case the CC in future detects that LLC "Statoil Fuel&Retail Latvia", LLC "Neste Latvija" and LLC "Lukoil Baltija R" have agreed on parallel behaviour in price fixing or otherwise agreed on the prices, the enterprises will be fined for a prohibited agreement.

The *Competition Law* stipulates that any market participant in a dominant position is prohibited to abuse it in any way within the territory of Latvia. Abuse of the dominant position may be also direct or indirect imposition or application of unfair purchase or sales price or other unfair trade conditions. The CC detected a breach of this particular norm in the activities of the Copyright and Communication Consulting Agency/Latvian Authors Association (AKKA/LAA) (see Box 6.23).

Box 6.23

The CC Repeatedly Fines the AKKA/LAA for Excessive Pricing

On April 2, 2013, the CC adopted a decision to fine the collective copyright management association AKKA/LAA for abuse of monopoly position by imposing a fine in the amount of LVL 45646. The AKKA/LAA imposed excessive tariffs on the small- and medium-sized stores and service providers for music airplay in customer and visitor areas; these tariffs were considerably higher than similar tariffs imposed not only in Lithuania and Estonia but also in the majority of the EU Member States.

The small- and medium-sized Latvian enterprises were forced to pay for music airplay in customer and visitor areas of less than 300 m² twice as much as similar enterprises in Lithuania and Estonia which are the countries of comparable level of economy and welfare as Latvia. In Estonia, the tariffs are substantially lower for all enterprises, while in Lithuania, enterprises with the total area below 850 m² pay less but larger enterprises pay a slightly higher tariff than in Latvia.

Yet, comparing the average tariff level in the EU Member States, Latvian enterprises depending on their size have to pay by 50-100% more for music airplay. The CC compared the purchasing power parity and GDP index of the EU Member States, thus enabling objective comparison of countries with a considerably different income level.

The AKKA/LAA imposed particularly unfair tariffs on the small- and medium-sized enterprises, thus putting them in a very unequal position against the larger competitors. Since traders include their costs in the prices for the goods for sale, the excessive tariffs actually caused additional costs for consumers.

The AKKA/LAA has exclusive rights to issue a permit for music airplay in customer and visitor areas to traders and service providers. Since the AKKA/LAA represents both Latvian and foreign authors and it has reduced the competitiveness of Latvian enterprises in foreign markets by imposing its excessive tariffs, the CC in its decision has concluded that the AKKA/LAA has violated both the Latvian Competition Law and the Treaty on the Functioning of the EU.

The CC first detected that the AKKA/LAA has abused its market power in late 2008. At that time, the CC concluded that the annual charge for public performance of musical works in Latvia is six times higher than that of Lithuania and Estonia, and recognized the charging scheme applied by the AKKA/LAA based on the division of music users according to the geographical principle as unjustified and unreasonable. The AKKA/LAA changed the charging scheme pursuant to the CC decision.

The CC carries out merger control of market participants, if the total turnover of the merging participants in the preceding financial year has been at least LVL 25 million or if their total market share in the particular market exceeds 40%. The *Competition Law* stipulates that before the merger, these market participants have to submit a notification about the planned operation to the Competition Council.

The CC has the right to prohibit a merger by a decision if that merger creates or strengthens dominant position. A merger may be prohibited also if the merger substantially reduces competition in any particular market. If the planned merger causes no significant impact, the CC adopts a permitting decision on the merger. Yet, in order to prevent negative consequences regarding competition in the market, the

CC may permit the merger by imposing binding conditions on the merger participants. Such CC permits on conditions were granted to LLC "BALTCOM TV" and LLC "IZZI COM" (see Box 6.24).

Box 6.24

The CC Permits Merger of Baltcom and Izzi on Binding Conditions

On April 8, 2013, the CC adopted a decision to permit a merger of LLC "BALTCOM TV" and LLC "IZZI COM". However, if these enterprises are selected as winners of the planned public tender for terrestrial transmission in the coming months, they will have to prepare conditions to be observed in order to prevent damage to competition and submit them to the CC.

Having assessed the impact of the merger on the market, the CC concluded that it would cause significant damage to competition only if the merging enterprise won the tender for provision of terrestrial transmission of pay television services currently provided by LLC "Lattelecom".

Thus, in order to protect the market and consumer interests, the CC will impose restrictions on the merger only in case of changes in the competition situation as a result of the tender.

Having evaluated the current competition situation, the CC concluded that the planned merger will have an impact on pay television service market in Riga, Jēkabpils, Ludza, and Balvi, while the overall impact on voice telephony market in Latvia on internet, data transmission market and wholesale of pay television channels will be insignificant.

The CC in its decision states that there are a number of alternative service providers on the pay television service market. One of the main alternatives is terrestrial transmission of pay television since it is going to cover the entire territory of Latvia and thus is the closest alternative for any customer willing to receive the pay television services but has no other options. Satellite television may be an alternative to the terrestrial television if there is no access to cable television; however, it is slightly different in terms of content and prices and not all places are suitable for installation of the necessary equipment. Nevertheless, online television provided by LLC "Lattelecom" is a new, important and perspective alternative. In future, online television is expected to be provided also by mobile telephone operators.

The CC believes that in the short-term and in the long-term the positions of LLC "Lattelecom" and the merging market participant will gradually become even; however, it will depend on the ability of the market participants to adapt to the changing market situation, to offer innovations, better service quality, as well as it will depend on the results of the tender for terrestrial transmission.

Competition promotion

This direction of activities includes market supervision and research, as well as development of the competition culture in the society. The task of the CC is to focus on gathering and analysing comprehensive information on competition situation in various markets, promotion of competition in markets with no competition or insufficient competition, improvement of public awareness about the positive impact of competition on public welfare.

By obtaining information on specific markets within the framework of market supervision, the CC analyses the competition situation, and if necessary, develops and submits proposals for improvement of the competition situation to responsible authorities, as well as checks the supervised markets for violations of the *Competition Law*.

One of such supervisions was carried out in the autogas market. Within the framework thereof the CC assessed competition in autogas wholesale and retail trade markets, as well as in related market – autogas equipment installation market. The supervision allowed to draw a conclusion that both autogas wholesale market and retail trade markets are highly concentrated and should be considered as oligopoly and in some cases even monopoly markets, thus indicating high possible competition risks. Yet, no information on prima facie evidence of possible violations of the *Competition Law* in the activities of the market participants was obtained within the supervision. No possible risks that restrict or distort competition were identified in the autogas equipment installation market (in strong competition environment in the market).

In order to survey knowledge and opinion of entrepreneurs concerning the competition policy and its implementation, the CC is carrying out polling of enterprises, associations and lawyer offices. Overall, entrepreneurs have approved the work done by the CC; however, they emphasized the need for further information about the competition law, specific decisions of the CC and related court rulings. Entrepreneurs and lawyer offices in particular also provided proposals for improvement of the institution's work, including, the need to strengthen the independence of the institution and involvement of industry experts in investigation of violations. The survey results are going to be used to improve the CC performance and mutual cooperation with market participants and the public.

In order to assess the need to establish local government companies and their impact on competition, a study on competition in the market and competition situation after local governments have involved in commercial activities was conducted by the CC order. The study allowed drawing a conclusion that local governments are tended to get involved in markets financed by the EU. Special state regulation is implemented for development of these markets, for example, waste management and production of renewable energy resources. Local governments usually get involved in such fields as water management services, steam supply and conditioning services, real property management, heat care services and waste collection, while the uncommon fields are undertaking and related services, distilling of spirits, restaurant services, development of television programmes, development of construction projects, vehicle service, production and sale of electricity, publishing of journals and periodicals and other fields. The study *Activities of local government companies in goods and service markets and the impact assessment of on competition environment* is available on the homepage of the CC (*http://www.kp.gov.lv/documents/18f2763ffb0b78297523649c32b52774a1c99857*).

In order to raise awareness of competition policy issues, the CC participated in the meeting of executive directors of Latvian local governments where it gave a presentation and invited the audience to discuss the current issues of the competition law in the context of local government activities. Among the main topics of the discussion are waste management and involvements of local governments in business, as well as the need to develop business activities according to the social responsibility principles. The issues related to local food procurements organised by local governments were also discussed, as well as possibilities to identify and prevent cartel agreements between procurement applicants were addressed.

In order to inform owners, managers, financial directors, business development managers, lawyers, marketing directors of enterprises, the CC participated in the seminar *Restrictions of Business Transactions and Perspectives of the Competition Law* organised by Deloitte Latvia where it addressed the abuse of dominant position in retail trade. The CC shared its vision of competition within the reimbursement system of pharmaceutical expenditure in the conference *Compensated Medications 2013-2020* organised by *BIG event*. Meanwhile, in seminar for Balvi local government representatives the CC provided information about the signs of possible prohibited agreement between applicants of a public procurement.

Since early 2013 a new structural unit has been launched in the CC. Its main aim is targeted and focused on combating of cartels by detecting and preventing such violations and providing information and educating enterprises and budget institutions all across Latvia. Prohibited agreements between competitors or cartels are a particularly severe violation of the Competition Law that distorts the market and harms consumers by an artificial rise in prices, reducing the choice or quality of goods and limiting the possibilities of fair enterprises to develop. Therefore, combating these violations still is a priority of the CC.

For the purpose of finding ways to help enterprises to better understand and exercise their competition rights, as well as give an opportunity to find out the latest news of competition surveillance in Latvia and Europe, the CC has prepared and will further regularly publish a newsletter *Competition Close-Up*.

6.11.2 Regulation of Public Utilities

The Public Utilities Regulation Commission (Commission) is a multi-sector regulator implementing regulatory functions in the sectors of energy, electronic communications, postal services and railway transport, water management and municipal waste management. The task of the Commission is to ensure the opportunity to receive uninterrupted and safe services to all users at economically reasonable prices and to ensure the possibility for enterprises providing public utilities to develop profitably according to the economic situation.

The Commission adopts its decisions independently and it is not subject to decisions of the government or other public authorities. The Commission Board members are appointed by the Saeima, and only a court may declare decisions taken by the Commission substantively unlawful and cancel them. Activities of the Commission are financed from the state duty paid by enterprises for regulation of public utilities on the basis of the turnover of the regulated public utilities.

Functions of the Commission include governing the regulated sectors and enterprises that operate therein, protecting the interests of users, and fostering development of public utility providers, setting tariff calculation methodologies and approving tariffs in accordance with the laws governing each sector, issuing licenses and registering electronic communications and mailing service entrepreneurs, promoting competition in the regulated sectors, settlement of disputes, and supervising the compliance of the provided services with license or general authorisation conditions and set quality requirements.

Regional structural units of the Commission have been established and are now operating in Latgale, Kurzeme, and Vidzeme regions, located respectively in Daugavpils, Saldus, and Cēsis.

According to the amendments to the law *On Regulators of Public Utilities* adopted by the Saeima on July 14, 2012 the Commission is institutionally and functionally independent, lawful, self-governing subject of public law and may independently use its budget under the law pursuant to the requirements of the European Union legislation.

The amendments to the Law envisage more efficient procedure for considering disputes arising out of public utilities rendering relationships, defining the consideration process of disputes and the procedure for appealing the Commission's decision more precisely.

At the same time, amendments to the law more precisely define the functions of the Commission in the field of monitoring power supply enterprises, the procedure for assessing tariffs, for calculating and paying the state fee for public services, the procedure for adopting decisions of the Commission and restrictions imposed on the Commission's Board members.

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, 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 May 28, 2013. Successful implementation thereof depends directly on implementation of the Guidelines on National Industrial Policy which outlines the directions of the necessary structural reforms.*

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 favourable environment for investments in Latvia and 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. Successful implementation of the guidelines requires a single and dynamic cooperation model for all parties involving public and local government authorities and private sector and scientific institutions alike.

Particular measures in these directions of action are implemented pursuant to the *Action Plan for Export Promotion of Latvian Goods and Services and Attraction of Foreign Investment for 2013-2019,* which is added to the guidelines document.

Attraction of Foreign Direct Investments

The FDI attraction policy is aimed at improving competitiveness of Latvia as 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[1] industries, particularly medium-high and high technology industries[2].

FDI play an important role in promotion of further economic growth in Latvia both through acquisition of industrial and management skills and creation of 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 meets the perspective cooperation possibilities of Latvia, as well as countries that ensure largest global investment outflows (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, 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 research institutions.

[1] Foreign demand-oriented industries – agriculture, mining and quarrying, manufacturing, transport and storage, information and communication services

[2] 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 and ammunition, electrical equipment, machinery and work equipment, motor vehicles, ships and boats, railway and other transport (except aircraft) and repair and installation of machinery and equipment (NACE Rev. 2. 20, 25.4, 27, 28, 29, 30 (except 30.3), 33)

The Coordination Council for Large and Strategically Important Investment Projects established in 2010 ensures coordinated interagency cooperation for successful implementation of investment projects; the Council is composed of the Ministers of Economics, Transport, Finance, Foreign Affairs, Environment, Agriculture, Regional Development and Local Governments, Education and Science, as well as the involved representatives from state and municipal institutions, infrastructural companies, non-governmental organizations, and other experts.

The Council meetings deal with issues of investment attraction strategy and activities to be carried out; identify problematic issues that hinder the progress of investment projects, for example, improvement of electricity connection and its quality in industrial areas, as well as instructions to solve such issues have been assigned to the responsible institutions thus ensuring successful implementation of investments projects.

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 establishment of shared service centres. Further information on attracted foreign direct investments is provided in Section 4.3.3 of the Report.

Measures to promote investments

With the present tax stimuli, in March 2012, in order to promote investments and develop a business-friendly environment in Latvia, the Cabinet of Ministers approved a new support programme co-financed by the EU Structural Funds for projects creating new jobs aimed at increasing the number of well-paid jobs and growth of added value and export. Currently, the projects are being evaluated. In order to promote development of manufacturing companies, on May 21, 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""* which is a new support programme co-financed by the EU structural funds for construction or reconstruction of industrial premises. At the moment, the available funding amounts to LVL 12.6 million, thus allowing to support at least 27 manufacturing companies until 2015, while over LVL 200 million are planned to be allocated to development of industrial areas in the next period of the structural funds. Support for construction or reconstruction of industrial premises will be provided to enterprises and port authorities planning to construct, renovate or reconstruct industrial buildings or structures, as well as lease the newly constructed, renovated or reconstructed industrial building to at least three mutually unrelated micro-, small- or medium-sized manufacturing enterprises for at least ten years, which will create at least 50 new jobs. LVL 6.6 million of the available funding is the ERDF funding, while the government budget overcommitment funding constitutes LVL 6 million. The maximum ERDF co-funding of the total eligible project costs available for the project implementation is 50%, the minimum ERDF co-funding is unlimited, while the maximum amount – one million lats. The projects have to be implemented in a city territory or within 10 km from its borders with the number of permanent residents over 20 thousand, except Riga. Acceptance of project applications will begin in mid-summer of 2013, the programme will be administered by IDAL.

In order to promote large investment attraction to Latvia, the amendments to the *Law On Corporate Income Tax* came into force on January 1, 2011 envisaging reintroduction of **corporate income tax rebate** for initial long-term investments made within the scope of eligible investment projects that ensure the commencement of a new activity profile or modernisation or expansion of the current activity, which includes manufacture of new products, changes in the current activity, transferring from the manufacture of one type of products to the manufacture of another type of products or from the provision of one type of services to the provision of another type of services, or essential changes in general activity processes. The abovementioned tax rebate is classified as state support and valid until December 31, 2013. It is applied to industries with high export potential or significant contribution to increase in value added and exports pursuant to the national medium-term priorities defined in 2009.

According to Section 17.^{2} of the *Law On Corporate Income Tax*, a taxpayer has the right to apply a tax rebate to initial long-term investments made within the scope of a supported investment project in the amount of 25% of the total initial amount of long-term investments up to LVL 35 million and in the amount of 15% of the total initial amount of long-term investments for the part, which exceeds LVL 35 million.

By June 1, 2013, the CoM has supported 9 eligible investment projects for the total investment amount of LVL 97.11 million, which might reduce the future corporate income tax payable to the government budget by LVL 22.23 million.

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.

In 2012, IDAL has provided over 2000 consultations on export-related issues including consultations on foreign markets, and search for business partners, 34 informative seminars (including seminars organized by the Enterprise Europe Network) about foreign markets and foreign trade related issues have been organized, as well as 22 sectoral market reports have been prepared. Furthermore, 33 trade missions have been organized (the number of participating entrepreneurs – 305) to China, Gulf countries, Sweden, Poland, USA and other countries, and 63 individual visits to potential cooperation partners abroad. Identification and implementation of export and investment projects is being carried out as well.

In the 1st quarter of 2013, IDAL has provided consultations on foreign markets and search for business partners to more than 600 companies, organized 5 trade mission (the number of participating entrepreneurs – 106) including business delegations to Ukraine within the framework of the visit of the President of the Republic of Latvia and to Moldova within the framework of the visit of the Prime Minister of the Republic of Latvia.

In 2012, IDAL has arranged national stands of Latvian enterprises in 16 international industry (manufacturing, IT, metal processing and automotive and construction, etc.) exhibitions abroad (the number of participating entrepreneurs – 111). In 2013, IDAL plans to arrange national stands of Latvian enterprises in 16 international industry (manufacturing, IT, metal processing and automotive, design, food, construction, etc.) exhibitions abroad. In the 1st quarter of 2013, IDAL has organized national stands in the following international exhibitions: *Ecobuild 2013*, Great Britain (construction), *Cebit 2013* in Germany (information and communication technologies), *Norsk Hytteliv*, in Norway (wooden construction). A total of 23 Latvian enterprises participated in the stands.

Essential contribution to the export promotion of Latvian merchants and attraction of foreign investments is rendered by ten Foreign Economic Representative Offices of Latvia located in Germany, Great Britain, Sweden, France, Russia, the Netherlands, Denmark, Norway, Japan, Poland, Lithuania, Ukraine, China, and Belarus.

The representations provide support to Latvian companies in developing and keeping business contacts, implementing external marketing measures, and provide information about requirements of particular foreign markets. Services of the Foreign Economic Representative Offices of Latvia and IDAL are provided to the entrepreneurs according to the one-stop agency principle: when looking for business partners abroad, entrepreneurs can access a stable, fast and capable support system: *merchant-IDAL-the Representative Office*. Thus, the representative offices provide individual business visits of entrepreneurs, support participation of enterprises in international exhibitions abroad, process export requests/projects, as well as process consultation requests/information applications in the field of foreign investment attraction.

In 2012, the Representations have organized 51 individual business visits, supported participation of enterprises in 28 international exhibitions abroad, processed 566 export requests/projects in fields of construction, metal processing, wood processing, trade, pharmacy and other sectors. 166 consultations have been provided/applications processed in the field of foreign investment attraction.

In the 1st quarter of 2013, the Representations have already processed 288 export requests/projects and 25 foreign company visits have been hosted in Latvia.

In April 2013, a wide range of international marketing measures *Appreciate Latvia (Оцени Латвию)* were implemented in Russia, Moscow.

On May 15, 2012, the Cabinet of Ministers approved establishment of Council for Coordination of Foreign Economic Policy run by the Minister for Foreign Affairs. The Council is composed of the Ministers for Economics, Transport, Agriculture, the President and representatives for the office of the Prime Minister, as well as the director of the Investment and Development Agency of Latvia, director general of the Employer's Confederation of Latvia and the Chairman of the Board of the Latvian Chamber of Commerce and Industry. The main objective of the established council is to ensure coordinated cooperation between public institutions and entrepreneurs in developing and implementing successful foreign policy to improve competiveness of the Latvian economy and strengthen exportability.

Activity 2.3.1.1 ***Access to International Trade Markets*** 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. By June 1, 2013, a total of 712 new cooperation agreements have been concluded with enterprises on participation in international marketing measures within the activity.

In order to promote the increase of the total export volume of enterprises (especially to countries with a high risk degree) and expand the export markets (CIS region, rapidly growing economies, etc.), as well as to strengthen the positions in existing export markets, the short-term export credit guarantees are available and described in more detail in Chapter 6.8 of the Report.

6.13 Consumer Rights Protection and Market Surveillance

The **Consumer Rights Protection Centre** (CRPC) is the main and coordinating institution in the field of supervision of laws and regulations regarding the protection of consumer rights, and its operations are aimed at ensuring 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.

As regards supervision of consumer rights, the CRPC in 2012 has provided 35 007 consultations to consumers and legal entities. When requesting a consultation, consumers most often have been interested in issues related to their rights if they have purchased goods and services incompliant with contract provisions, as well as failure to observe the principle of legal equality of the contracting parties. Meanwhile, enterprises most often have been interested in various issues related to market supervision and unfair commercial practice, advertising, and e-commerce.

In 2012, the CRPC has received 2151 consumer complaints and applications. Comparing to 2011, the number of complaints has slightly increased – by 2%, which might be explained by the stable economic activity of the population. Most often consumers have filed complaints concerning goods and services incompliant with contract provisions, and failure to observe the principle of legal equality of the contracting parties. Out of all received complaints, footwear quality, mobile phones and electronic goods. In the field of services, the majority of complaints have been about aviation, electronic communication services and rent/public utilities services. In 2012, the majority of complaints concerning the failure to observe the principle of legal equality of the contracting parties are related to consumer credit contracts and behaviour of creditors. The content dynamics of the complaints filed over the past few years have changed substantially. However, as the popularity of non-banking consumer credit services and the interest of different social groups in the current sector-specific issues increased, the share of consumer complaints concerning non-baking consumer credit services increased significantly as well.

Within protection of consumers' economic interests, the CRPC in 2012 has implemented surveillance activities in such areas as protection of collective interests of consumers in the field of electronic communication services, consumer crediting, vehicle rental services, supervision of commercial practice applied outside regular point of sales or place of service provision, supervision of commercial practice in the essential oils sector, supervision of commercial practice in the outdoor advertising sector, supervision of security guarantees issued by complex tourism service providers to consumers, and supervision of contract provisions. Considering the increasing number of complaints and requests for consultations, the observance of consumer rights in collective online shopping portals is set as a priority.

In the field of protection of collective interests of consumers and supervision of contracts, the surveillance project of electronic communication services completed by the CRPC in 2012 was a success story. After investigating and identifying the main issues in electronic communication service contracts and implemented commercial practice, in order to improve the situation and promote a common understanding of the applicable requirements, the CRPC has developed guidelines for electronic communication service providers. A positive tendency has been observed during the project implementation showing that enterprises are tended to respond to the CRPC requests to voluntarily eliminate nonconformities with the legal requirements: out of all requests made in 43 cases, approximately 75% of the enterprises have submitted a written commitment to the CRPC not to apply the unfair contract provisions or make voluntary steps to prevent unfair commercial practice. As the results of investigations show, the number of violations in the electronic communication service market is tended to decrease.

In 2013, the CRPC has set such priority areas as supervision of commercial practice related to online plane ticket pricing, sale of food supplements, and supervision of commercial practice in consumer crediting, vehicle rental services, driving school services and commercial practice in the field of price comparison websites, collective online shopping, supervision of commercial practice in the essential oils sector and supervision of security guarantees issued by complex tourism service providers to consumers, and supervision of contract provisions, as well as supervision of price indication for goods and services in relation to introduction of the euro. In addition to implementation of surveillance projects, considering the changes in the regulatory framework, the licensing process of out-of-court debt recovery service providers was launched in early 2013.

Box 6.25

Improvement of the Legal Framework

For the purpose of improving consumer rights protection in purchase and service contracts signed between enterprises and consumers, the Ministry of Economics has prepared *amendments to the Consumer Rights Protection Law*, and submitted to the CM for approval on May 22, 2013. The draft law has been prepared as part of transposition of the rules laid down in the *Directive 2011/83/EU* of the European Parliament and of the Council of 25 October 2011 on consumer rights into the laws of Latvia. The draft law specifies the effective rules in respect of what type of contracts are distance contracts and contracts entered into outside regular place of business or professional activities, as well as clearly lays down the rights and obligations of the parties when consumer exercises the right of refusal, i.e. withdraws from the contract within 14 days. For the purpose of solving issues identified in practical application of the *Consumer Rights Protection Law,* the draft law envisages improved requirements for responsibility of seller and service provider for noncompliant products or services, claims that consumer might forward to seller or service provider in case of noncompliant product or service, as well as unfair contract provisions. Among other things, the draft law envisages amendments in respect to consumer crediting contracts for enterprises to avoid granting credits without assessing sufficiently consumer's ability to pay.

In relation to implementation of the measures to introduce the euro, on May 7, 2013, the CM approved the *Procedures for Displaying Prices of Products and Services* developed based on Article 13 (3) of the *Law on the Procedure for Introduction of the Euro* envisaging the procedure for dual price display. In the period of dual price display, namely from October 1, 2013 to June 30, 2014, prices for goods and services must be indicated in both lats and euro. The procedure has been developed in order to give consumers a possibility to monitor prices for goods and services and get used to the new currency, as well as to let the public prepare itself for the change of currency in good time and make it easier to compare the value of a good in both currencies. Prices for goods and services will be displayed in both currencies according to the official exchange rates of the lat and the euro and strictly based on mathematical principles. Such a requirement for price display in both currencies is set for the purpose of ensuring protection of consumer rights and to help consumers make an information-based and economically reasonable decision.

On November 8, 2012, the *Saeima* adopted the *Law on Out-Of-Court Debt Recovery* aimed at protecting natural entities from aggressive debt recovery practices, encourage voluntary debt payment, as well as making it possible for potential creditors to assess the ability of a particular person to fulfil commitments. According to the assignment laid down in the law, the *Regulations Regarding the Procedure for Licensing Debt Recovery Service Providers* and the *Regulations Regarding the Acceptable Amount of Debt Recovery Costs and Non-recoverable Costs* developed by the Ministry of Economics came into force on January 29, 2013. The Cabinet *Regulations Regarding the Procedure for Licensing Debt Recovery Service Providers* lay down the procedure by which a special permit (licence) for the provision of debt recovery services shall be issued, re-registered, suspended and cancelled and determine the amount of the state fee for the issue and re-registration of a special permit (licence), as well as the requirements for a debt recovery service provider to receive a special permit (licence). The *Regulations Regarding the Acceptable Amount of Debt Recovery Costs and Non-recoverable Costs* stipulate that an out-of-court debt recovery service provider is entitled to require reimbursement of the costs related to the debt recovery; however, the total cost shall not exceed LVL 12.

On April 23, 2013, the EU Council of Ministers approved the proposal for the *Directive of the European Parliament and of the Council on Alternative Dispute Resolution* (ADR) and the Regulation of the *European Parliament and of the Council on Online Dispute Resolution (ODR) for consumers*. Both laws have been developed to strengthen consumers' and entrepreneurs' confidence in cross-border transactions in the EU single market. The directive imposes an obligation on the EU member states to ensure conformity of the ADR structure to such quality criteria as professionalism, impartiality, transparency, efficiency and fairness, as well as an obligation of enterprises to inform consumers about the ADR structure that can solve a potential contractual dispute between them. The regulation on consumer ODR envisages developing a European scale online platform as a single access point for consumers and entrepreneurs to solve contractual disputes by automatic forwarding of the consumer's complaint to the competent ADR structure. The EU member states must transpose the requirements of both laws within two years.

In 2012, discussions continued regarding the proposal for the *Directive of the European Parliament and of the Council on consumer credit agreements relating to immovable property* approved by the European Commission on March 31, 2011. The Draft Directive envisages setting requirements for advertising mortgage crediting services, information to be provided prior to signing the contract, verifying consumer's creditworthiness, calculation of the annual percentage 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 requirements for competence of the given service providers. After reaching an agreement on the draft directive in the European Council, discussions on the European Parliament's comments has been launched in summer 2012 that will continue also in 2013.

The ***European Consumer Centre*** (ECC Latvia) continues providing support and information to consumers in case of unsuccessful EU cross-border purchases. 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. Consumers in 2012 have most often turned to the ECC Latvia concerning cross-border issues in relation to aviation services, which is about 37% of the total number of filed complaints and rendered consultations, while online shopping is the second most topical issue.

In 2012, the CRPC in the field of **market surveillance** has implemented surveillance projects for such product groups as vehicle components, personal protective equipment, toys, and machinery (lawn mowers), construction products, general safety of goods and services (food imitation products, candles, oil lamps, trampolines, baby walking frames (walkers), highchairs for children and office supplies) and electric goods.

Extraordinary supervisory activities of dangerous equipment have been carried out in relation to the accident at the skiing slope *"City Slope"* of LLC "Olimpiskais centrs "SIGULDA"" in early 2012, in which an 11-year-old skier was injured. The investigation of the accident lead to a conclusion that additional inspections are required in other slopes as well, thus, 5 other skiing complexes were inspected during the reporting period. A number of problems were detected in the field of ski lift operations, as well as general safety of the service. In order to improve the situation, the CRPC developed the *Ski Slope Safety Guidelines* by involving experts from the Ski Slope Association of Latvia, as well as the *Latvian Association* of *Ski and Snowboard Instructors*. After implementing the guidelines, the CRPC inspected 15 ski slopes and concluded that all of the inspected slopes are in compliance with the instructions for use and the first aid equipment. Significant improvements have been observed in the field of warning consumers about risks and the use of safety equipment by placing safety upholstery, nets and fences.

In 2013, the CRPC in the field of **market surveillance** has identified such priority directions as safety and conformity improvement of services, supervision of dangerous equipment and state metrological in such fields as safety and conformity improvement of pressure equipment, construction products, electric goods, toys, personal protective equipment and machinery general safety of goods and services, dangerous equipment is planned to be performed, along with conformity surveillance projects of measurement equipment market and the content amount and labelling of pre-packed goods in their manufacturing enterprises. A price surveillance project is also going to be implemented for the purpose of supervising the procedure of price indication and price indication in relation to introduction of the euro.

In the field of **state metrological supervision**, the CRPC has assessed conformity of measurement equipment to the normative requirements at the place of use in 76 manufacturing, trading, and service rendering enterprises in 2012. A total of 3075 units of measurement equipment (including non-automatic weighing instruments, fuel filling equipment) were subjected to metrological monitoring. So far, the control measures of pre-packed goods included in the CRPC action plan have been implemented by carrying out conformity control of the content amount and labelling of pre-packed goods in manufacturing and wholesale enterprises.

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 base of the laws and regulations in accordance with the European Union requirements, taking into account the needs of the national market and economy, hence ensuring compliance of the products and services, and fostering better competitiveness of the 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 acts.

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 the 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 informative 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 introduction of quality management, environmental quality and other voluntary management systems in enterprises in order to ensure manufacturing of high-quality products, service rendering, 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.

The offices Standardization Bureau, Latvian National Accreditation Bureau, and Metrology Bureau forming the Limited Liability Company with share capital "Centre of Standardization, Accreditation and Metrology" under the supervision of the Ministry of Economics, carry out the functions and tasks of national standardization, accreditation, and metrology institutions.

6.14.2 Accreditation, Standardization, Metrology

Since July 1, 2009, the Limited Liability Company "Centre of Standardization, Accreditation and Metrology" has been carrying out the tasks in the field of standardization, accreditation, and metrology as stipulated in the *Standardization Law*, *Law on Conformity Assessment*, *Law on Uniformity of Measurements*, as well as in other related laws.

Standardization

The Standardization Bureau (LVS) of LLC "Standardization, Accreditation, and Metrology Centre" in capacity of the national standardization organization, in compliance with the *Standardization Law*, manages and coordinates 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). LVS is also a corresponding member of the International Organization for Standardization (ISO) and 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.

Until May 1, 2013, 35 937 standardization documents have been registered in the LVS, including 31 451 European standards adapted to the status of a Latvian standard. In 4 months of 2013, 51 standardization technical committees and 4 working groups coordinated by the LVS have adapted 561 European standards, 31 mandatory applicable standards and Eurocodes have been translated into Latvian. Standardization information services have been provided to 1236 legal and physical persons.

Continuing the improvement of the electronic sales system of standards, more than 73% of all standards have been sold via e-shop.

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* – every month to 2171 regular customers in fields of their interest.

In order to link legislation with standards and make the information search easier, a contract has been signed with the official journal of RL *Latvian Herald (Latvijas Vēstnesis)* on exchange of information and interlinking the portal www.likumi.lv and the website of the Standardization Bureau www.lvs.lv, as well as information on the applicable standards regarding Latvian legislation has been updated.

The LVS continues development of technical infrastructure to provide entrepreneurs with an easy access to standardization information and to promote application of more European and international standards to entrepreneurship.

Accreditation

The Latvian National Accreditation Bureau (LNAB), which is a structural unit of LLC "Standardization, Accreditation, and Metrology Centre", ensures the activity of the national accreditation system. In compliance with *Regulation (EC) No 765/2008 of the European Parliament and of the*

Council, LNAB acts in capacity of the national accreditation institution and in this capacity it is announced (notified) to the European Commission.

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. Many of the institutions are expanding their field of activities. At the moment, the status of accreditation is maintained for 243 accredited institutions. New accreditations have been awarded to two laboratories in the Russian Federation, while accreditation is maintained for one laboratory in Kazakhstan and one laboratory in Azerbaijan. The conformity of one laboratory is maintained in compliance with the *Principles of Good Laboratory Practice*. One institution has been accredited according to the requirements of the environmental management and audit scheme (EMAS). LNAB continues providing accreditation services in Ukraine, where one institution for personnel certification has been accredited. Information about the accredited institutions is available on the website of the LNAB *www.latak.lv*.

LNAB has approved conformity of the accreditation system to the *Multilateral Recognition Agreement (MLA) of the European Cooperation for Accreditation (EA)* in six spheres of accreditation. In order to continuously conform to these requirements and harmonize accreditation procedures, employees of LNAB participate in several committees – EA Inspection and Certification Committee, EA Laboratory Committee and working groups, meetings of the Multilateral Recognition Agreement Committee and General Assemblies.

In the framework of international cooperation, LNAB also collaborates with accreditation institutions of Belarus, Ukraine, and Uzbekistan. Cooperation with the accreditation institution of Georgia is continued by assisting in fulfilment of the European and international requirements.

LNAB has also fostered participation of national laboratories in international inter-laboratory comparative testing programmes and has organized examinations of skills. Furthermore, training seminars are organised for conformity evaluation institutions and LNAB involved experts.

Metrology

Since July 1, 2009, the Metrology Bureau of LLC "Standardization, Accreditation and Metrology Centre" (LATMB) is the national metrology institution of Latvia and its aim of activity is to ensure and develop credibility and traceability of measurements in the country. The Metrology Bureau fulfils assignments in the field of metrology stipulated in the *Law on Uniformity of Measurements*.

The National measurement standards are being calibrated and standard maintaining procedures of the standards are being performed in the national metrology institutes (NMI) of the European Union.

Calibration of the DC standard 7000 and the national multi-functional calibrator 4808, and calibration of national length standards has been carried out at the Finnish NMI. In May, calibration of angular measurement standards has been carried out at the Italian National Institute of Metrological Research *I.N.R.I.M.*

In the first half of 2013, stability analysis and drift assessment of national electric measurements and length standards were carried out over a period of the calibration. 7 reliability validation procedures for calibration results have been fulfilled in the field of CMC *(Calibration and Measurement Capabilities)*.

Until May 1, 2013, conformity of 11 measurement equipment types was evaluated and certified, including re-evaluated conformity of measurement equipment types and extended certificates for 8 types. The list of approved types available on the website of the Metrology Bureau is updated on a regular basis. 8 consultations on regulated metrology issues have been provided.

The annual quality management system report of LATMB has been prepared and submitted for consideration to the Technical Committee for Quality (TC-Q) of the European Association of National Metrology Institutes (EURAMET). All the necessary measures for maintaining international recognition of calibration and measurement capabilities CMC have been carried out by using the database KCDB of the International Bureau of Weights and Measures (BIPM).

In 2012, LATMB continued cooperation with the EURAMET, as well as the International Organization of Legal Metrology (OIML) and the European cooperation in legal metrology (WELMEC). Cooperation continues with metrology institutions of Lithuania and Estonia.

Cooperation still continues with Latvian metrology institutions. A total of 31 reference standards, as well as 2 mass comparators of LLC "National Metrology Bureau of Latvia" have been calibrated.

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 narrow the business activity performed by the state and local governments.

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* came into force on September 1, 2005, prescribing the procedure of completing the privatization process and land reform and ensuring completion of the use of privatization certificates (see Box 6.26).

Box 6.26

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 August 31, 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 the state or local government property to privatization is adopted;
– that privatization may be denied 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 the Cabinet of Ministers or a local government had to adopt decisions on bringing a state or local government property to privatization by December 30, 2010;
– that decisions on bringing the state or local government property involved in dispute regarding property rights to privatization shall be adopted in four months from coming into force of court decision or a notarial act;
– that the state joint stock companies "Latvenergo", "Latvijas pasts", "International airport "Riga"", "Latvijas dzelzceļš", "Latvijas gaisa satiksme" and "Latvijas valsts meži" are not subjected to privatization or alienation;
– the deadlines for the persons willing to buy out land allocated for permanent use have to submit an application on buying land property (August 31, 2006 or November 30, 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 (September 1, 2008), as well as for the application for a decision on the allocation of the property for payment has to be submitted (May 31, 2010 or August 31, 2011)and that the land purchase agreement has to be concluded by December 30, 2011;
– that privatization certificates do not have an expiry term, but may be only 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 December 28, 2007.

In order to ensure successful and open progress of 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.

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.

From September 1, 2005, when the *Law on the Completion of Privatization* came into force, until May 31, 2013, 636 proposals for privatization of real estate, 57 proposals for privatization of state capital shares, and 4350 proposals for privatization or privatization continuation of land have been registered in the Register of Privatization Proposals of the Privatization Agency. After August 31, 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 Latvian Privatization Agency according to its competence.

The Cabinet of Ministers has not yet considered 8 proposals for privatization of state property objects, out of which two proposals for privatization have not been considered due to litigation pending regarding ownership rights. Three proposals for privatization have not been considered because consideration thereof is hindered by legal issues. The ministries have objections against bringing three state property objects to privatization.

No decision has been made on privatization of 79 state property objects due to failure to verify 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 the privatization proposals thereof have been sent to the relevant local governments or the privatization of those objects have been rejected. 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, 52 legal proceedings have been closed and court has ruled on satisfying the application of the Privatization Agency and establishing the legal fact that the property is a property without an owner that belongs to the state. In 12 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 have been arisen in a matter to be adjudicated in accordance with special adjudication procedures and such dispute is required to be adjudicated in court in accordance with procedures regarding actions. In 3 cases, legal proceedings are still pending. After giving a court ruling or issuing a notarial deed on recognizing the property as a property without an owner or an heir according to Section 14^2 of the transitional provisions of the *Law on the Completion of Privatization*, the Cabinet of Ministers shall, within four months after coming into legal force of the court ruling or the notarial deed on recognizing the property as a property without an owner or an heir, make a decision on bringing the property object to privatization or a justified rejection to bring it for 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 lats (LVL) and/or privatization certificates.

From April 17, 1994 until May 31, 2013, the privatization provisions in the statutory procedure have been approved for 2514 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 emerged as a result of capitalization of debts) amounted to LVL 1.669 billion, of which LVL 402.13 million was in cash and LVL 1.267 billion in nominal values was for privatization certificates. New owners took over obligations of privatized state companies (enterprises) for the value of more than LVL 187.95 million. The amount of the specified investments was LVL 146.35 million, while the amount of investments actually made reached LVL 267.54 million.

The Privatization Agency carries out privatization of state-owned land since 1997. By May 31, 2013, 5115 state land lots were privatized (purchase agreements signed). The total sales price for the privatized state land constitutes LVL 201.79 million, of which LVL 98.90 million was in cash and LVL 102.88 million in property compensation certificates. On May 31, 2013, income from privatization of these land lots amounted to LVL 192.78 million, of which LVL 94.71 million was in cash and LVL 98.08 million – in property compensation certificates.

Privatization of local government property objects and land

A decision concerning privatization of local government real estate is made by the municipality - city (county) council. The decision is made on the basis of a privatization proposal submitted by any natural or legal person.

A natural or legal person eligible to acquire local government property in Latvia within the process of privatization can be the subject of privatization of local government property (real estate, a deemed part of the real estate, capital company, capital shares, land). Payments for local government property objects have to be made in lats (LVL) and/or privatization certificates.

Privatization of local government property in the municipality area is ensured by the property privatization commission of the respective municipality (city, county).

Compliance of privatization projects, regulations, and announcements approved by a municipality council with the provisions of the *Law on Privatization of State and Local Government Property* and the *Law on the Completion of Privatization* is ensured by the Ministry of Economics.

From February 17, 1994 until June 1, 2013, the Ministry of Economics has reviewed and accepted for information 3323 privatization projects for the total estimated price of LVL 160.7 million (*inter alia* payments in certificates for the nominal value of LVL 59.14 million).

From January 1, 1997 until June 1, 2013, the Ministry of Economics has reviewed and accepted privatization provisions in respect to 1671 building land lots and vacant local government land lots (separate announcements of privatization of building land lots as from September 1, 2005) for the total value of land in the amount of LVL 26.4 million (of which LVL 13.3 million must be paid in property compensation certificates).

Section 41(2) of the *Law on Privatization of State and Local Government Property Objects* imposes an obligation that the council of municipality submits a decision on approval of privatization project of local government property object, and the approved privatization project to the Ministry of Economics. The submission of a decision on approval of provisions (announcement) regarding privatization of a building land lot or a vacant land to the Ministry of Economics is voluntary and is not imposed by the law.

According to Section 5(7) of the *Law on the Completion of Privatization*, after August 31, 2006, local governments on a quarterly basis must provide the Ministry of Economics with data regarding the received privatization proposals for local government property objects and building land and vacant land, decisions on bringing these property objects and land to privatization, the sale price and the amount of privatization certificates to be used for payment.

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*. As of May 31, 2013, 112.38 million privatization certificates have been issued to 2.4 million people. Out of which 104.37 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, 970 thousand for house ownership, 814.7 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 December 1, 2007, in accordance with the Section 27 of the *Law on Completion of Privatization*, 58 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 May 31, 2013. Compensations for the total amount of LVL 17.45 million have been paid to 8411 persons, thus cancelling 0.62 million property compensation certificates.

Table 6.6

Use of Privatization Certificates

(as of May 31, 2013)

Type of property	Amount	Number of privatization certificates	including the number of property compensation certificates
		million	
Residential buildings	446 thousand apartment privatization units	38.0	0.590
Enterprises and other properties	no exact data	7.3	0.110
Capital shares (stocks)	no exact data	44.5	0.954
including:			
in public offering	128.7 million shares	37.1	0.858
Land	317.1 thousand land lots	17.4	5.163
Total:		**107.1**	**6.817**
% of total certificates issued		95.3%	85.1%

As part of cancelling 0.16 million privatization certificates for political repressions, compensations for the total amount of LVL 4.64 million have been paid to 26.2 thousand politically repressed persons by May 31, 2013. According to Section 28 of *Law on Completion of Privatization*, 3.4 thousand politically repressed persons have lost the right to cancel 16 thousand privatization certificates.

By May 31, 2013, 107.11 million privatization certificates or 95.3% of the total number of issued certificates have been used for privatization of state and local government property (see Table 6.6). From

April 1, 2008 until April 1, 2013, instead of 474.25 thousand property compensation certificates 602.38 thousand privatization certificates have been used.

In May 2013, holders of privatization certificates could use services of 7 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 on May 31, 2013, varied from 2.44 thousand privatization certificates in January to 7 thousand privatization certificates in April and from 0.25 thousand property compensation certificates in May to 1.72 thousand property compensation certificates in April.

According to Paragraph 2 of *Regulations Regarding the Use of Privatization Certificates* approved by the Cabinet of Ministers on October 16, 2007, privatization certificate accounts open and service JSC "Latvijas Krājbanka" and Mortgage bank as well as other crediting institutions, which are legal to accept the money deposits by natural persons and which have agreed their internal rules with Commission for Licensing Mediation Companies of Privatization Certificates. On May 1, 2013, 2.506 million privatization certificates or 2.2% of the total number of granted privatization certificates, including 0.108 million property compensation certificates were stored on the accounts of 380 thousand natural persons.

On May 1, 2013, 0.287 million privatization certificates or 0.3% of the total number of granted certificates, including 0.006 million property compensation certificates were stored on the accounts of privatization compensations of legal persons.

On November 21, 2011 the Financial and Capital Market Commission adopted a decision on terminating all financial services provided by the JSC "Latvijas Krājbanka". On December 13, 2011, the Riga Regional Court announced the bankruptcy procedure of JSC "Latvijas Krājbanka" based on the application of the Financial and Capital Market Commission. Moreover, the bankruptcy procedure of the insolvent JSC "Latvijas Krājbanka" was initiated by the decision of Riga Regional Court of May 8, 2012.

According to Subparagraph 31.9 of the *Regulations Regarding the Use of Privatization Certificates*, the bank servicing the privatization certificate account of a customer has a duty to: in case the bank loses the status of a credit institution or the right to accept cash deposits of natural persons, or decides to terminate servicing privatization certificate accounts, it must immediately terminate opening of new accounts, continuing servicing accounts until their transfer to another bank and conclude an agreement with another bank on transfer of privatization certificate accounts by coordinating the procedure for transfer of accounts with the Commission for Licensing Mediation Companies of Privatization Certificates. Pursuant to Paragraph 2 of the *Regulations Regarding the Use of Privatization Certificates*, only the Mortgage Bank and JSC "Latvijas Krājbanka" in liquidation are the credit institutions entitled to open and service privatization certificate accounts at the moment.

Currently, JSC "Latvijas Krājbanka" in liquidation is subject to an obligation imposed by the law to terminate opening of new privatization certificate accounts and to continue servicing the existing accounts until conclusion of an agreement with another bank on transfer of privatization certificate accounts. As mentioned above, the Mortgage Bank is the only credit institution entitled to take over privatization certificate accounts administered by JSC "Latvijas Krājbanka" in liquidation.

Considering the ongoing transformation process of the Mortgage Bank (see Box 6.8), the authorities responsible for the transfer of privatization certificate accounts are currently working on the most efficient model for servicing privatization certificate accounts to be applied also in future.

The Cabinet of Ministers in the meeting of December 18, 2012 approved the draft regulations *Amendments to Regulations Regarding the Use of Privatization Certificates* aimed at simplifying the procedure for individual transfer of privatization certificate accounts from one credit institution to another.

At the same time, further administration solutions of privatization certificates are being developed, a conceptual decision whereof will be adopted in 2013.

Privatization process of residential buildings

Privatization of residential buildings in Latvia was initiated in 1995. It was implemented by the Central Privatization Commission of Residential Houses (since January 1, 2004 – State Agency "Housing Agency" (*"Mājokļu aģentūra"*), since January 1, 2008 – Construction, Energy and Housing State Agency, since July 1, 2009 – Latvian Privatization Agency), as well as by the local government residential building privatization commissions in compliance with the procedure stipulated in the *Law on Privatization of State and Local Government Residential Houses*.

As of May 31, 2013, 365 residential buildings and 1556 state apartment properties were in the possession and under management of the Latvian Privatization Agency, out of which 930 state apartment properties are situated in residential buildings in possession of the Latvian Privatization Agency and 625 state apartments are situated in residential buildings that are handed over to management of apartment owners.

A total of 9 decisions on commencement of privatization of state residential houses have been made within time period from December 1, 2012 until

May 31, 2013. Privatization announcements have been sent to 94 tenants of state apartments to be privatized and to owners of state apartments brought to privatization according to the procedure specified in the *Law on Privatization of State and Local Government Residential Houses* within time period from November 30, 2012 until May 31, 2013. A total of 77 contracts on purchasing state apartment properties to be privatized have been concluded within the time period from November 30, 2012 until May 31, 2013.

A total of 24 state apartment buildings have been handed over to owners of apartment properties in possession within time period from December 1, 2012 until May 31, 2013. Yet, 79 state apartment properties have been handed over to the possession of local governments of republic cities, towns and counties within the period from December 1, 2012 until May 31, 2013.

Land reform

The main goal of the land reform is to rearrange the legal, social, and economic relations of land use and ownership from the command economy to the 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 privatization (alienation) of land owned by the state or local government. Redemption (purchase) of land allocated for permanent use and 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 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 the Mortgage and Land Bank of Latvia (the Mortgage Bank) by November 30, 2011.

Overall, during the land reform until December 30, 2011, the Mortgage Bank concluded 174 231 agreements on 181 945 land units of more than 1.2 million hectares.

From early 1994 until late 2011, about 18.5% of rural land in Latvia had been redeemed. Most of the agreements with the Mortgage Bank had been concluded in 1998, i.e. 14% of all agreements concluded in 17 years. The abovementioned can be explained by the fact that on October 30, 1997 the Saeima approved the *Law on Completion of Land Reform in Rural Areas* thus envisaging that land users had the opportunity to redeem the land for privatization certificates until December 31, 1999. Although these conditions have been amended multiple times, it has not had any particular impact on the activity of land users until 2004 as only 6% of all concluded agreements have been signed during this period. Yet, in 2005, the number of concluded agreements increased rapidly due to coming into force of the *Law on Completion of Privatization* on September 1, 2005 approved by the Saeima on June 16, 2005 which similarly to the *Law on Completion of Land Reform in Rural Areas* also limited the deadlines for redemption of land for privatization certificates.

The Law on Completion of Privatization was amended in 2009, 2010, and 2011, and land redeemers were given a second opportunity to conclude an agreement with the Mortgage Bank in order not to lose the pre-paid privatization certificates. From 2009 until 2011, about 9% of all persons having concluded an agreement in rural areas have taken the opportunity to conclude the agreement with the Mortgage Bank.

If an agreement with the Mortgage Bank was not concluded before the prolonged term in the *Law on Completion of Privatization* – until December 30, 2011, both urban and rural land redeemers lost the opportunity to redeem the land at its cadastral value, as well as lost the pre-payment already made with privatization certificates before the cadastral survey.

According to the data of the Mortgage Bank entered in the National Real Estate Cadastre Information System until December 30, 2011, no agreements have been concluded with the Mortgage Bank on nearly 3600 land units of a little over 12 500 hectares in rural areas. Pursuant to the provisions of the *Law on Completion of Land Reform in Rural Areas* the structural units of the State Land Service had to provide information about the unredeemed land units to local governments by June 30, 2012. According to the *Law on Completion of Privatization* and the *Law On Completion of Land Reform in Rural Areas*, local governments, for their part, have to make a decision on termination of land use rights and jurisdiction to the local government or transferring to land reserve fund by September 30, 2012.

According to the law *Amendments to the Law On Completion of Land Reform in Rural Areas* approved by the Saeima on November 15, 2012 (effective as of December 14, 2012), the deadline for decision-making regarding termination of land use rights of persons who have failed to conclude an agreement with the Mortgage Bank by December 30, 2011 has been extended to September 30, 2013.

Section 16(1) of the *Law On Completion of Land Reform in Rural Areas* envisaged that the former land owners or their heirs, as well as former land owners who until July 21, 1940 commenced the purchase (concluded an accessory contract) of real property left in Latvia by German emigrants from the "General

Agricultural Bank" or the "State Land Bank", as well as the heirs of such persons to whom the ownership rights to immovable property have not been restored or the property compensation certificates thereof have not been granted, would have an opportunity to claim land units of equal value allocated for completion of the land reform by a decision of the local government until December 30, 2009.

If the former land owners or their heirs wanted to restore their ownership rights to land, according to the *Law on the Completion of Land Reform in Rural Areas* they had to submit a proposal to the Central Land Commission (CLC) by December 28, 2007, but documents confirming ownership and hereditary rights had to be submitted by September 1, 2008.

Regulation of the Cabinet of Ministers of December 20, 2008 No 1030 *Procedure on Reviewing Requests Submitted to the Central Land Commission* prescribes the procedure according to which former land owners or their heirs must restore land ownership rights to land planned for completion of land reform.

Before starting the process of restoring land ownership rights, the State Land Service (SLS) in cooperation with the local governments examines whether:

- ownership rights to the claimed land have not been already recognized or restored to the submitter of proposal or to another person;
- property compensation certificates have not been received;
- the proposal on restoration of ownership rights has been submitted in the corresponding local government by June 20, 1991;
- the documents confirming ownership and hereditary rights to the claimed land have been submitted by June 1, 1996;
- the land has been allocated for permanent use or rights to permanent use have been terminated and a land lease agreement for this land has been concluded with the local government.

After performing the said examination, the CLC decided on the priority group for reviewing applicants' claim.

The former owners or their heirs who had submitted a claim for restoring ownership rights and documents confirming ownership or hereditary rights by June 20, 1991, but have not received the land or property compensation certificates, as well as former land owners who by July 21, 1940 had started to redeem the real estate left in Latvia by German emigrants from the General Agriculture Bank or State Land Bank, are considered as the first priority claimers regardless of the claim submission date.

The status of the second priority claimers corresponds to those former owners or their heirs, who had submitted a claim for restoring ownership rights by June 20, 1991, as well as had submitted documents confirming ownership and hereditary rights by July 1, 1996.

The status of the third priority claimers corresponds to those applicants, who had submitted the claim after June 20, 1991, or documents confirming ownership or hereditary rights after July 1, 1996.

The CLC has recognized claims for ownership rights to land of 12 982.64 hectares allocated for completion of land reform submitted by 1066 persons. 14% of all claimers for land allocated for completion of the land reform are the first priority claimers, 3% – the second priority claimers, but the third priority claimers constitute the largest number of claimers for land allocated for completion of the land reform, i.e. 83 per cent.

In order to ensure restoration of ownership to land allocated for completion of the land reform, local government and regional level commissions for completion of land reform have been established in the SLS regional branches, as well as a state level commission for the completion of land reform has been established in the central structure of the SLS. The commissions established by the SLS organize sending a land unit list to the applicants and summarize the land units selected by the applicants. A representative of the particular local government, authorized to sign the allocation schemes of land distribution allocated for completion of the land reform and land boundary schemes intended for restoring ownership rights, must participate in the work of these commissions.

After the auction, the SLS commission for completion of the land reform sends the auction minutes and a land boundary scheme signed by the claimer to CLC for preparing a statement and sending it to the claimers for continuing the processing of ownership rights.

The process for the restoration of ownership rights to the first priority claimers was commenced in 2010. Since August 2010, the state level commission for completion of the land reform established by the State Land Service has examined claims of 91 first priority claimers.

Examination of claims of the first priority claimers in commissions for completion of land reform of local government and regional level, as well as in state level was completed at the end of March 2011.

After receiving the CLC statement on restoration of ownership rights, the first priority claimers carry out a cadastral survey of land units. After the cadastral survey, the CLC makes decisions on restoration of ownership rights, and the claimer thereby obtains the rights to record the property in the Land Register.

In April 2011, the preparation of lists of land units planned for completion of land reform and sending thereof to second and third priority claimers for selecting the respective land units was launched at the local government or regional level. Those claimers having insufficient area for compensating the inheritable land at regional level were offered an opportunity to select land units at state the level within the territory of Latvia.

A total of 35 claims of second priority claimers for the selection of land planned within the land reform have been examined, the majority of former properties of second priority claimers were located in the territory of former Ludza district, Valka district, Cēsis district, Preiļi district, and Balvi district. Land boundary schemes were selected and signed for a total of 37 land units for an area of 155.5 ha. 30% of second priority claimers refused to choose land units. Examination of claims of second priority claimers at local government, regional and state level was completed in November 2011.

A total of 693 claims of third priority claimers for selection of land planned within the land reform have been examined. 37 third priority claimers refused to choose the land allocated for restoration of ownership rights.

In some areas of Latvia, there was insufficient land planned for the land reform for the third priority claimers, and therefore 188 third priority claimers were granted the rights to select land in all rural territory of Latvia. The CLC granted 194 third priority claimers the rights to select land in all territory of Latvia for restoration of ownership rights to the claimed land of 2650.83 hectares. The state level commission for the completion of land reform of the State Land Service started working in late July 2012.

By June 1, 2013, the state level commission for the completion of land reform of the State Land Service had examined applications for restoration of ownership rights to 229 selected land units. 34 third priority claimers were allocated the entire land claimed for restoration of ownership, by signing the land boundary schemes of 137 land units.

According to Section 16(3) of the *Law on Completion of Land Reform in Rural Areas* (version effective until December 14, 2012), the CLC was entrusted with the decision-making (recognition) on restoration of ownership rights to the land allocated for completion of land reform until December 30, 2012.

However, since claimers often changed the land units they had selected or delayed the selection, the deadline for restoration of ownership rights to land allocated for completion of the land reform was also delayed.

Considering all the above, on December 14, 2012, the Saeima approved the law *Amendments to Law On Completion of Land Reform in Rural Areas* stipulating that the CLC shall make a decision on recognising restoration of ownership rights to land allocated for completion of the land reform by December 30, 2013.

On November 15, 2012, the Saeima approved the law *Amendments to Law On Completion of Land Reform in Rural Areas* (in force since 14.12.2012) extending the term for submission of announcements and reports until November 30, 2014.

Yet, despite the extended term for submission of announcements and reports, by June 1, 2013, preparation reports and announcements have already been commenced in 4 towns: Olaine, Līgatne, Saldus and Limbaži.

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. 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.

In mid-2013, the state holds 100% shares in 70 capital companies; it has decisive influence over 7 capital companies and holds less than 50% shares in 65 companies. The state holds shares directly in a total of 142 companies.

There are 323 capital companies in the Republic of Latvia, in which a local government is the sole member (local government capital companies), 39 capital companies are under decisive influence of local governments, while local governments hold 50% or less shares in 243 companies. Four local governments have no holdings in capital companies.

Box 6.27

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 broader 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 norm to limit state commercial activities.

Management of state capital shares

Latvia applies the decentralised model for state capital shares management which is implemented by the holder of capital shares – a line ministry or any other institution. The decentralised model allows diverging interpretations of laws and regulations and application thereof depending on understanding of the shareholder or other factors. 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 roles at the same time (the role of customer, owner and sectoral policymaker in one person;
– low return on equity;
– no clear definition of economic and specific (sectoral policy) 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 business environment;
– the regulation of state capital shares management is fragmented, open for interpretations and incomplete;
– political decision-making in day-to-day management.

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 *Guidelines on Corporate Governance of State Owned Enterprises* of the Organisation for Economic Cooperation and Development in the meeting of May 15, 2012.

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, including the draft 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*, as well as 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 draft laws have been approved in the Cabinet meeting on May 28, 2013 and are going to be submitted to the Saeima for consideration.

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 revise conditions for commercial activity of public persons. Implementation of the 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 defines financial and non-financial (social) objectives.

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 support, 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 coordinates by the bureau;
- 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.

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;
- to implement a partially centralised model for state capital shares management. Establishment of a centralized management institution – the State Capital Shares Management Bureau. In a partially centralised model, 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 State Capital Shares Management Bureau responsible for monitoring financial performance and introduction and implementation of corporate governance principles;
- the State Capital Shares Management Bureau should be established as a direct administration institution subordinated to the Cabinet of Ministers under the supervision of the Prime Minister. The State Capital Shares Management Bureau should be financed from the government budget. The State Capital Shares Management Bureau shall have 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 (if the State Capital Shares Management Bureau is not the holder of capital shares) regarding coherence between the financial objectives laid down in the medium-term strategy for activities of the capital company and the non-financial objectives laid down in the medium-term strategy for activities of the capital company and the share payable as dividends; (3) to consult the Cabinet, the holders of public person capital shares and capital companies on the aspect of implementation of corporate governance; (4) to ensure preparation of an annual public report on state owned capital companies and capital shares; (5) to assess the financial objectives and performance achieved by capital companies; (6) to assess and provide a conclusion on the need for acquisition, maintenance, termination of the public person shareholding, as well as the need for acquisition or termination of decisive influence of the state according to the law; (7) to develop and maintain a database of candidates of the council and the board members; (8) to develop draft laws and regulations and policy planning documents according to its competence and submit them to the Cabinet for approval; (10) to perform functions of the holder of capital shares in those capital companies where the bureau has been appointed as the holder of capital shares; (11) to implement alienation and privatisation of state capital shares;
- 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 State Capital Shares Management Bureau is expected to get involved in assessment of the medium-term strategy for activities of a capital company by providing a conclusion;
- to lay down conditions for assessment of performance of capital companies coordinated by the State Capital Shares Management Bureau (the Guidelines on Good Corporate Governance, common framework for achievement of financial objectives). The holder of capital shares shall assess the abovementioned, make a decision on further action to increase return on assets and the value;
- to lay down requirements for ensuring transparency of information – a possibility to access information on the objectives, performance, latest financial results, management structure of capital companies and other information;
- the State Capital Shares Management Bureau shall prepare the annual public report on state owned capital companies and capital shares in the previous year and submit it to the Cabinet and the Saeima for information by July 30 of the current year;
- a capital company may establish a council only in case the company in the current financial year has achieved: (1) net turnover above LVL 15 million; (2) total amount of the balance

above LVL 3 million; (3) the average number of employees exceeds 50.

- a motivating remuneration system for the board and the council members. The extent of remuneration of the board and the council members shall be determined in the general meeting of shareholders (council if any such council has been established) pursuant to the remuneration regulations issued by the Cabinet and developed by the State Capital Shares Management Bureau based on the average extent of remuneration and social guarantees for the management in private capital companies of equal size (net turnover, the total amount of balance, the number of employees) or in some cases in the sector where the relevant capital company is operating. Remuneration shall be linked with the performance as well. Remuneration conditions shall 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 using the database, based on the criteria for professionalism and competence (education, experience, expertise in the sector, finance, management, motivation methods, etc.). The State Capital Shares Management Bureau develops the database of candidates of the council and the board members, maintains and updates it on a regular basis. An appointment commission composed of the representatives nominated by the State Capital Shares Management Bureau and the holder of state capital shares or the council (if any such council has been established), as well as independent experts and representatives nominated by the relevant line ministry, as necessary, assesses the candidates from the data base and puts forward to the holder of state capital shares or the council of the capital company. At the same time, if the state capital company is important for implementation of a certain sectoral policy, the line ministry appoints at least a half of the number of council members under the Articles of Association to the holder of state capital shares. Representatives nominated by the ministries shall meet the required qualification criteria for entering a person in the database of candidates of the council and the board members. The holder of state capital shares or the council are 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;
- to determine the 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 draft laws developed within the framework of the reform of commercial activity and capital shares management of public persons is expected to come into force on January 1, 2014. Thus, the State Capital Shares Management Bureau is expected to be established by April 1, 2014.

6.17 National Economy Council

The National Economy Council (NEC) of the Ministry of Economics is an advisory institution established by NEC founder organizations – the Ministry of Economics, Latvian Chamber of Commerce and Industry, Latvian Association of Local and Regional Governments, Free Trade Union Confederation of Latvia, and 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 the 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 1-7-32 of November 9, 2012.

In order to represent the interests of sectors professionally, as well as to improve cooperation between the Ministry of Economics and other state institutions, 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 NEC activity is to promote development and implementation of favourable business environment policy in Latvia, as well as to promote 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 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.

NEC reviews and monitors settlement of issues, draft normative documents, national economy development concepts, the state budget, and other documents important for the development of Latvian economy. NEC prepares proposals and adopts recommending decisions on these issues. 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 NEC are of recommending nature.

NEC cooperates with the Cabinet of Ministers, ministries, and other state institutions to achieve that the proposals suggested by NEC necessary for improving the business environment are included in the laws and regulations prepared by the responsible institutions.

Box 6.28

<u>NEC Personnel and Work Organization</u>

Based on a decision of the Managing Committee, 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 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).*

NEC consists of 26 NEC experts designated by NEC Managing Committee, including the Minister for Economic, the NEC chairperson and representatives from business organisations, public structures and other organisations.

Representatives from the Foreign Investors' Council in Latvia, Riga Technical University, the association "Latvian Market Association", the Latvian Academy of Sciences and the Latvian Chamber of Crafts participate in the NEC meetings in observer status.

The NEC founders in the meetings of NEC Managing Committee make decisions on changes or additions to the composition of NEC.

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.

NEC meetings are held on average once in a month.

The work of 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 NEC between NEC meetings.

On May 21, 2009, NEC, the Ministry of Economics, and the Ministry of Finance signed a cooperation memorandum on *Growth, Competitiveness, and Employment*. The cooperation memorandum is aimed at cooperation and harmonized action of 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 development and implementation of sustainable strategy of Latvia.

In order to represent professionally the interests of economic sectors in an efficient dialogue with the Ministry of Economics, the NEC and other business organisations and state institutions, the Ministry of Economics has set up a model for cooperation with the national economy sectors.

The NEC reviews proposals for 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 in its turn informs the drafters of the laws and regulations about proposals for improving legislation submitted to the NEC and carries out other measures to implement programmes for development of national economy and improvement of business environment approved within the framework of the government declaration.

At the moment, 14 sectoral associations are represented in NEC (chemistry and pharmaceutics, 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).

Box 6.29

NEC on Priorities of Economic Policy

NEC believes that Latvia should continue the work on development of a stable macroeconomic environment and the growth of national economy in general. 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 the society, by timely identifying the risk sectors where violations of competition law are possible, by limiting administrative and other barriers to the competition.

NEC still considers the most problematic spheres are taxation policy and administration, labour force education, macroeconomic stability, and non-predictability of amendments to the legislation.

The normative acts 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 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 ones must be promoted. The export promotion institutional base, 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.

By signing the memorandum of understanding, the parties agreed to unite 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 draft legislation elaborated by the ministries.

In the first half of 2013, 5 National Economy Council meetings have been held, in which the following main issues have been considered:

- economic breakthrough: *Draft Guidelines on National Industrial Policy for 2013-2020*;
- economic breakthrough: *Draft Guidelines on Regional Policy until 2020* prepared by the Ministry of Environmental Protection and Regional Development;
- economic breakthrough: *Latvian Energy Long-Term Strategy. 2030 – Competitive Energy for Society*;
- *Tax Policy Strategy for 2014-2016*;
- Further limitation and reduction of costs of the mandatory procurement component (MPC);
- *Action Plan of Combating Shadow Economy* and its status;
- Time schedule for development of the *Smart Specialization Strategy* and defining priority research directions thereof;
- Medium-term and long-term labour market forecasts.

7. RECOMMENDATIONS

In the post-crisis period, Latvian economy has become more sustainable. Our economic structure has become versatile, exports are more diversified and we are now selling more of our products and services in different markets.

At the same time, it should be noted that the current economic advantages of Latvia are mainly based on low labour costs and sectors of the low-technology industries. Yet, we cannot escape the expected rise in labour costs in the coming years due to the growth and open labour market. It means that Latvia may lose it competition in the low-cost segments faster than it gains advantages in manufacture of higher value added products. In order to avoid the low-income *"trap"*, the *National Industrial Policy* needs to be introduced to foster transition from low- to medium- and high-technology industries.

The main challenges to the industrial policy requiring active state action are the following:

- **limited financing.** Although the situation in the financial market has become stable, crediting is still at a very low level, which is largely related to the strong financial market risk perception of creditors and borrowers. The limited possibilities of many enterprises to access finances have become a crucial challenge to investments and development. Therefore, it is necessary to strengthen the banking sector, at the same time expanding and improving alternative sources of financing for investments;
- **labour costs and competitive prices**. Until now, the improving competiveness of Latvia was mainly achieved at the expense of cuts in labour costs. Yet, it will be impossible to maintain the advantage of cheap labour under circumstances of liberalisation of the labour market and international labour mobility, and therefore the rise in labour costs may become a challenge to competiveness of producers in the domestic and foreign markets. In order to mitigate the influence of the rise in labour costs on competiveness of Latvian produces, it is necessary to develop a competitive tax system, as well as to provide state support to any field related to cost reduction of manufacturing resources;
- **low productivity and weak innovation performance**. The productivity level of Latvian manufacturing is far behind the average EU level. The current low innovation absorption reduces the possibility to improve the situation as fast as possible. The innovation process should be linked to developing competitive advantages. Therefore, the share of state expenditures on innovation and building motivation of enterprises play an important role in attracting the interest of more enterprises in investing in technology, research and development. Support instruments should be focused on reducing costs and risks and promoting cooperation;
- **transformation of international business**. Global challenges form a new business model characterized by more sophisticated supply and production chains that lead to developing a specialisation of the country in a specific sector or value added chain of product, intensifying internal specialisation (division of labour) of sectors (manufacturing). Thus, identifying and developing this new business model is a precondition for moving towards higher productivity. In order to ensure development of Latvian competitive advantages, it is necessary to foster internal and external partnership, entering international industry and supply chains in various ways by supporting clusters, improving management skills, attracting FDI, at the same time actively offering ourselves in the global market, etc.;
- **access to and skills of workers**. Considering the negative demographic and migration trends, issues related to access to labour force will become increasingly topical in the upcoming years along with the economic growth in Latvia. Modernization of production based on development of new technologies sets higher requirements for the labour quality and professional mobility. Access to qualified workers becomes an essential factor affecting the development of the manufacturing. In order to mitigate the negative impact of demographic changes on the development and modernization of manufacturing, it is necessary to promote development of vocational education and life-long learning system by ensuring adequacy between labour supply and the demand, focusing more on improving the skills of employees and increasing professional mobility. The measures should be constant with certain support from the government, as well as they should be attractive to employers and employees. The launched higher education reform should also be continued to stimulate

quality, strengthen compliance with the market demands and link with scientific research institutions and avoid fragmentation of budget resources.

It is equally important to continue implementing the measures for improving the business environment, particularly those related to improving institutional framework (legislation, tax policy, support institutions) and infrastructure. Also stable macroeconomic environment must be maintained.

In order to prepare for and adapt to the significant structural changes, the labour market requires proactive reforms. The social assistance system must be strengthened and reformed to make it more efficient and at the same time to ensure better protection of the poor. Latvia has to focus on organizing and encouraging motivation to work.

Taking into account the abovementioned, in our opinion, the immediate tasks of the economic policy are as follows:

– **for improving the business environment and ensuring competitiveness:**
  – to implement measures to improve management and efficiency of the legal system, especially to reduce the backlog of court cases and length of legal proceedings. To improve the framework for insolvency process and arbitration courts, to introduce a mediation process. To adopt the new Construction Law envisaging significant improvements and enhancement of the construction process;
  – to elaborate a mechanism for developing industrial areas aimed at ensuring coordinated and result-based development of industrial areas in regions, thus facilitating business development and attracting new local and foreign investments;
  – to restructure the tax system, by making it socially fairer and business-friendlier. In the medium-term, 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 helping the entrepreneurs;
  – to revaluate participation of a public person in business activities and implement a reform of state assets (capital companies, capital shares) administration;
  – to promote development of e-government and e-services. To reduce the risks of implementing information system and e-service projects by strengthening administrative capacity and competence of customers and monitoring project implementation. Functionality of the e-signature must be expanded, accessibility of e-services must be provided and the usage of electronic procurements must be facilitated;
  – to ensure introduction of the one-stop agency principle with regard to availability of the state and local government services. To introduce a one-stop agency principle in registration of real property data, thus ensuring data exchange between the National Real Estate Cadastre Information System and the State Unified Computerised Land Register;
  – to develop an updated legal framework of the construction process and new construction standards, including adaptation of the Eurocode standards into the system of laws governing the construction sector, thus creating pre-conditions for development of a sustainable and competitive construction sector;
  – to improve mutual coordination of data and terms for entering data in state registers and other information systems and to ensure maximally complete and quick updating of information stored in the registers in order to prevent discrepancy of information between the registers and the actual situation, as well as to avoid repeated requests of information from respondents;
  – to actively address the most severe violations of the *Competition Law* – prohibited agreements and abuse of the dominant position. As regards the abovementioned violations, particularly identification of cartels, preventive measures are of major importance by performing inspections in the priority markets and implementation of tolerance program;

– **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 to credit resources for commercial activities in case of insufficient security for attracting the necessary amount of credit resources;
  – to develop venture capital instruments for stimulating investments in development and expanding activities of enterprises. Financing of venture capital funds requires private investor resources;

- **for developing a knowledge-intensive economy:**
  - to apply corporate income tax relief to research and development costs for development of enterprise research activities in Latvia;
  - to facilitate cooperation between scientists and entrepreneurs by supporting competence centres in order to promote cooperation between the research and manufacturing sectors for implementing industrial research, new products, and technologies, as well as to support technology transfer contact points for purposeful development of the necessary research competence at universities and research institutions and to promote introduction of research results in production;
  - to support development of new products and technologies by fostering entrepreneurs to develop industrial research by introducing new products, services and technologies into production;
  - to support the development of science potential more actively by concentrating it in areas where Latvia has comparative advantages;

- **for promoting exports:**
  - to continue ensuring access to export credit guarantees in order to increase access to the markets with a higher risk degree and to promote exports of Latvian goods and services;
  - to continue supporting the participation of entrepreneurs and their unions in international exhibitions and trade missions, in order to foster acquisition of new markets;
  - to develop and expand the network of Latvian foreign economic representation offices thus providing the Latvian entrepreneurs with a range of state export support services broadly and easily accessible in export markets;
  - to ensure representation of Latvian external economic interests within the framework of a multilateral, bilateral and regional trading policy to improve contractual conditions of international trade;
  - to continue addressing protective measures by eliminating trade barriers faced by Latvian entrepreneurs both in the EU internal and foreign export markets, thus fostering access to world markets and exportability of Latvian entrepreneurs;

- **for ensuring access to workers and improving the supply:**
  - to timely identify inadequacy between the labour supply and demand according to the development trends of the labour market by providing information to education policy makers; to improve cooperation among various institutions in implementing pre-emptive changes in the labour market;
  - to improve the life-long learning system to prevent the current mismatch in the labour market and reduce the risks of structural unemployment;
  - to increase attractiveness and quality of vocational education by ensuring its conformity to the labour market demands;
  - to pay particular attention to the youth who are neither studying nor working, aimed at returning them back to the education system for obtaining qualification and practice;
  - to encourage active involvement of employers in improving the quality of education – developing traineeship places, participation in development and improvement of education programmes, as well as development and implementation of active labour market policy measures;
  - to develop an interdisciplinary education/study programme focusing on developing business competence; to increase the role of the sciences and natural sciences in basic and secondary education;
  - to develop 1st stage professional higher education (college);
  - to revise frameworks of legal employment relationship by increasing flexibility between employer and employee;
  - to promote correspondence 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 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, agricultural manufacturing and processing policy areas (agricultural policy, forestry policy, fisheries policy), environmental, regional transport, and communication policy areas, as well as to stress it in international relations, education and training;
  - to promote and support energy efficiency in multi-apartment buildings, public buildings, industrial buildings by developing a sustainable financing model (rotating fund) for improvement of energy efficiency;
  - to revise the minimum requirements for energy efficiency of building envelopes and engineering technical systems, considering the most optimal costs, contributing to the lowest costs during the estimated lifetime;
  - to set the requirements and define the objectives regarding 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 application of good practice of energy efficiency of buildings to public sector buildings;
  - to strengthen support for research, development and implementation of new energy-efficient technologies, thus providing a possibility for dynamic development of energy efficiency solutions, as well as innovations and new jobs;
  - 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 Latvian and Northern electricity market integration and to increase market liquidity and objective, transparent electricity pricing, as well as development of regulatory framework of the market;
  - to complete risk assessment for possible liberalization scenarios of the natural gas market of Latvia;
  - to promote implementation of the energy infrastructure development projects and energy market integration measures within the *Baltic Energy Market Interconnection Plan*, as well as to achieve entering the infrastructure projects important for Latvia in the list of projects of common significance;
  - to develop proposals for reducing the risks of increasing electricity prices by evaluating the current support;
  - 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 growth 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 personal initiative of any person anywhere in Latvia under the conditions of mutual public understanding and dialogue.