Ministry of Economics
Republic of Latvia

ECONOMIC DEVELOPMENT OF LATVIA REPORT

Riga, December 2012

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REPORT

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Comments, questions, or suggestions are welcomed:

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Dear reader,

The regular ***Report on the Economic Development of Latvia*** prepared by the specialists from the Ministry of Economics is available for your evaluation. 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 evaluation of the state's economic situation and policy, as well as gives forecasted development perspectives of economy.

Economy of Latvia has been growing very successfully in 2012. After the rapid economic growth in 2011, economic perspectives of Latvia were assessed rather cautiously in early 2012. Aggravation of the debt crisis in the euro zone and a slowdown in global trade growth rates were observed until the mid-year, while uncertainty about the expected fiscal consolidation in the majority of developed countries forces a number of international institutions to cut global growth forecasts for 2012. The concerns over the weak EU growth unfortunately turned out to be true and economic activity was poor in the region. At the same time, Latvian economy was relatively resistant to external collapses, and the economic growth remained stable in 2012.

According to the estimates of the Ministry of Economics, GDP has increased by 5.2% in 2012. Latvia has been the fastest growing economy 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.

Recovery of the Latvian economy has been also recognized internationally as the international rating agencies raised the credit rating of Latvia thus reducing public expenditures for external debt management and borrowing expenses for entrepreneurs.

Unfortunately, not all residents have felt the effect of the improving economic situation. In some cases, income inequality has become even more apparent. Job opportunities and salaries are growing slower than the overall economy, and though the unemployment rate has been dropping, it remains relatively high.

Yet, the economy of Latvia has become more sustainable during the post-crisis period. Our economic structure has become versatile and exports are more diversified, and we sell our goods and services in many different markets. 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. Considering the expected weak economic growth in the European Union, the Ministry of Economics has forecasted a more moderate economic growth of Latvia in 2013 than it was in 2012, while GDP might increase within 4 per cent.

Latvian entrepreneurs have proven their ability to produce and export high quality goods that secure balanced economic growth of Latvia not only in statistical figures, but also in real life. However, in order to maintain long-term economic growth, one of the main objectives and challenges will be the increase in productivity. Higher productivity in both private and public sector is a precondition for a rise in wages and thus – overall social welfare. Our aim is to help enterprises to develop, produce high profitability goods and services, and create new, well-paid jobs through the *National Industrial Policy* (NIP). The NIP must become the key cross-industry document of the economy policy covering responsibility areas and tasks of a range of ministries. It also refers to further improvements of business environment in Latvia.

The Ministry of Economics expects to submit the *Guidelines on the National Industrial Policy for 2013-2020* to the Cabinet of Ministers for consideration in 2013. The Guidelines contain an analysis of development of national economy, identification of issues hindering the growth and setting the required directions of action. *The Guidelines on Promoting Exports of Latvian Goods and Services and Attracting Foreign Investments for 2013-2019* will be submitted to the Cabinet of Ministers for consideration along with the *Guidelines on the National Industrial Policy for 2013-2020*.

The state support programme for adjusting industrial premises is expected to be implemented in 2013, whereas support for construction of industrial connections is expected to be provided in the next programming period of the structural funds in order to ensure coordinated and result-based development of industrial territories that would foster business and help attracting new local and foreign investments. Yet, the institutional framework of the Development Financial Institutions will be prepared in cooperation with the Ministry of Finance to provide support to business growth at different stages through various financial instruments. Further improvements of the business environment require active work of all involved parties on further reforms, in particular regarding improving the legal system and adoption of the *Construction Law* in the Saeima, which are crucial measures to improve Latvian business competiveness.

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 area 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.

The Cabinet of Ministers is also expected to approve the long-term energy policy document - *Latvian* E*nergy Long-Term Strategy 2030 – Competitive Energy for Society* in the 1st quarter of 2013. One of the key energy priorities in 2013 still is progress of regional energy projects.

One of the key priorities of the Ministry of Economics is development and approval of the *Remigration support measure plan* in the Cabinet of Ministers, as well as allocating the financing in the budget of 2014 for implementing the plan in order to fully launch implementing all directions of action under the plan and develop active dialogue with the Diaspora of Latvia abroad and help Latvians to easily and practically return to Latvia if they have decided and want to come back.

One of the main issues at the government level in 2013 is the EU budget for the next programming period 2014-2020. Defending the interests of Latvia in the European budget – it will require joint effort of ministries and non-governmental organizations alike. The government must also jointly work on cross-industry reforms incorporated in the government declaration and the action plan of the government.

Joining the euro zone on January 1, 2014 is also an important task for Latvia. Membership of the euro zone will help ensuring sustainable overall development of Latvia by reducing various costs related to currency exchange for residents and enterprises thus developing a stable business and investment environment in 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 on 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!

December 2012

Daniels Pavļuts,
Minister for Economics

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
TWh	Terawatt per hour
USA	United States of America
WTO	World Trade Organisation

Country Abbreviations

AT	Austria	IE	Ireland
BE	Belgium	IT	Italy
BG	Bulgaria	LT	Lithuania
CZ	Czech Republic	LU	Luxembourg
CY	Cyprus	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 huge 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 was 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 3rd quarter of 2012, the GDP has increased by 14.7%. The improving economic growth is mainly due to the increase in external demand and thus – in exports, as well as the growth of tradable sectors. The increasing revenues from exports, in their turn, foster gradual rise in the domestic demand.

Although there was an increasing uncertainty in external markets in the second half of 2011, Latvian economy kept growing at a steady pace and GDP increased overall by 5.5% in 2011. Stable growth of national economy of Latvia has been observed also in 2012, despite the overall weak growth in the EU in 2012. In the three quarters of 2012, GDP in Latvia was by 5.6% higher than in the corresponding period of 2011. The GDP growth was determined by the increase in both exports and demand in the domestic market. **According to the evaluation of the Ministry of Economics, overall in 2012, GDP has increased by 5.2 per cent.**

Table 1.1

Latvia: Key Economic Development Indicators

	2008	2009	2010	2011	2012e	2013f
	(changes in comparison with the previous year, %)					
Gross domestic product	-3.3	-17.7	-0.9	5.5	5.2	4.0
Private consumption	-5.8	-22.6	2.4	4.8	5.5	4.1
Public consumption	1.6	-9.4	-7.9	1.1	-4.1	1.8
Gross fixed capital formation	-13.8	-37.4	-18.1	27.9	13.2	2.5
Exports	2.0	-14.1	11.6	12.7	7.0	4.8
Imports	-10.8	-33.3	11.4	22.7	3.6	5.9
Consumer prices	15.4	3.5	-1.1	4.4	2.3	1.5
	(% of GDP unless indicated otherwise)					
General government sector balance	-4.2	-9.7	-8.1	-3.4	-1.2	-1.4
General government debt	19.8	36.7	44.5	42.2	44.5	45.8
Export-import balance	-13.6	-1.5	-1.4	-4.8	-3.9	-4.3
Changes in the number of employed (aged 15-74 years)*	*0.5*	*-12.2*	*-4.6*	2.5	2.7	2.4
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	12.2

e – evaluation, f – forecast
* – data since 2011 has been recalculated according to the Population Census. Recalculations of 2008-2010 will be available in the second half of 2013. 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 2011, exports of Latvian goods and services increased by 12.7%. In the 3rd quarter of 2012, despite the strained economic situation in the EU, export volumes increased by 7.3% in comparison with the corresponding period of the previous year.

Further growth opportunities of exports will be affected by changes in external demand and 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 2011, private consumption exceeded the level of 2010 by 4.8%, while in the three quarters of 2012 it was by 5.7% higher than in the corresponding period a year ago. Overall, private consumption falls behind the level of the 1st quarter of 2008 when it started to decline by nearly 20%. More rapid recovery of private consumption is limited by the still high unemployment level and household indebtedness.

In relation to the absorption of the EU structural funds, including public investments in infrastructure and enterprise investments in production equipment, investments are increasing rapidly. In 2011, investments increased by 27.9%. Yet, in the three quarters of 2012, investments have increased by 16.2%, compared to the corresponding period of the previous year. The increase in investments is based to a great extent on investments in such sectors as energy, wood processing and production of metal articles. The low bank crediting level is still one of the factors hindering investments. Despite the substantial increase, investments are still at a rather low level.

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 mainly due to the dropping FDI flows in the 2nd quarter of 2012. Yet, in the 3rd quarter, the FDI flows increased threefold, compared to the previous quarter. The FDI stock in the economy of Latvia constituted LVL 6838.6 million at the end of September 2012. Comparing to the end of 2011, the FDI stock has increased by 4%, including manufacturing – by 4.5%. Investments in services sectors constitute a larger share of the FDI stock in the structure of sectors.

Both, the increase of demand for intermediate consumption goods in manufacturing **and improving situation in the domestic market foster an increase of imports**. In 2011, the growth rates of imports exceeded the growth of exports, and the negative export-import balance increased to 4.8% of GDP. Yet, in the three quarters of 2012, volumes of goods and services imports exceeded the level of the corresponding period of 2011 by 3.9%. Since imports grew at a slower pace than exports, the foreign trade deficit dropped to 4.1% 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.

Production volumes of manufacturing continue growing due to the remaining positive export tendencies. In 2011, production volumes of the sector were by 11.7% higher than a year ago, but in the three quarters of 2012 they increased by 10.5% in comparison with the corresponding period of the previous year. 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.

Increasing activities of foreign trade has fostered also the growth of transport sector by 8.1% in 2011 and by 4.9% in the three quarters of 2012 compared to the corresponding period of the previous year.

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 9.6% in 2011, but in the three quarters of 2012 – by 9.8% in comparison with the corresponding period of the previous year. After the substantial decline during the crisis, the construction sector resumed growth in 2011 and grew by 11.9% within a year. In the three quarters of 2012, construction kept growing fast (by 16.3%, compared to the three quarters of 2011). It should be taken into account that the sector went through a deep recession during the crisis.

After the deflation caused by the crisis when the 12-month consumer price inflation decreased to -4.2% in February 2010, **prices started increasing again**. In 2011, the 12-month consumer prices increased by 4%, while in 2012 – only 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. Dynamics of world fuel prices also had a major influence. Considering the relatively rapid price increase in 2011, **the average price level in 2012 was by 2.3% higher than a year ago**.

The Ministry of Economics forecasts **a moderate rise in prices in 2013** (on average by 1.5% per year). At the same time, high uncertainty about food and fuel prices in the world will remain.

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**. At the end of the 3rd quarter of 2012, compared to the corresponding period of the previous year, the balance of deposits attracted by banks has increased by 6.1%. It was mainly determined by the considerable increase in the balance of non-resident deposits, while the balance of resident deposits decreased (mainly due to the decrease in central and local government deposits).

Since the end of 2009, the **interest rates have stabilised.** The weighted average interest rate of short-term loans granted in lats was 5.2% in the 3rd quarter of 2012, but the weighted average interest rate of long-term loans – 9.7%, which are among the lowest interest rates in the recent years. The weighted average interest rates on short-term and long-term deposits issued in EUR were correspondingly 3.6% and 7.3%, which are lower than the interest rates on credits issued in LVL.

Loans for total amount of LVL 768.5 million have been granted anew to residents in the three quarters of 2012. Comparing to the corresponding period of 2011, the amount of new loans granted to residents has increased by 11.4%. As regards the business sector, the majority of loans have been granted to financial and insurance operations and electricity, gas and heat supply sectors.

The quality of the loan portfolio continues improving and in the 3rd quarter of 2012, there were 19.8% loans with overdue payments. Comparing to the 3rd quarter of 2011, the amount thereof has shrunk by 1/3. Resident loans with overdue payment above 180 days have also been decreasing in this period (by 41%).

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, at the end of the 3rd quarter of 2012, they were by 11.1% lower than a year ago. It is mainly based on the decrease in the balance of mortgage loans (by 14.3% in a year).

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, since 2008, Latvia has carried out budget consolidation in the amount of LVL 2.3 billion with fiscal impact of 17% of GDP. As a result of budget consolidation implemented by the government, the budget deficit in 2010 and 2011 decreased to 8.1% and 3.4% of GDP, respectively. Provisional data show that **the budget deficit in 2012 has been 1.2% of GDP thus creating the preconditions for terminating the procedure for preventing the excessive budget deficit proposed by the EU, as well as ensuring fulfilment of the Maastricht criterion on the budget deficit**, laying a strong foundation for Latvia to introduce euro on January 1, 2014.

In order to strengthen fiscal discipline further and avoid excessive budget deficit and development of government debt, in May 2012, the Saeima ratified the EU *Fiscal Discipline Treaty*. The Saeima has adopted the *Fiscal Discipline Law* (FDL) stipulating 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 commissions.

The Saeima **approved the government budget for 2013 with a deficit of 1.4%** of GDP. The general government deficit is expected to be below 0.8% of GDP in 2014 and 0.3% of GDP in 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 the 3rd quarter of 2012, the number of employed reached 905 thousand which is by 3.4% or 30 thousand more than in the 3rd quarter of 2011. The unemployment rate in the 3rd quarter of 2012 was 13.5% which is by 1.5 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 thousand unemployed which is by 26.5 thousand less than in December 2011. The highest unemployment rate remained in the Latgale region (21.1%), while the lowest – in Riga (6.8%). In late 2012, 44.2% of the total number of registered unemployed was long-term unemployed (jobless for longer than a year).

According to the evaluation of the Ministry of Economics in 2012, the number of employed has increased by 2.7% in total, while the average unemployment rate of the year has dropped to 14.8%. 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 be still closely related to the export possibilities, and therefore **the highest risk to the growth of Latvia is related to global economic development.**

Considering the expected weak economic growth in the EU, **the Ministry of Economics forecasts slightly more moderate economic growth of Latvia in 2013 than it was in 2012 and GDP might grow within 4 per cent**.

The growth of the economy 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 state budget.

The more rapid development scenario expects that **the growth rate of GDP in Latvia may reach stable growth of 5% per year.** 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. DEVELOPMENT OF THE WORLD ECONOMY[1]

Although the global economic recovery continues, it still is slow. Growth of the developed countries is currently at a level that is too low to considerably reduce the high unemployment rate, and the high growth rates are dropping also in the largest developing countries.

The key factors hindering growth in the developed countries are fiscal consolidation and still weak financial systems. Fiscal consolidation limits the demand that may have a negative impact on further economic growth. Restricting conditions still exist for borrowing financial resources.

Table 2.1

GDP Growth

(per cent in comparison with the previous year)

	2010	2011	2012f	2013f
World including:	**5.1**	**3.8**	**3.3**	**3.6**
USA	2.4	1.8	2.2	2.1
Japan	4.5	-0.8	2.2	1.2
EU including:	2.1	1.6	-0.2	0.5
Eurozone	2.0	1.4	-0.4	0.2
CIS	4.8	4.9	4.0	4.1
China	10.4	9.2	7.8	8.2

Source: *The World Economic Outlook October2012, International Monetary Fund*; f – forecast.

The weak growth and uncertainty in developed economies limits global trade that, in its turn, affects the growth of such developing countries as China, India, etc.

According to the evaluation of the International Monetary Fund, the global growth was 3.3% in 2012 which is slower than in 2010 and 2011. A weak economic growth is expected in the majority of regions also in the first half of 2013, and yet, global GDP may exceed the level of 2012 by 3.6% in 2013.

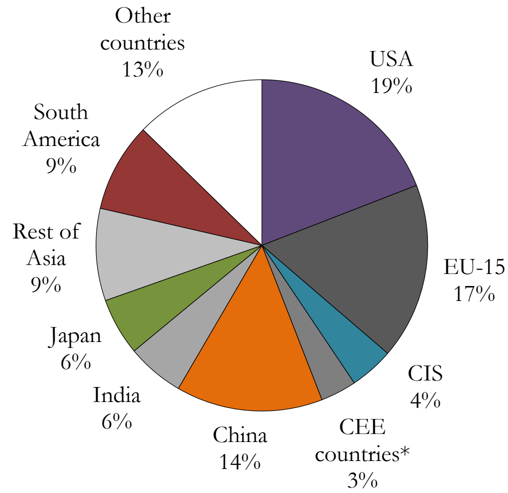
Among developed countries the **USA** has showed a relatively stable economic growth reaching the pre-crisis economic level already in the second half of 2011. Yet, compared to the pre-crisis level, the growth still is slow. In 2012, situation in the labour market has improved, though the recovery was moderate also in 2012. External uncertainties had a negative impact on the economic growth of the USA in 2012.

The growth of the USA in near future is considered uncertain due to both external and internal risks. The higher external risk is the lingering crisis in the euro zone that may affect the growth of the USA exports. The main internal risk is related to the expected fiscal consolidation measures.

Figure 2.1

Breakdown of the World's GDP by Groups of Countries in 2011

(structure, GDP by purchasing power parity units)



Source: *The World Economic Outlook October 2012, 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

In 2012 and 2013, the growth of USA is expected to amount to slightly over 2%. A more rapid economic growth will be limited by high indebtedness of households, weak confidence indicators, strained financial conditions and the need for fiscal consolidation. Recovery of housing market might provide great contribution of the economic growth of the USA in 2013 and upcoming period, as well as improvements in the labour market that might improve consumer confidence.

[1] The preparation of the section is based on periodicals: *International Monetary Fund- World Economic Outlook, October 2012; European Commission-European Economic Forecast, Autumn 2012; European Central Bank- Monthly Bulletin, December 2012.*

In 2012, the growth decreased also in the countries of **Asia** region. A weaker external demand had a negative impact on the dynamics of exports in the region. At the same time, the weaker export indicators were partially compensated by the growing domestic demand. The dropping prices and housing market activities resulted in partial giving up of the restrictive monetary and credit policies in 2012. Yet, it had not the expected effect on growth promotion. The decreasing growth of China has affected the growth in the rest of Asia.

Table 2.2

The Main Macroeconomic Indicators of the Asia region
(per cent)

	2011	2012f	2013f
GDP growth, including:	5.8	5.4	5.8
China	9.2	7.8	8.2
India	6.8	4.9	6.0
Japan	-0.8	2.2	1.2
Consumer prices, including:	5.0	3.9	3.8
China	5.4	3.0	3.0
India	8.9	10.2	9.6
Japan	-0.3	0.0	-0.2
Current account balance (% of GDP), including:	1.9	1.2	1.3
China	2.8	2.3	2.5
India	-3.4	-3.8	-3.3
Japan	2.0	1.6	2.3

Source: *The World Economic Outlook October 2012, International Monetary Fund;*
f – forecast.

Further and medium-term economic growth of the countries in the Asia region will be more moderate than in the previous decade. It is mainly based on the expected weak external demand that will particularly affect the largest exporting countries of the region.

Overall in 2012 and 2013, the growth of Asia region is expected to be slightly below 4%. The growth of China in this period will amount to 8-9%, while in India 5-6%. The economic growth of Japan in 2012 was expected to amount to about 2% and it was mainly based on the activities in the construction sector, as well as industrial growth. Yet, the economic growth rate of Japan in 2013 is likely to be moderate – about 1 per cent.

Since the second half of 2011, growth of the **European Union** in general and the euro zone in particular has been weak. Currently, a number of member states, especially in the euro zone, are facing structural issues related to internal and external imbalances, as well as factors restricting the growth with respect to the recent financial crisis and the dropping global growth rates.

Gradual global economic recovery and improving confidence in 2013 will allow the EU and euro zone economies to develop faster.

The implemented structural reforms and economic balance measures will have a positive effect in the long run. The EU economic growth in the long-term will depend on an increase in competiveness and productivity.

Contrary to the forecasts for 2012, the overall GDP has decreased in the EU-27 member states (including the euro zone countries). The growth might resume gradually in early 2013. Improved confidence of entrepreneurs and consumers and its positive impact on consumption and investments is a substantial precondition for growth. Yet, exports will be the main economic driver in 2013.

Due to strong exports, the growth of **Lithuania** and **Estonia** in 2011 was significantly above the average EU level, yet, these rates dropped in early 2012.

Comparing to 2011, the economy of Lithuania was negatively affected by external factors, as well as dropping rates of the domestic demand at the beginning of 2012. Recovery of the labour market and reducing debt-servicing costs had a positive impact on private consumption in early 2012. The growth was limited by the weak confidence of entrepreneurs that affected the decrease in investment rates. Yet, foreign trade was negatively influenced by the weak external environment, as well as temporary shutdown of the oil refining factory.

In 2013, the growth will be mainly based on the domestic demand. The weak external environment and post-election uncertainties may slightly slow down the investment rates at the beginning of the year. The improving economic situation in the euro zone in the second half of the year might have a positive impact on growth through foreign trade. Overall, growth in Lithuania is expected to amount to slightly over 3% in 2013 which is a little more than in 2012.

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 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.

In 2013, the growth of Estonia, like in Lithuania, is expected to be slightly over 3%, mainly due to the stable domestic demand, as well as recovery of partner economies.

Table 2.3

The Main Macroeconomic Indicators of the EU Member States

(per cent)

	GDP growth			Consumer prices			Unemployment		
	2011	**2012f**	**2013f**	**2011**	**2012f**	**2013f**	**2011**	**2012f**	**2013f**
Austria	2.7	0.8	0.9	3.6	2.4	1.8	4.2	4.5	4.7
Belgium	1.8	-0.2	0.7	3.5	2.6	1.8	7.2	7.5	7.7
Denmark	0.8	0.6	1.6	2.7	2.4	2.0	7.6	7.7	7.7
Finland	2.7	0.1	0.8	3.3	3.0	2.5	7.8	7.9	8.1
France	1.7	0.2	0.4	2.3	2.3	0.7	9.6	10.2	10.7
Germany	3.0	0.8	0.8	2.5	2.1	1.9	5.9	5.5	5.6
Greece	-7.1	-6.0	-4.2	3.1	1.1	-0.8	17.7	23.6	24.0
Ireland	1.4	0.4	1.1	1.2	2.0	1.3	14.4	14.8	14.7
Italy	0.4	-2.3	-0.5	2.9	3.3	2.0	8.4	10.6	11.5
Luxemburg	1.7	0.4	0.7	3.7	2.9	1.9	4.8	5.4	6.4
The Netherlands	1.0	-0.3	0.3	2.5	2.8	2.4	4.4	5.4	6.1
Portugal	-1.7	-3.0	-1.0	3.6	2.9	0.9	12.9	15.5	16.4
Spain	0.4	-1.4	-1.4	3.1	2.5	2.1	21.7	25.1	26.6
Sweden	3.9	1.1	1.9	1.4	1.0	1.3	7.5	7.5	7.4
United Kingdom	0.9	-0.3	0.9	4.5	2.7	2.1	8.0	7.9	8.0
Bulgaria	1.7	0.8	1.4	3.4	2.5	2.6	11.3	12.7	12.7
Cyprus	0.5	-2.3	-1.7	3.5	3.2	1.5	7.9	12.1	13.1
Czech Republic	1.9	-1.3	0.8	2.1	3.6	1.1	6.7	7.0	7.3
Estonia	8.3	2.5	3.1	5.1	4.3	4.1	12.5	10.5	9.8
Hungary	1.6	-1.2	0.3	3.9	5.6	5.3	10.9	10.8	10.8
Latvia	5.5	4.3	3.6	4.2	2.4	2.1	16.2	15.2	14.3
Lithuania	5.9	2.9	3.1	4.1	3.4	3.1	15.4	13.5	12.4
Malta	1.9	1.0	1.6	2.5	2.9	2.2	6.5	6.3	6.3
Poland	4.3	2.4	1.8	3.9	3.8	2.6	9.7	10.1	10.5
Romania	2.5	0.8	2.2	5.8	3.5	4.9	7.4	7.4	7.3
Slovakia	3.2	2.6	2.0	4.1	3.7	1.9	13.6	13.5	13.5
Slovenia	0.6	-2.3	-1.6	2.1	2.8	2.2	8.2	8.5	9.3

Source: *European Commission- European Economic Forecast, Autumn 2012*;
f – forecast.

The growth in the **CIS countries** remained stable in early 2012. It was mainly fostered by the high process for the key export goods, high harvest of agriculture in 2011, as well as strong financial flows. Yet, the financial crisis of the euro zone countries has negative impact on the financial sector of three largest CIS countries – Kazakhstan, Russia, and Ukraine. Investment rates have slightly decreased. At the same time, growth in the region is maintained on the account of increasing credit amounts in Russia and other largest exporting countries of energy resources.

Table 2.4

Main Macroeconomic Indicators of the CIS
(per cent)

	2011	2012f	2013f
GDP growth, including:	4.9	4.0	4.1
Russia	4.3	3.7	3.8
Ukraine	5.2	3.0	3.5
Kazakhstan	7.5	5.5	5.7
Consumer prices, including:	10.1	6.8	7.7
Russia	8.4	5.1	6.6
Ukraine	8.0	2.0	7.4
Kazakhstan	8.3	5.0	6.6
Current account balance (% of GDP), including:	4.6	4.2	2.9
Russia	5.3	5.2	3.8
Ukraine	-5.5	-5.6	-6.6
Kazakhstan	7.6	6.2	4.5

Source: *The World Economic Outlook October 2012*, *International Monetary Fund;*
f – forecast.

The drop in prices for export good negatively affecting the largest exporting countries is considered a risk of further growth of the region. The growth of the region will also depend on external demand in related to improving economic situation in the euro zone countries.

In 2012-2013, the growth in the CIS countries will amount to about 4%, including Russia – slightly below 4%. The main driver of the growth will be domestic demand based on expansive fiscal policy and increasing crediting. Yet, the growth of Ukraine is expected to be considerably lower than in 2011 due to the global financial crisis and the weak external demand.

The growth rates of the CIS countries will increase in the upcoming period along with the improving situation in the euro zone.

3. Growth

3.1. Gross Domestic Product Dynamics and Aggregate Demand

3.1.1. Development Trends

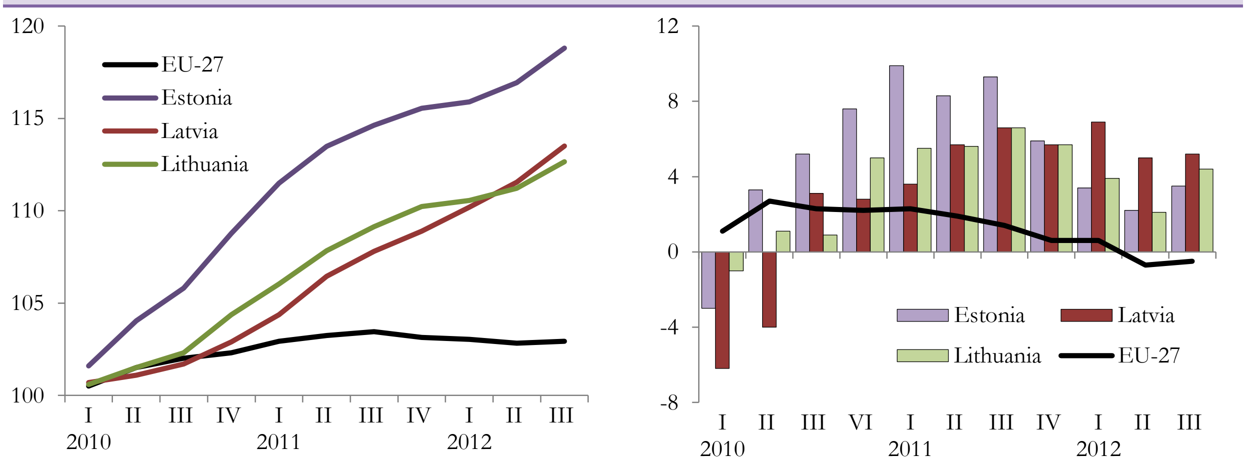
The global financial crisis severely affected the economy of Latvia. During the crisis, the gross domestic product decreased by approximately 25%. Since the end of 2009, a gradual growth is seen in the economy of Latvia.

In 2011, the GDP increased by 5.5%. Despite the weak economic growth in the EU, the economy of Latvia kept growing rather fast in 2012. In the three quarters of 2012, the GDP was by 5.6% higher than in the corresponding period of 2011. In the 3rd quarter of 2012, the GDP was by 14.7% higher than at the lowest point of the crisis in the 3rd quarter of 2009 and has now reached 86% of the pre-crisis level. Latvia has been one of the fastest growing economies in the EU over the past few years.

Figure 3.1

GDP Dynamics by Quarters

Seasonally adjusted data, 4th quarter of 2009 = 100	Against the respective period of the previous year, %



Due to the restored competiveness during the crisis, export has become the main driver of recovery of Latvian economy. In 2011, the volumes of goods and services exports have increased by 12.7%, thus exceeding the pre-crisis level.

The volumes of export kept growing also in 2012. In the three quarters of 2012, goods and services export exceeded the level of the corresponding period of 2011 by 7.3%. 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, which means that entrepreneurs are accessing new markets.

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

Increased profits from exports have fostered the growth of domestic demand. Since the 1st quarter of 2010, domestic demand has been increasing largely due to the increase in private consumption and rapid increase in investments. In 2011, domestic demand increased by 8.7 per cent.

Table 3.1

Dynamics GDP of Latvia by Expenditure Items

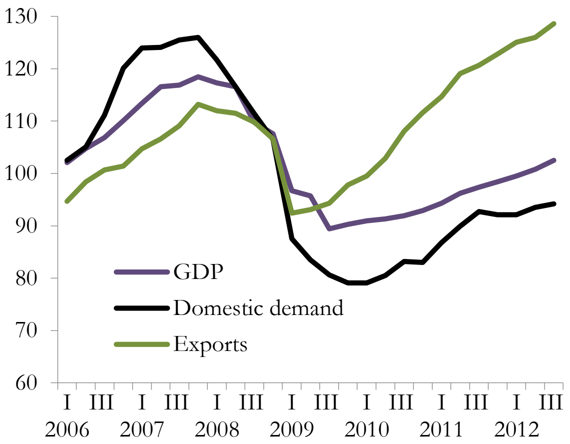
	2005-2007 on average per year	2008-2010 on average per year	2011	2012 I-IX	2005-2007 on average per year	2008-2010 on average per year	2011	2012 I-IX
	changes compared to the respective period of the previous year				contribution to changes, %			
Private consumption	15.7	-9.3	4.8	5.7	10.5	-6.7	3.3	4.0
Public consumption	4.0	-5.4	1.1	-4.9	0.6	-0.8	0.2	-0.7
Gross fixed capital formation	15.7	-23.8	27.9	16.2	5.3	-7.4	5.8	3.8
Inventories	–	–	–	–	-0.9	-0.7	2.6	-2.9
Exports	12.1	-0.7	12.7	7.3	5.0	-0.3	6.7	4.1
Imports	16.7	-12.8	22.7	3.9	-10.2	8.3	-13.0	-2.6
GDP	**10.3**	**-7.6**	**5.5**	**5.6**	**10.3**	**-7.6**	**5.5**	**5.6**

The domestic demand kept growing in 2012 and in the three quarters it was by 6.5% higher than in the corresponding period of 2011. Comparing to the lowest level of domestic demand during the crisis – in the 4th quarter of 2009, domestic demand has increased by 10.2 per cent.

Figure 3.2

Quarterly Changes in GDP and Major Expenditure Items

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



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 goods and services.

In 2011, import increased by 22.7%, while in the three quarters of 2012, the import volumes of goods and services were by 3.9% higher than in the corresponding period of 2011. Despite the relatively rapid growth of import over the past few years, they are 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.

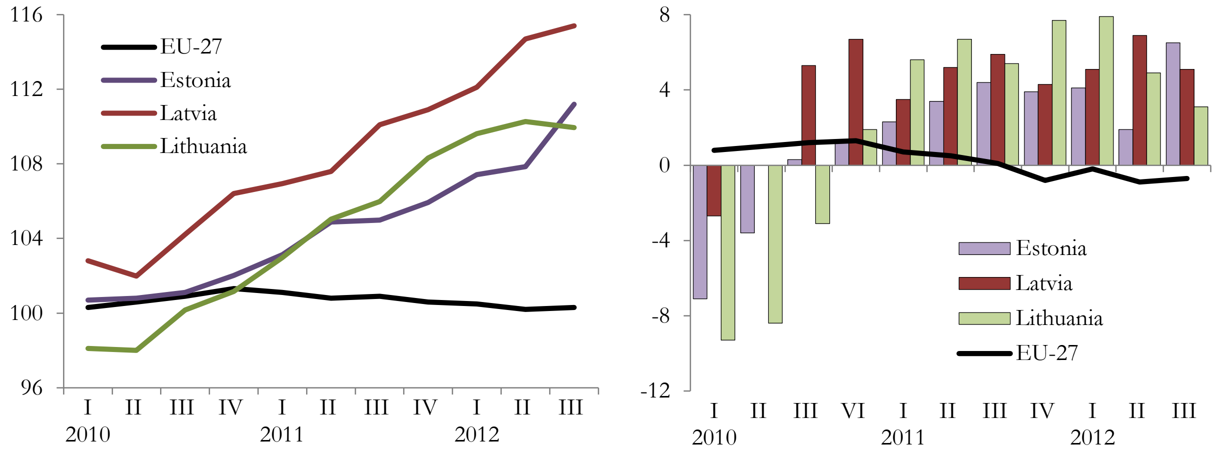
3.1.2. Private and Public Consumption

The decrease of **private consumption** started due to the crisis. The dropping private consumption was determined by significantly worsening situation in the labour market – growing unemployment and decreasing wages. 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 2009= 100	Changes compared to the respective period of the previous year, %

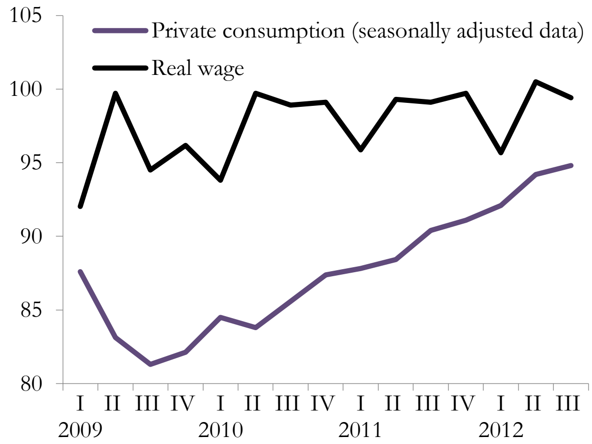


In 2012, the growth of private consumption still was fostered by the increasing employment and wages. In the three quarters of 2012, private consumption exceeded the level of the corresponding period of 2011 by 5.7 per cent.

Figure 3.4

Dynamics of Real Wage and Private Consumption

(4th quarter of 2008 = 100)



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 points.

Overall, consumer confidence has improved by nearly 12 points in 2012. The improvement is largely based on more optimistic consumer reviews on general economic situation in the country and financial situation in their families. In spite of general consumer optimism, they are concerned about potential increase in prices and unemployment.

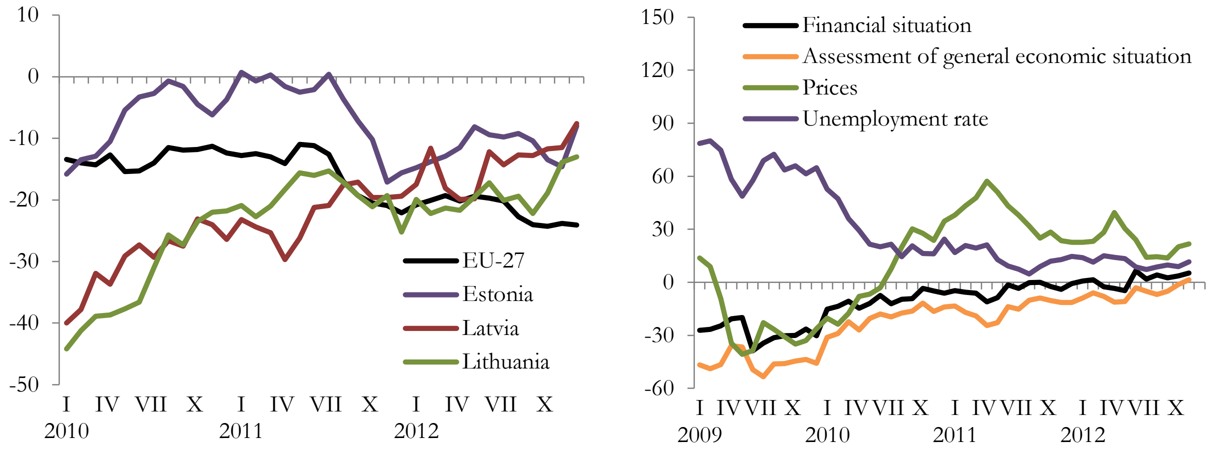
The volumes of **public consumption** or public services shrunk fast during the crisis. In 2011, public consumption was by 14.4% lower than in 2007. The drop was based on implementation of the state budget consolidation measures.

Figure 3.5

Consumer Confidence Indicator*

(response balance, seasonally adjusted data)

Consumer Confidence in the Baltic States and EU-27	Consumer evaluation for the upcoming 12 months



* 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.

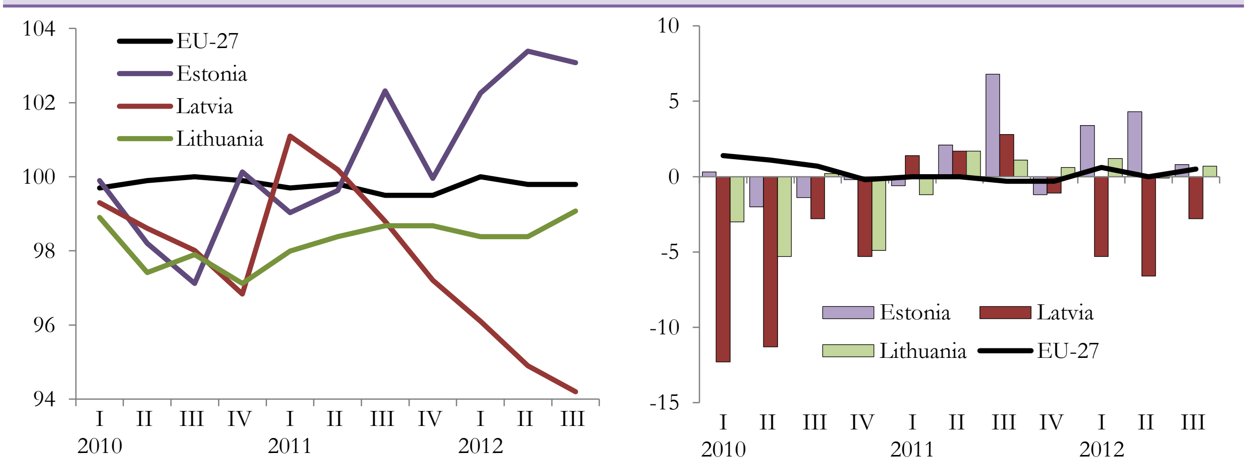
It resulted in reduced share of public consumption in the GDP. In 2008, public consumption accounted for 20% of GDP, in 2009 – 19.6%, in 2010 – 18.4%, whereas in 2011 – only 17.3% of GDP.

Although the economic situation is improving, the government commitment to keep on reducing the budget deficit limits rapid increase in expenditures. In the three quarters of 2012, the volumes of public services were by 4.9% lower than in the three quarters of 2011.

Figure 3.6

Changes of Public Consumption by Quarters

Seasonally adjusted data, 4th quarter of 2009 = 100	Over the respective period of the previous year, %



3.1.3. Investments

Investments are a part of the aggregate demand characterized by an explicitly cyclic nature and are highly sensitive to any changes in the economic situation and business environment. Investments often are both the cause of business cycle phases and the booster of cyclic fluctuations.

During the global financial crisis investments in the economy of Latvia decreased significantly. However, investment activities are growing rather fast along with the stabilising economic situation. It should be noted that cyclic fluctuations of investment volumes have been observed in all EU member states, though they have been considerably stronger in the Baltic States.

The rapid decrease in investments in Latvia during the years of economic recession was intensified by a substantial debt of enterprises accumulated during the rapid growth years, as well as by worsening solvency of the Latvian banking system. In 2010, investments were by 56% lower than in 2007. The decrease in investments was mainly due to low domestic and external demand, as well as due to the low manufacturing capacity load. Since the end of 2010, investment activities in Latvia have been gradually increasing though they are still at a very low level. In 2010, investments in the economy of Latvia were almost by a half lower than in 2007 and constituted 18.3% of GDP.

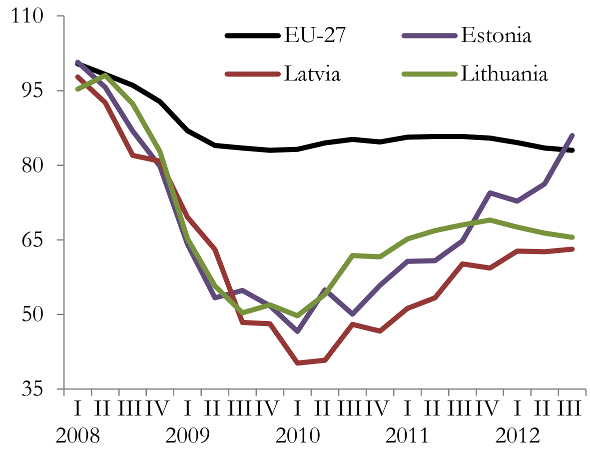
Decline in investments from 2008 till 2009 was observed also in other EU Member States. Sensitivity of investors to economic fluctuations was to a great extent determined by the worsening financial situation of companies due to a rapidly narrowing market. Since 2008 to 2010, investments in the EU Member States have 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.

Since 2011, the situation has turned the other way round. Investment volumes in the Baltic States increased rapidly within a year (in Latvia – by 27.9%, in Lithuania – by 18.3% and Estonia – by 25.7%). The Baltic States took the leading position among the EU member states in terms of the growth rates of investment volumes. It should, however, be noted that the rapid increase in investment volumes was to a great extent related to the low base effect. In 2011, investments in the economy of Latvia constituted 56.6% of the level of 2007.

Figure 3.7

Changes in Investment Volumes

(4th quarter of 2007=100)



The investments kept growing at a high pace also in the first half of 2012. In the 1st quarter of 2012, as compared to the corresponding period of the previous year, investments have increased by 39% and in the 2nd quarter – by 20.5%. Yet, in the 3rd quarter, investment volumes were by 2% higher than a year ago. In the 3rd quarter of 2012, non-financial investment volumes were by just 2% higher than in the 3rd quarter 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. A more rapid increase in investments is prevented by the still weak crediting, as well as the awaiting behaviour of entrepreneurs considering the uncertain external situation. Overall, in the three quarters of 2012, investments in national economy of Latvia exceeded the investments of last year by 16.2%. Investments constituted nearly ¼ of GDP over the past two years.

Table 3.2

Gross Capital Formation

	2005-2007 average annually	2008	2009	2010	2011	2012 I-IX
			changes in per cent			
GDP	10.3	-3.3	-17.7	-0.3	5.5	5.6
Gross Capital Formation	11.9	-19.7	-47.1	4.2	42.7	3.3
– gross fixed capital formation	15.7	-13.8	-37.4	-18.1	27.9	16.2
			% of GDP			
Gross Capital Formation	37.5	31.2	20.5	19.8	25.3	25.4
– gross fixed capital formation	32.7	29.7	21.6	18.2	21.3	22.7
– changes in inventories	4.9	1.6	-1.1	1.6	4.0	2.7

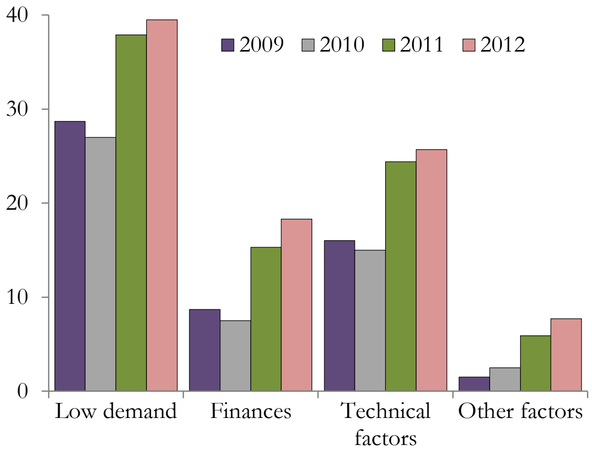
The state plays an important role in the investment process. The state provides a significant support to private investments through the EU structural funds co-financing under weak crediting conditions.

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 16.4%, contributing by 4.5 percentage points to the total increase in investments.

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 2012, the role of "access to finance" factor in the investing process is increasing, which is related to the slow restoration of private sector crediting channels.

Figure 3.8

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 has reached 69.4%, but at the end of 2012 it has 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. In comparison with 2007, investments in agriculture increased by 23.5%, real estate transactions – by 23.2%, investments in the hotel and restaurant business increased almost twice. However, the investment volumes in other sectors decreased. A particularly significant decrease of investment volumes was observed in the energy sector, financial services, manufacturing and construction. In total, investments in manufacturing 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 goods production sectors 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%), information and communication services (by 8.2%). It should be noted that investments in manufacturing increased by 5.5 per cent.

Stabilization of the economic situation has positively affected the investment process in Latvia. It is recovering rather rapidly. According to provisional data, investment dynamics of goods production sectors is almost three times faster than services sectors. In 2011, investments in services sectors increased by 16.6% and constituted almost 60% of total investments in the economy of Latvia. Investments in goods production sectors in 2011 were almost by 42% higher than a year ago. It was mainly due to the substantial investments in the energy sector and manufacturing.

In the three quarters of 2012, investments in the economy of Latvia were almost by 20% higher than a year ago. Out of all investments, 42.5% were investments in residential buildings, constructions and structures and nearly 40% have been invested in equipment and machinery.

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

Table 3.3

Dynamics and Structure of Investments by Sectors *

	Growth rates					Structure				
	2005-2007 average annually	2009	2010	2011	2012 I-IX	2005-2007 average annually	2009	2010	2011	2012 I-IX
Agriculture and forestry	1.5	-41.0	-16.3	66.0	46.9	4.4	3.8	5.9	6.0	7.4
Manufacturing	15.5	-53.1	5.5	30.7	1.4	16.2	9.3	13.0	17.4	15.7
Construction	22.2	-46.1	-33.3	35.3	43.7	7.2	9.1	8.0	1.6	1.9
Trade	-1.5	-50.6	-24.2	32.0	32.2	13.2	8.0	8.0	7.0	7.5
Transport and communications	3.0	-40.1	8.1	8.9	26.8	13.2	11.5	19.4	18.1	20.4
Other commercial services	21.4	-30.9	-37.7	-7.6	63.2	23.4	25.0	20.6	6.2	8.5
Public services	11.1	0.0	-44.3	25.7	4.5	14.7	25.1	18.5	28.8	21.6
Other industries	7.8	-35.3	-9.8	49.3	24.2	7.8	8.2	9.7	14.8	17.0
Total	**15.9**	**-37.4**	**-18.1**	**27.9**	**16.2**	**100**	**100**	**100**	**100**	**100**

* 2011 and 9 months of 2012 – by quarterly data

In the nine months of 2012, investments in services sectors have increased by 21.6% which is slightly faster than in the goods production sectors. It was mainly influenced by the huge investments in trade, transport and storage sector, as well as real estate transactions. Investments in the given sectors have increased correspondingly by 32.5%, 40% and 117% constituting over a half 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 dealing with management of real estate for remuneration or on the basis of a contract.

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 27 per cent.

In the three quarters of 2012, investment volumes in goods production sectors have increased by 17.5% constituting 42% of the total investment volume in national economy, as compared to the corresponding period of the previous year. In the three quarters of 2012, most of the investments have been made in electricity, gas supply and air conditioning sector. Investments in this sector exceeded the investment volumes of the previous years by 20.3% constituting 15% of the total investment volume.

Investments in water supply, sewerage, waste management and remediation activities have increased nearly by one and a half time.

Investments in manufacturing have been gradually 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 production sectors 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 30.4% in 2011, compared to 2010. More than a half of the investments in manufacturing were made in wood processing and production of metals.

In the three quarters of 2012, LVL 211 million or 15.5% of the total investment volumes in the economy of Latvia have been invested in manufacturing, which is by 1.4% more than in the corresponding period of 2011.

Table 3.4

Dynamics and Structure of Investments in Manufacturing *

(per cent)

	Growth rates					Structure				
	2005-2007 average annually	2009	2010	2011	2012 I-IX	2005-2007 average annually	2009	2010	2011*	2012 I-IX
Food industry	-1.8	-52.0	-6.1	60.1	109.7	20.4	15.1	13.4	17.7	30.9
Light industry	-13.3	-32.8	-30.0	83.1	28.3	2.6	2.5	1.7	1.6	1.3
Wood processing	18.2	-88.3	139.6	147.0	-12.4	26.4	8.4	19.1	31.0	26.7
Paper industry and publishing	20.2	-71.5	152.6	44.5	-40.3	7.5	2.5	5.9	3.0	1.8
Chemical industry and related industries	24.3	-11.4	16.3	6.9	-24.9	7.7	12.2	13.5	8.5	7.4
Production of other non-metallic mineral products**	79.0	-19.7	-51.9	-78.5	-38.9	15.1	39.3	17.9	6.5	4.7
Production of metals and metal articles**	20.5	-59.4	130.1	157.5	-33.4	7.2	7.0	15.2	20.4	15.4
Production of machinery and equipment	9.0	-43.7	90.1	173.7	13.3	2.0	2.0	3.6	1.4	1.3
Production of electrical and optical equipment	7.1	-53.7	15.8	106.9	70.8	2.7	1.1	1.9	1.8	2.6
Production of vehicles	25.0	0.4	43.2	148.2	-13.5	2.4	4.5	3.5	4.4	4.1
Other industries	20.9	-27.0	-23.7	255.3	33.1	6.0	5.4	4.3	4.0	3.8

* 2011 and 9 months of 2012 – by quarterly data;
** estimation of the Ministry of Economics

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 situation in the real estate market. Investments in this sector constituted 6.5% of total investments in manufacturing in 2011. Also in the three quarters of 2012, investments in production of construction materials were also by 40% lower than a year ago.

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 total investments in manufacturing. At the same time, it should be mentioned that investments for rationalising the production process have been increasing in 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

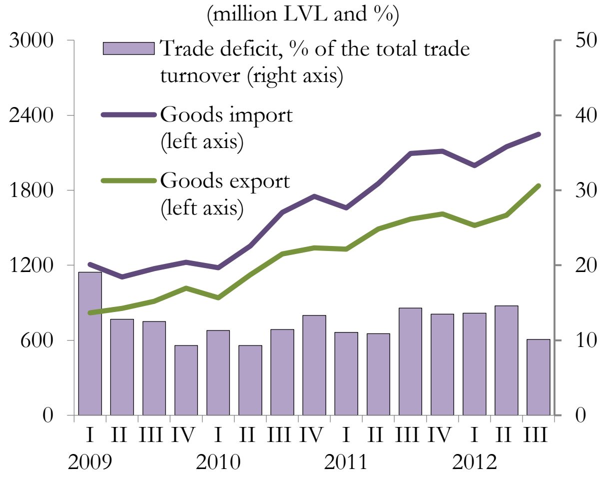
Exports and imports of goods

Despite the remaining uncertain external situation, Latvian export is growing fast. In 2011, exports of Latvian goods in current prices increased by 28% (by 14% at constant prices) compared to 2010. Also in 2012, exports of goods continue increasing rapidly and in January-November 2012, exports have increased by 15% in current prices compared to the eleven months of 2011.

In 2011, imports of goods in current prices increased slightly faster than exports – by 31% (by 23% at constant prices) compared to 2010. Yet, in the eleven months of 2012, import of Latvian goods increased at a slightly slower pace than export – by 13%, compared to the level of January-November 2011.

Figure 3.9

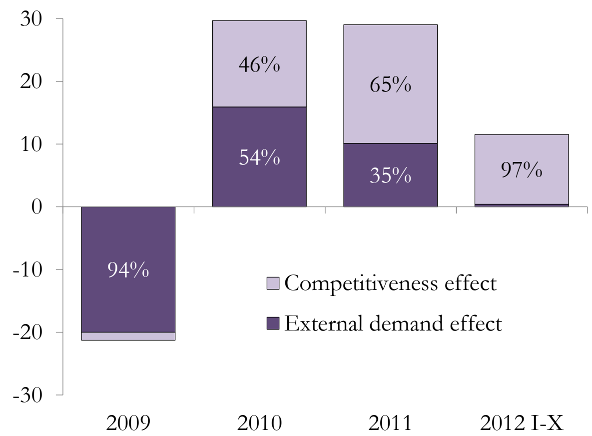
Exports and Imports of Latvian Goods by Quarters
(million LVL and %)



As export of goods increased faster than import in 2012, the external trade deficit is decreasing as well. In January-November 2012, it is considerably lower than it was in the period of rapid growth and now constitutes just about 10% of the foreign trade volume. Yet, in 2007-2008 it constituted over ¼ of the total foreign trade volume.

Figure 3.10

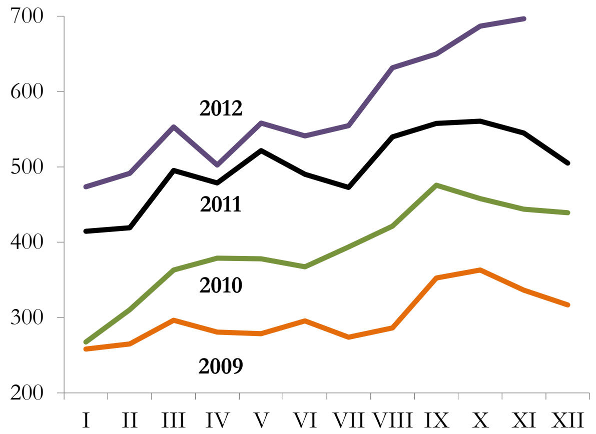
Breakdown of export changes by analysing the constant market share
(structure of changes in Latvian export to the EU countries, per cent)



The fastest decline in export volumes observed in 2009 was mainly related to the significantly narrowing demand in the major trade partner countries in the European Union. As the economy resumed growing in 2011, it is mainly influenced by the improving competiveness of Latvian entrepreneurs. Latvian export continues growing fast also in 2012, although the overall growth in the EU has been weak in 2012.

Figure 3.11

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



The total exports of Latvian goods in January-September 2012 were affected by the worsening trade conditions, the import unit value index increased by 8%, whereas that of export – by just 3%. Export prices grew faster for food industry products, machinery and chemical industry products. Yet, export prices decreased for timber and timber articles.

In January-November 2012, export volumes of goods increased in all 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 over 40% of the total increase in exports and the share of the group in the total export structure has increased correspondingly by 3.5 percentage points and constitutes nearly 20%. In 2012, it became the largest export group of Latvian goods. The growth of this product group is due to the high harvest of crops and oilseeds in 2012, as well as the increase in certain food production products.

Export of machinery and metal processing product group have also considerably increased. Both of the product groups constituted about ¼ of the total export increase.

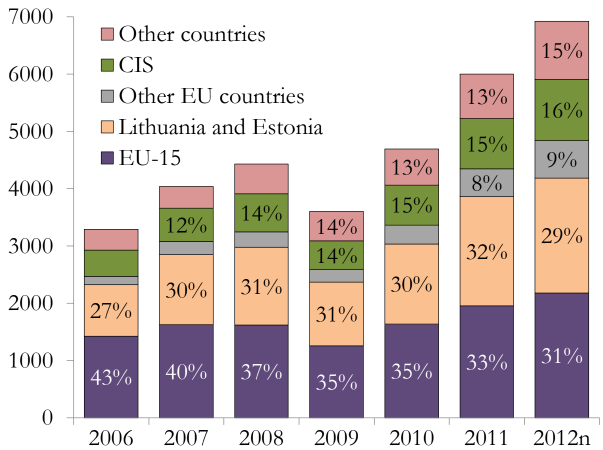
Table 3.5

Exports by the Main Commodity Groups
(%, in current FOB prices)

	2011		January-November 2012	
	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**	**27.8**	**15.4**	**15.4**
agriculture and food products	16.4	17.0	40.3	6.5
wood and wood products	16.8	13.5	4.7	0.8
metal and metal articles	14.5	33.5	12.3	1.8
machinery products	12.7	25.3	23.7	3.0
products of chemical industry and related industries, plastics	10.5	25.3	2.5	0.3
minerals	9.1	93.8	17.7	1.6
vehicles	6.7	41.9	-8.8	-0.6
light industry products	4.7	19.4	15.9	0.7
other goods	8.6	27.7	14.3	1.2

Figure 3.12

Structure of Latvian Exports by Groups of Countries
(million LVL)

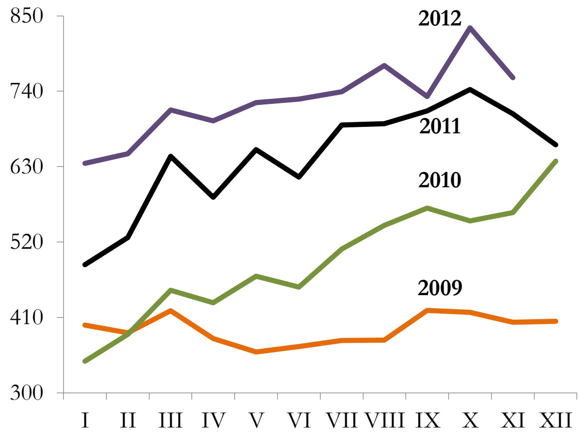


Exports to the EU Member States increased by 11% in January-November 2012 compared to the corresponding period of 2011. The growth in exports of agriculture and food product group contributed the most to this increase (more than 40%).

In January-November 2012, exports to the CIS countries increased by 22%. The growth in exports of agriculture and food product group contributed the most to this increase (50%), similarly like to the EU Member States.

Figure 3.13

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



The increase in imports of goods in January-November 2011 was mainly influenced by the increase in imports of mineral products, machinery products, and agriculture and food products, altogether constituting 2/3 of the total increase in imports.

Import from the EU countries in January-November 2012 has increased similarly to the total import, while import from the CIS countries has increased faster due to a rapid increase in import of mineral products and vehicles.

Table 3.6

Imports by the Main Commodity Groups

(%, in current CIF prices)

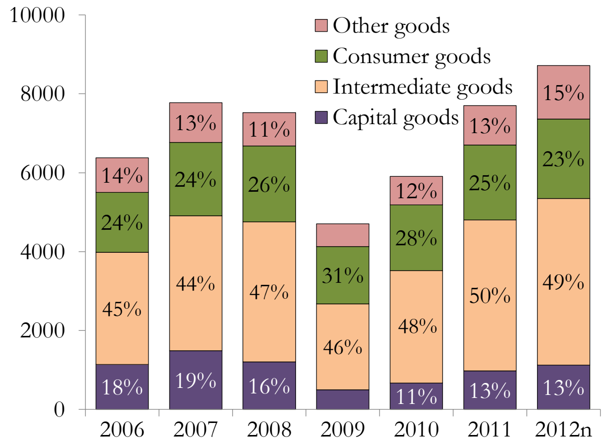
	2011		January-November 2012	
	structure	**changes compared to the previous year**	**changes compared to the respective period of the previous year**	**contribution to changes in volumes**
Total including:	**100**	**30.6**	**13.2**	**13.2**
mineral products	17.3	47.4	18.3	3.1
machinery products	17.3	37.5	17.1	2.9
agriculture and food products	15.1	21.0	16.6	2.5
products of chemical industry and related industries, plastics	14.9	15.7	6.1	0.9
metal and metal articles	10.9	39.2	8.7	1.0
vehicles	9.0	63.8	5.7	0.5
light industry products	5.3	22.5	14.9	0.8
wood and wood products	1.5	19.8	22.3	0.3
other goods	8.7	8.2	12.2	1.0

Until 2009, the share of import of capital goods shrunk along with the decreasing investments, yet, an opposite tendency is observed in the post-crisis period – in 2011, namely, import of capital goods and intermediate goods was growing faster.

Figure 3.14

Imports by Classification of the Broad Economic Categories

(related to the basic sections of national accounts, in current CIF prices, million LVL)

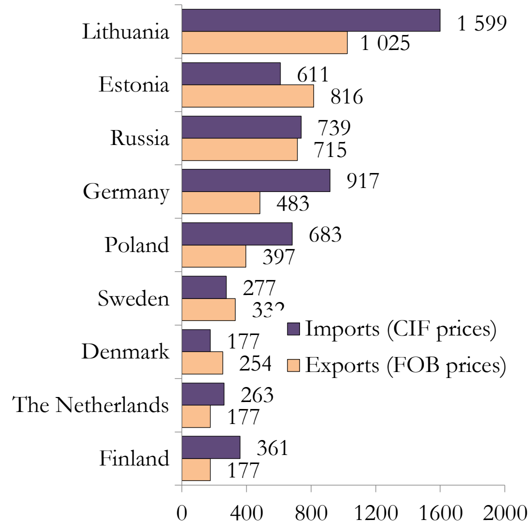


The biggest **trade partners** of Latvia from January until November 2012 were Lithuania – 18% of the total foreign trade turnover, Russia, Estonia and Germany – each 10%, Poland – 8%, Sweden and Finland – each 4%, and the Netherlands, Denmark and Belarus – each 3 per cent.

Figure 3.15

Foreign Trade Turnover of Latvia in January-November 2012 with major partner countries *

(million LVL)



* 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.

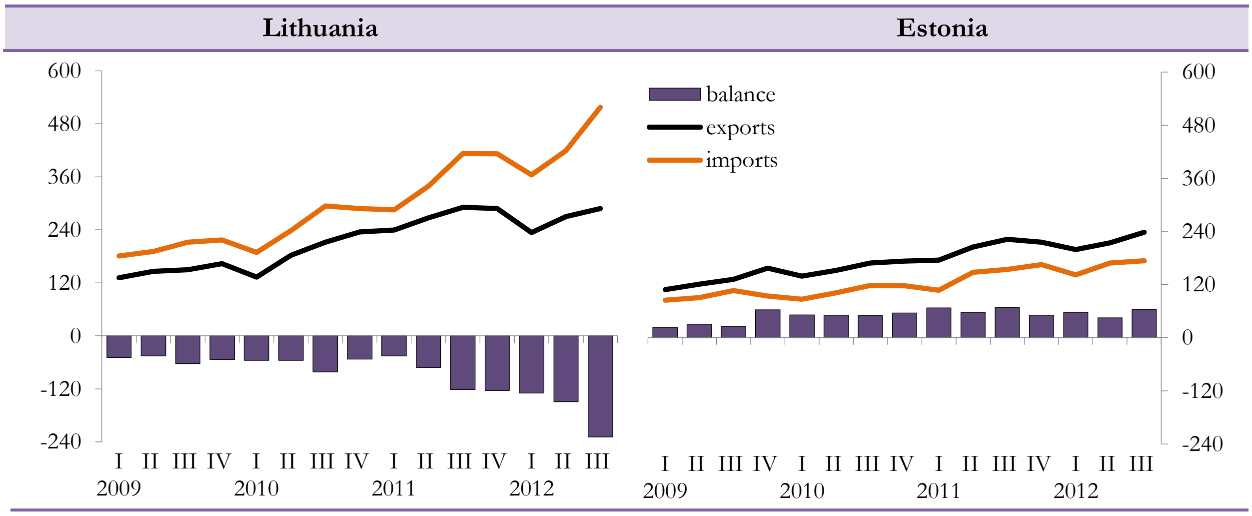
As usual, the trade balance with Estonia is positive, whereas with Lithuania – explicitly negative.

In January-November 2012, trade deficit with Lithuania was about LVL 500 million. The positive trade balance of Estonia covers just one third of the abovementioned amount, thus constituting a deficit for both countries in the approximate amount of 9% of the trade turnover with both countries.

The main groups of products exported to Estonia and Lithuania are agricultural and food products, as well as machinery products, however, the largest share in imports from Lithuania and Estonia constitute mineral products and agriculture and food products.

Figure 3.16

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



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 the three quarters of 2012 covered 65% of the negative trade balance of goods.

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. Road transport constitutes the largest share in transit export.

In January-September 2012, export groups of commercial services 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 the three quarters of 2012, export volumes of services to the EU Member States have increased similarly to the total exports of services – by 13%. Transit exports and exports of commercial services constitute the largest share in exports of services to the EU Member States.

The volumes of exports of services to the CIS countries increased slightly slower as the total exports of services – by 6% in January-September 2012. The increase was mainly ensured by revenues from tourists coming from the CIS countries (about 60% of the total increase). Export of commercial services to the CIS countries has increased significantly as well.

Table 3.7

Exports and Imports of Services
(per cent)

	2011				January-September 2012			
	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 including:	**100**	**100**	**15.1**	**13.1**	**100**	**100**	**13.1**	**9.7**
Transport services	50.2	31.0	17.2	17.4	51.8	32.3	15.1	11.9
– sea transport	12.9	7.6	2.3	12.9	13.7	7.4	19.6	4.9
– air transport	7.9	10.1	-2.7	7.1	8.1	11.2	7.4	16.8
– rail transport	13.5	5.1	32.7	29.3	14.2	4.8	19.0	1.5
– road transport	14.9	8.1	34.9	29.8	14.7	8.7	12.3	18.8
– other transport	1.1	0.2	14.2	34.6	1.1	0.2	10.6	15.1
Travel	17.3	29.2	14.0	12.0	16.7	26.7	6.8	-0.9
Other services	32.5	39.7	12.5	10.7	31.5	40.9	13.6	15.9
– communication services	2.3	4.9	0.3	16.8	2.7	5.0	34.7	13.7
– construction services	1.9	2.7	5.0	-0.7	2.3	4.7	48.6	91.9
– insurance and financial services	7.6	5.2	31.9	19.0	6.7	4.2	9.9	-16.3
– information and computer services	4.0	4.6	26.6	15.1	4.1	4.6	21.7	11.8
– other commercial services	15.4	21.2	4.3	9.2	14.6	21.0	8.3	15.3
– other services	1.3	1.3	18.3	-4.2	1.1	1.4	-11.6	29.0

Figure 3.17

Exports of Services by Quarters
(million LVL)

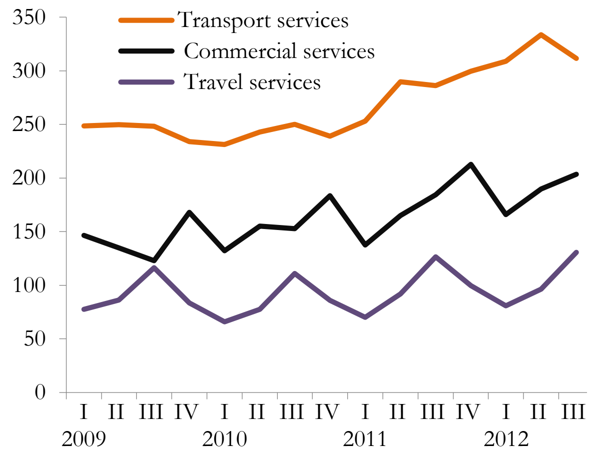
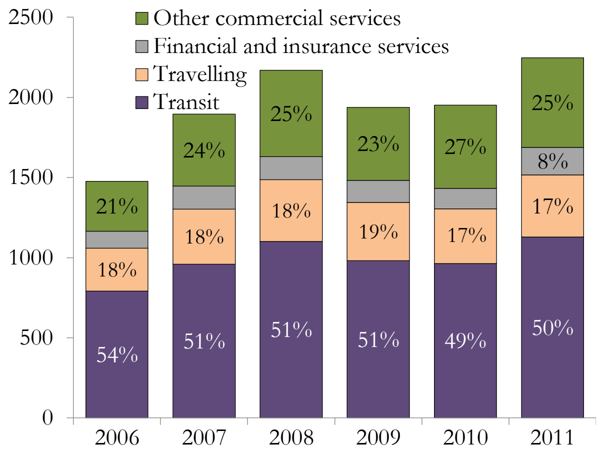


Figure 3.18

Exports of Services by Items
(million LVL)



In January-September 2012, services export to Estonia and Lithuania significantly increased, by 17% and 24% respectively. The main services export groups to both countries are commercial services, as well as services related to transportation.

3.2. Contribution of Sectors

3.2.1. Structure of the Economy and Development Tendencies of Sectors

The economic crisis affected all sectors of the economy. Trade, construction and manufacturing sectors experienced a substantial decrease. 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 and prices in the domestic market during the crisis fostered competiveness of Latvian producers leading to export growth and thus also to development of tradable sectors.

The increasing role of tradable sectors in the national economy is proven by the structure of sectors. In 2008, tradable sectors (agricultural, forestry, manufacturing and transport service sectors) constituted only 26% of the total value added; today the share of these sectors has reached 37 per cent.

The increase in the total export revenue has progressively fostered domestic demand and thus also development of more domestic market-oriented sectors.

Table 3.8

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

	2000	2005	2008	2009	2010	2011	2012n
Agriculture, forestry, and fishery	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	14.4
Other industries	4.2	3.3	4.3	4.9	5.3	5.2	5.0
Construction	6.8	7.0	10.1	8.0	5.3	5.4	6.3
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	12.2
Other commercial services	25.1	25.7	28.4	27.5	27.2	26.3	25.8
Public services	17.0	15.1	16.5	17.0	15.2	14.0	13.4
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**

In 2011, growth was observed in practically all sectors of the economy due to the remaining stable external demand, as well as the gradually growing domestic demand.

Manufacturing volumes in 2011 increased by 11.7%. The increase in external trade activities has fostered the growth of transport sector by 8.1%. The growing domestic demand led to an increase in the amount of provided services in the trade sector by 9.5% in 2011. These sectors have contributed the most to economic growth in 2011 – altogether they ensured 4/5 of the total economic growth.

After the deep recession during the crisis, the construction sector resumed growth in 2011 – increased by 11.9% in a year.

However, the situation in the services sectors is improving at a moderate pace and the output volumes of both public and commercial services sectors in 2011 remained at the level of 2010.

Despite the tense economic situation and even the obvious recession in several EU countries, national economy of Latvia kept growing in 2012.

As the export opportunities continued, it allowed the manufacturing to grow at a steady pace – in the three quarters, production volumes were by 10.5% higher than in the corresponding period of 2011. Considering the increasing share of the sector in national economy, the increase in production volumes in the given period ensured over ¼ of the total economic growth.

In 2012, growth was observed also in the agriculture and forestry sector. Manufacturing, agriculture and forestry sectors still provide a great contribution to growth, and in the three quarters of 2012 these sectors constituted 1/3 of the total GDP growth.

Construction volumes kept growing also in 2012 – in the three quarters, the volumes exceeded the level of the corresponding period of the previous year by 16.3%. Although construction volumes have been growing quite fast over the past year and a half, currently they have reached only 55% of the pre-crisis level. It should be noted that the recovery of the sector is mainly related to public contracts and the EU funds projects. The high contribution of public contracts in construction the sector is likely to decrease as financing from structural fund is not expected to increase in the coming years.

Table 3.9

Dynamics of GDP

(in % compared to the corresponding period of the previous year, seasonally unadjusted data)

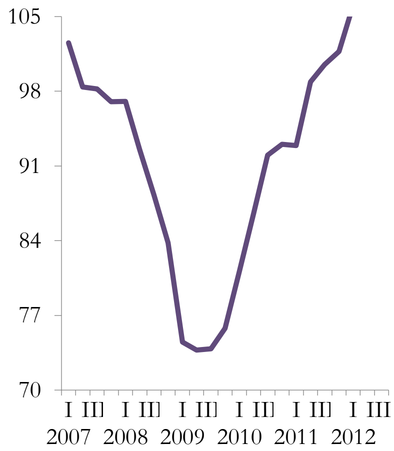
	2005-2007 average annually	2008-2010 average annually	2011	2012 I-IX	2005-2007 average annually	2008-2010 average annually	2011	2012 I-IX
	Changes in volumes				*Contribution to growth*			
Agriculture, forestry	3.9	-1.0	-0.5	6.4	0.1	0.0	0.0	0.3
Manufacturing	4.1	-3.6	11.7	10.5	0.6	-0.5	1.5	1.6
Other industries	3.4	1.5	-0.9	-3.3	0.1	0.1	0.0	-0.1
Construction	20.3	-23.3	11.9	16.3	1.8	-2.3	0.7	0.9
Trade, accommodation, and catering	15.7	-11.3	9.5	7.3	3.5	-3.1	1.9	1.6
Transport and storage	10.1	-0.3	8.1	4.9	1.1	0.0	1.0	0.7
Other commercial services	9.8	-2.7	1.2	2.7	2.5	-0.8	0.3	0.8
Public services	3.5	-5.9	0.6	-0.7	0.5	-0.8	0.1	-0.1
GDP	**10.3**	**-7.6**	**5.5**	**5.6**	**10.3**	**-7.6**	**5.5**	**5.6**

In 2012, a decrease in production volumes was observed in other industries (electricity, gas supply, heat supply), that is mainly based on lower volumes of produced electricity and heat energy due to weather conditions.

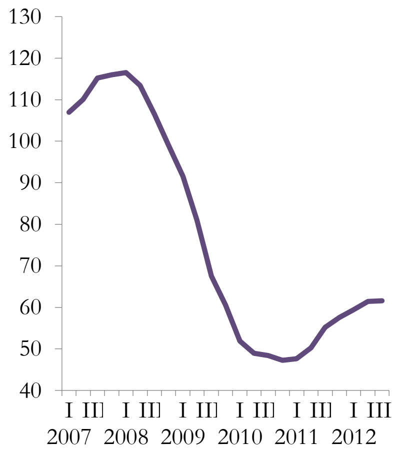
In 2012, the growth remained also in the transport and storage sector. In the three quarters of 2012, the sector increased by 4.9% in comparison with the corresponding period in 2011. The growth of the sector is based on the rise in volumes of freight. In the eleven months of 2012, freight in railway exceeded the level of the corresponding period of 2011 by 3.9%, while in 2012, compared to 2011, the volume of delivered and received freight in Latvian ports increased by 9.3%. The volume of freight by transport vehicles remained at the level of the previous year.

Figure 3.19

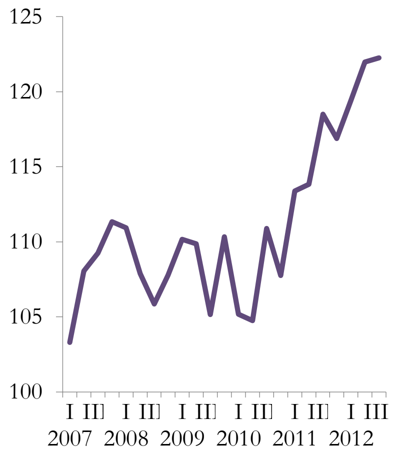
Manufacturing
changes in value added, seasonally adjusted data, 4th quarter of 2006 = 100



Construction
changes in value added, seasonally adjusted data, 4th quarter of 2006 = 100



Transport and storage
changes in value added, seasonally adjusted data, 4th quarter of 2006 = 100



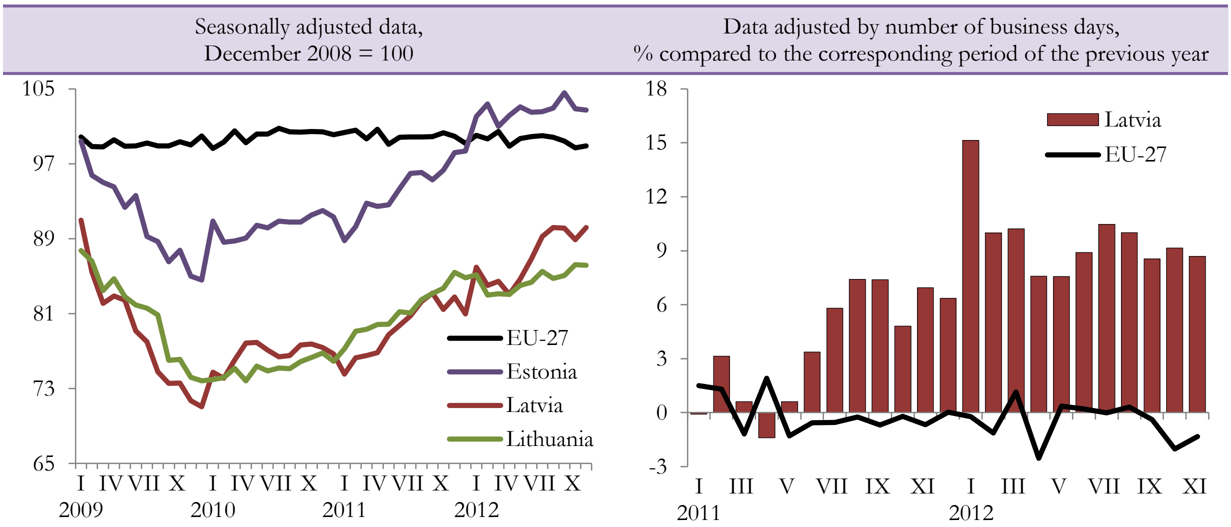
The trade sector continued growing in 2012 due to the increasing private consumption. In the three quarters of 2012, the amount of services provided in the sectors was by 7.3% higher than in the corresponding period of the previous year. Considering the large share of the sector, the trade sector ensured over ¼ of the total economic growth in the three quarters of 2012.

In 2012, the retail trade turnover has grown steadily. In November 2012, compared to November 2011, the retail trade turnover increased by 8.8%, but in the eleven months of 2012, the retail trade turnover was by 9.8% higher than in the corresponding period of the previous year.

Non-food retail trade has contributed the most to the total increase in the retail trade turnover in a year. Non-food retail trade turnover in November was by 12.2% (in comparable prices) higher than a year ago. Retail trade of computers, software and telecommunication equipment contributed the most to the increase in the retail trade turnover ensuring 42% of the total increase in the retail trade turnover. The dropping automotive fuel prices led to a rapid increase in the turnover of retail sale of automotive fuel in November (by 11.4%) ensuring 1/5 of the total increase in retail trade turnover in 2012. The increase in retail trade of clothing, footwear and different household goods also provided considerable contribution. Retail trade of food products constitutes one third of the total retail trade turnover. Yet, retail trade turnover of food products is growing slowly and in November it was by 2.1% higher than in November 2011.

Figure 3.20

Retail trade turnover



Since the mid-2009, wholesale volumes have been increasing rapidly already exceeding the pre-crisis level. In the three quarters of 2012, wholesale enterprises' turnover was by 13.4% higher than in the three quarters of 2011, and in the 3rd quarter of 2012 it exceeded the highest pre-crisis level in mid-2007 by 3 per cent.

In 2012, moderate growth has been observed also in other services sectors – in the three quarters of 2012, the amount of services provided in the sector was by 2.7% higher than in the corresponding period of the previous year. The information and communications sector has been the most successful among commercial services sectors in 2012. In the three quarters of 2012, the amount of services provided in the given sector was by 8.8% higher than in the three quarters of 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.

The volume of services provided in the public service sector is affected by the consolidation measures of the government expenditures. In the three quarters of 2012, the amount of public services was by 0.7% lower than in the three quarters of 2011.

Although in 2012 stable growth has been observed in most of the sectors, external risks still exist in relation to further development in the euro zone.

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 ¼ lower in 2009 than before the crisis – in 2007.

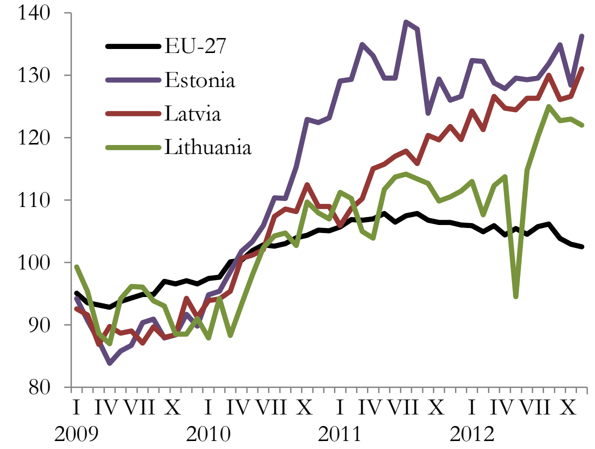
It should be noted that competiveness of Latvian manufacturing is largely based on relatively cheap labour and low overall costs. In 2006 and 2007, the rise in labour costs and prices resulted in losing these advantages to a great extent. Yet, the overall wage level and prices in the domestic market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

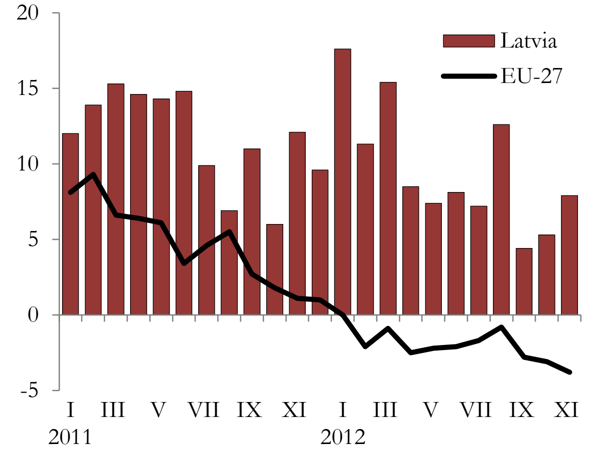
Since the second half of 2009, production volumes have been growing in manufacturing. As the economic growth resumed, manufacturing grew at a considerably faster pace than the overall national economy. Currently, manufacturing is the main driver of the national economic growth.

Figure 3.21

Manufacturing Production Volume Index

Seasonally adjusted data, December 2008 = 100	Data adjusted by the number of working days, % compared to the corresponding period of the previous year





In 2011, production volumes of manufacturing exceeded the level of 2010 by 11.7%. The growth of the sector was mainly based on both stable external demand and a gradual increase of demand in the domestic market. Overall, in 2011, production volumes reached the pre-crisis level. It must be noted that the production volumes increased steadily also at the end of 2011, when the EU Member States, namely the key export markets of Latvia, experienced slower growth rates.

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

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**	**63.6**
Food and beverage industry	22.7	22.2	33.9
Light industry	4.2	11.1	84.6
Wood processing	22.1	19.3	73.2
Paper industry and publishing	3.9	3.9	58.7
Chemical industry and related industries	7.9	6.3	77.3
Production of other non-metallic minerals	5.8	4.3	45.5
Production of metals and metal articles	15.5	11.0	77.3
Production of electrical and optical equipment	5.5	3.6	89.5
Production of machinery and equipment	2.3	2.8	80.3
Production of vehicles	3.8	3.2	93.2
Other industries	6.1	12.2	43.6

* estimation of the Ministry of Economics

In the eleven months of 2012, production volumes of manufacturing were considerably higher than in the corresponding period of 2011 – an increase by 10.2%. None of manufacturing industries was tended to narrow production even when the demand in foreign markets remained weak.

In this period 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.

The large increase in production volumes of manufacturing fosters labour demand. In the 3rd quarter of 2012, there were by 5.2% occupied jobs in manufacturing than a year ago. 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. At the same time it should be noted that the number of employed in manufacturing is growing considerably slower than the output.

In 2012, turnover of manufacturing production increased steadily – in the eleven months it exceeded the level of January-November 2011 by 13.8%. The turnover grew mainly on the account of the increase in production volumes, while producer prices for both exported products and those sold in domestic markets have been growing at a moderate pace.

Metal processing, wood processing, production of electric and optical equipment, as well as chemical industry have contributed more than 60% from the total increase in manufacturing turnover in 2011.

Due to the gradually growing demand in domestic market, turnover of production sold in domestic market in the eleven months of 2012 was by 6.3% higher than in the eleven months of 2011. Turnover of exported production has increased by 18.6% in this period which is a proof of the still high demand for Latvian industrial production in foreign markets.

In the eleven months of 2012 almost 64% of the total manufacturing production of the sector was exported. Almost 1/4 is exported to the EU-15 markets. Around 30% of the exported production is sold in Lithuania and Estonia. Exports to the CIS countries, in its turn, constitute 17 per cent.

In the eleven months of 2012, compared to January-November 2011, turnover of exported production has been increased the most in metal processing (by 35%). Considering the large share of this sector in manufacturing, export of metal and metal articles ensured almost one third of the total increase in exported industrial production. In 2012, a significant rise in turnover of exported production has been seen also in manufacture of computers, electronic and optical equipment, as well as manufacture of vehicles.

Table 3.11

Changes of Production Volumes in Manufacturing

(% compared to the corresponding period of the previous year)

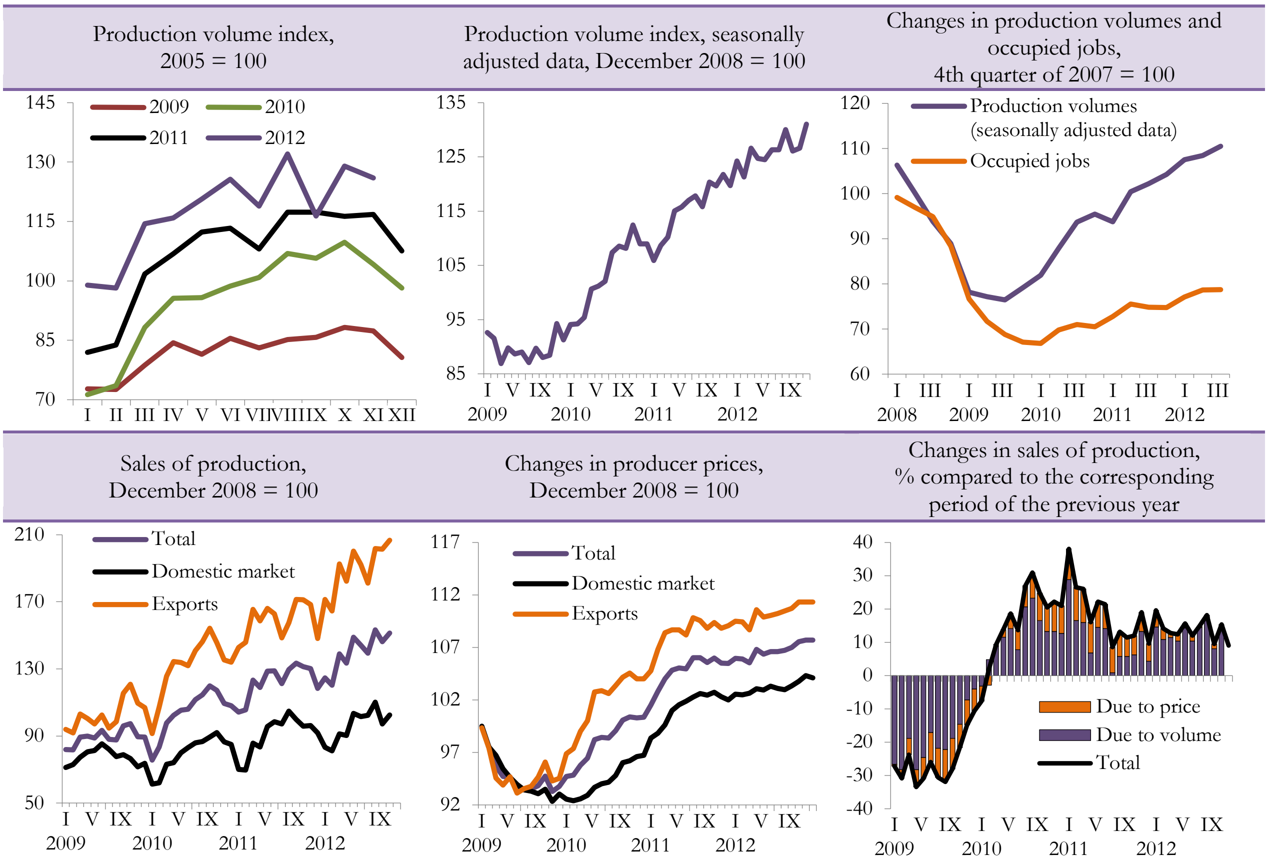
	2007	2008	2009	2010	2011	2012 I-XI
Manufacturing – total	**0.3**	**-3.4**	**-20.2**	**16.5**	**11.7**	**10.2**
Food industry	1.3	-2.0	-16.1	-0.1	-0.2	3.0
Light industry	0.3	-12.2	-38.6	19.4	19.4	1.6
Wood processing	-6.0	-12.1	1.6	33.0	12.6	6.5
Paper industry and publishing	0.2	-3.9	-17.1	19.8	-0.5	12.2
Chemical industry and related industries	3.1	-2.0	-18.5	5.2	4.4	7.8
Production of other non-metallic minerals	-17.1	-14.4	-40.1	17.6	24.2	11.9
Production of metals and metal articles	11.5	1.4	-27.1	24.2	28.3	17.9
Production of electrical and optical equipment	3.8	14.1	-34.8	33.2	29.6	22.3
Production of machinery and equipment	5.0	10.4	-35.5	17.8	37.1	9.7
Production of vehicles	10.7	5.8	-49.7	59.0	37.0	16.1
Other manufacturing industries	3.0	-5.5	-20.1	-4.9	9.5	27.9

It should be noted that the largest contribution to turnover of production sold in the domestic market was provided by wood processing, as well as production of non-metallic minerals. It is mainly explained by recovery of construction.

Latvian producer prices are largely influenced by tendencies in foreign markets. Since the second half of 2011 the weakening general demand in the EU states has led to a very moderate increase in Latvian producer prices for exported production – in December 2012 they were by 2.1% higher than a year ago. Although the demand in the domestic market is increasing gradually, it is still relatively low and has no major impact on producer prices. Producer prices for production sold in domestic market have increased by 2% in a year.

Figure 3.22

Indicators Characterising Manufacturing

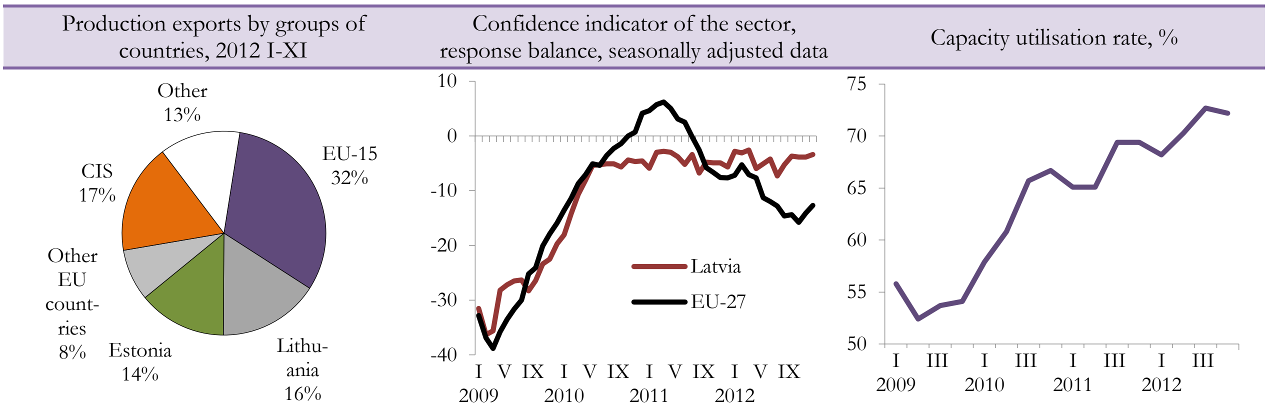


The load of production capacity keeps increasing in line with the increase of production volumes. In the 4th quarter of 2012, the level of the load of production capacity in manufacturing was 72.2% – by 2.2 percentage points higher than at the end of 2011. It should be noted that the load of production capacity in most of the sectors is very close to the historically highest indicators.

The results of conjuncture surveys of Latvian manufacturing enterprises show that in general evaluation of entrepreneurs regarding further growth possibilities has not changed basically. The overall confidence of Latvian producers in 2012 was better than the overall EU-27 producer reviews on future. The overall confidence indicator of manufacturing in Latvia in December 2012 was -3.4 points, and that is by 2.3 points better than the indicator at the end of 2011. The manufacturing confidence is still affected by uncertainty about development perspectives of the main trade partner countries.

Figure 3.23

Development Trends of Manufacturing



The food and beverage industry is the largest manufacturing industry. The industry constitute one fifth of all manufacturing by both turnover and number of jobs. More than 66% of all food industry production is sold in the domestic market. As the domestic demand narrowed during the crisis, production volumes of the industry also shrank significantly – in 2009 they were by 18% lower than in 2007.

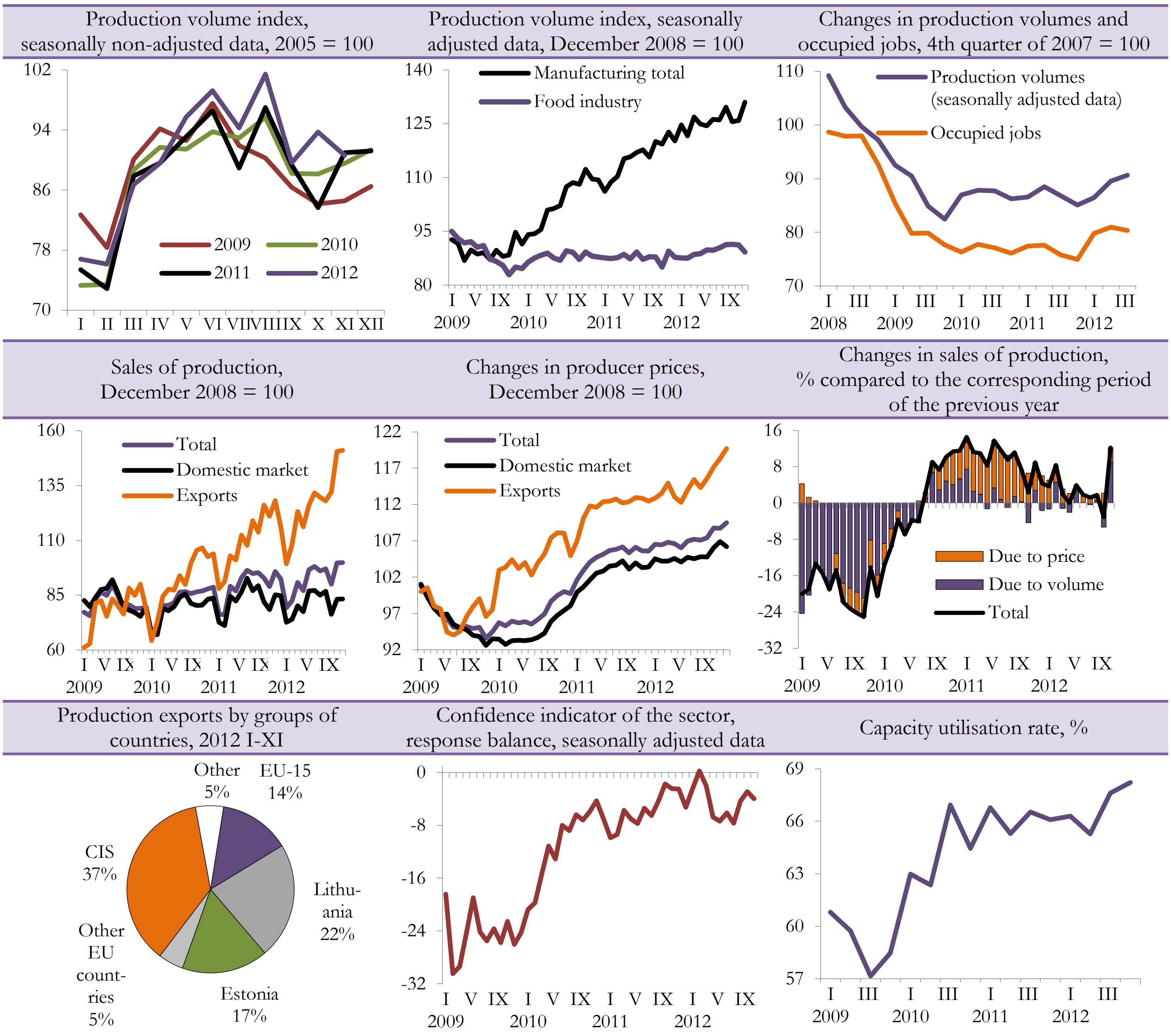
The recovery of the food industry is rather slow due to moderate increase of demand in the domestic market, while the share of exports in the total turnover of the industry is rather small. In 2010 and 2011, production volumes of food industry remained at the level of 2009. Yet, in 2012, production volumes of the industry slightly increased due to the large rise in volumes of exported production – in the eleven months of 2012 they exceeded the level of January-November 2011 by 3 per cent.

It should be noted that revenues from sales in food industry are growing faster under the influence of both the volume of manufactured production and producer prices. In 2011, turnover increased by 9.3% on the account of the rise in producer prices due to the rise in food prices worldwide. In 2012, food prices in the world were decreasing and producer prices in the industry also increased at a slower pace (in December prices were only by 3.7% higher than a year ago). It had a certain impact also on turnover which was rather moderate in 2012 – in the eleven months it exceeded the level of the corresponding period of the previous year by 3.2 per cent.

The gradually improving situation in the industry is also proved by changes in the number of occupied jobs. In the 3rd quarter of 2012, there were by 6% more jobs in the food industry than a year ago, although the number of jobs is by 21.4% lower than before the crisis.

Figure 3.24

Indicators Characterising Food and Beverage Industry



The sector of **light industry** is mainly oriented to exports, therefore, production volumes of the sector significantly narrowed when external demand decreased. In 2009, production volumes of the sector decreased two times if compared to 2007.

The light industry is recovering slower from the crisis consequences than manufacturing in general. Although in 2010 and 2011 production volumes in light industry increased by nearly 20% annually, they still are far behind the pre-crisis level.

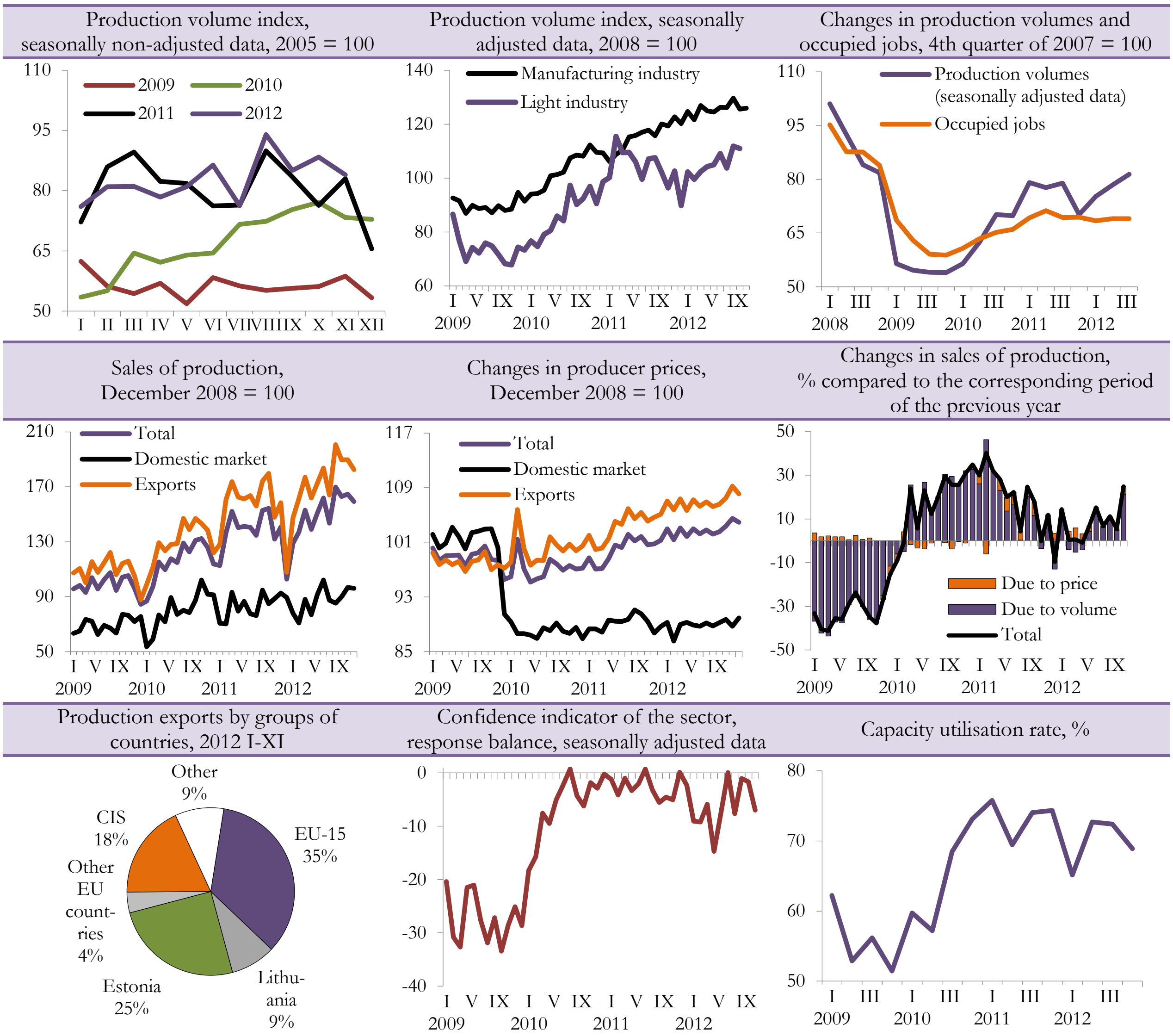
In January-November 2012, production volumes in the industry were by 1.6% higher than in the eleven months of the previous year. A slower increase in 2012 was mainly determined by the deteriorating economic situation in the largest export markets. It should be noted that 2012 has been a more successful year for manufacturers of textile articles – in the eleven months production volumes exceeded the level of January-November 2011 by 4.6%. At the same time, production volumes of clothing did not increase at all, compared to 2011.

The turnover of the sector increased rapidly after the crisis which was determined by the increase in production volumes. The turnover dynamic was rather moderate in 2012 – in the eleven months the turnover was by 8.7% higher than a year ago. The increase was still ensured by exports – sales revenues from exports increased by 9.3%, while sales volumes in domestic market – by 5.2 per cent.

Changes in producer prices have a relatively minor impact on the turnover which was very moderate in 2012. In December, producer prices were by 2.6% higher than they were a year ago. The moderate growth of the industry has certain influence on labour demand – in 2012, the number of occupied jobs in the industry has not increased at all.

Figure 3.25

Indicators Characterising Light Industry



Wood processing is one of the largest manufacturing sectors, and it plays an important role in the total growth of the manufacturing sector. Overall, the sector constitutes 1/5 of the total turnover and all jobs in manufacturing. Wood processing is one of the first sectors that resumed growth after the huge decrease in manufacturing volumes and in 2010, the output of the sector already exceeded the pre-crisis level.

Production volumes of the sector continue increasing. In 2011, output increased by 12.6%, while in the eleven months of 2012 – by 6.5% if compared to a corresponding period year ago. Overall, since the 1st quarter of 2009, production volumes of the industry have increased by more than 80%, at the same time, the number of jobs in the industry has increased by 17.8%. It means that the significant increase in production volumes during the post-crisis period is to a great extent based on improving productivity.

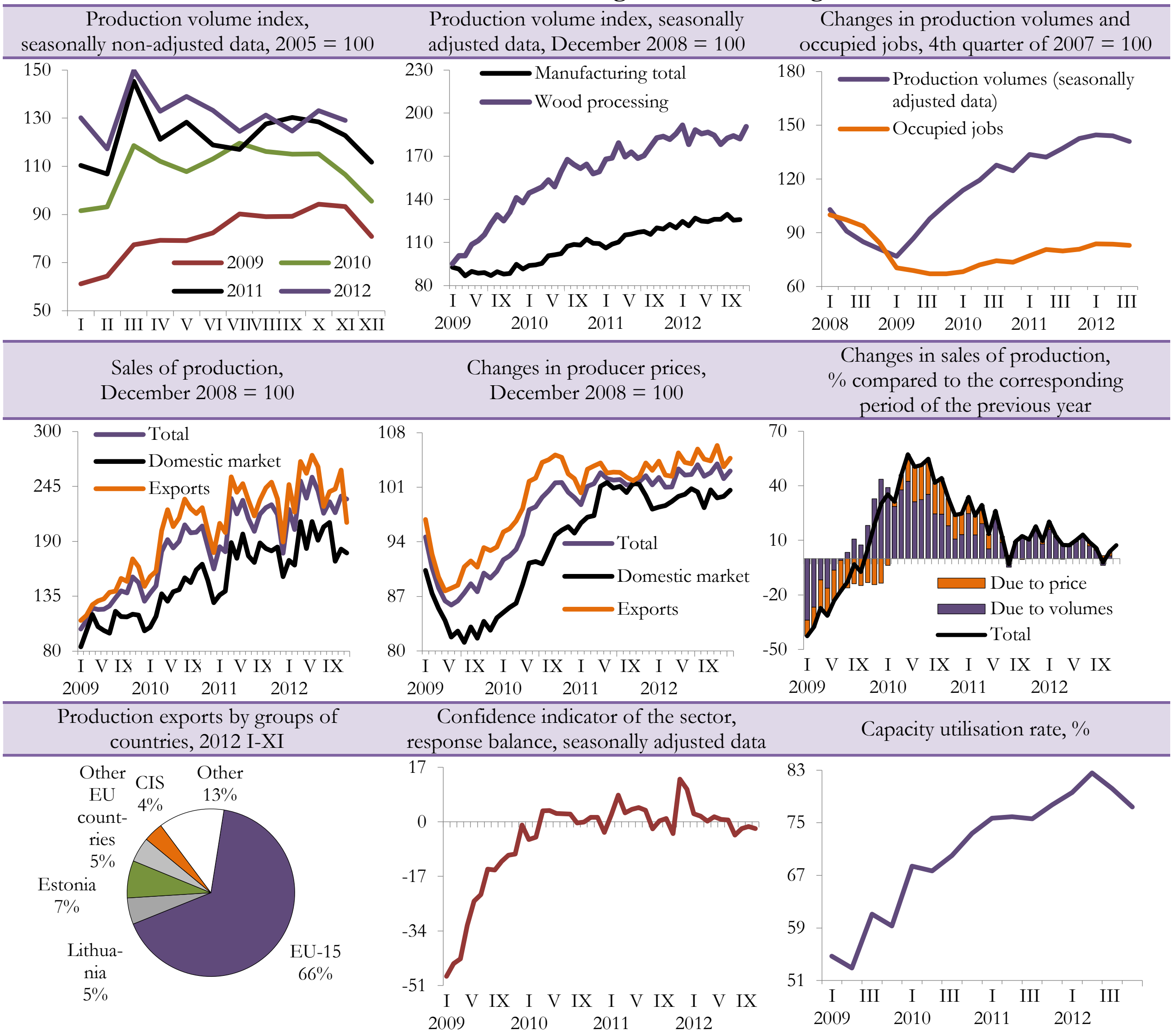
The turnover of wood processing production is also growing steadily, mainly due to the expanding export possibilities. About 3/4 of the total production in the sector is being exported, mainly to the EU-15 countries.

Sales volumes of exported products in 2011 increased by 13%, but in the eleven months of 2012 – by 8.3% in comparison with the eleven months of 2011. The demand for wood production is increasing also in the domestic market, fostered by gradually increasing activities in construction. In the eleven months of 2012, the turnover of production sold in the domestic market was by 8.3% higher than in January-November 2011.

After the significant rise in producer prices in 2010 and in the first half of 2011, producer prices have been further rising at a very moderate pace. In December 2012, producer prices in wood processing were by 1.7% higher than in December 2011.

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.

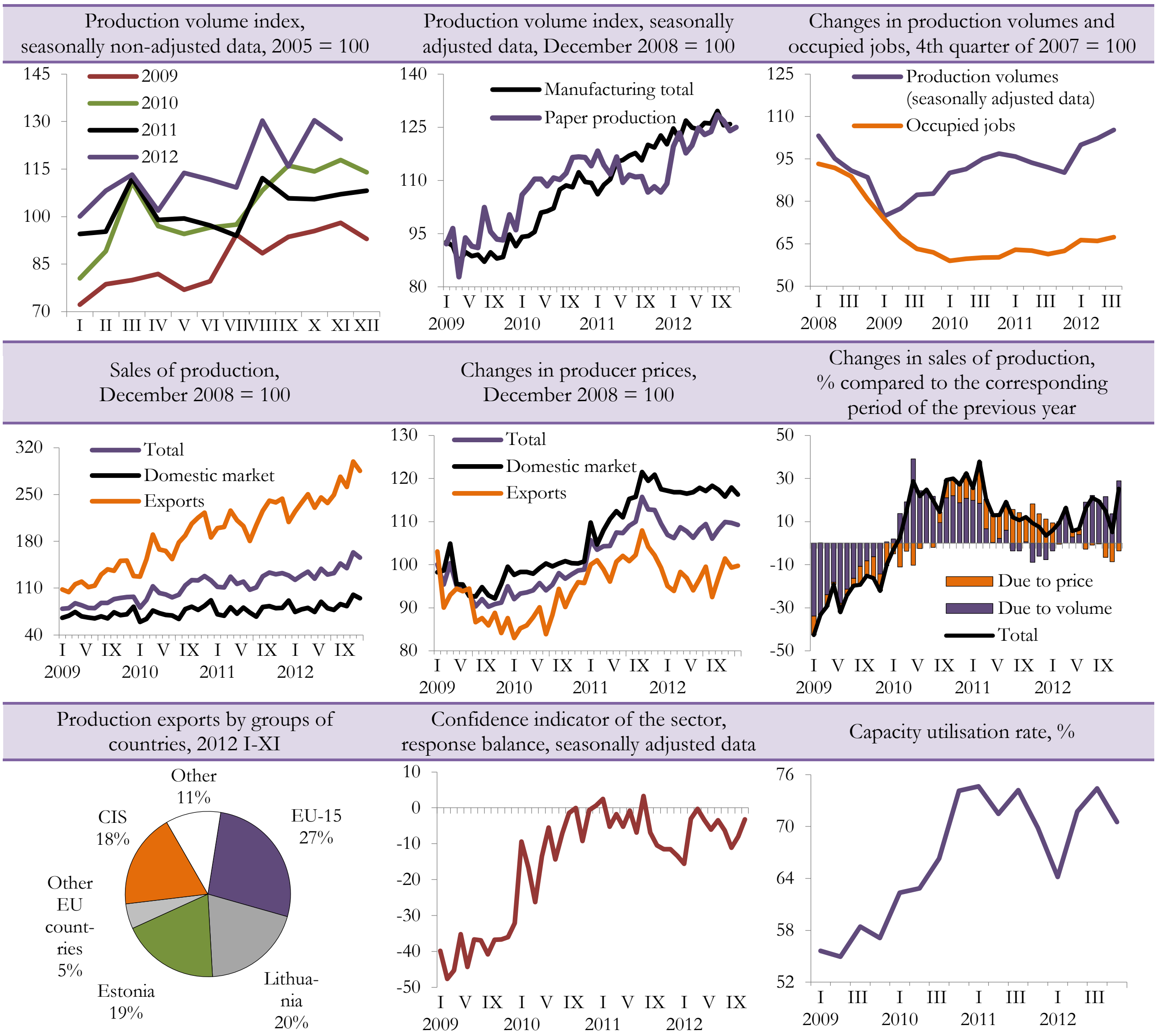
Development of the paper industry and publishing has been uneven after the crisis. After a rapid increase in production volumes in 2010, the output shrank (by 0.5%) in 2011, influenced by weaker output indicators in the first half of the year. Yet, in the eleven months of 2012, production volumes are by 12.2% higher than in the eleven months of the previous year and have reached the level of 2007.

Despite the decreasing production volumes in 2011, the rising producer prices promoted an increase in turnover of the industry. In 2011, the turnover of the sector increased by 12.7%. In 2012, the increase in turnover was mainly determined by the increase in production volumes. In the eleven months of 2012, the turnover exceeded the level of the corresponding period of 2011 by 14.2%. The increase in revenues from exports constitutes the largest contribution.

Producer prices in 2011 increased by almost 11%. Despite the weak domestic demand, prices for production sold in domestic market grew faster than those for exported production. The level of producer prices slightly dropped in 2012. In December 2012, producer prices were by 0.2% lower than a year ago.

Figure 3.27

Indicators Characterising Paper Production and Publishing Industry



The ***chemical industry*** and allied industries constitute nearly 8% of the total turnover of manufacturing and provide over 6% of filled jobs. Over ¾ of chemical industry products are exported. During the crisis, production volumes of the chemical industry have decreased by one fifth. Development tendencies differ among the chemical industry subsectors. In 2011, production volumes increased in pharmacy (by 12.3%), as well as in production of rubber articles (by 2.3%), while volumes of production of chemical substances shrank (by 3.4%). In the eleven months of 2012, production volumes of the chemical industry increased by 7.8% compared to the eleven months of 2011. Production volumes of the pharmacy sector shrank (by 2.1%) and production of rubber articles continued increasing (by 2.4%) at a moderate pace, while production volumes of chemical substances increased by 18 per cent.

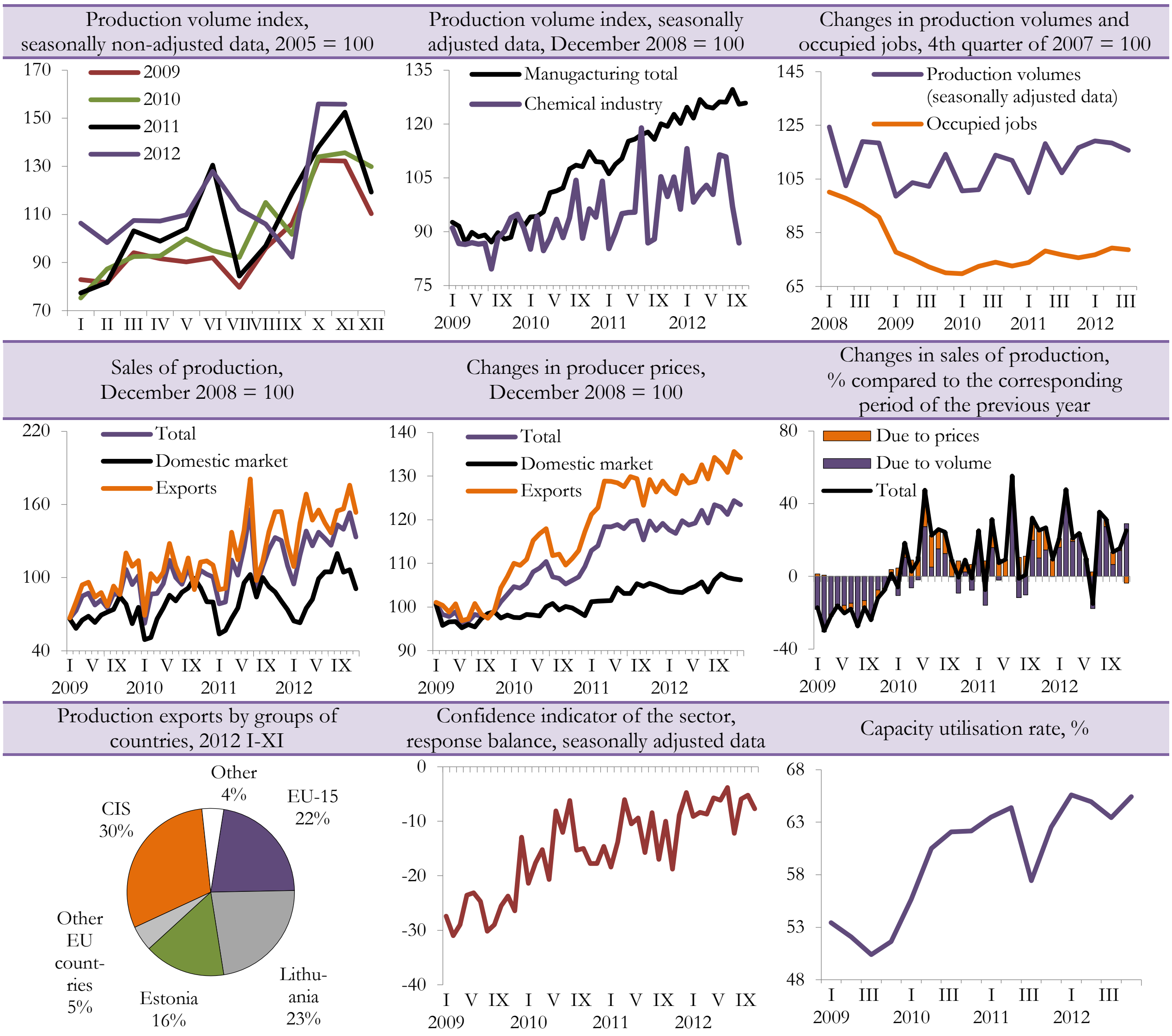
Due to the increase in sales of exported production, the total turnover of the sector continues growing. In 2011, the turnover of the chemical industry increased by 18%. In the eleven months of 2012, the total turnover exceeded the level of the corresponding period of 2011 by 16%. Exports still provide the largest contribution to the increase in the turnover. The sales of production in the domestic market grew along with the improving situation in the domestic market (by 13%).

The number of jobs in the chemical industry has been growing slower than output. In the 3rd quarter of 2012, the number of occupied jobs was by 2.5% higher than a year ago.

After the rapid rise in producer prices in 2010 and 2011, the rise in prices has become considerably more moderate. In December 2012, producer prices were by 3.6% higher than in December 2011.

Figure 3.28

Indicators Characterising Chemical Industry



The sector of **production of other non-metallic minerals** is mainly focused on the domestic market. The development of sector 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 considerably. In 2009, the production output of the sector shrank by almost a half in comparison with 2007.

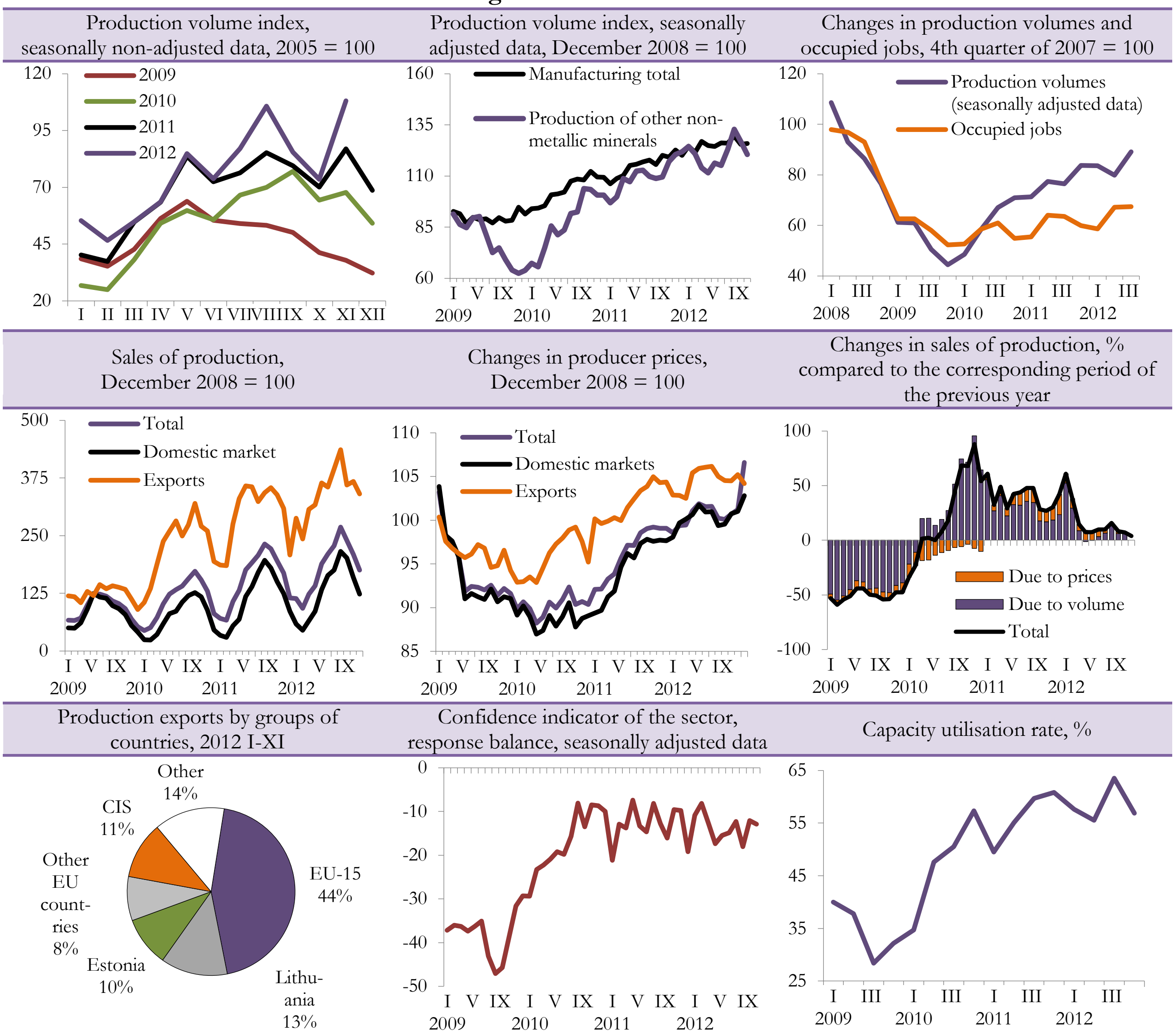
Production volumes have been increasing since 2010 and in 2011 were by 24% higher than in 2010. The recovery of the sector after the crisis is mainly related to the ability to focus on foreign markets – mainly to the old EU Member States and owing to the gradually resuming activities in the domestic market. In 2012, production volumes continue increasing – in the eleven months, the volumes have increased by 12% in comparison with the eleven months of 2011.

The turnover of the sector has been growing rapidly during the post-crisis period. The increase in sales revenues from exports has contributed greatly to the turnover – in 2011, the revenues were one and a half times higher than in 2009 and continued increasing also in 2012. As the economic situation gradually improved, the turnover in the domestic market also increases (in 2011 – by 48% and in the eleven months of 2012 – by 12%). In the eleven months of 2012, the total turnover of the sectors was by 12.5% higher than a year ago and the share of exported production reached 45% of the turnover of the sector.

After the considerable drop in producer prices in 2010 and 2011, the rise in producer prices in production of non-metallic minerals, like the rest of manufacturing industries was moderate in 2012 – in December 2012, producer prices were by 2.6% higher than a year ago.

Figure 3.29

Indicators Characterising Production of Other Non-Metallic Minerals



Metal processing is one of the largest manufacturing industries, mainly focused on foreign markets. A total of 77% of manufactured production is sold in foreign markets with the EU states being the key sales market.

Production volumes of the metal processing sector have been increasing rapidly since the mid-2009. In 2011, production output in the industry has increased by 28%. The sector provides one of the greatest contributions to the total growth of manufacturing industry. Despite the strained economic situation in the EU, Latvian metal processing industry kept growing fast in 2012, which proves that Latvian producers have been able to find new sales niches. In the eleven months, production volumes exceeded the level of the corresponding period of the previous year by almost 18 per cent.

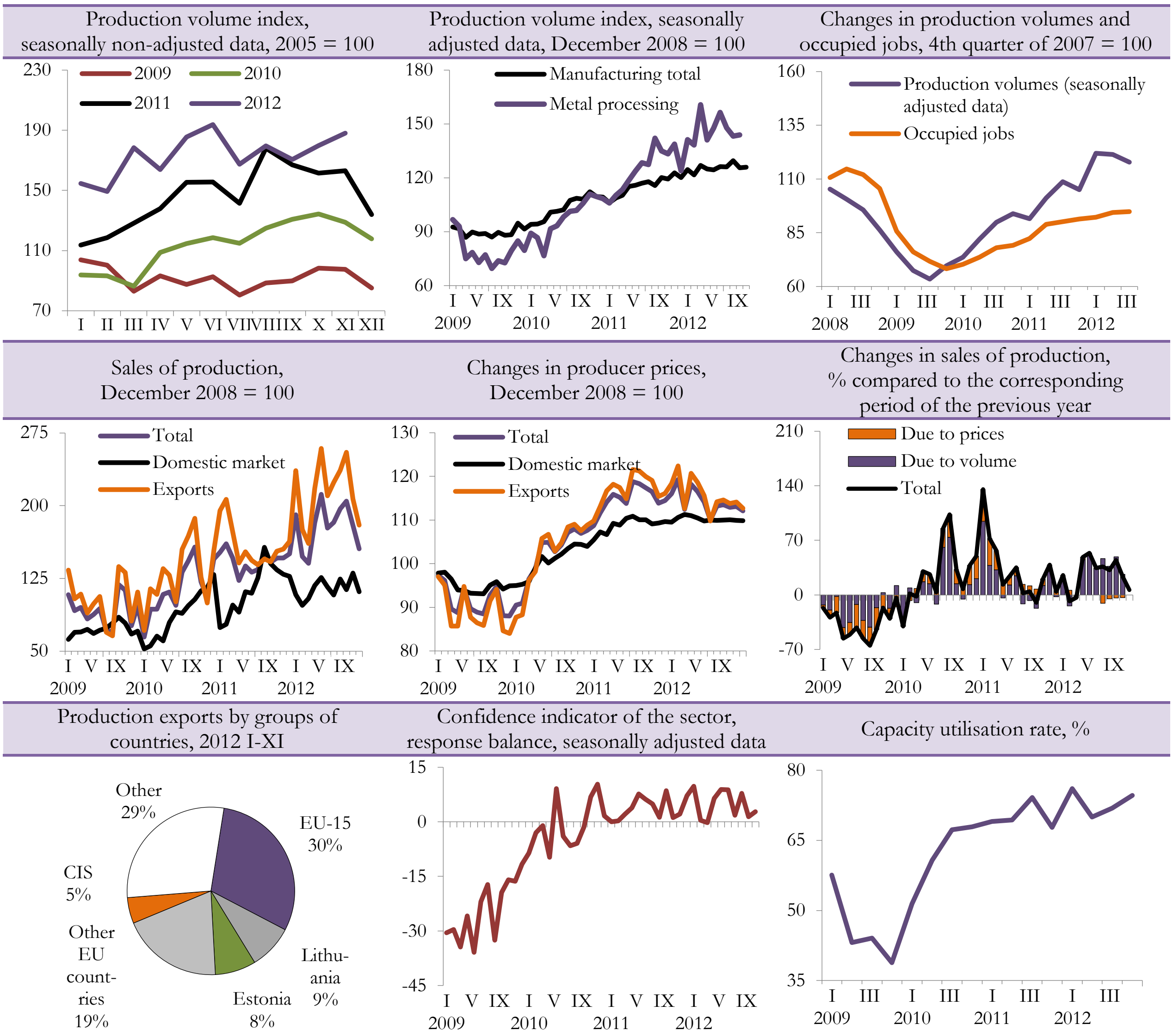
The turnover of the industry has increased significantly over the past few years, fostered also by the rapid rise in producer prices in 2010 and 2011. It should be noted that not only the turnover of exported production has increased after the crisis (in 2011 – by 54% compared to 2009), but also the turnover in the domestic market (by 55%). In 2012, the turnover of the sectors continued growing and in the eleven months of 2012 exceeded the level of the corresponding period of 2011 by 26 per cent.

It should be noted that the rise in world prices for metal slowed down at the end of 2011 which was reflected also in the dynamics of producer prices in the industry. In December 2012, producer prices were by 2% lower than a year ago.

The considerable rise in production volumes fosters an increase in jobs. In the 3rd quarter of 2012, there were by 5.1% more jobs in metal processing than in the 3rd quarter of 2011. The industry employs more than 11% of all workers 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 2011, the production volumes of electrical and optical equipment exceeded the level of 2009 by over 70%. Increase in production volumes of electronic equipment has contributed the most to the growth of the sector, but the production volumes of computer, electronic, and optical equipment are increasing slightly slower. Overall, a rapid growth of the sector was observed also in 2012 – in the eleven months, the production volumes exceeded the level of the corresponding period of 2011 by 22.3 per cent.

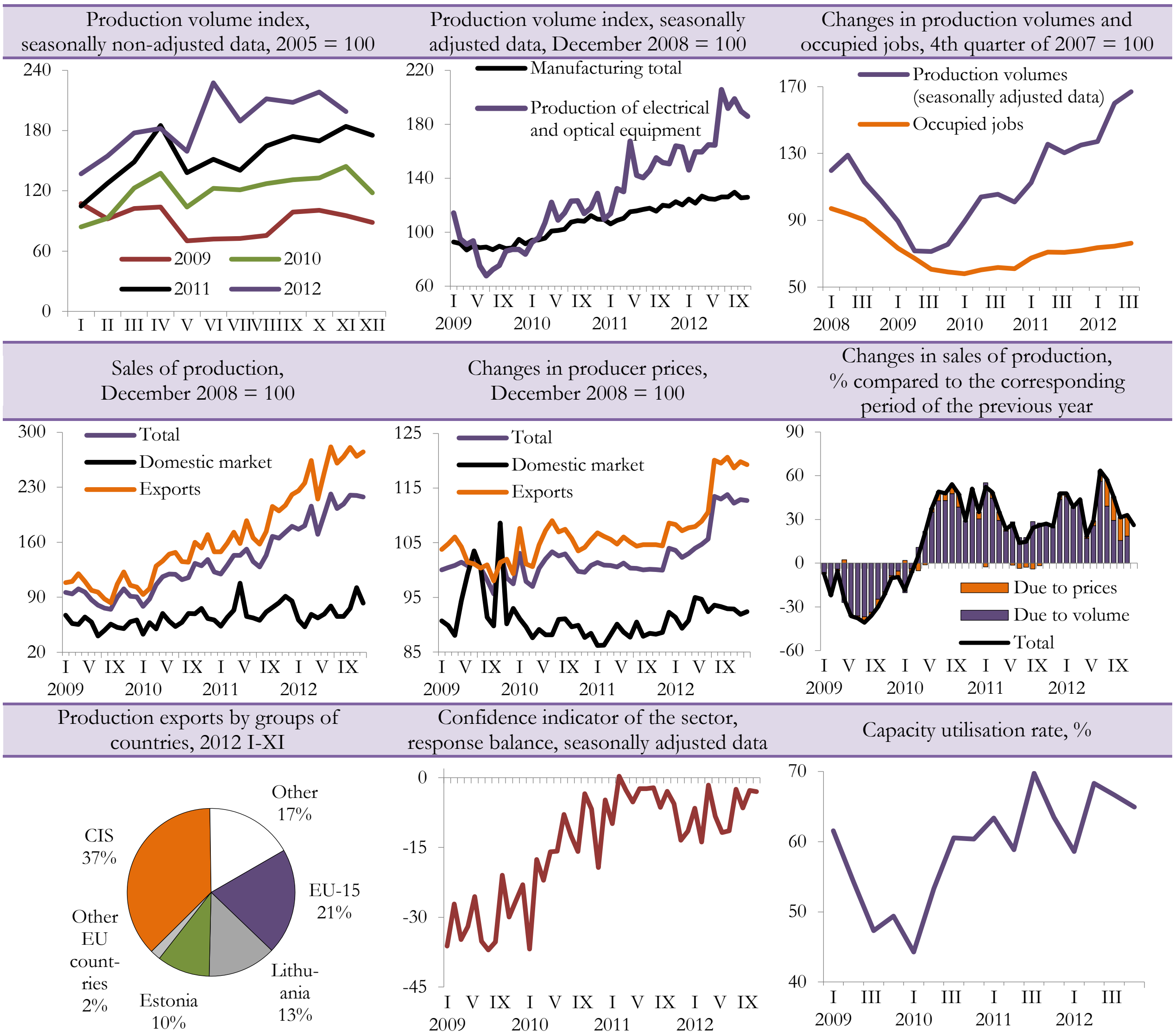
The sales revenues of the sector are increasing in line with the increase in production volumes. Since 2010, the turnover of exported production has been increasing by 30% annually. Overall, the industry exports almost 90% of manufactured production. The turnover of production sold in the domestic market increases slower.

Unlike other manufacturing industries, producer prices practically did not increase in production of electrical and optical equipment in 2010 and 2011. Yet, producer prices considerably increased in the second half of 2012 – in December 2012, they were by 8.3% higher than a year ago. The rise in producer prices was determined by the rise in producer prices for exported production.

Considering the fast growth of the industry over the past few years, the number of jobs has also been increasing gradually. In the 3rd quarter of 2012, there were by 7.6% more occupied jobs in the industry than a year ago.

Figure 3.31

Indicators Characterising Production of Electrical and Optical Equipment



80% of all production produced in the sector of ***production of machinery and equipment*** is sold in foreign markets – mainly to Lithuania, Estonia, and the CIS countries. During the crisis, the turnover of the sector has equally rapidly shrunk both for exported production and for the production sold in the domestic market. Since 2010, production volumes of the industry have been growing, moreover, faster than overall in manufacturing.

The production output of machinery and equipment in 2011 was by 37% higher than a year ago and already exceeded the pre-crisis level. In late 2011 and early 2012, the growth of the industry was negatively affected by the deteriorating situation in certain trade partner countries. Yet, in January-November 2012, the increase in production volumes reached nearly 10%, compared to January-November 2011.

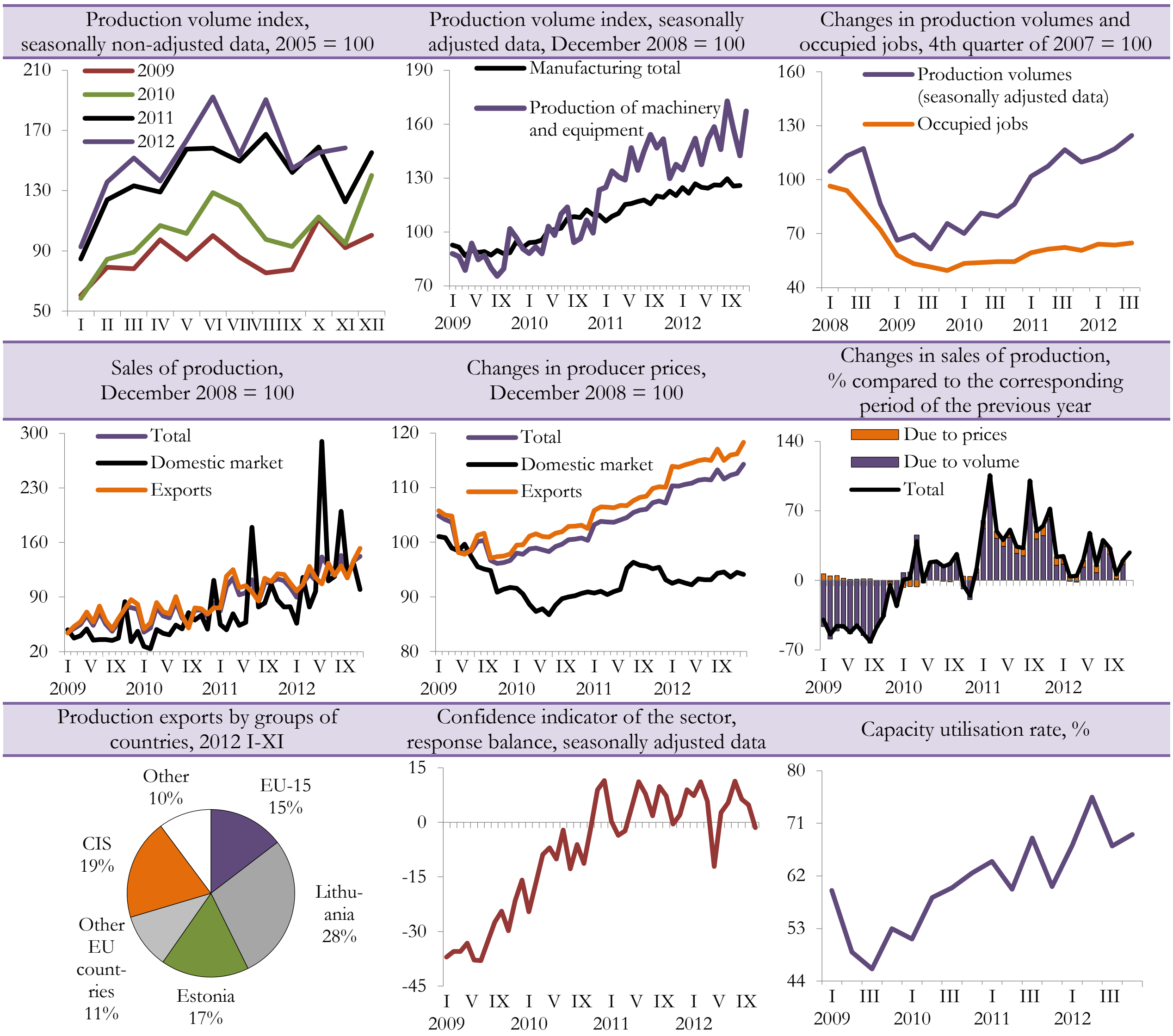
In 2011, the turnover of both exported production and production sold in the domestic market exceeded the level of 2010 by 50 per cent.

In the eleven months of 2012, the total turnover of the industry was by 21.4% higher than a year ago. The turnover of exported production has increased by 15%. Due to the improving economic activities in the domestic market, the turnover of production sold in the domestic market in the eleven months of 2012 exceeded the level of the corresponding period of 2011 by almost 60 per cent.

Producer prices in the industry have been rising since 2010 mainly due to the rise in prices for exported production. In November 2012, producer prices for exported production were by 7.5% higher than a year ago. While producer prices for production sold in the domestic market have increased by 1.1 per cent.

Figure 3.32

Indicators Characterising Production of Machinery and Equipment



Production of transport vehicles is characterised by marked fluctuations of production volumes related to changes in new orders. As approximately 90% of production is exported, fluctuations of external demand have a significant impact on development of the sector. Almost ¾ of all exported production is sold in the EU market. The output volumes of the sector have been increasing since 2010.

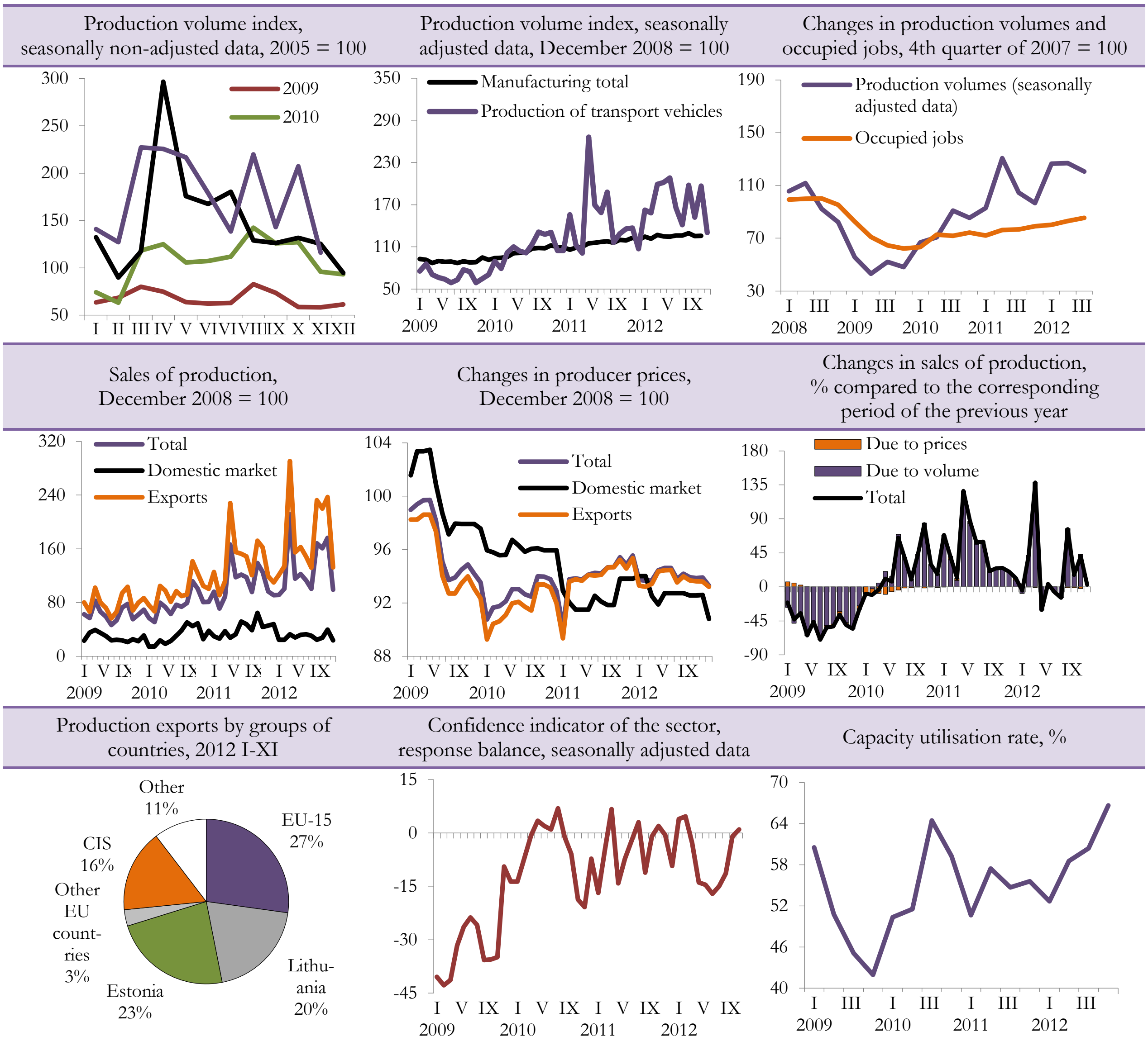
The volumes of new orders in the domestic market and external markets increased rapidly in the second half of 2010 and in 2011. As a result, the output of the sector in 2011 exceeded the level of 2009 two times. In the eleven months of 2012, production volumes in the industry exceeded the level of the corresponding period of 2011 by 16 per cent.

The turnover of the sector is growing in line with the increase in production volumes. In 2011, the turnover of exported production has increased by 45%, while revenues from production sold in the domestic market – by 33%. In the eleven months of 2012, the turnover was by 18% higher than in the corresponding period of 2011. The increase in the turnover in 2012 was determined by the rise in revenues from exported production, while the turnover in the domestic market decreased.

Although the demand for production of the industry has been growing over the past few years, producer prices are dropping. In December 2012, producer prices for exported production were by 2.3% lower and prices for production sold in the domestic market were by 3.2% lower than a year ago.

Figure 3.33

Indicators Characterising Production of Transport Vehicles



3.3. Forecasts

The Ministry of Economics has prepared medium-term forecasts of economic development until 2016. 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 European Commission, as well as of the International Monetary Fund have been used for developing forecasts of the Ministry of Economics in the analysis of external markets and evaluation of global economic development tendencies.

Economic Development in 2013

In 2012, Latvian economy has been resistant to external collapses – exports continued growing along with production volumes of manufacturing. The improving situation in the labor market fostered an increase in private consumption and accordingly volumes of retail trade. Tax revenues were higher than expected. Unlike the trends in the EU, confidence of the Latvian public and entrepreneurs remained positive. Overall, according to the evaluation of the Ministry of Economics, GDP has increased by 5.2 per cent in 2012.

Further development of the economy of Latvia will be still closely related to the export possibilities, and therefore the highest risk to the growth of Latvia is related to global economic development. The International Monetary Fund forecasts a more rapid growth of global economy in 2013 than in 2012, at the same time the growth of Europe is expected to be weak and recovery – gradual in the near future.

The remaining weak demand in external markets is expected to lead to a more moderate growth of export volumes of Latvian goods and services in 2013 than in the previous years. Further increase in export volumes will be greatly based on the ability to improve competiveness and find new market niches. The domestic demand is expected to continue growing in 2013. Yet, a more rapid increase in consumption will be still limited by a relatively high unemployment rate and indebtedness of households. The overall dynamics of investments will be affected by a cautious crediting policy of commercial banks, whereas private sector investments will be influenced by the awaiting behaviour of entrepreneurs regarding future perspectives.

All main sectors of the national economy are likely to grow in 2013, though at a slightly slower pace than in 2012. Export-oriented sectors – mainly manufacturing will greatly contribute to the growth also in 2013. The growth of this sector is expected to be considerably faster than average in the national economy. The volume of trade services and commercial services will increase along with the growing private consumption. Construction and public services sectors are likely to grow at a slower rate in 2013.

The Ministry of Economics forecasts slightly more moderate economic growth of Latvia in 2013 than it was in 2012 and GDP might grow up to 4 per cent.

Development Perspectives in 2014-2020

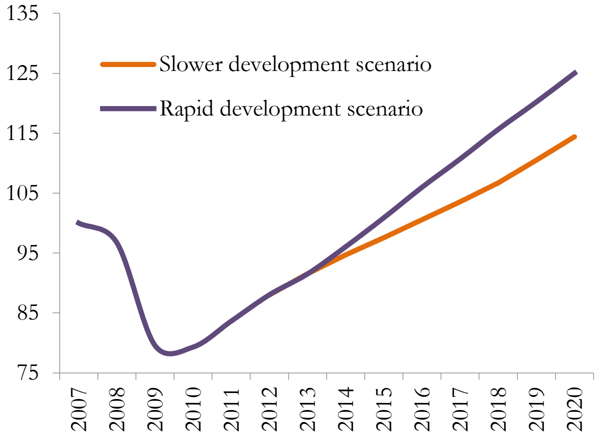
The medium-term growth of the economy cannot be as rapid as it was from 2005 until 2007 because it will no longer be driven by the huge inflow of finance that stimulated domestic consumption and mainly fostered growth of services sectors.

The medium-term growth of the economy will depend to a great extent on the structural policy implemented by the Latvian government for improvement of competitiveness, as well as on the solutions the euro zone countries will be able to adopt to eliminate the tension in the financial sector in order to avoid possible economic stagnation.

Figure 3.34

Forecast of Latvian GDP

(2007 = 100)



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 are opportunities of manufacturing industries that depend on the ability of to make structural changes in the industry. It is a necessary precondition for strengthening the competitive positions of Latvia in the global market, at the same time increasing the profitability of total exports.

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 3.12

Forecast of Latvian GDP by Expenditure Items

	2011 fact	2012	2013	2014-2020 (average annually)*
		growth rates, % over the previous year		
Gross domestic product	**5.5**	**5.2**	**4.0**	**3.2 .. 4.6**
Private consumption	4.8	5.5	4.1	3.2 .. 4.6
Public consumption	1.1	-4.1	1.8	2.4 .. 3.9
Gross fixed capital formation	27.9	13.2	2.5	2.4 .. 4.8
Exports	12.7	7.0	4.8	4.4 .. 4.7
Imports	22.7	3.6	5.9	4.2 .. 4.6
			structure, %	
Gross domestic product	**100**	**100**	**100**	**100**
Private consumption	62.2	62.3	62.6	63.1 .. 63.0
Public consumption	17.3	15.6	15.7	16.3 .. 16.7
Gross fixed capital formation	21.3	23.3	23.6	26.2 .. 24.7
Changes in inventories	4.0	2.7	2.4	0.2 .. 0.1
Exports	58.8	61.0	63.1	65.7 .. 62.5
Imports	63.6	65.0	67.5	71.6 .. 67.0
Export-import balance	-4.8	-3.9	-4.3	-5.9 .. -4.5

* structure at the end of the period

The more rapid development scenario foresees stable medium-term growth and economic development of the EU. The more rapid development scenario foresees that growth rates of manufacturing (and respectively also of exports) will remain comparatively high also after 2013, based mainly on both the increased competitiveness of Latvian producers and on the growth of external demand. The weaker development scenario is based on an assumption that the global economy will develop unevenly at slower growth rates, including slower recovery of the EU from the debt crisis.

Table 3.13

Forecast of Latvian GDP by Sectors

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

	2011 fact	2012	2013	2014-2020 (average annually)
Gross domestic product	**5.5**	**5.2**	**4.0**	**3.2 .. 4.6**
Agriculture, forestry	-0.5	6.6	3.1	2.2 .. 2.7
Manufacturing	11.7	9.2	5.4	4.3 .. 5.4
Other industry	-0.9	-1.6	3.2	2.9 .. 3.2
Construction	11.9	12.9	3.0	3.9 .. 6.0
Trade, accommodation	9.5	7.3	4.8	3.2 .. 4.2
Transport and storage	8.1	3.6	2.5	3.2 .. 4.3
Other commercial services	1.2	2.9	4.1	2.9 .. 4.7
Public services	0.6	-0.2	2.7	2.6 .. 4.0

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 a rapid decrease in the output, thus allowing improving competiveness of national economy with respect to internal devaluation measures. However, further growth no longer can rely on such drastic measures and an increasing emphasis will be placed on quality improvements of the labour market in order to address the main challenges to the national economic growth – demography (migration and ageing labour), increasing labour costs and inadequacy between skills and demand.

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 without well-considered migration policy might become a factor hindering the growth.

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, since 2008 Latvia has carried out budget consolidation in the amount of LVL 2.3 billion with a fiscal impact of 17% of GDP, out of which about 6.8% 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.

Table 4.1

General Government Budget

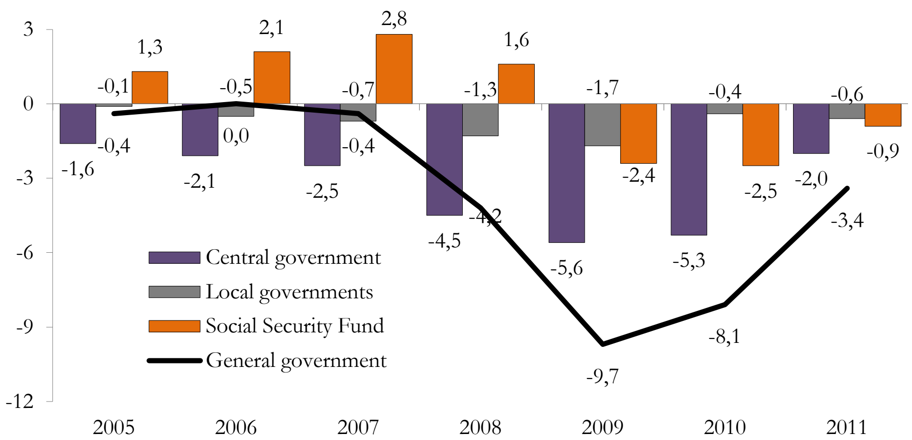
	2006	2007	2008	2009	2010	2011
Revenues (million LVL)	4208.0	5235.5	5605.8	4442.6	4513.0	4993.4
(% of GDP)	37.8	35.6	34.9	34.0	35.3	35.0
Expenditures (million LVL)	4263.2	5292.3	6286.9	5712.7	5549.5	5483.4
(% of GDP)	38.3	36.0	39.1	43.7	43.4	38.4
Balance (million LVL)	-55.1	-56.8	-681.0	-1270.0	-1036.5	-490.0
(% of GDP)	-0.5	-0.4	-4.2	-9.7	-8.1	-3.4

As a result of budget consolidation implemented by the government, the budget deficit in 2010 and 2011 decreased to 8.1% and 3.4% of GDP, respectively.

Figure 4.1

General Government Budget Balance by Sub-Sectors

(% of GDP)



The Saeima approved the government budget for 2012 with a deficit in the amount of LVL 309.7 million or 2.1% of GDP. Since the fiscal situation has been improving faster than expected, a number of amendments were made to the government budget in July 2012. Additional resources were allocated for single measures having no fiscal impact on the coming years. Financing was allocated for the purpose of tackling demographic issues, activities providing investments in public infrastructure and social integration activities, etc. According to the amendments to the government budget the expected budget deficit in 2012 is LVL 287.1 million or 1.9% of GDP. Flash estimate shows that the budget deficit in 2012 has been 1.5% of GDP.

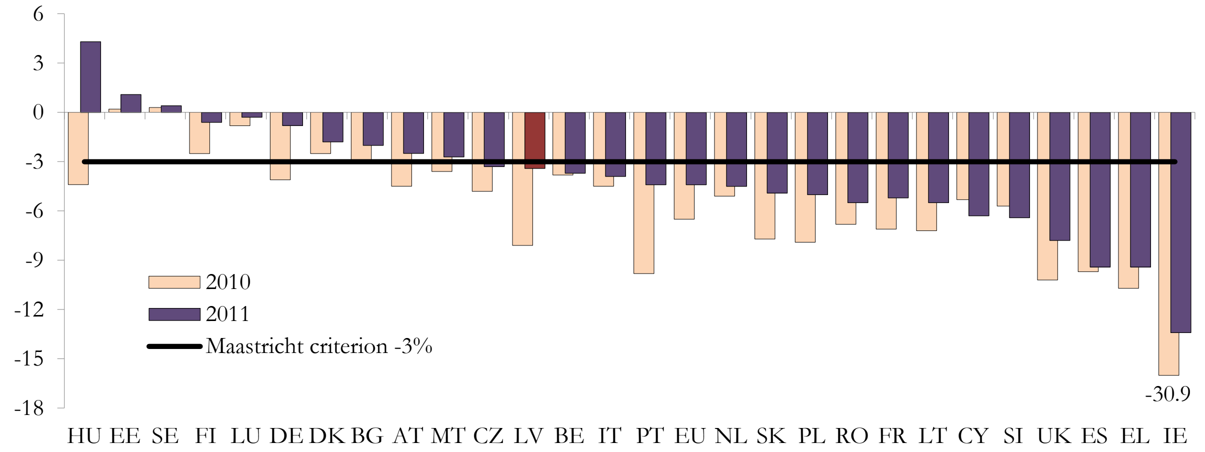
Over the past few years, the general government budget deficit is composed of the deficit in the central government budget and the local government budget, as well as the Social Security Fund (see Figure 4.1). Until 2008, the social insurance budget had a surplus; however, deficit has appeared over the last three years.

The level of the average budget deficit of the EU Member States in 2011 was 4.4% of GDP (in 2010 – 6.5% of GDP, in 2009 – 6.9% of GDP). The budget condition of 25 EU Member States has improved in 2011. The budget deficit had been observed in 2011 almost in all 24 EU Member States. Ireland, Greece, Spain, and the United Kingdom had the highest general government budget deficit against GDP in 2011. The budget deficit in these countries exceeded 7% of GDP. Only Hungary, Estonia, and Sweden had a budget surplus.

Figure 4.2

General Government Budget Balance in the EU Member States in 2010 and 2011

(% of GDP)



According to the forecasts of the European Commission published in autumn 2012, the budget situation in the EU Member States is expected to continue improving both in 2012 and 2013. In 2012, the level of the average budget deficit of the EU Member States is forecasted to be in the amount of 3.6% of GDP, but in 2013 – 3.2% of GDP. In 2012, the highest budget deficit that could exceed 6% of GDP is expected in Ireland, Spain, Greece and the United Kingdom.

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.

The general government deficit is expected to be below 0.8% of GDP in 2014 and 0.3% of GDP in 2015.

In order to ensure development of sustainable and counter-cyclical fiscal policy, the *Draft Law on Fiscal Discipline* (FDL) has been developed stipulating binding fiscal conditions for both the annual state 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.

The FDL and the *Draft Amendments to the Constitution of the Republic of Latvia* were submitted to the Saeima on December 6, 2011. On January 12, 2012, the FDL was approved at the Saeima in the 1st reading and in the 2nd reading – on December 20. Requirements of the new *Treaty on Stability, Coordination* *and Governance in the Economic and Monetary Union*[1] have been introduced in the FDL for the 2nd reading at the Saeima, thus ensuring improved compliance with the EU level requirements. The law is expected to be adopted in the final – the 3rd reading in early 2013.

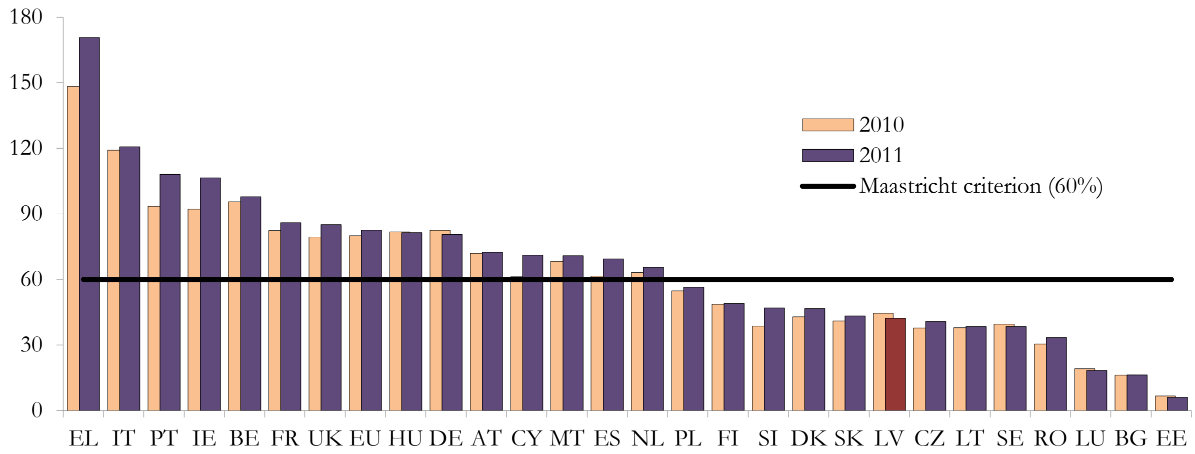
Consideration of *Amendments to the Constitution* continues at the Saeima committees. On January 17, 2012, it was considered by the Saeima Legal Affairs Committee, and forwarding of the amendments to *the Constitution* for further consideration was postponed until the working group of the Saeima Legal 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 2011, the EU average level of the public debt was 82.5% of GDP (80% of GDP in 2010, 74.6% of GDP in 2009). The public debt exceeded the Maastricht criterion that is 60% of GDP in 14 EU Member States in 2011. In 2011, the highest public debt was observed in Greece, Italy, Ireland, Portugal and Belgium, while the lowest general government debt was registered in Estonia, Bulgaria and Luxembourg. According to the European Commission's forecasts published in autumn 2012, the average level of the general government debt in the EU will reach 86.8% of GDP in 2012 and continue increasing also in 2013.

Figure 4.3

General Government Debt in the EU Member States in 2010 and 2011
(% of GDP)

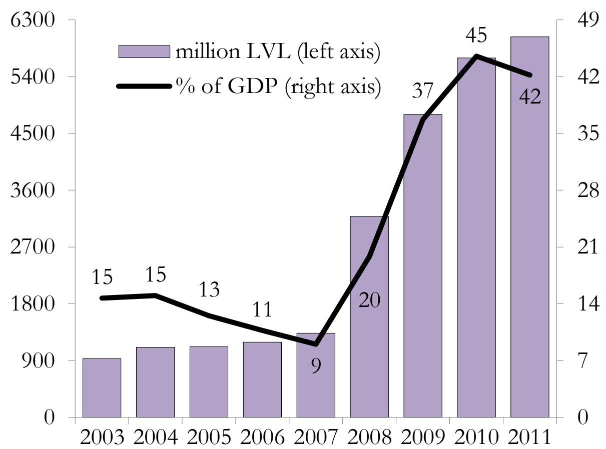


The general government debt in Latvia has gradually increased until 2007. Since 2008, it has been growing rapidly to ensure the financial obligations of the government and reached LVL 5694.6 million or 44.5% of GDP at the end of 2010 (see Figure 4.4). At the end of 2011, it was LVL 6028.3 million or 42.2% of GDP, but at the end of 3rd quarter of 2012, it was LVL 6392.9 million. The level of the general government debt is mainly influenced by the central government debt.

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

Figure 4.4

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



[1] It should be noted that at the end of May 2012 the Saeima supported the draft law ratifying the *EU Fiscal Discipline Treaty*.

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 priced 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.

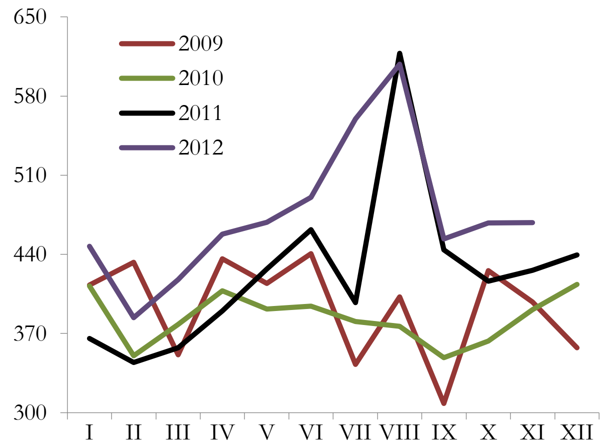
Taking into consideration the planned borrowing strategy, the debt level of the general government in the medium term is likely not to exceed 60% of GDP, which is the criterion under the *Maastricht Treaty*.

4.1.2. Budget Revenues

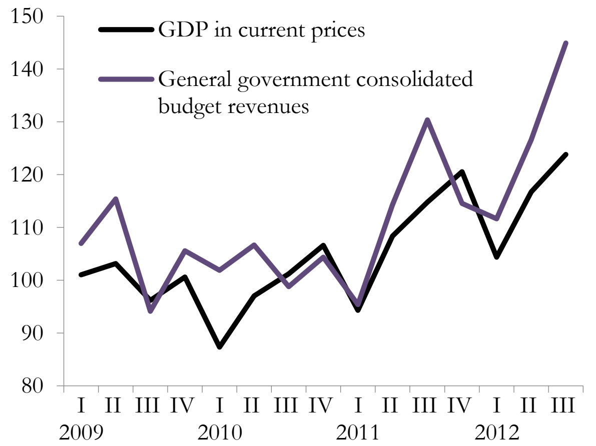
After the decrease in revenues of the general government consolidated budget during the economic downturn in 2009 and 2010, budget revenues started to increase again as the economic activities gradually resumed in 2011. Budget revenues constituted LVL 5087.3 million in 2011 which was by LVL 480 million 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 the eleven months on 2012 they were by LVL 5223 million or 12.4% higher than in the eleven months of 2011.

Figure 4.5

General Government Consolidated Budget Revenues
(million LVL)



GDP in Current Prices and General Government Consolidated Budget Revenues
(4th quarter of 2006 = 100)



Almost ¾ of all tax revenues consist of tax collections. The rest of budget revenues were largely based on income from foreign financial assistance. In August 2012, income from foreign financial assistance has doubled due to repayment of the European Union fund resources to the government budget as planned.

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

Table 4.2

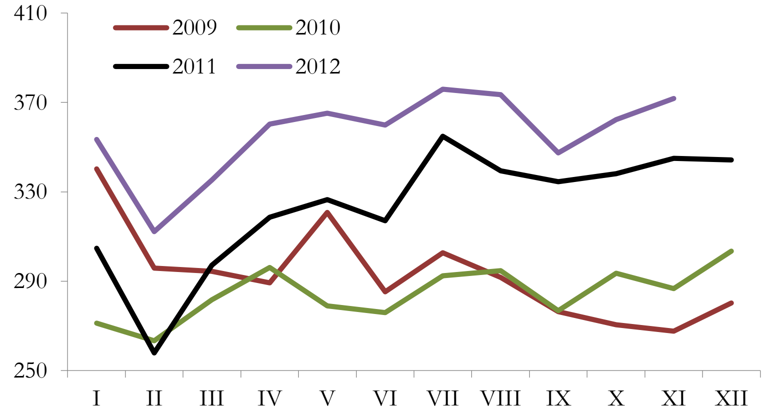
Budget Revenues
(% of GDP)

	2008	2009	2010	2011	2012 I-IX
General government consolidated budget revenues	**35.6**	**36.2**	**36.2**	**35.9**	**38.1**
I Tax revenues	**29.4**	**26.9**	**26.8**	**27.4**	**28.3**
1. Indirect taxes	10.5	10.1	10.2	10.3	10.8
– value added tax	6.9	6.1	6.5	6.8	7.4
– excise tax	3.4	3.9	3.6	3.4	3.3
– customs duty	0.2	0.1	0.1	0.1	0.1
2. Income taxes and property taxes	10.0	7.6	7.8	7.8	7.7
– corporate income tax	3.1	1.5	0.9	1.4	1.6
– personal income tax	6.4	5.6	6.2	5.6	5.7
– real estate tax	0.4	0.6	0.7	0.8	0.3
3. Social insurance contributions	8.7	8.9	8.6	8.7	8.6
4. Other taxes	0.3	0.2	0.2	0.6	1.2
II Other revenues	**6.2**	**9.3**	**9.4**	**8.5**	**9.8**

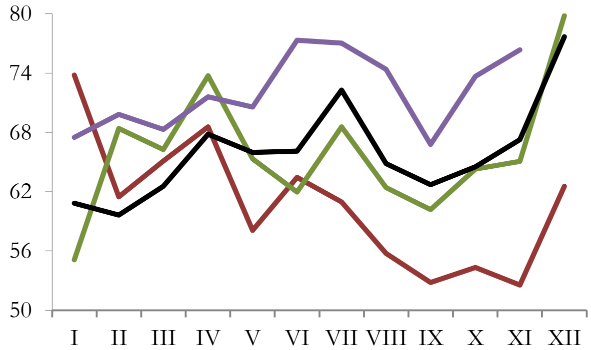
In the eleven months of 2012, tax revenues constituted LVL 3917.5 million which is by LVL 383.6 million or 11% more than in the corresponding period of the previous year. The increase in revenues from value added tax, mandatory state social insurance contributions and personal income tax provided the most considerable contribution in the eleven months of 2012.

Figure 4.6

Tax Revenues (million LVL)



Personal Income Tax



Mandatory State Social Insurance Contributions
(excluding resources of state funded pension schemes)

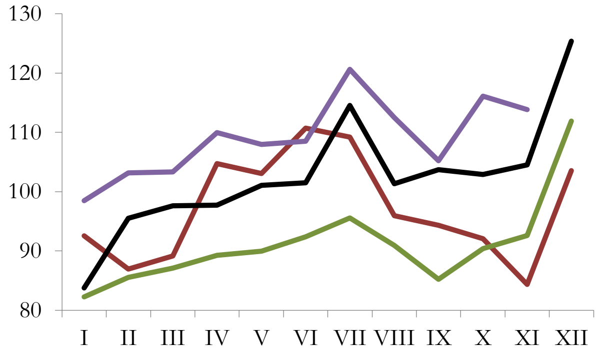
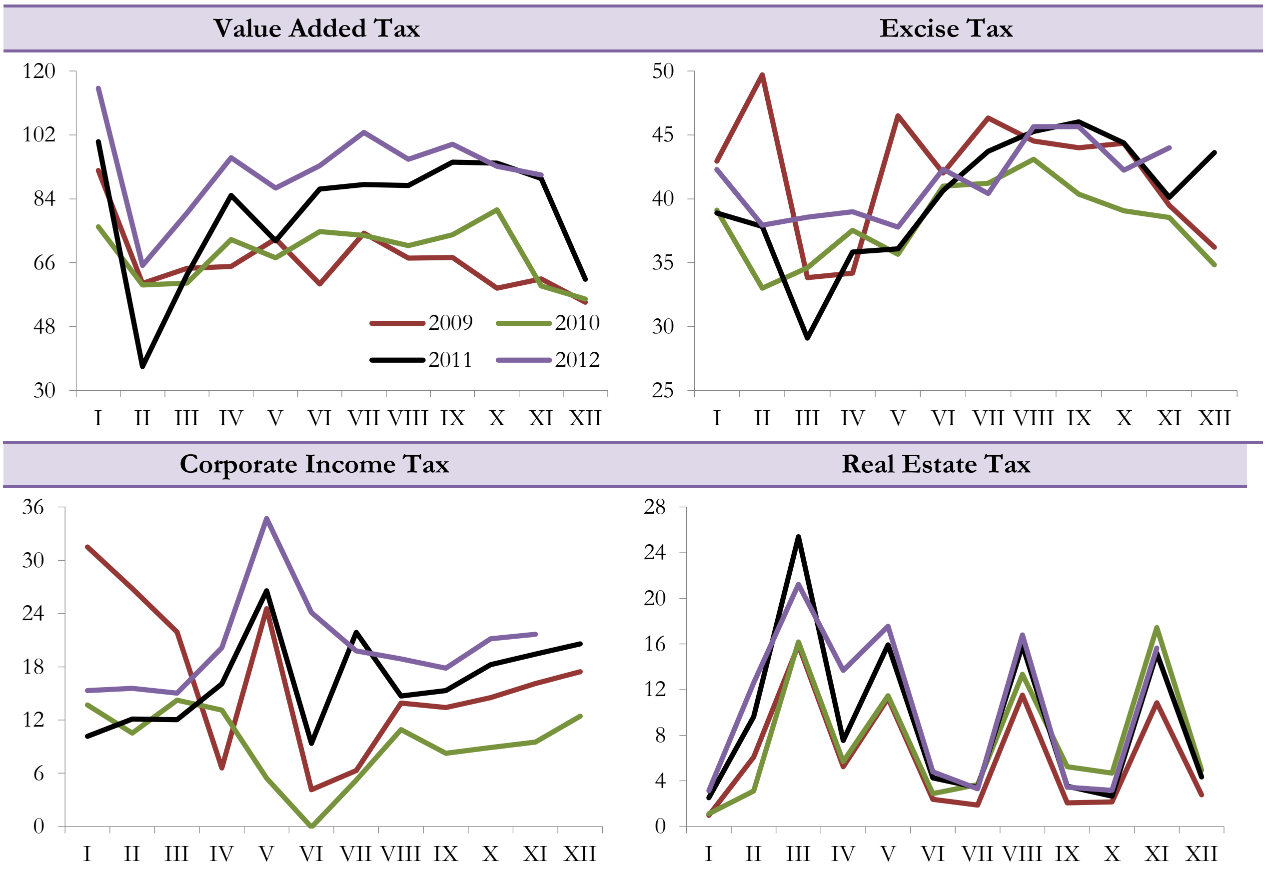


Figure 4.6 continued



In 2012, revenues from **employment tax** increased along with the increasing number of employed and wages. In January-November 2012, they were by 9.6% more than in the eleven months of 2011. Employment taxes constituted a half of all tax revenues.

In the eleven months of 2012, revenues from personal income tax were LVL 793.3 million which is by LVL 78.8 million or 11% more in comparison with the eleven months of 2011.

Starting from 2013, the personal income tax standard rate will be reduced from 25% to 24%, but from 2014 to 22% and in 2015 to 20%. As of July 1, 2013 the rate of personal income tax relief for dependants will be increased (from 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.

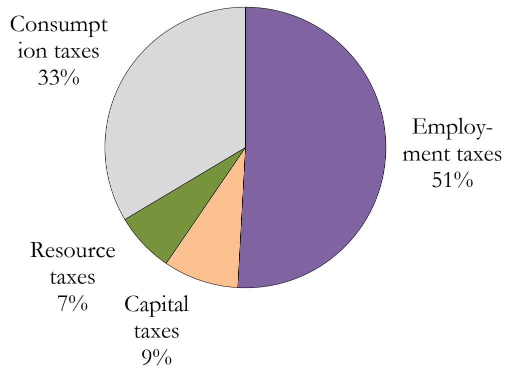
In the eleven months of 2012, revenues from mandatory state social insurance contributions amounted to LVL 1199.7 million. It was by LVL 95.4 million or 8.6% more than in the eleven months of 2011.

The maximum amount of the object for social insurance contributions is cancelled until the end of 2013, i.e. persons must make social insurance contributions from all labour income within this period.

Figure 4.7

General Government Consolidated Budget Tax Revenues by Tax Groups in January-November 2012

(%)



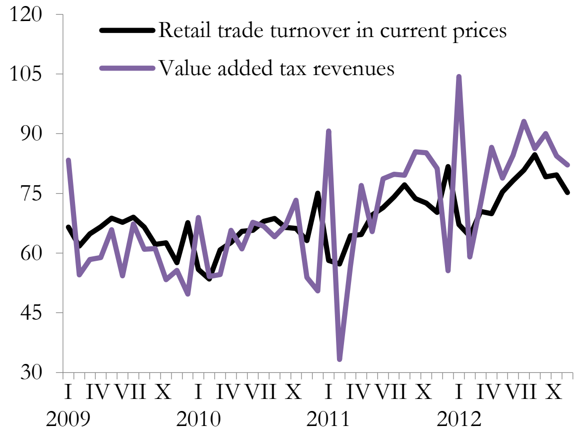
Revenues from **consumption taxes** constitute 1/3 of all tax revenues. The increase in private consumption and thus the increase in retail trade turnover in the eleven months of 2012 allowed collecting by 11.5% more taxes than in the corresponding period of 2011.

In 2011, revenues from value added tax were by 16.2% more than a year ago. Revenues from value added tax kept growing fast also in 2012. In the eleven months of 2012, tax revenues amounted to LVL 1017.4 million – by 13.4% more than in the eleven months of 2011.

Figure 4.8

Retail Trade Turnover and Revenues from Value Added Tax

(December 2007 = 100)



As of 2012, the reverse value added tax is applied to construction services, which means that the recipient of these services pays the value added tax for provided construction services into the state budget, thus limiting fraud in the construction sector.

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 applicable rates in other Baltic States (in Lithuania – 21%, in Estonia – 20%).

The excise duty revenues from consumption were growing at a slower pace in 2012 (alcoholic beverages, tobacco and other excise goods). In the eleven months of 2012, tax revenues amounted to LVL 198.3 million which is by LVL 4.4 million or 2.3% more than in the corresponding period of 2011.

Since 2012, amendments to the *Excise Duties Law* are in force applying to the criterion for regular movement of goods to be imported from the third countries by natural persons (replacing the existing definition "not more than once a day" with "not more than once in seven days"), thereby reducing the risk of abuse of exemption from the excise duty under the law.

The share of **capital taxes** in the total tax revenues in the first eleven months of 2012 was 8.7%. Capital tax levy has increased the most among the tax groups in 2012. In January-November, capital tax levy was by 20.5% higher than in the corresponding period of 2011.

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 the eleven months of 2012, revenues from corporate income tax have increased by LVL 48.4 million or 27.5%, compared to the corresponding period of 2011. Revenues from real estate tax, on the other hand, have increased by LVL 7.2 million or 8.9% amounting to LVL 115.4 million in the eleven months of 2012 compared to the corresponding period of the previous year.

Resource tax group is the smallest tax group constituting 6.9% of all tax revenues in 2012. In the eleven months of 2012, resource tax revenues have increased slower than those of other groups – by 6.1%, compared to the corresponding period of the previous year.

In January-November 2012, revenues from the excise duty for oil products and natural gas was LVL 257.6 million – by 5.5% more than within the same period of previous year. However in the same period revenues from the natural resources tax increased by approximately 20 per cent.

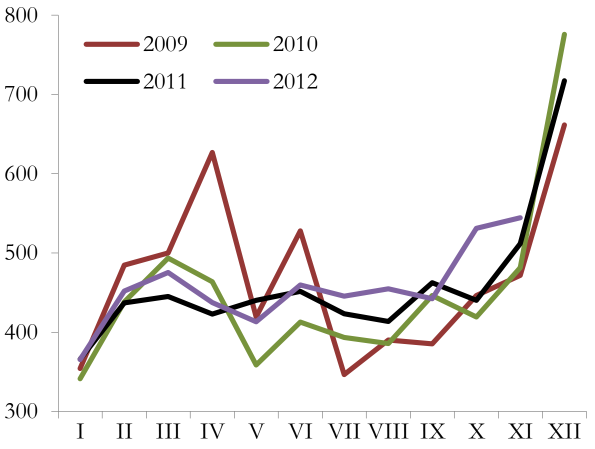
4.1.3. Budget Expenditures

After the sharp cut in expenditures during the economic crisis, the government 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 5020.9 million which is by LVL 206.1 million or 4.3% higher than in the eleven months of 2011.

Figure 4.9

General Government Consolidated Budget Expenditures
(million LVL)



In the eleven months of 2012, in comparison with the same period of previous year, the expenditures for subsidies and grants increased by 4.4 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.

In 2012, the expenditures for subsidies and grants constituted 46% of all budget expenditures which is by 10 percentage points more than in 2008.

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 the eleven months of 2012, capital expenditures were by 5.5% higher than in the corresponding period of the previous year.

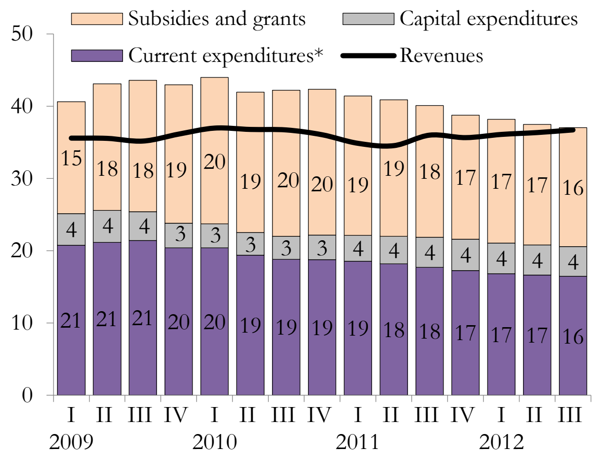
Despite the increase over the past few years, the share of capital expenditure in the total expenditure has not been considerably changed, compared to 2008 – in 2012 they constituted average 10% of the total government budget expenditures.

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 44 per cent.

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

Figure 4.10

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

According to the expenditures by functional categories, the highest share in the first eleven months of 2012, was for social protection – 30.4% of all expenditures, economic affairs – 17.1%, expenditures for general government services – 13.4% and education – 16.7%. However, the lowest share of all expenditures was for environmental protection – 2%, defence – 2%, and management of municipal territories – 2.7 per cent.

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)

	2009		2010		2011		2012 I-IX	
	structure	against GDP	structure	against GDP	structure	against GDP	structure	against GDP
Expenditures – total	**100**	**43.0**	**100**	**42.5**	**100**	**38.8**	**100**	**34.4**
General public services	14.8	6.4	13.4	5.7	12.1	4.7	13.4	4.6
Defence	2.4	1.0	2.0	0.9	2.3	0.9	2.0	0.7
Public order and safety	4.5	1.9	4.4	1.9	4.4	1.7	4.6	1.6
Economic affairs	15.7	6.7	16.0	6.8	19.0	7.4	17.1	5.9
Environmental protection	2.2	0.9	1.1	0.5	2.5	1.0	2.0	0.7
Management of municipal territories and housing	2.1	0.9	2.5	1.1	3.0	1.2	2.7	0.9
Health	7.5	3.2	7.2	3.1	7.8	3.0	7.9	2.7
Recreation, culture and religion	3.4	1.5	2.9	1.2	3.2	1.3	3.3	1.1
Education	19.6	8.4	16.7	7.1	17.1	6.6	16.7	5.7
Social security	27.9	12.0	33.8	14.4	28.5	11.0	30.4	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% mainly due to the increase in central government expenditures for the total fixed capital formation.

Table 4.4

Public Demand

	% of GDP				Changes in comparison with the previous year, %			
	2008	2009	2010	2011	2008	2009	2010	2011
Public demand	**24.9**	**23.8**	**22.2**	**21.7**	**-3.5**	**-13.3**	**-9.7**	**6.0**
Public consumption	**20.0**	**19.6**	**18.4**	**17.4**	**1.6**	**-9.4**	**-7.9**	**1.1**
– central government*	10.9	10.5	10.7	9.6	0.8	-10.6	-0.5	-4.5
– local governments	9.1	9.1	7.7	7.9	2.5	-8.0	-16.5	8.8
Gross fixed capital formation	**4.9**	**4.3**	**3.7**	**4.3**	**-15.4**	**-24.1**	**-15.8**	**24.0**
– central government*	1.8	1.5	1.2	1.8	-38.1	-25.4	-26.1	68.5
– local governments	3.1	2.7	2.6	2.4	7.5	-23.3	-10.0	3.3

* including Social Security Fund

4.2. Prices

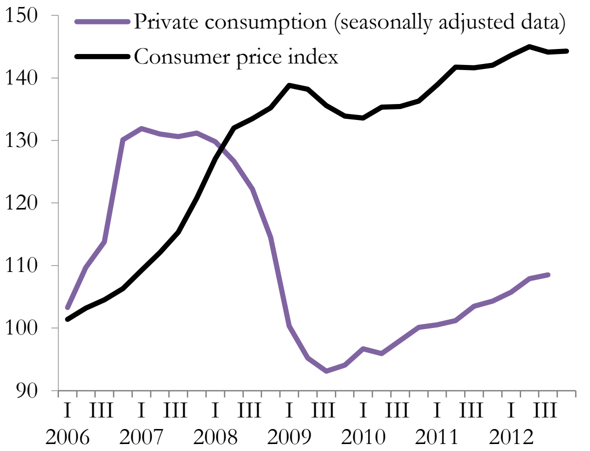
4.2.1. Consumer Prices

In 2012, despite the growth in Latvia that has been the fastest among the European Union states, consumer prices remained growing at a moderate pace, close to the level of seasonal fluctuations. In 2012, the consumer prices increased 2.5 times slower than in 2011, when prices reached 4% (12-month inflation). The rise in prices in 2012 was mainly based on the increase in administratively regulated prices, food prices and transport costs. World fuel price dynamics also had great influence.

Figure 4.11

Private Consumption and Consumer Price Index

(4th quarter of 2005 = 100)



In 2012, consumer prices increased by 1.6% (12-month inflation), but taking into consideration rapid increase of prices in 2011, the average price level was by 2.3% higher than a year ago.

Factors influencing prices in 2012:

– Overall, the increase in administratively regulated prices and prices for other products and services related to housing maintenance by 5.6% influenced the average price level by nearly 1 percentage point within a year. The increase in natural gas tariffs reached 17.3% within a year and lead to a rise in administratively regulated prices for heat energy and gas, as well as a rise in price for housing rent and waste collection services;

– The rise in prices for food products that in 2012 have increased by 3.1% and that increased the total level of prices by almost 0.8 percentage points. Changes in prices for food products depend mainly on world price fluctuations. Yet, in 2012, it no longer has the influence it had in the previous year. In December 2012, world food prices were by nearly 1% lower than in December 2011;

– The rise in world prices for oil products at the beginning of year affected the rise in fuel prices in Latvia significantly. In April 2012 compared to December 2011 the rise in fuel prices in Latvia reached 11%, in September it was 10.3%. However, the fall of fuel prices in May-July and October-November 2012 was one of the factors that most of all influenced the decrease of average price level in these months. Overall, the increase in fuel prices reached 4.5% in 2012, though it was three times lower than in the previous two years. However, the positive effect of the decrease in fuel prices is hindered by the appreciation of the US dollar against the euro;

– The decrease in prices for communication services had influence on the average price level which shrunk by nearly 0.3%. A reduction was observed in mobile telecommunication prices and internet service prices;

– The reduced VAT rate as of July 1, 2012 had a certain influence on the decrease in consumer prices and service prices. In July, it reduced the overall price level by 0.5 percentage points that was expected to be reached in a longer period of time. Besides, the reduced rate had greater influence on food prices than on the overall price level. The influence of tax changes was observed further in the second half of 2012.

Table 4.5

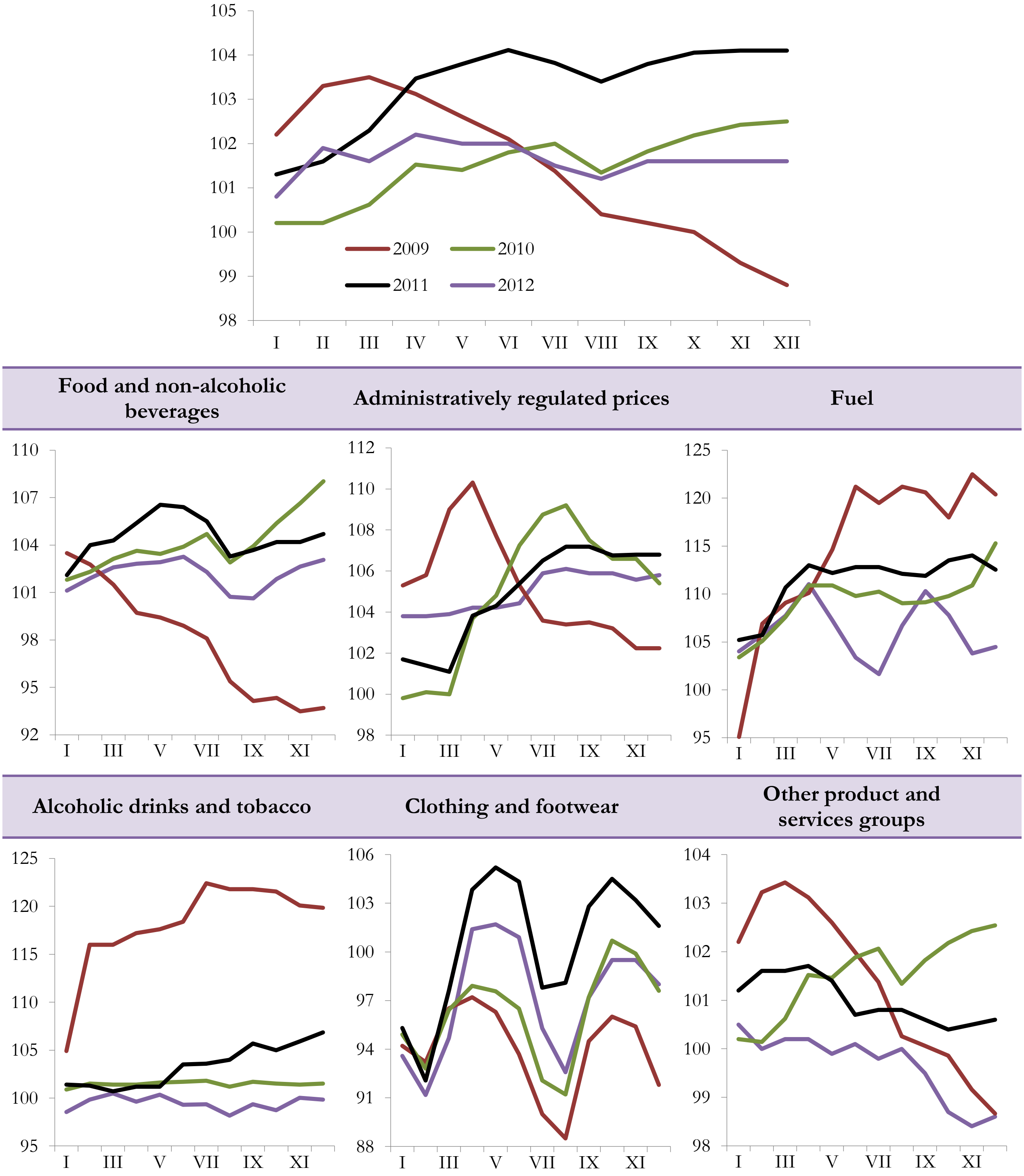
Consumer Price Changes by Months

(per cent)

		Compared to the previous month	Compared to the respective month of the previous year	Average during the year
2011	October	0.2	4.4	4.1
	November	0.0	4.2	4.2
	December	0.0	4.0	4.4
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

Figure 4.12

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

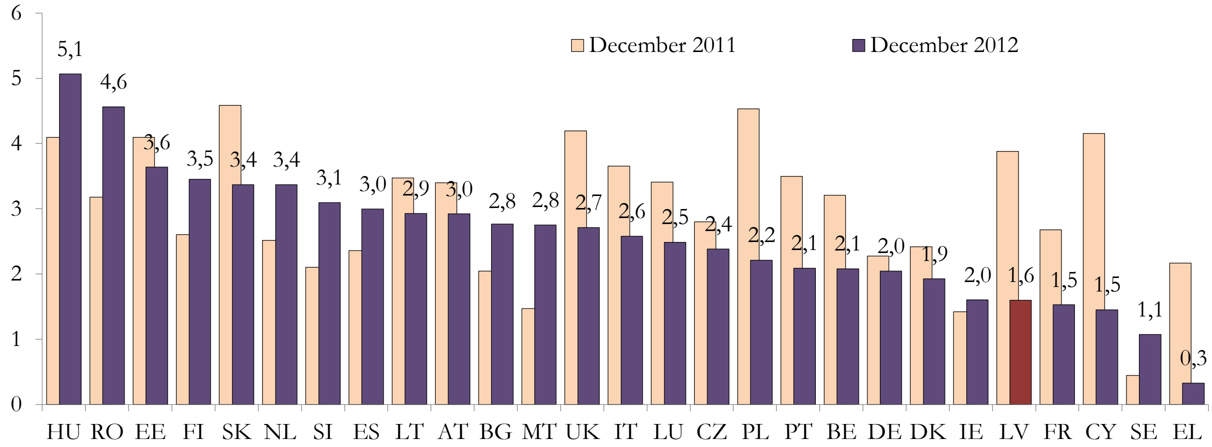


In 2013, the price changes will be close to the level of seasonal fluctuations. The Ministry of Economics forecasts a moderate price dynamics within 1.5% in 2013. No significant changes are expected in relation to administratively regulated prices in 2013. The reduced personal income tax rate and increase in tax reliefs might have an insignificant effect on promoting private consumption. At the same time, increased uncertainty will remain about food and fuel prices in the world.

Figure 4.13

Changes of the Harmonised Consumer Prices in the EU Member States

(12-month inflation, %)



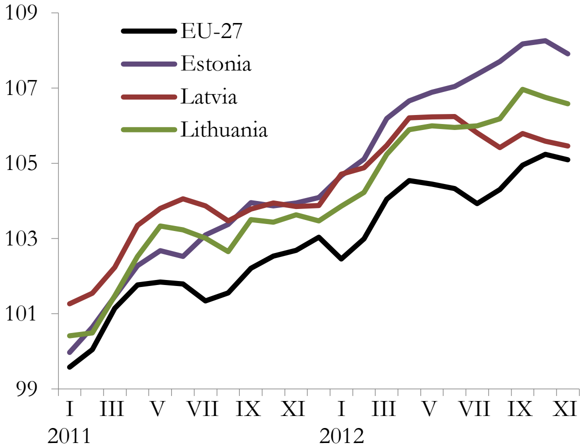
Source: *Eurostat*

In 2011, compared to 2010, the average price level in the European Union has increased by 2.6%. Just like in Latvia, it was determined by the rise in prices for food products and energy.

Figure 4.14

Harmonised Consumer Prices Index

(December 2010 = 100)



In December 2012 compared to December 2011, the price level in the EU Member States has increased faster than in Latvia – by 2.3%. The price inflation rose most rapidly in Hungary, Malta and Romania, thus becoming the countries with the highest inflation rate in the EU. Meanwhile, the inflation decreased most rapidly in Cyprus, Latvia and Greece.

If comparing the Baltic States, the highest increase in consumer prices in December 2012, as compared to December 2011, was observed in Estonia (by 3.6%), the most moderate – in Latvia (by 1.6%). In Lithuania, consumer prices have increased by 2.9%. In December 2012, as compared to December 2011, the consumer prices in the Baltic States continued increasing for the food product group and energy. Considering the drop in the prices for food products and oil products worldwide, the rise in food prices and fuel prices became more moderate since April and even a drop in fuel prices was observed in the middle of the year. The prices started rising again in the last months of the year, while a decrease has been observed in the energy group after the rapid increase in July-September.

The highest increase in prices for food product group and energy among the Baltic States was observed in Estonia – by 5.3% and 6.4%, respectively, in Latvia the lowest price increase was for food product group – by 2.4% (in Lithuania – by 3.5%), while the lowest increase in prices in Lithuania was experienced for energy – by 2.6% (in Latvia – by 6.5%). A rapid increase in administrative prices has been observed in all Baltic States – in Estonia by 8.1%, in Latvia by 5.9% and in Lithuania by 4.4 per cent.

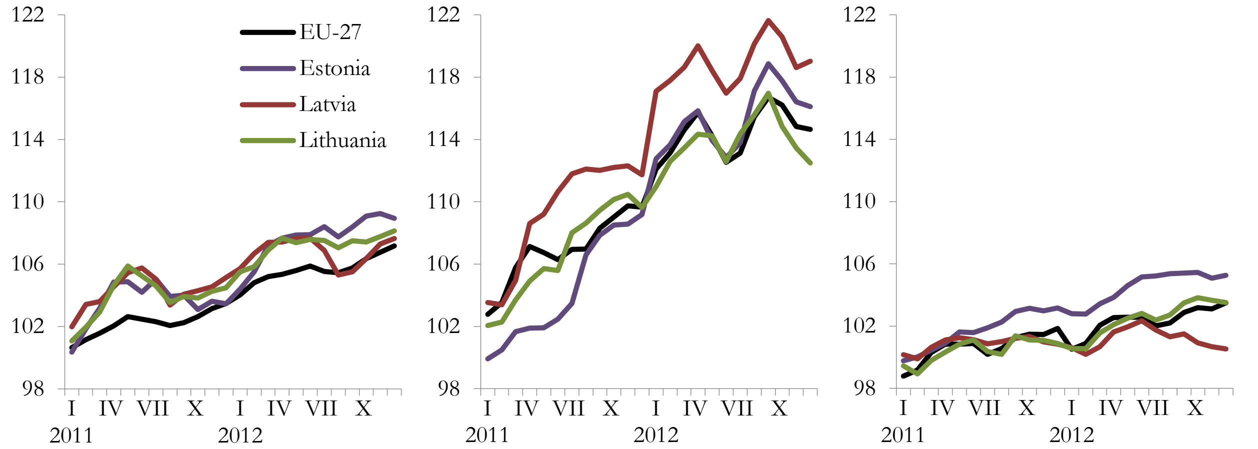
It should be noted that in November 2012 compared to November a year ago, prices in Estonia and Lithuania for the services group increased faster than in Latvia – by 2.3% and 3.1% (in Latvia – by 0.8%) respectively. In the second half of 2012, prices in Latvia are mostly affected indeed by the increase in the prices for food product group and energy because apart from those two groups, a drop in prices by 0.3% has been observed for the rest of the groups in November.

Figure 4.15

Harmonised Consumer Prices Index by components

(December 2010 = 100)

Food products (including alcohol and tobacco)	**Energy**	**Total price index excluding energy and food products**



4.2.2. Producer Prices

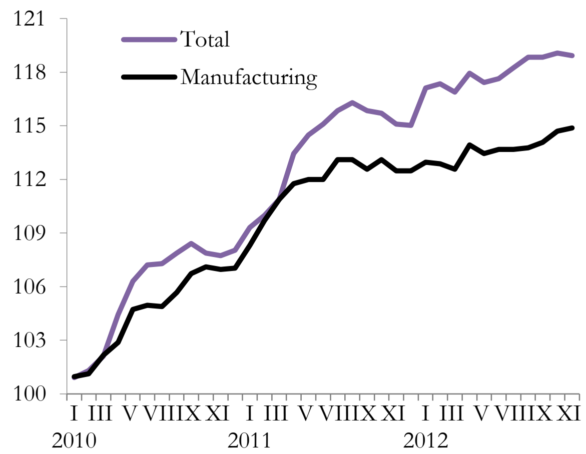
After the rapid increase in 2010 and the first half of 2011, **producer prices** in general were moderate further on. In the eleven months of 2012, producer prices showed slight, though steady growth mainly due to the rising demand in domestic market.

In November 2012, as compared to November 2011, prices have increased by 3.2%. Prices for products sold in domestic market have increased by 4.3% within the year. The highest increase in the prices for products sold in domestic market has been for electricity, gas supply, heating and air conditioning, as well as production of electric devices, clothes, food products and non-metallic minerals.

Figure 4.16

Producer Price Changes

(December 2009 = 100)

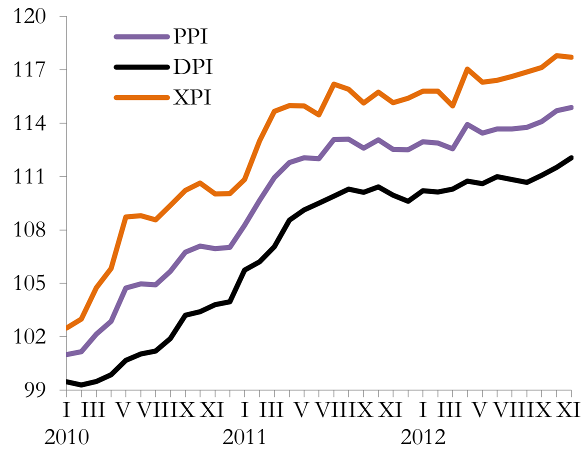


Producer prices for exported products, for their part, are mainly affected by the weakening demand in our key markets – they have increased by 2%. The most significant increase in prices for exported products has been for production of computers, electronic and optical equipment, mining and quarrying, production of food products and clothing.

Figure 4.17

Dynamics of Producer Price Changes in Manufacturing

(December 2009 = 100)



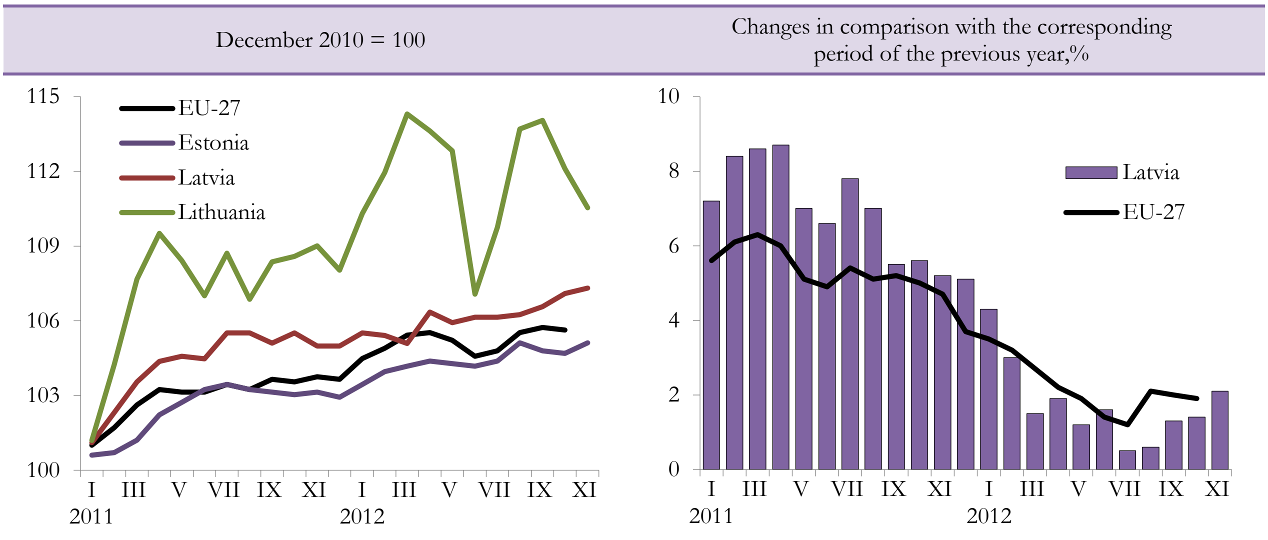
PPI – producer price index,
DPI – producer price index for products sold in the domestic market,
XPI – producer price index for exported products.

Slightly over 60% of manufacturing products is 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 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 November 2012, as compared to November 2011, has increased by 2.1%. In November 2012, as compared to November 2011, the manufacturing producer prices in domestic market have increased by 1.9%, while prices for exported products – by 2.2%. After the rapid increase in producer prices in 2010 and the first half of 2011, producer price changes in general were moderate further on.

Figure 4.18

Producer Price Index in Manufacturing



Overall, the producer prices in the EU stabilised in 2010 and continued rising in the first half of 2011, however the producer prices began declining in the mid-2011 also in the European countries. It was mainly based on the decrease in food and agricultural prices, as well as on the decrease in prices for raw materials and metals, 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 the USA, as well as slowdown of the world trade growth rate, and uncertainty about expected fiscal consolidation in the majority of developed countries.

In the eleven months of 2012, the producer prices in the EU kept growing at a moderate pace. If comparing the Baltic States, the most rapid increase of the producer price index in manufacturing in November 2012, as compared to November 2011 was observed in Latvia (by 2.1%), the most moderate – in Lithuania (par 1.6%). In Estonia, produce prices increased by 2 per cent.

In the eleven months of 2012, a twofold increase in manufacturing producer prices has been observed in Lithuania (by 4.6%), whereas the tendency of increase is similar in Latvia and Estonia – by 2 per cent.

4.2.3. Foreign Trade Unit Value Indices

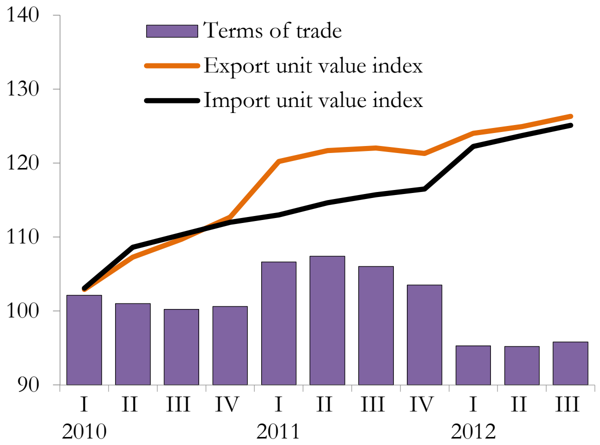
At the beginning of 2011, in comparison with the respective period of the previous year, the terms of trade improved considerably as import prices increased at almost half the speed as those of export. Taking into account the rapid increase in the unit value, since the beginning of 2012 the terms of trade have worsened and in the 3rd quarter of 2012 compared to the respective period of 2011, the unit value for exported goods increased by 3.5% and that of imported goods – by 8.1 per cent.

The average export unit value level in the 3rd quarter of 2012, in comparison with 3rd quarter of 2011, was mainly raised by the increase in the unit value for machinery and mechanical appliances, prepared foodstuffs, products of the chemical and allied industries, as well as textile and textile articles. The unit value increase for mineral products, transport vehicles, machinery and electric equipment, as well as prepared foodstuffs had the greatest impact on the average unit value level.

Figure 4.19

Export and Import Unit Value Indices and Terms of Trade

(export and import unit value indices 4th quarter of 2009 = 100; terms of trade, % to the respective quarter of the previous year)

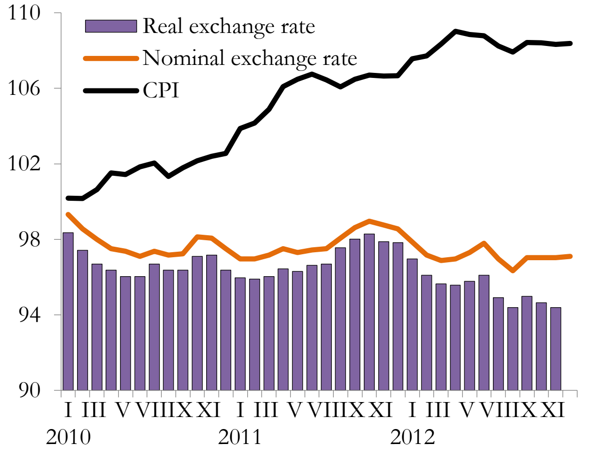


As competiveness of Latvian entrepreneurs improved, the real effective exchange rate of the Latvian lats continued decreasing in 2010 and at the beginning of 2011. Despite the slight increase at the end of 2010 and at the end of 2011, generally it is at a low level. At the beginning of 2011, the decrease of the real effective exchange rate of the lats has been determined by the low nominal effective exchange rate of the lats, but at the end of the year, the increase of the real effective exchange rate of the lats was determined by the rise in consumer prices. As the nominal effective exchange rate continues decreasing also in 2012, it can be concluded that the competiveness of Latvian entrepreneurs is maintained.

Figure 4.20

Effective Exchange Rate of the Lats *

(December 2009 = 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

After significant fluctuations of the current account due to the adjustments of external imbalance caused by the financial crisis, the current account has remained steady at a slight deficit since the end of 2010. In 2011, the deficit of the current account reached 2.4% of GDP, while in the three quarters of 2012 – 2.5% of GDP (in the 1st quarter – 3.1%, in the 2nd quarter – 2.7% and in the 3rd quarter – 1.8%). At the moment, the current account is a proof of external balance of Latvian economy.

Similar trends were 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 has been seen all three Baltic States and at the moment the balance of current account is negative.

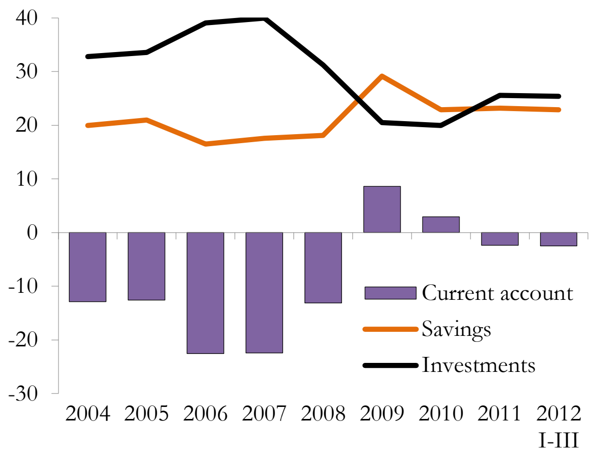
Figure 4.21

Current Account Balance in the Baltic States

(% of GDP)

Figure 4.22

Current Account, Investments and Savings
(% of GDP)



In the three quarters of 2012, the current account deficit reached 1.4% in Estonia, 1.8% in Lithuania and 2.5% of GDP in Latvia. Comparing to the corresponding period of the previous year, the deficit of the current account in Lithuania has decreased two times, while the balance of current account significantly deteriorated in Estonia resulting in deficit. The current account deficit in Latvia has remained at the level of the previous year.

During the period of rapid decline, fluctuations of the balance of the current account was mainly related to the changes in the items of income balance, while recently the current account changes is based on the export and import dynamics of goods.

Table 4.6

Balance of Payments of Latvia
(% of GDP)

	2008	2009	2010	2011	2011 I-IX	2012 I-IX
A. Current account	**-13.1**	**8.6**	**2.9**	**-2.4**	**-2.6**	**-2.5**
Trade balance	-17.8	-7.1	-7.1	-10.9	-10.7	-10.7
Exports	*28.5*	*28.4*	*37.9*	*42.8*	*42.9*	*44.2*
Imports	*-46.3*	*-35.5*	*-45.0*	*-53.7*	*-53.6*	*-54.9*
Balance of services	4.0	6.0	6.2	6.5	6.4	7.0
Net revenues	-1.6	6.3	0.2	-1.1	-1.4	-1.9
Current transfers, net	2.2	3.4	3.6	3.1	3.1	3.1
B. Capital account	**1.5**	**2.4**	**1.9**	**2.1**	**2.4**	**3.0**
C. Financial account*	**11.5**	**-6.9**	**-2.1**	**-4.1**	**0.3**	**2.0**
Direct investments	3.0	0.6	1.5	5.0	5.7	2.7
Abroad	*-0.7*	*0.2*	*-0.1*	*-0.2*	*-0.3*	*-0.8*
In Latvia	*3.8*	*0.4*	*1.6*	*5.2*	*5.8*	*3.5*
Portfolio investments**	0.8	2.3	-2.8	-1.8	-2.9	0.0
Assets	*1.8*	*3.2*	*-0.1*	*-1.0*	*-2.3*	*-3.0*
Liabilities	*-1.0*	*-0.9*	*-2.7*	*-0.8*	*-0.6*	*3.0*
Other investments	7.6	-9.8	-0.8	-7.2	-2.3	-0.7
Assets	*-1.4*	*-4.0*	*-3.3*	*-1.5*	*3.0*	*-0.4*
Liabilities	*9.0*	*-5.8*	*2.5*	*-5.7*	*-5.3*	*-0.3*
D. Net errors and omissions	**-1.8**	**0.8**	**1.2**	**-0.1**	**-0.2**	**-0.3**
E. Reserve assets	**2.0**	**-5.0**	**-4.0**	**4.5**	**0.1**	**-2.1**

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

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 10.9% 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 the three quarters of 2012, exports have increased slightly faster than imports. Comparing to the corresponding period of the previous year, exports in current prices increased by 12%, while imports – by 11.4%. In the nine months of 2012, foreign trade deficit has remained at the level of the previous year due to the nearly even dynamics of imports and exports – 10.7% of GDP. It should be noted that in the 3rd quarter of 2012, exports increased three times faster than imports and volumes thereof was 1.7 times higher than average in a quarters in 2007, while volumes of imports exceeded the average quarterly volume of imports in 2007 by just 13 per cent.

The balance of services is positive and has been growing in the past few years, covering over a half of the foreign trade deficit. In 2011, surplus of balance of services was 6.5% of GDP but in the three quarters of 2012, the positive balance of services increased to 7% of GDP and was by 0.6 percentage points higher than a year ago. As in the previous year, 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 situation improved, the income balance has been negative since the 3rd quarter of 2010. Overall in 2011, there was a slight deficit of the income balance -1.1% of GDP, while in the three quarters of 2012, the deficit of income balance has increased to 1.9% of GDP (including in the 3rd quarter of 2012 it was 2.3% of GDP). The increase of income balance deficit was related to the increase of non-resident investment income including an increase in the amount of non-residents' paid dividends. It should be noted that average quarterly non-resident income from investments in national economy of Latvia in 2012 was by 40% lower than average quarterly in 2007, while non-resident income from dividends and distributed profit of branches reached 90% of the level of 2007.

The huge deficit of the current account in the pre-crisis period reflected a significant imbalance between domestic investments and savings.

The inflow of foreign capital until 2007 positively affected investments on the one hand, but on the other hand it became a substantial factor for decreasing the level of savings. In 2007, the investment level increased from 33% to 40.4% of the GDP, but the level of savings decreased from 20.2% to 18.1% compared to 2004, ensuring less than a half of domestic investment financing.

As the conditions in the global financial markets deteriorated, the situation changed drastically. A high debt burden, decrease of economic activities and income, as well as uncertainty about the future development fostered thrift of households. Along with the increase in the level of savings, the investments are decreasing rapidly. In 2009, the share of investments in GDP was 20.5%. However, the level of national savings in 2009 was 29.1% of GDP. In 2010, the level of savings dropped to 22.9% of GDP, yet, savings still exceeded the level of investments due to the remaining low investment activities. Yet, the deteriorating balance of the current account in 2011 and in the three quarters of 2012 was mainly related to a more rapid increase in investments while savings remained at the level of the previous year.

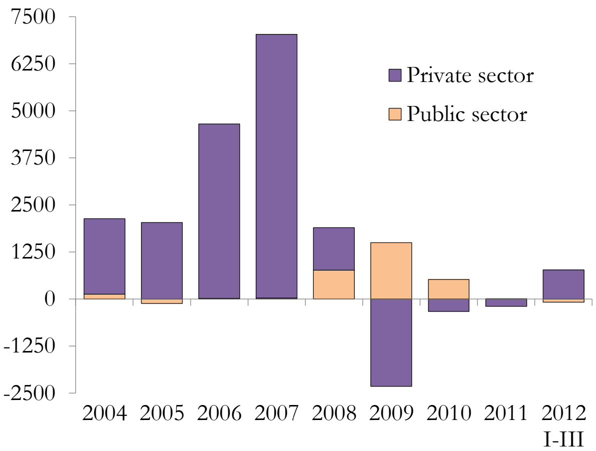
4.3.2. Financial Flows

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 financial account (excluding reserve assets) was 24.5% of GDP, while in 2009 the deficit of 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 financial sector, as well as the policy for restructuring debts and reducing debt commitments of the public sector.

Figure 4.23

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 2 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.

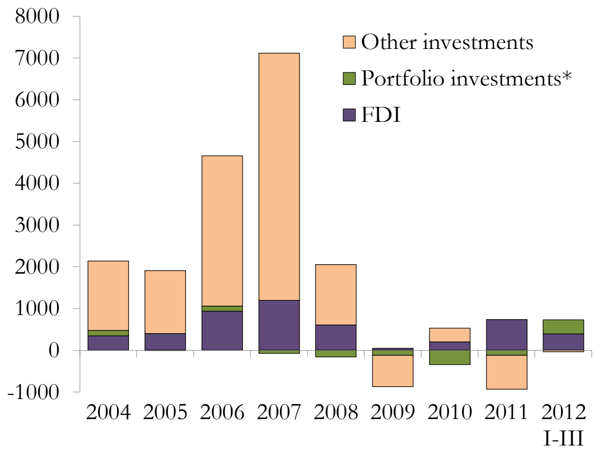
In 2011, foreign private capital flows were negative mainly due to the decrease in liabilities of the banking sector. In general, the deficit of the financial account balance was 4.1% of GDP in 2011. In the 1st quarter of 2012, public debt commitments increased considerably, thus influencing the positive balance of 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 the nine months of 2012, the balance of the financial account was positive – 2% of GDP.

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

Figure 4.24

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



* portfolio investments and derivative financial instruments

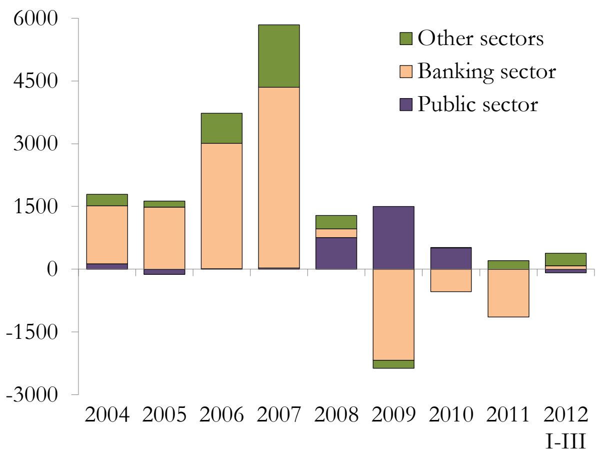
During the period of 2005-2007, the foreign direct investments in the inflowing foreign capital structure on average constituted almost 20%. In comparison with 2004, the volume of FDI has tripled, but in 2008 compared to 2007, the FDI stock has decreased by almost a half and covered 30% of the negative 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 the three quarters of 2012, the amount of FDI was by 33.9% lower than in the corresponding period of the previous year. 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 in the incoming financial flows is small and has not been exceeding 10% of these flows over the last three years. In 2010 and 2011, the balance of portfolio investments was negative, which was mainly due to the increase of foreign assets in the banking sector in the form of portfolio investments. In the three quarters of 2012, there was a slight surplus of the balance of portfolio investments (0.3% of GDP). Fluctuations of portfolio investment flows are considerably influenced by the activities aimed at stabilizing the balance of the banking sector, as well as reducing the public debt commitments and restructuring the debt.

Table 4.25

Incoming Foreign Investment Flows by Sectors *
(million LVL)



* excluding foreign direct investments

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.

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 three quarters of 2012, there was a slight deficit of the balance of other investments 0.7% of GDP.

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 financial sector.

The data of the international investment balance of Latvia shows that the government gross external debt was LVL 4853.9 million (32% of GDP) at the end of September 2012, i.e. by almost 9% lower than a year ago. The total gross external debt of Latvia has also decreased constituting 145.2% of GDP at the end of September 2012 – by 11 percentage points lower than a year ago.

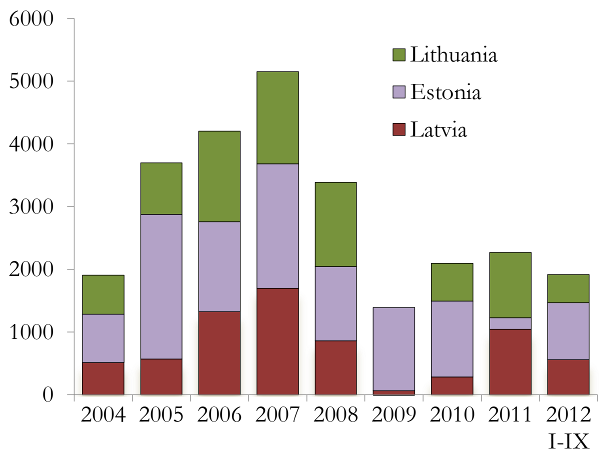
4.3.3. Foreign Direct Investment

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 4.26

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 1915.8 million in the three quarters of 2012 which is by 2.2% less than in the corresponding period of the previous year. Although incoming FDI flows have remained close to the level of the previous period 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 33.9% and 49.4% in this period, while Estonia experienced a fourfold increase.

From 2010 until September 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. (the drop in FDI flows in Lithuania was mainly determined by the large investments in 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 comparison with 2011, but in the nine months of 2012 FDI of Latvia 2.7 times exceeded the amounts in the corresponding period of the previous year.

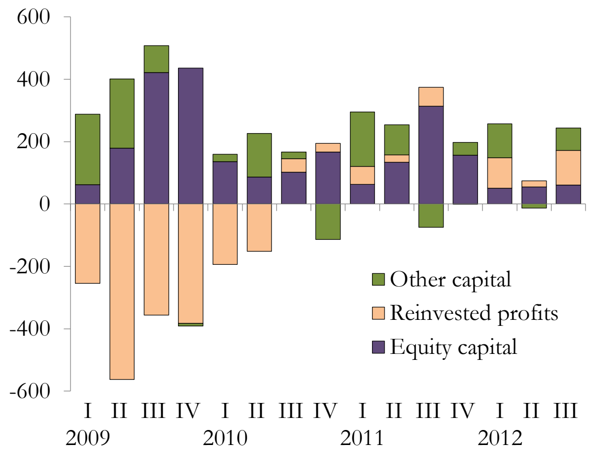
The structure of the incoming FDI by types of investments shows that since the 4th quarter of 2008 until the 2nd quarter of 2010, direct investment enterprises have been operating with losses. In 2009, the losses reached LVL 1094.5 million (EUR 1542 million). Losses of the foreign direct investment enterprises 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. Also in the first nine months 2012, the level of incoming FDI remained rather high (3.5% of GDP).

According to the international investment balance of Latvia, the FDI stock in the economy of Latvia reached LVL 6838.6 million (EUR 9730.4 million) at the end of the 3rd quarter of 2012 which is by 5.4% more than at the end of the 3rd quarter of 2011. The share of FDI in the structure of foreign capital stock constituted 26.2 per cent.

Figure 4.27

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 September 2012, the FDI of the EU Member States constituted 73% of all FDI stock, a fifth 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 September 2012, investments of Sweden entrepreneurs constituted almost 24.3% 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 3rd quarter of 2012, direct investments of Sweden have increased by 8.8%, and these investments have almost doubled in comparison with late 2010, which is mainly related to mutual transactions in the banking sector between Estonia and Sweden. Therefore, the FDI stock of Estonian entrepreneurs decreased by almost a half constituting 5.6% of the total FDI stock at the end of September 2012 (at the end of 2010 – 14.1%).

Large 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 September 2012 constituted almost 40% of the total FDI stock in the economy of Latvia.

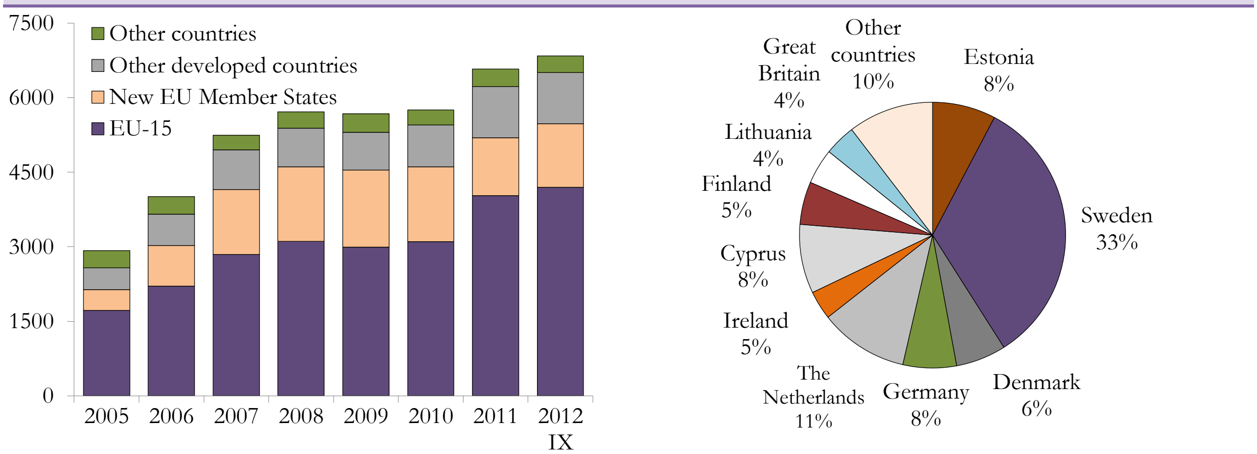
The FDI are focused mainly in services sectors.

Figure 4.28

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 September 2012)



During the period of rapid growth, investments in the financial intermediation sector and real estate activities explicitly dominated in the structure of incoming FDI flows. The average annual amount of FDI in service sector was by almost 6.5 times higher than in manufacturing. During the economic downturn, the amount of annual incoming FDI flows decreased four times, in trade – almost 20 times, but the decrease in investment intensity in real estate was rather small. Overall, the amount of annual FDI flows in services sectors shrunk by 26.8%. It should be noted that the amount of annual incoming FDI flows in manufacturing industries was almost three times higher than before the crisis.

Table 4.7

FDI Stock by Sectors
(million LVL)

	FDI stock (at the end of the period)			Flows (average per year)			
	2004	2007	2012 III	2005-2007	2008-2009	2010-2011	2012*
Primary sectors	49.8	113.1	234.3	10.6	20.1	15.7	1.3
Manufacturing	276.1	516.8	816.4	64.1	81.2	59.4	46.2
Energy	164.7	270.7	245.3	20.2	11.3	5.3	8.0
Construction	36.5	85.5	90.7	18.4	7.4	-8.8	-0.3
Trade	395.7	676.4	989.6	102.6	5.8	50.4	57.5
Transport and communications	333.3	392.5	499.8	17.4	2.0	16.2	34.3
Financial intermediation	375.9	1486.2	1606.1	341.7	82.1	97.3	126.7
Real estate activities	415.7	1156.3	1537.1	115.4	91.3	169.1	41.3
Other services	289.6	549.6	819.3	151.1	25.9	63.5	79.5

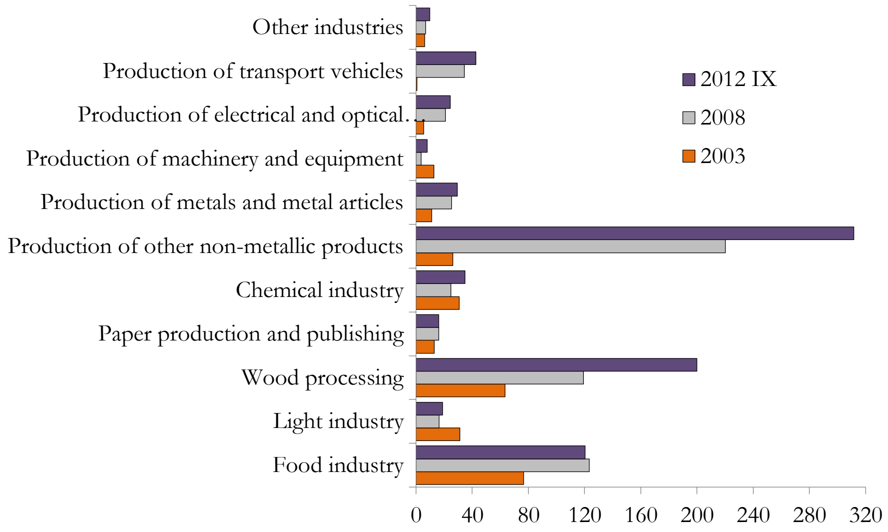
* FDI flows in the three quarters

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 average annual investments in service sectors exceeds the investments in manufacturing industries by six times. At the end of September 2012, the FDI stock in services sectors constituted 79.7% of the total FDI stock in the national economy of Latvia, i.e. by 1.5 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 September 2012, the FDI stock in goods production constituted 20.3% of the total FDI stock in the national economy of Latvia. Compared to the end of 2007, they have increased by 40.6 per cent.

Figure 4.29

FDI Stock in Manufacturing
(end of the period, million LVL)



From the end of 2007 until the end of September 2012, a particularly rapid increase of the FDI stock in industry was observed in manufacturing – by 58%. The increase of the FDI stock in manufacturing to a great extent was influenced by substantial investments in production of construction materials (increase by 107.8%) and wood processing (increase by 77%). The share of sectors mentioned above in the FDI stock constituted 62.7% in manufacturing at the end of the 3rd quarter of 2012 (at the end of 2007 – 51%).

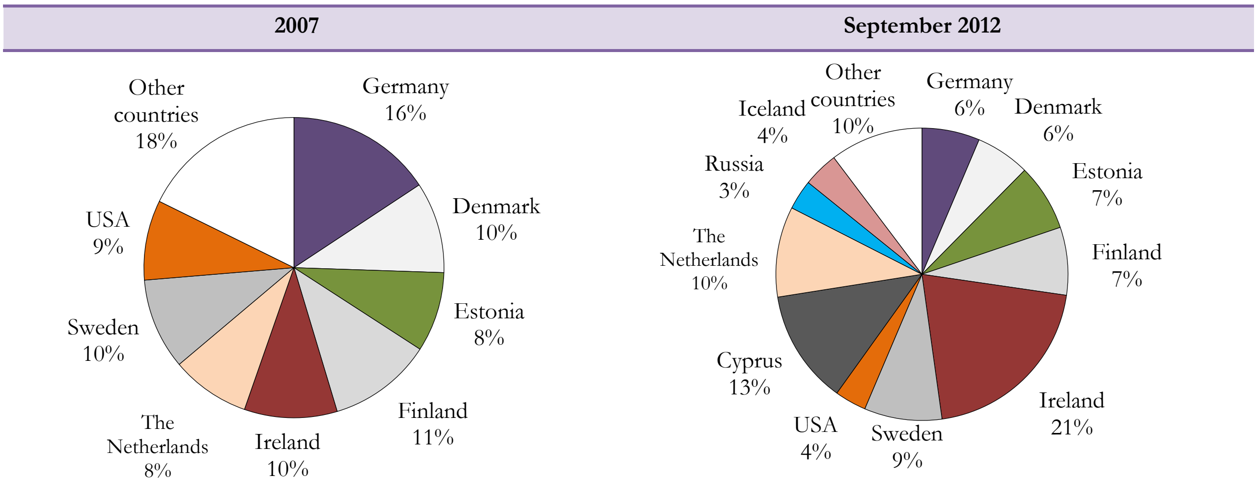
In general, upon evaluating the FDI structure in manufacturing, it can be concluded that it is constantly changing. In some sectors, like the light industry, the FDI have been decreasing already since 2005, and the main reason for that was loss of competitiveness in foreign markets. Similar tendencies are 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 September 2012, the FDI stock in the light industry increased by 19.6% compared to the end of 2010.

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 constituted 14.7% of the FDI stock in manufacturing (at the end of 2010 – 13%). The FDI in production of electrical and optical equipment has been increasing since 2010 – by 77.4% at the end of September 2012 compared to the end of 2010.

Foreign investments in production of vehicles also increased. At the end of September 2012 the level of FDI stock in this sector exceeded the level of 2010 by 17.5%. At the same time, FDI have significantly (about 71%) decreased in production of machinery and equipment, compared to late 2010. The share of this sector in the structure of FDI stock constituted 1% in manufacturing at the end of September 2012 (at the end of 2010 – 3.8%). Changes of the FDI stock in other manufacturing sub-sectors are insignificant.

Figure 4.30

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



By evaluating the change in the structure of 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 FDI stock in medium-high-technology industries at the end of September 2012 constituted almost 12% of the total FDI stock (at the end of 2007 – 10.6%).

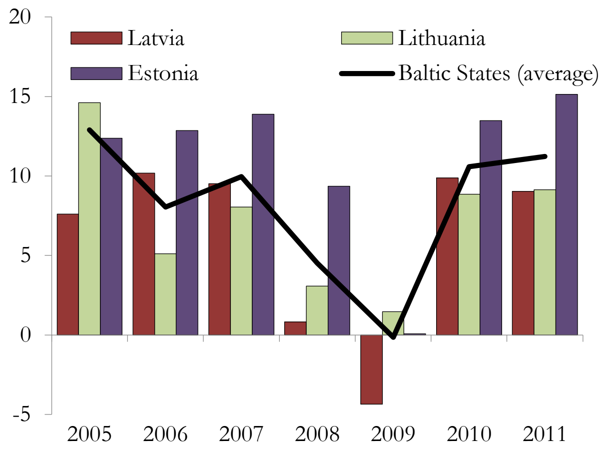
The largest investments in manufacturing have been made by investors from Denmark, Finland, Germany, Sweden, Ireland, Estonia, the Netherlands, and Cyprus. Investments of the abovementioned countries constituted 80% of the FDI stock in manufacturing. It should be noted that by the end of 2007, none of 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 September 2012, 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 of 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 35.3% and 36%, and Finland – by 21.6%. At the same time, at the end of March 2012, investment stock by Russian businessmen in manufacturing increased almost four times, when compared to the end of 2007 and was 3.3% of FDI stock in manufacturing.

Although FDI flows in Latvian manufacturing has 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 the 3rd quarter of 2012, Lithuania has attracted 37.5% of all incoming

FDI in manufacturing in the Baltic States, Estonia – 44.4% but Latvia – only 18.1%. The average annual investments per one worker in manufacturing was larger in Estonia than those in Lithuania, correspondingly EUR 1840 and EUR 807, while in Latvia – only EUR 679. This means that foreign investors find manufacturing in Latvia less attractive than in neighbouring countries when comparing the Baltic States. It is partially explained by comparison of FDI rate of return[1].

Figure 4.31

Incoming FDI rate of return in manufacturing in the Baltic States
(per cent)



Estonia has the highest FDI rate of return in manufacturing, while Latvia and Lithuania has presented almost one and a half times lower rate. It should be noted that since 2010 the FDI rate of return in Latvia has been higher than in the pre-crisis period. Furthermore, the FDI rate of return in manufacturing was almost by a half lower in the pre-crisis period than overall in the national economy of Latvia, currently it is 1.6 times higher. It means that foreign direct investments in manufacturing of Latvia are relatively more profitable than in other sectors of national economy.

The Investment and Development Agency of Latvia (IDAL) plays a significant role in attracting foreign investment. 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: 33% of the projects have been submitted in metal processing and electronics sectors, while 30% – IT sector (including global service centres). 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 the three quarters of 2012, 328 investment information requests have been processed which exceed the planned amount of the year, 74 investment offers have been prepared, the IDAL representations have organized visits to 84 potential investors, organized visits of 91 potential investors to Latvia and worked with 70 potential investment projects. As a result of the abovementioned activity, a decision on the implementation of 9 projects in Latvia has been made (for example, investments from Germany/Italy in yacht building project; investments from Germany in production of cast agglomerated stone surfaces and timber industry; investments from USA in timber industry, as well as development of IT solutions; investments from Norway and Denmark in establishment of shared service centres; investments from Russia in automotive project, etc.).

Project implementation is expected to attract investments in the amount of EUR 17.6 million thus creating over 940 jobs.

The work with investment projects involves analysing the reasons why potential investors do not prefer Latvia on a regular basis. Based on international practice – investment decisions are made on average in 18-36 months, though the global economic and financial crisis has led to a longer decision-making process and companies are more cautious when making such decisions, the work has been continuing with some of the companies for several years, while some have recently started to work with IDAL and it will take some time to make the final decision on investments.

The IDAL is working on new investment stimuli for attracting foreign investments, for example, as of January 1, 2011, entrepreneurs are offered to receive corporate income tax relief for large investment projects, as well as grants for creation of new jobs

[1] FDI rate of return = *(Income paid in t)/(Stocks at the end of the period t-1)*

were approved on March 13, 2012. As of November 2012, there is a new grant available for creation of new jobs. A new aid programme or a new call for the programme *High value added investments* aimed at supporting costs of purchase of production equipment are also expected.

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.

4.4. Financial and Capital Markets

4.4.1. Monetary Policy and Exchange Rate

The main goal of 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. 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.

On December 13, 2012 the EU reached a political agreement on establishing a single supervisory mechanism for the oversight of credit institutions aimed at restoring confidence in the banking sector. It will be composed of the ECB and national competent authorities. After joining the eurozone, 3 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.

Moreover, those member states which have not introduced euro but are willing to be a part of the single supervisory mechanism, can launch enhanced cooperation with the ECB and participate in the activities of the Supervisory board with equal rights.

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.

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[1] 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)[2].

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

[1] Special Drawing Rights (SDR) – special currency code in accordance with the international currency classifier ISO 4217 – XDR

[2] Participation in the EMU has been defined in the EU Accession Treaty, but Latvia is allowed to choose the most appropriate time for the euro introduction

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. Duration of participation in the ERM II will depend on the capability of Latvia to reach the economic convergence level set by the Maastricht criteria. The Bank of Latvia will continue implementing former policy of fixed exchange rate until the euro is introduced in Latvia.

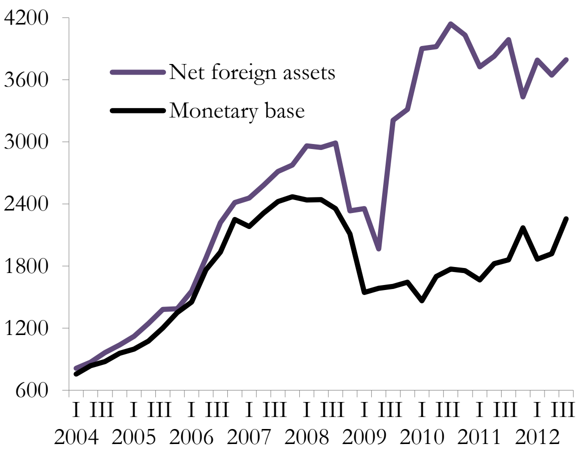
On December 13, 2012, the Saeima considered the draft *Law on Introduction of Euro* in the first reading. The law sets January 1, 2014 the euro introduction target date in Latvia. The law also provides the main conditions for introduction of euro that are related to introduction and defined in the *National Euro Changeover Plan*. The purpose of the law is to ensure efficient and transparent introduction of euro in Latvia. It also sets a period for dual currency circulation for lats and euro, a period for free currency change, a period for parallel price reflection, costs of euro introduction, adapting accounting and credit registers to euro introduction and other activities related to euro introduction. The Saeima might vote on the *Law on Introduction of Euro* in the final reading at the end of January 2013.

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 4.32). Coverage of the monetary base (cash in circulation and deposits in the Bank of Latvia) with net foreign assets was 168.2% at the end of the 3rd quarter of 2012.

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 November 2012 have increased by 5.9% constitution EUR 5480.4 million in comparison with the end of November 2011.

4.4.2. Market Structure and Development

At the end of the 3rd quarter of 2012, 20 **banks** operated and 10 EU branches of foreign banks were registered in Latvia. 12 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 2012, several Latvian banks went through structural changes:

– Within the framework of sale of commercial shares of SJSC "Mortgage and Land Bank of Latvia" launched in July 2012, the customer service of the commercial shares has been transferred to JSC "Swedbank". Thus, the decision of Latvian government and international commitments towards the European Commission are also fulfilled envisaging gradual termination of commercial activity of the Mortgage Bank by the end of 2013;
– the process of selling the shares of JSC "Citadele banka" (launched in the mid-2011), is suspended at the moment 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. On February 14, 2012 JSC "Citadele banka" made the last advance repayment of term deposit to the Ministry of Finance of the Republic of Latvia;
– On May 10, 2012 a decision to cancel the licence (permit) for credit institution activity issued to JSC "Latvijas Krājbanka". The decision was adopted based on the decision of Riga Regional Court of May 8, 2012 on initiating bankruptcy procedure. The sale of bank's loan portfolio was launched in the mid-2012 by implementing measures to attract potential investors. The loans of JSC "Latvijas

Krājbanka" have been divided in five loan portfolios;
- On March 15, 2012 a decision was made to cancel the licence for credit institution activity issued to JSC "Parex banka" and permit to reorganize the bank by registering it as a commercial company that is in no way related to credit institution activities. Such a decision was made based on the plea of JSC "Parex banka" to cancel the licence for credit institution activity issued to bank. On May 8, 2012 after changing the status and the name, JSC "Parex banka" started working as a professional distressed asset management company – JSC "Reverta". With its asset portfolio in the amount of nearly one billion, Reverta is the largest manager of distressed assets in the region.

In the 3rd quarter of 2012, performance indices of all Latvian banks complied with the regulatory requirements. Liquidity ratio of banks was 59.4% (minimum regulatory requirement is 30%) and in comparison with the corresponding period of 2011 it has slightly decreased.

In the 10 months of 2012, 15 Latvian banks and 4 foreign bank branches operated with profit of LVL 140.5 million.

In the 3rd quarter of 2012, the average banking sector capital adequacy ratio continued increasing and reached 17.7% (minimum regulatory requirement is 8%). Both the return on assets (ROA)[1] and the return on equity (ROE)[2] of banks have increased and were 0.8% and 7.6%, respectively (in the 3rd quarter of 2011 ROA – 0.4% and ROE – 4.7%).

The insurance market keeps growing at a moderate pace. In the three quarters of 2012, 9 **insurance companies**, 2 of which offered life insurance and 7 – non-life insurance, as well as 13 branches of foreign insurance companies operated in Latvia. Comparing to 2011, the number of insurance companies operating in Latvia has been decreased by 4 insurance companies.

In the three quarters of 2012, as compared to the corresponding period of 2011, the amount of gross premiums signed by insurance companies has increased by 3.9% reaching LVL 183.7 million, while the amount of paid gross compensations remained unchanged – LVL 95.2 million. In the three quarters of 2012, insurance companies operated with profit of LVL 7.5 million life insurance companies – with nearly LVL 2 million profit, while non-life insurance companies – with profit of LVL 5.5 million.

Since 2010, the situation in the **Latvian securities market** has significantly improved. Although the situation deteriorated in early 2012 due to instabilities in the euro zone and the negative impact of global stock market, the situation in securities market improved again by the end of the year, the OMX Baltic Benchmark index value was 540.1 points (data of December 18, 2012), which is by 25% higher than at the beginning of the year. NASDAQ OMX Riga index value has also increased by 5% in this period. NASDAQ OMX Tallinn index value has increased the most (by 35.8%).

In the 3rd quarter of 2012, the amount of central government debt securities in bank assets has increased by 7.3% compared to the corresponding period of 2011 mainly due to the increase in the amount of foreign central government securities by 36.6%, whereas the amount of Latvian central government securities has decreased by 16.7%. 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 29.9%), the amount of shares and other variable-yield securities slightly increased as well.

A positive fact in 2012 was the issue of the following bonds in Latvia:
- February 14, 2012 – 5-year bonds in the amount of USD 1 billion with the fixed interest (coupon) rate set at 5.25% a year (profitability 5.37%). The transaction involved a wide range of investors from USA, Europe, including London and Asia, thus achieving diversification of investors in external markets;
- December 5, 2012 – 7-year bonds in the amount of USD 1.25 billion with the fixed interest (coupon) rate set at 2.75% a year (profitability 2.88%) which is the lowest interest rate on securities ever since Latvia started borrowing public loans from international financial markets.

The emission was implemented according to the national borrowing strategy, thus fully attracting the annual planned emissions to the external financial markets to refinance the international borrowing programme thus ensuring lower interest rates on the loan from the international borrowing programme of the European Commission. This proves confidence of foreign investors in external markets.

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

4.4.3. Assets, Deposits and Loans

Bank assets of Latvia keep decreasing and were LVL 19.8 billion at the end of the 3rd quarter of 2012 which is by 4.4% lower than in the corresponding period of the previous year. Bank credits (60.5%) and claims on credit institutions (16.7%) constituted the largest part of bank assets.

The amount of currency in circulation has considerably increased constituting LVL 1053.4 million in circulation at the end of the 3rd quarter of 2012, which is by 18% more than in the corresponding period of 2011.

At the end of the 3rd quarter of 2012, the balance of private and corporate deposits attracted by banks increased by 6.1% in comparison with the corresponding period of the previous year. The amount of residents' deposits decreased, while non-resident deposits considerably increased and now constitute a half of all deposits, which is a sign of channelling of non-resident financial resources to Latvia. As of 2013, tax on international holdings is expected to be cancelled, thus making Latvia more attractive to international investors. The increase in non-resident deposits in Latvia relates to the unstable financial situation in Europe that encourages transferring financial resources to Latvia. As the non-resident deposits keep increasing, the main risk is closely connected to money laundering attempts and therefore banks should pay more attention to customer assessment. Regular market supervision and inspections in banks are carried out by the FCMC.

In the 3rd quarter of 2012, changes of the deposit currency structure continued. Unlike the late 3rd quarter of 2011, when majority of deposits were in euro, the amount of deposits in euro have decreased and is now close to the amount of resident deposits in lats. Majority of non-resident deposits are in USD (64.6%) and the amount thereof keep growing, while the amount of deposits in euro is decreasing. Comparing to the pre-crisis period (2007) there are no significant changes in the currency structure.

The balance of bank **loans** granted still continues decreasing. The balance of loans granted to residents' financial institutions, non-financial corporations and households decreased by 11.1% at the end of the 3rd quarter of 2012 in comparison with the corresponding period of the previous year. Yet, the balance of loans has decreased by a third since the 3rd quarter of 2008. The decrease in the balance of loans was mainly affected by the weak crediting and its slow recovery.

Table 4.8

Monetary Indicators of the Latvian Banking System

	2007	2008	2009	2010	2011	2012 IX
at the end of the period, million LVL						
Net foreign assets	-4482.8	-5914.6	-3022.0	-1219.8	-224.8	155.0
Net domestic assets	10654.0	11846.1	8842.3	7609.8	6710.9	6316.8
Domestic loans	13 018.2	14 279.7	12 204.3	11 215.1	11 045.4	9765.2
to the government (net)	-87.4	-370.0	-1474.6	-1430.8	-663.8	-982.7
to companies and individuals	13 105.6	14 649.7	13 678.9	12 645.9	11 709.2	10 747.9
Other assets (net)	-2364.2	-2433.6	-3362.0	-3605.3	-4334.5	-3448.4
Broad money M2X	6171.3	5931.4	5820.3	6390.0	6486.1	6471.8
Cash in circulation (without vault cash balance)	900.0	866.1	667.3	807.4	1040	1062.8
Deposits of individuals and companies	5271.3	5065.3	5153.0	5582.7	5446.1	5409.0
including:						
overnight deposits	2864.9	2308.0	2206.2	2782.1	3109.2	3202.3
time deposits	2406.4	2757.3	2946.8	2800.6	2336.9	2206.7
Domestic loans	31.8	9.7	-14.5	-8.1	-1.5	-5.7
including:						
to companies and individuals	34.0	11.8	-6.6	-7.6	-7.4	-10.7
Broad money M2X	12.6	-3.9	-1.9	9.8	1.5	2.6
Cash in circulation (without vault cash balance)	-7.1	-3.8	-23.0	21.0	28.8	19.6
Deposits of individuals and companies	16.9	-3.9	1.7	1.1	-2.5	-0.2
GDP (at current prices)	**32.3**	**9.3**	**-18.7**	**-2.2**	**11.7**	**8.7**

In the three quarters of 2012, the banking sector has issued a total of 69.9 thousand new loans in the amount of LVL 768.5 million to residents which in terms of the number is a half of the number issued in the corresponding period of the previous year, yet by 11.4% more than in the corresponding period of the previous year. The majority of new loans have been issued to households (93%), yet in terms of amount – to companies (82%).

As regards the business sector, in the three quarters of 2012, one third of the new loans have been granted to the agriculture, forestry, and fishery sector, but in terms of amount, 1/3 of all new loans (LVL 206 million) have been granted to financial and insurance operations. One of the most important sectors of national economy – manufacturing experienced a decrease in new loans in terms of both number and amount. A noticeable decrease in new loans has been seen also in the transport and storage sector. The number of new loans in agriculture has significantly decreased, while the amount has doubled.

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. In the three quarters of 2012, the amount of new loans granted for purchase of housing has increased by 21.1% reaching LVL 91.9 million. Housing crediting is gradually resuming though a moderate increase is further expected in the amount of housing credits.

Like before, in the 3rd quarter of 2012, mortgages dominate in the structure of loans granted to domestic companies and individuals; the share of mortgages in the total loan structure has shrunk to 54.8%. The share of commercial credits and industrial credits in the total loan structure has increased to 33.9%, which is the highest indicator since 2006, though no significant changes in the structure of loans have been observed in the past few years.

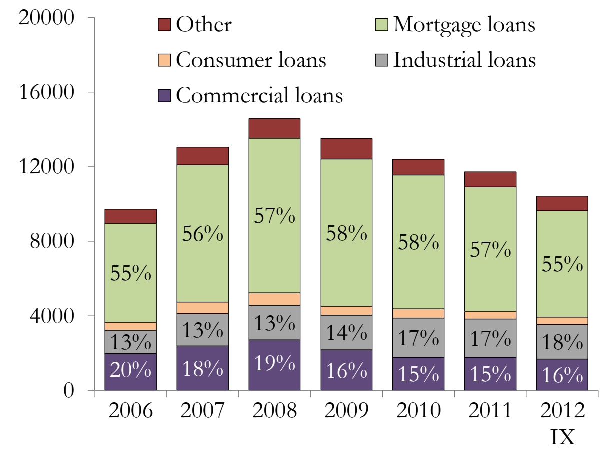
The balance of granted mortgage loans experienced the most rapid decrease (in the 3rd quarter of – by 14.3% compared to the corresponding period of the previous year).

Consumer crediting also experiences a decrease in the balance of loans in the 3rd quarter (by 7.5% compared to the corresponding period of the previous year).

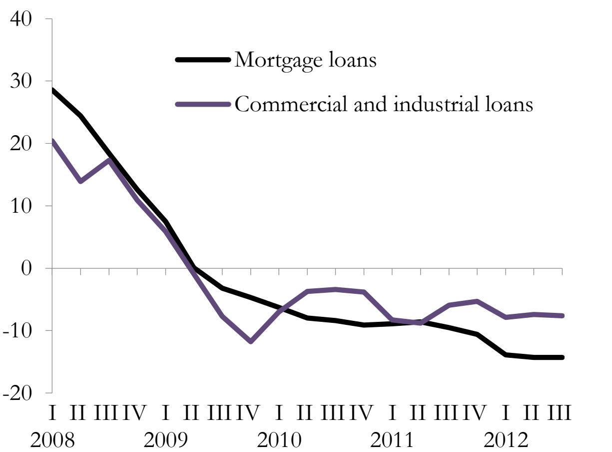
The balance of commercial credits has been dropping already since the late 2008 reaching the lowest point in early 2010 and the decrease in the balance of commercial credits has been slowing down since then. The balance of industrial credits practically remained at the level of 2008. In the 3rd quarter of 2012, the balance of industrial and commercial credits decreased by 7.6% compared to the corresponding period of the previous year. The balance of industrial credits experienced a faster decrease.

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, %)



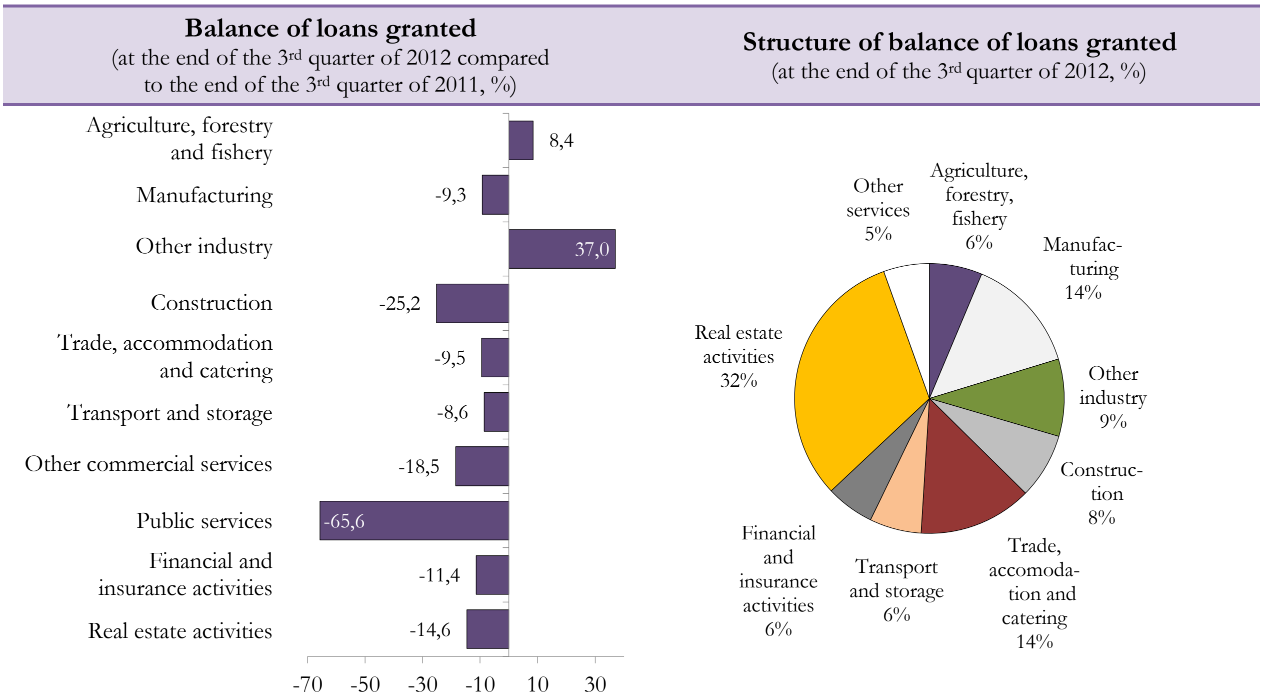
The majority of loans issued to residents have been granted for **entrepreneurship** (54%), where as 45% – to households. In the late 3rd quarter of 2012, the total amount of loans issued to residents in the national economy constituted LVL 5678.8 million which is by 10.1% less than in the corresponding period of 2011. Business crediting mainly relies on the EU structural funds co-funding and future access to it, as well as other EU aid programmes. Unlike the EU structural funds, the EU aid programmes require the enterprise to submit the project in particular programme, and the project is later evaluated centrally at the EU level and competes with project application of other countries. The most rapid decrease in the balance of granted loans by sectors of national economy has been observed for public services (by 65.6%). The balance of loans granted to construction decreased by almost one third. An increase in the balance of granted loans has been observed also in manufacturing industries like electricity, gas and heat supply, as well as water supply and waste management. A slight increase in the balance of loans has been seen also agriculture.

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 (14%), as well as construction sector (8%).

In the 3rd quarter of 2012, the amount of loans issued in lats has slightly increased. 12.6% of all loans granted to residents are loans in lats. The majority of loans (82.8%) are granted in EUR. The amount of these loans has decreased by 26.5% in the 3rd quarter of 2012 compared to the 3rd quarter of 2011.

Figure 4.34

Loans to Residents by Sectors of Economy



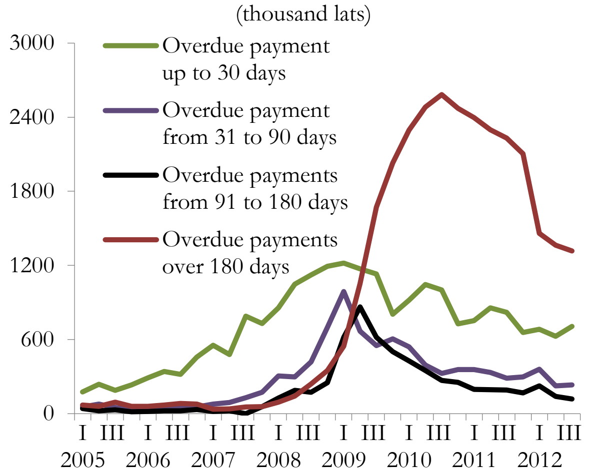
The amount of **loans with overdue payments** in the total loan portfolio keeps dropping and was at 19.8% in the 3rd quarter of 2012; however, the amount has decreased three times compared to the corresponding period of 2011. It was mainly determined by the decrease in the amount of loans with overdue payments above 180 days by 41%, which is a positive trend considering that these loans constitute more than a half (55%) of all loans with overdue payments. The amount of loans with overdue payments from 91 to 180 days also considerably decreased during this period (by 38.7%).

The improving quality of banks' loan portfolio is mainly related to writing-off bad debts and improving solvency of enterprises. In 2011, the banking sector wrote off debts in the amount of LVL 312 million, while in the three quarters of 2012 – banks wrote off loans in the amount of LVL 207.7 million.

Figure 4.35

Loans with overdue payments

(thousand lats)



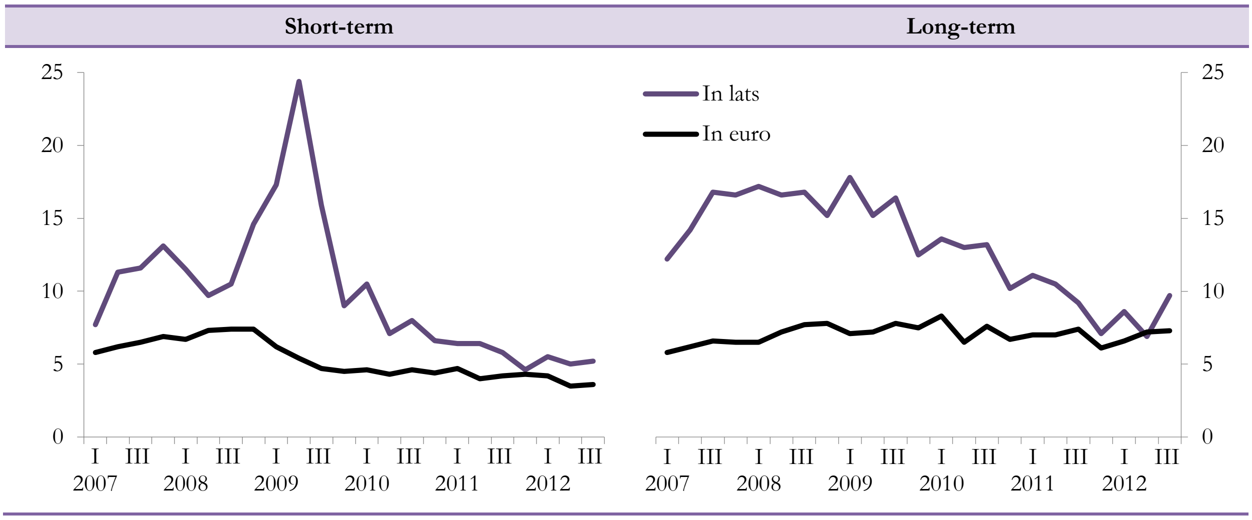
As regards loans with overdue payments, the loan portfolio or corporate customers is shrinking faster, while the quality of loans issued to households is improving slower and at the end of the 3rd quarter the 26.5% of the balance of loans issued to households were loans with overdue payments. The quality of corporate loans has significantly improved along with recovering growth of the national economy. At the end of the 3rd quarter of 2012, 16.4% of loans granted to sectors of the national economy were loans with overdue payments. The majority of loans with overdue payments are in sectors like mining and quarrying (28.4%) and art, entertainment and recreation (24.3%), while the lowest number – in public administration and defence (1.3%) and financial and insurance activities (2.9%). There are 17% loans with overdue payments and delayed loans in manufacturing and the amount is decreasing.

In 2012, 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 is decreasing. At the end of the 3rd quarter of 2012, restructured loans and loans currently being recovered constituted 25.1% of the total loan portfolio. The share of restructured loans in the total banks' loan portfolio decreased to 14.7%, while the share of loans currently being recovered – 10.4% of the total banks' loan portfolio.

Figure 4.36

Weighted Average Interest Rates for Loans Granted in Credit Institutions, Quarterly Profile

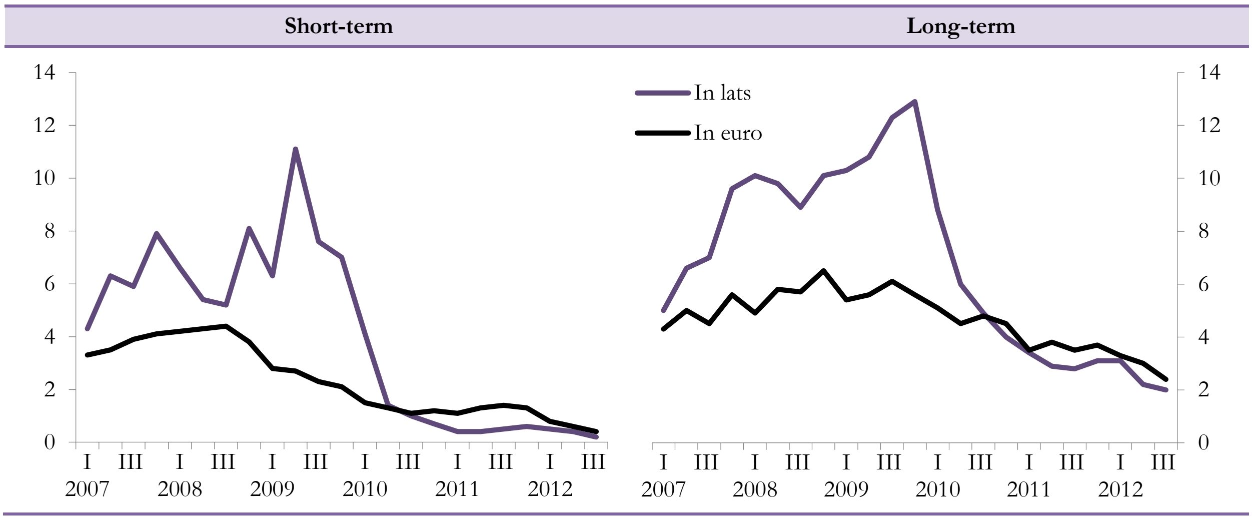
(per cent)



In the 3rd quarter of 2012, the weighted average **interest rates** on short-term loans granted to companies and individuals were accordingly 5.2% and 3.6%, which means that they have become stable over the past two years and fluctuations are insignificant. Fluctuations of interest rates on long-term loans granted in LVL are more explicit reaching 9.7% in the 3rd quarter of 2012. Fluctuations of the weighted average interest rates on long-term loans granted in EUR were less explicit reaching 7.3% at the end of the 3rd quarter of 2012.

Figure 4.37

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



In the 3rd quarter of 2012, the interest rates on short-term and long-term deposits attracted in LVL in credit institutions reached the lowest indicators over the past few years and were even lower than those of EUR, accordingly 0.2% and 2%. The interest rates on short-term and long-term deposits attracted in EUR in credit institutions also reached the lowest indicators, accordingly 0.4% and 2.4 per cent.

5. LABOUR MARKET

5.1. Employment and Unemployment

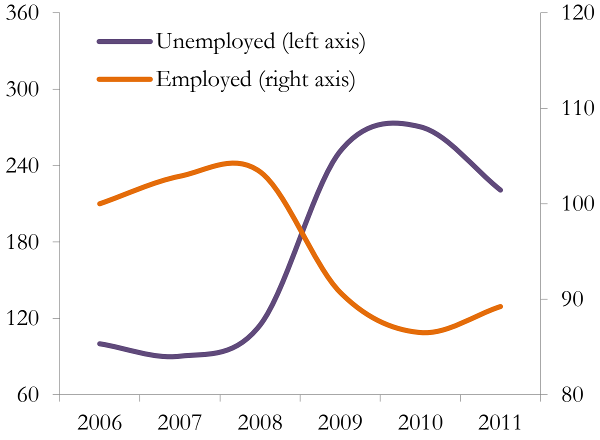
The gradual increase of economic activities has a positive impact on the labour market – the employment rate is growing and the high unemployment caused by the crisis is decreasing. At the same time, certain population groups, especially people with low education and qualification level, older people,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

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 number of economically active population in 2011 has increased by 0.6%. A more rapid increase was hindered by negative demographic tendencies – a decreasing number of working-age population.

The situation in the labour market kept improving in 2012. In the three quarters of the year, the number of employed increased by 2.7% or 23.5 thousand, as compared to the corresponding period of 2011. Overall, 905.1 people were employed in the 3rd quarter of 2012. The employment rate in the 3rd quarter of 2012 increased to 57.5% (in the 3rd quarter of 2011 it was 54.9%). The unemployment rate in the 3rd quarter of 2012 dropped to 13.5 per cent.

Figure 5.1

Changes in the number of employed and unemployed
2006 = 100

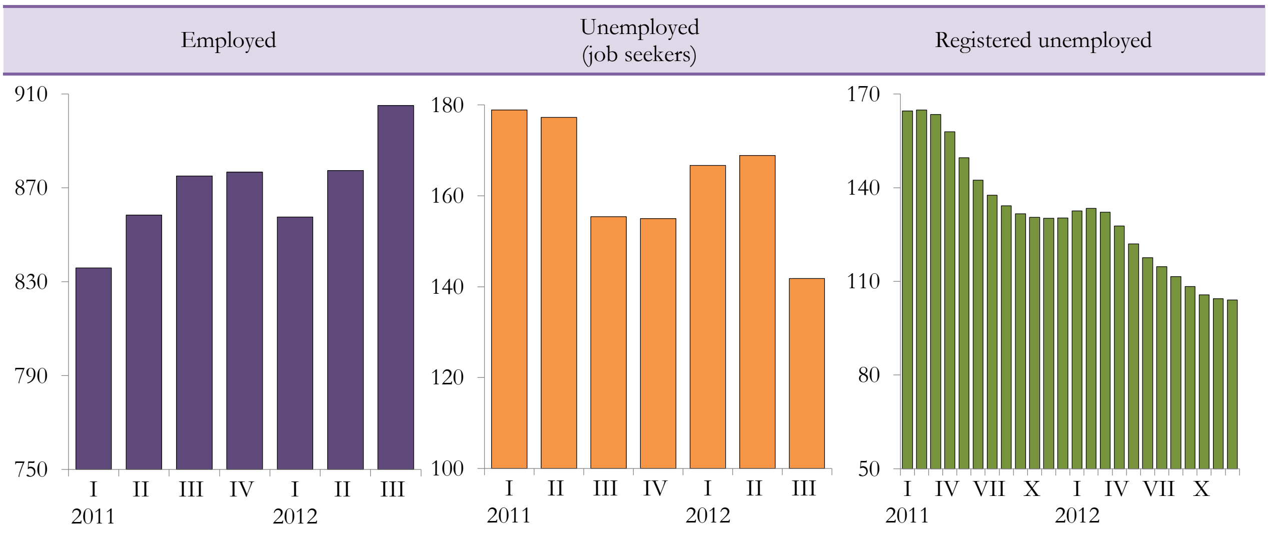


Source: CSB, estimation of the Ministry of Economics

In September 2012, Latvia had the seventh highest unemployment rate in the EU.

Figure 5.2

Employment and unemployment in Latvia
(thousands)



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%).

The current unemployment rate is mainly related to the cyclical unemployment, though there are some signs of structural unemployment as well. However, there is a risk that some of the currently unemployed will not be able to find a job for a longer period resulting in a more explicit structural unemployment, as sectors that recover faster from the crisis are neither the ones offering vacancies before the crisis nor those where people lost their jobs during the crisis. The national economy is experiencing structural changes and there may appear disparity between the labour supply and demand – skills of job seekers fail to meet employer requirements.

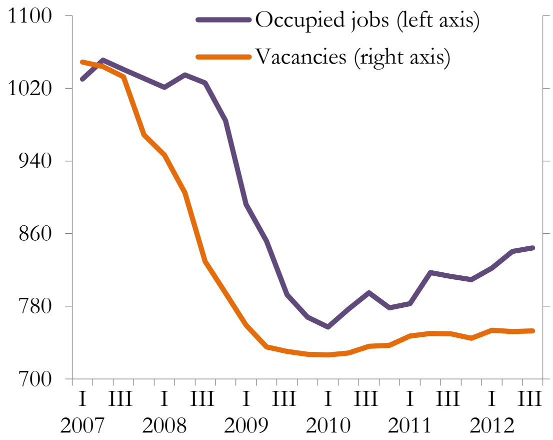
According to the Labour Force Survey data (compiled by CSB), in the 3rd quarter of 2012, about a half (49.7%) of the total number of unemployed or 70.5 thousand people were jobless for more than one year.

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 the 3rd quarter of 2012 has increased by 31.2 thousand or 3.8% compared to the corresponding period of 2011. At the same time the number of vacancies increased by 6.2% or approximately 200 jobs.

Figure 5.3

Free and Filled Positions

(at the end of period, thousands)



In 2011, the number of filled positions increased in all sectors. The highest increase in the number of filled positions in 2011 compared to 2010 was in construction (by almost 11%), agriculture (by 8.5%) and manufacturing (by 7.1%), while the lowest increase – in the public services sector (by 0.4%) and trade (by almost 2%). Similar tendencies remained also in 2012.

Table 5.1

Filled positions by sectors on average per year

	Number (thousand)			Changes (%)	
	2009	2010	2011	2011/2008	2011/2010
Total	**826.1**	**776.7**	**805.5**	**-20.8**	**3.7**
including:					
Agriculture	17.9	17.5	19.0	-8.7	8.5
Manufacturing	104.1	101.8	109.1	-21.5	7.1
Other industries	23.7	22.4	22.9	-14.0	2.3
Construction	54.6	46.0	50.9	-43.0	10.7
Trade, accommodation	173.3	159.7	162.8	-26.6	1.9
Transport and storage	67.6	66.8	68.8	-11.6	3.1
Other commercial services	162.8	148.4	157.0	-20.0	5.8
Public Services	222.1	214.2	215.0	-12.3	0.4

The Population Census took place from May until June 2011. According to the provisional results of the Population Census, the data on 2011 have been recalculated (see Table 5.2.). According to the data of the Population Census the biggest number of the employed in 2011 were in the public services sector – almost ¼ of all employed, trade and commercial services – each almost 20% and manufacturing – 13% of all employed.

Table 5.2

Key Indicators of Employment and Unemployment

Indicators	2010 (without correction)	2011 (without correction)	2011* (recalculated according to the results of the Population Census 2011)
Population (aged 15-74 years, thousand)	1772.8	1754.3	1595.3
Economically active population (aged 15-74 years, thousand)	1157.0	1147.0	1028.2
Number of employed (aged 15-74 years, thousand.)	940.9	970.5	861.6
Employment rate (aged 15-74 years, %)	53.1	55.3	54.0
Economic activity rate (aged 15-74 years, %)	65.3	65.4	64.5
Unemployment rate (share of unemployed persons to the economically active population aged 15-74, %)	18.7	15.4	16.2
Number of unemployed (job-seekers) (aged 15-74 years, thousand)	216.1	176.4	166.6

* Data on 2011 according to the Population Census data. Previous years have not been recalculated and are not comparable.

5.2. Labour Costs and Productivity

During the economic recession decreased not only the number of employed but also wages. As the economic situation has stabilized, wages have started growing since the end of 2010, while the unemployment rate remains relatively high.

The average gross wage in 2010 was LVL 445, i.e. by 3.5% lower than in 2009 and by 7.3% lower than in 2008. As regards assessment of wage dynamics during the crisis, it should be noted that, taking into account the severity of the economic recession in Latvia, overall, wage adjustments were relatively moderate and the labour market was balanced mainly on the account of the decrease in the number of the employed.

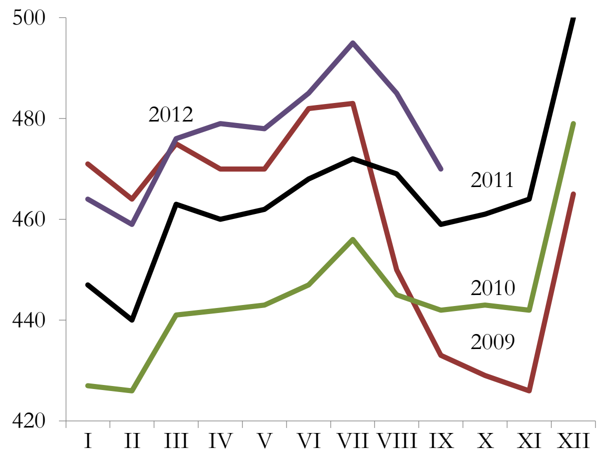
The average gross wage in 2011 was LVL 464, i.e. by 4.4% higher than in the previous year, yet by 3.2% lower than in 2008. The wages continue growing along with the increase of economic activities. In the three quarters of 2012, the average gross wage was by 3.6% higher than in the corresponding period of the previous year and practically reached the level of 2008.

It should be noted that the adjustment of wages in the public sector was considerably bigger than in the private sector, mainly due to the necessity to limit state budget expenditures. Thus, in 2011, the average gross wage in the public sector was by almost 13.1% lower than in 2008. While the average gross wage in the private sector in 2011 exceeded the level of 2008 by 2.2 per cent.

Figure 5.4

Average Gross Monthly Wage of the Employed

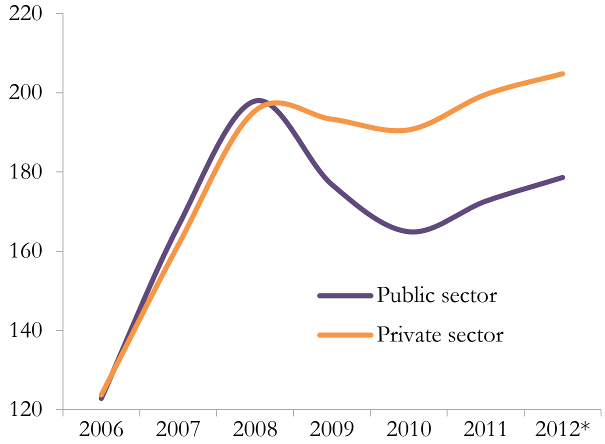
(in lats)



In 2011, compared to the previous year, the average gross monthly wage of the employed in public and private sectors increased almost evenly, by 4.7% and 4.6%, respectively. While in the nine months of 2012, compared to the corresponding period of the previous year, the average gross monthly wage of the employed in the public sector was growing slightly faster than in the private sector – correspondingly by 4.3% and 3.4%. The average gross monthly wage of the employed in the public sector and private sector is becoming balanced as a result of uneven adjustment over the previous years. In 2012, the average gross monthly wage of the employed in private sectors was by 10% lower than in the public sector (in 2008 – by 30%).

Figure 5.5

Average Gross Monthly Wage of Employed in Public and Private Sectors
(2005 = 100)

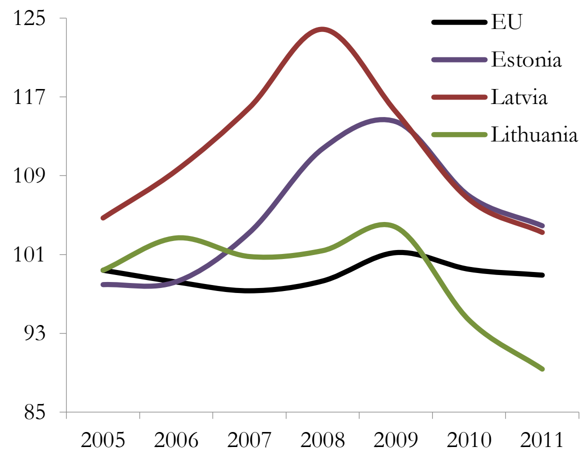


* 9 months of 2012

Wages are increasing in almost all sectors of the economy. In 2011, the average gross monthly wage of the employed in manufacturing compared to the previous year increased by 5% and was by 3.1% higher than in 2008. The increase in wages in the industry remained relatively high also in the three quarters of 2012. The average gross monthly wage of the employed in manufacturing in 2012 was by 4.8% higher than a year ago and it increased faster than average in national economy.

Figure 5.6

Changes of Real ULC in the EU and Baltic States
(2004 =100)



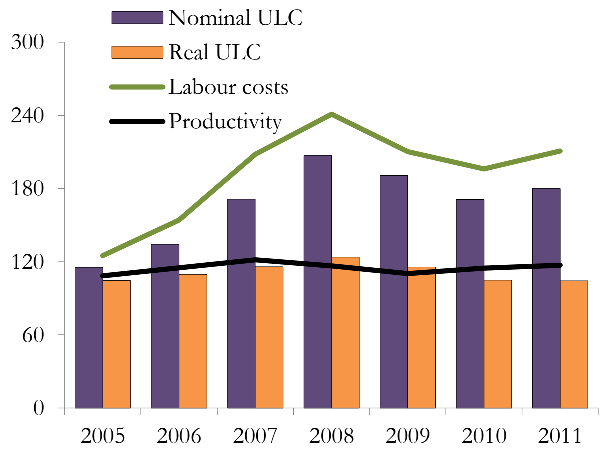
The adjustments in product and labour markets caused by the crisis eliminated the gap between productivity and labour costs resulting in gradual improvement of Latvia's competiveness in external markets as proved by the dynamics of the production unit labour costs (ULC)[1].

Compared to the years of rapid growth, when changes (growth) in the ULC were mainly determined by structural factors, the ULC dynamics since 2008 to a great extent are related to the cyclical factors or crisis consequences.

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% as the number of employed decreased faster than the payroll. As a result, the real ULC decreased by 6.2 per cent.

Figure 5.7

Changes of Labour Costs in Latvia
(2004 =100)



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 real ULC in 2010 were by 9.2% lower than in the previous year.

In 2011, both the number of employed and the payroll increased along with the resuming economic growth. As the payroll increased faster than the

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

number of employed, the labour costs increased by 7.5%, while productivity increased by 2% in 2011, i.e. slower than the labour costs. Yet, since real wages increased slower than productivity, the real ULC in 2011 has decreased by 0.5%, thus proving that the increase in labour costs did not have a negative impact on competiveness of Latvia. Moreover, in the three quarters of 2012, productivity increased faster than real wages and the real ULC decreased by 5% in comparison with the three quarters of 2011.

At the same time, it should be noted that the dynamics of unit labour costs and productivity over the last two years show that labour costs will continue growing along with the increase of economic activities. Therefore, further competiveness depends on the ability to increase productivity.

5.3. Labour Market Forecasts

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

The situation in the labour market has been improved within a year along with the increasing economic activities. According to the estimates of the Ministry of Economics, the number of employed increased by approximately 2.7% in 2012 compared to 2011. At the same time, the unemployment rate dropped by 1.4 percentage points constituting on average 14.8% in 2012.

The situation in the labour market is expected to continue improving also in 2013; moreover, improvements will be explicitly observed in terms of wages and job opportunities. At the same time, recovery is going to be moderate due to the slowdown in economic growth.

In 2013, the number of the employed might raise on average by 21 thousand or 2.4%, compared to 2012. The employment rate will increase respectively by 2.3 percentage points to 58.6%. Overall, the number of the employed will increase to 906 thousand in 2013.

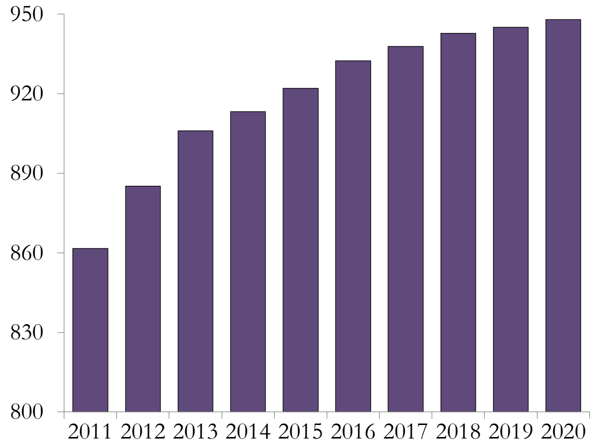
The number of jobseekers in 2013 might decrease by 18% (28 thousand) – to 126 thousand and the average annual unemployment rate will be 12.2 per cent.

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

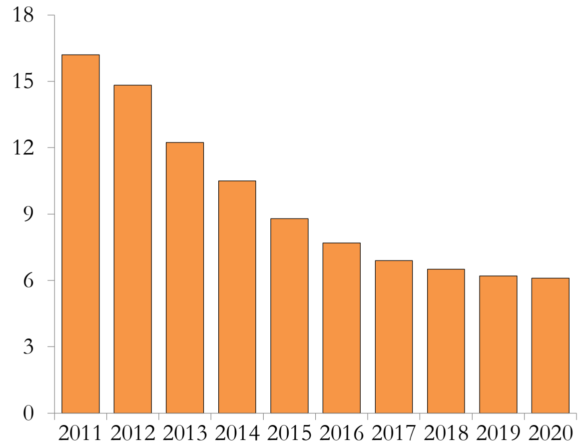
The number of the employed is expected to increase on average by 10% or 86 thousand until 2016 compared to 2011. The most rapid increase in employment is expected until 2016, while after 2016 employment growth rates will gradually slow down mainly due to the supply factors – negative demographic tendencies. In 2020, the number of working population might reach 948 thousand and the share thereof in the total population (aged 15-74 years) will approach 65 per cent.

Figure 5.8

Employed*
(thousand)



Unemployment rate*
(per cent)



* The actual data reflected in 2011 (the CSB recalculation of the Labour survey data according to the results of the Population Census 2011).

The unemployment will also continue declining, though remaining high until 2014 – above 10%. The situation might considerably change starting from 2015 – the unemployment rate will be about 8% and the shortage of labour will become a topical issue. In total, the unemployment rate might drop to approximately 6% 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 manufacturing (by 6.2 thousand or 5.1%) and in a range of services sectors – information and communication service sector (by 3.4 thousand or 15.1%), professional scientific services sector (by 2.7 thousand or 3.9%), as well as financial services and real estate sectors (in total 4.2 thousand or 8.5%). 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 the 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, construction and commercial services sector.

At the same time, the number of the employed is expected to drop in primary sectors – mainly agriculture and forestry. It is 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 highest uncertainty is related to further development of the European debt crisis. Although the situation in the euro zone has become stable, 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.

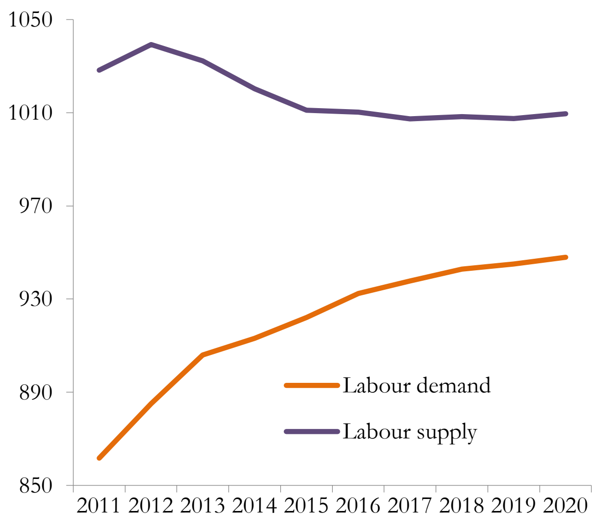
Internal challenges in Latvia, however, are mainly related to a gradual decrease in the number of population (particularly, working-age population), as well as general labour force ageing tendencies.

According to the estimates of the Ministry of Economics, the number of the working-age population (aged 15-74 years) will drop by about 8% until 2030 in comparison with 2011. At the same time, the demographic burden will increase by about 17%. 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.

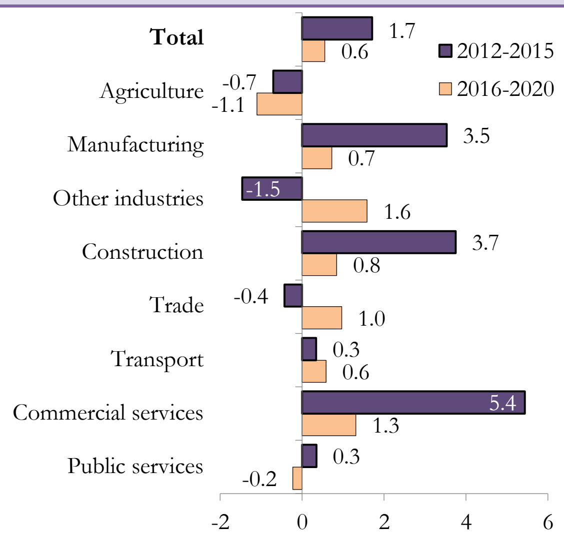
In general, these tendencies will escalate the problem of labour shortage until 2030 that might cause various disproportions in the labour market.

Figure 5.9

Labour force demand and supply
(thousand)



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



5.4. Employment Policy

The quantitative target set by Latvia in the context of the implementation of 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, 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;
– 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 is 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 develop business ties with Latvia, for example, to start own business (return migration 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, in December 2012 the working group proposed nine directions of remigration support measures to create favourable conditions for remigration:

1. ensuring one-stop agency principle – appointing single authority for navigating the required steps in various public authorities, providing information and consultations, also remotely, about moving to and living in Latvia to nationals of Latvia living abroad or their families;
2. access to the labour market information – introducing an efficient two-way communication mechanism for employers to inform nationals of Latvia living abroad about demanded specialists/ vacancies, traineeship possibilities, and for people living and studying abroad to contact potential employers. Thus, the CV and Vacancies database of the State Employment Agency needs to be improved, promoted and widely linked to other websites, etc.;
3. attracting high-skilled workers – grant state and EU financing to enterprises for attracting the necessary high-skilled specialists, including returning or attracting high-skilled specialists and scientists living abroad to Latvia;
4. learning the Latvian language – provide support for Latvian language learning after returning to Latvia to all family members of Latvian nationals (including spouses and children) irrespective of their nationality and the level of Latvian language knowledge;
5. cooperation with Diaspora (developing and maintaining business ties) – active exploitation of Latvian organizations abroad and their measures to inform Diaspora about the latest developments in Latvia, particularly about job and business opportunities, as well as provide consultation about available support instruments for business start-ups and activities, demanded specialists in Latvia and success stories, inform the youth living abroad about possibilities to get involved in the work of

Latvian public and local government authorities, by ensuring volunteer jobs, promoting "business ambassadors" among Latvians living abroad;

6. support to students returning/integrating in the education system of Latvia, as well as their parents – improving and expanding the existing support mechanism for students returning from abroad;
7. Action/requirements of public administration/local government authorities and state enterprises for employee selection – public authorities and capital companies must strictly assess how reasonable are requirements of foreign language knowledge for job candidates since Russian language knowledge is an issue for a large part of Latvian nationals and their families who have been studying or living abroad for a longer period. If Russian or any other foreign language is required for the job duties, language lessons should be organized for the new employees;
8. Expanding the range of persons eligible to apply for the status of repatriate – preparing and approving necessary amendments to the *Repatriation Law* thus expanding the range of persons (including persons who have left the country after May 4, 1990) eligible to apply for the status of repatriate;
9. Recognizing qualifications and diplomas in Latvia, as well as revising requirements for regulated professions – identified direction of the measure requiring additional analysis) – assessing the Latvian practice for recognizing qualification and diplomas acquired abroad, as well as revising the list of regulated professions would allow identifying the areas where the most significant barriers to employment of returning people in professions of their qualification lie, as well as it is necessary to improve the procedure for persons having obtained the right to work in regulated professions in Latvia to restore these rights if they have left the country, have not been working in the profession for a while or have been working in this profession in another country.

In 2013, the Ministry of Economics in cooperation with the involved institutions will continue working of specific remigration support measures to be incorporated in the *Remigration support measure plan for 2013-2016*. The plan will also give 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. In performance of its functions, the SEA influences the labour market by both active employment measures and preventive unemployment reduction measures.

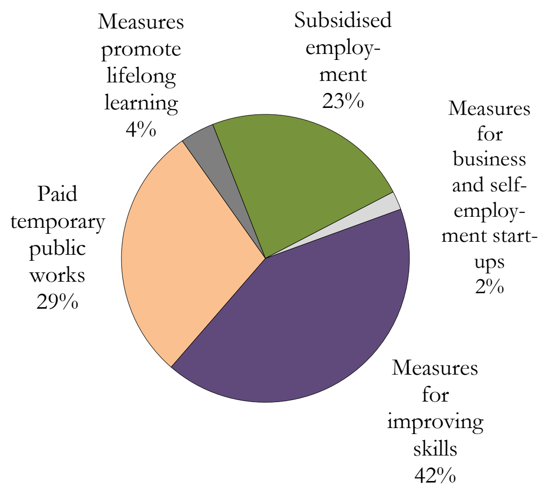
The total funding for active labour policy measures has been increasing rapidly over the past few years. In 2008, a total of LVL 11 million was used for these measures, in 2009 – LVL 32 million, in 2010 – LVL 64 million, in 2011 – LVL 50 million.

Yet, in the first half of 2012, the utilised funding has reached nearly LVL 14 million, and most of it – about 85% is financing of the European Social Fund.

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 been also granted for paid temporary work and subsidized employment.

Figure 5.10

Distribution of the active labour market policy measures' funding in the first half of 2012



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.

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 2010 and 2011. In 2007, a total of 64.6 thousand unemployed were involved in the active employment measures, in 2008 – 84.8 thousand, in 2009 – 237.9 thousand, but in 2010 – 269.2 thousand, while in 2011 – 287.5 thousand unemployed, in the three quarters of 2012 – 153 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 the three quarters of 2012, the number of such unemployed was 92.3 thousand (excluding informal education). The rest of the measures in this period were implemented to the following extent: 3.7 thousand unemployed were involved anew in professional training, retraining, and promotion of qualification, measures for specific person groups – 764 persons, paid temporary public work – 23.3 thousand, complex support measures – 11.9 thousand, informal education – 9.7 thousand, measures for business or self-employment start-ups – 319 unemployed, the SEA inspector assistant training and practice – 8 persons, and 8 persons has started training at the employer.

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

- improved conditions for implementation of the measure *Training at the employer*;
- launched development of the unemployed profile system for the work with the unemployed aimed at providing customized services to each unemployed;
- improved job search system by preparing legal basis for new active employment measure *Launching job search support measures* aimed at encouraging the unemployed and job seekers to search for a job and integrate 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.

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

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

The career consultations help clients to increase awareness about their professional disposition. In terms of the number of clients serviced, this is the most important preventive unemployment reduction measure. In 2010, career consultation services were provided to 78.4 thousand people, 61.5 thousand of them were unemployed and job seekers, in 2011, 47.7 thousand were serviced, 39.9 thousand of them unemployed and job seekers, in the three quarters of 2012 – 47.3 thousand, 42.3 thousand of them unemployed and job seekers.

A training coupon system is used in the measure *Training Programmes for Involvement of Adults in Lifelong Learning* aimed at promoting availability of lifelong learning. 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 using LVL 0.9 million of the funding, while in 2011 – 15 638 persons, (incl. 4715 transferred from 2010), funding – LVL 2.6 million, and in the three quarters of 2012 – 5836 persons (incl. 4727 transferred from 2011), financing – LVL 0.6 million.

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 the 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: effectivization 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 the 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 the 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, whereas 12.5% is expected to be reached by 2013.

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 the employed training 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 a base for development of 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).

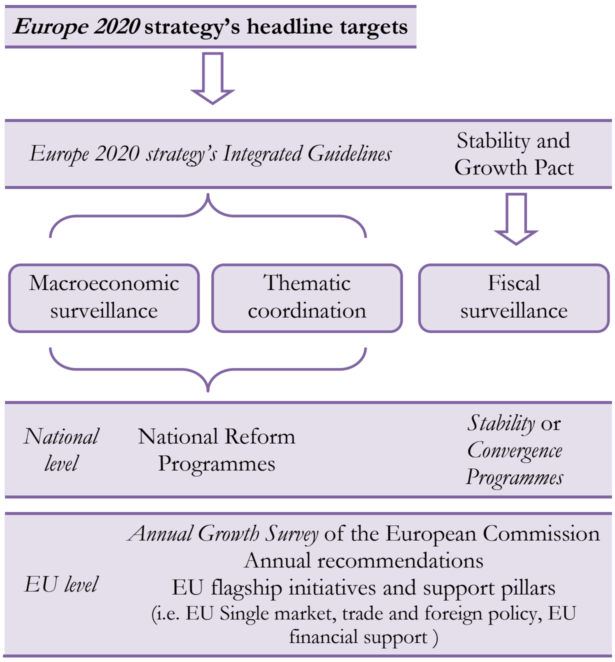
The surveillance of implementation of the *Europe 2020 strategy* consists of two pillars (see Figure 6.1) – macroeconomic and thematic surveillance (National Reform Programmes of the EU Member States for the implementation of the *Europe 2020 strategy* and their conformity with the *Integrated Guidelines* 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 economic policy at the EU level within the European semester (see Figure 6.2). Multilateral surveillance of both programmes is carried out at the EU level, based on which the European Commission is entitled to give a policy warning, if the economic policy of any particular EU Member State is not in line with the EU *Integrated Guidelines* and 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

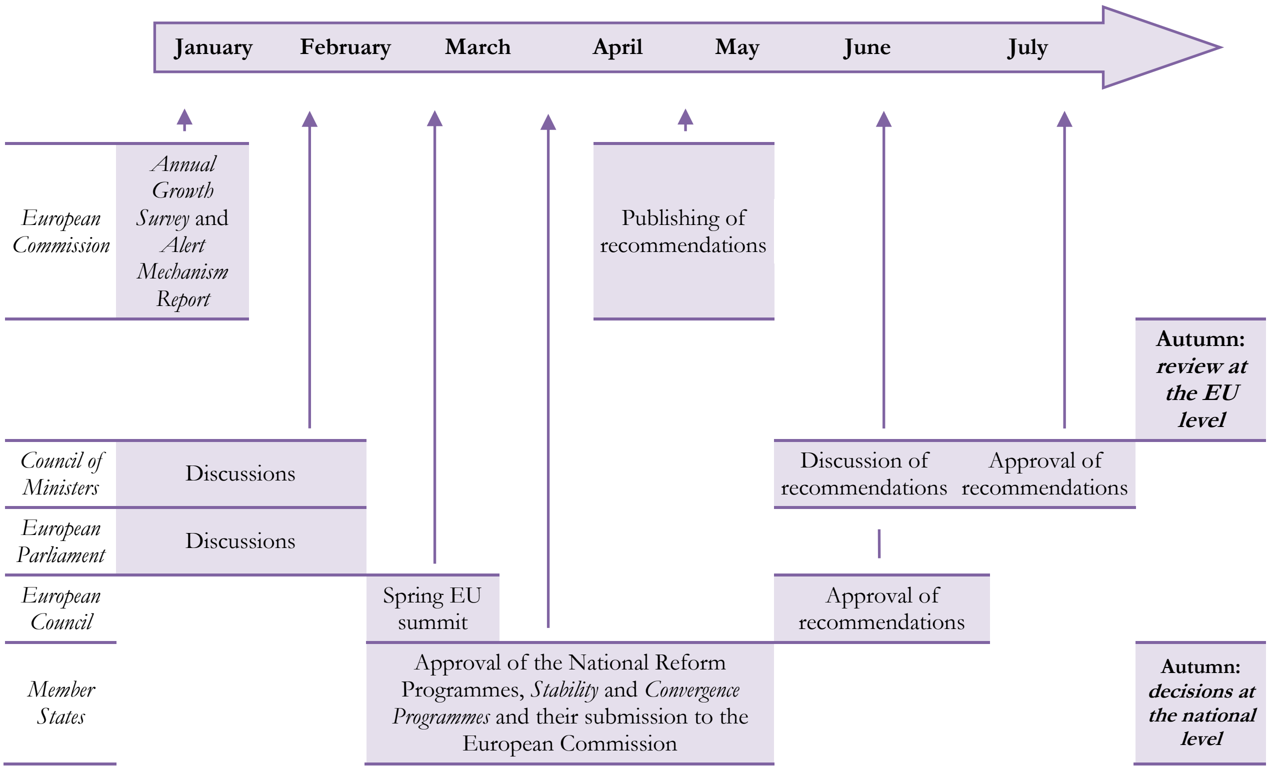


Taking into account the current eurozone crisis that has a negative impact on the EU in general, leaders of the EU institutions and Member States keep looking for ways to improve the EU economy. The European Council on March 24-25, 2011 approved the *Euro Plus Pact* and the European Council on June 28-29, 2012 approved the *Compact for Growth and Jobs* that further strengthened the coordination of the EU economic policy (see Box 6.1).

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 Box 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*.

Figure 6.2

The European semester and surveillance of national programmes of the EU Member States



Box 6.1

Euro Plus Pact

The *Euro Plus Pact* **is aimed at** strengthening the pillar of the Economic and Monetary Union and at improving the quality of economic policy coordination, thus increasing competitiveness and achieving better convergence. The primary focus of the *Euro Plus Pact* is on those policy areas that fall under the national competence of the EU Member States and by the help of which competitiveness can be increased and macroeconomic imbalances eliminated.

The primary focus of the *Euro Plus Pact* is on areas of the eurozone countries, however, non-eurozone countries may also join the pact. Currently, apart from the eurozone countries, several other EU Member States have joined the *Euro Plus Pact*, among them Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania. Those EU Member States that have joined the *Euro Plus Pact* have to reflect definite measures oriented towards implementation of this pact in their National Reform Programmes, *Stability* and *Convergence programmes*.

The *Euro Plus Pact* has four key **priorities**:

– *Fostering competitiveness* by ensuring wage dynamic conformity to productivity, fostering competitiveness and liberalization of "protected" sectors, eliminating unreasonable restrictions in the sector of professional services and retail trade, improving education system, promoting research and development (R&D) and innovation, developing infrastructure and improving business environment;
– *Fostering employment* by implementing labour market reforms aimed at ensuring flexicurity, reducing undeclared employment and increasing participation in the labour market, fostering lifelong learning, implementing tax reforms aimed at eliminating tax burden imposed on the employed, however, taking into consideration the aim to preserve tax revenues;
– *Ensuring sustainability of public finances* by adapting the pension systems to demographic development, limiting early retirement schemes and fostering employment of older workers, as well as by introducing the EU fiscal rules based on the Stability and Growth Pact into the national legislation;
– *Reinforcing financial sector stability* by adapting the national legislation on surveillance of the banking sector in compliance with the EU requirements.

Box 6.1 continued

Compact for Growth and Jobs

The *Compact for Growth and Jobs* encompasses actions to be taken by the Member States and the EU with the aim of relaunching growth, investment and employment as well as making Europe more competitive. The compact emphasizes the need for the EU Member States to implement Council's country-specific recommendations and pay particular attention to the priorities set out in the *Annual Growth Survey* of the European Commission (i.e. pursuing differentiated, growth-friendly fiscal consolidation, restoring normal lending to the economy, promoting growth and competitiveness for today and tomorrow, tackling unemployment and the social consequences of the crisis, modernising public administration) – see also Box 6.2.

The *Compact for Growth and Jobs* at the EU level emphasizes the need for action to further deepen the EU Single Market, develop a digital single market, reduce the administrative burden, develop the EU internal energy market, strengthen innovations, boost financing of the economy (EUR 120 billion has been mobilised for fast-acting growth measures), better spending of the EU budget, improve tax policy, boost employment and foreign trade, as well as strengthen financial stability in the Economic and Monetary Union.

The European Council on October 18–19, 2012 reviewed the implementation progress of the *Compact for Growth and Jobs*. Overall, the members of the European Council welcomed progress made so far, but also called for a determined and result-oriented action to deepen the EU Single Market, develop transport, energy and digital networks in the EU, promote research and innovations, enhance competiveness of industry, boost employment and social integration, particularly tackling the youth unemployment, etc.

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.

At the moment, two additional regulations applicable to eurozone countries only (so called "two-pack") are being discussed. Both regulations are aimed at more intense supervision of fiscal policy in the eurozone, i.e. supervision of draft government budgets and correction of excessive budget deficit, as well as stricter supervisory procedures for the eurozone countries in financial difficulties.

Box 6.2

***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* which are going to be the main subject of discussions at different levels of the EU Council thus launching the third cycle of the European semester.

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 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;
– *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.

Box 6.2 continued

Alert mechanism and scoreboard

The European Commission publishes the annual *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 per cent of GDP, with a threshold of +6% of GDP and -4% of GDP;
- net international investment position as per cent of GDP, with a threshold of -35% of GDP;
- 5 years percentage change of export market shares measured in values, with a threshold of -6%;
- 3 years percentage change in nominal unit labour cost, with thresholds of +9% for euro-area countries and +12% for non-euro-area countries;
- 3 years 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 a 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 commitments 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 in-depth analysis and publishes it in the *In-depth review*.

In the second *Alert Mechanism Report* (published on November 28, 2012) the analysis of the scoreboard led the European Commission to a conclusion that considers that the risks of imbalances in the following Member States warrant further investigation: Belgium, Bulgaria, Cyprus, Denmark, Finland, France, Italy, Hungary, Slovenia, Spain, Sweden, United Kingdom, Malta and the Netherlands.

The *Alert Mechanism Report* concluded that the following countries did not require a further in-depth review at this point: Austria, Czech Republic, Estonia, Germany, Latvia, Lithuania, Luxembourg, Poland and Slovakia.

A conclusion on the need for an in-depth analysis was not addressed to Greece, Ireland, Portugal and Romania as these Member States coordinate their policy within the international loan programme with the European Commission and the International Monetary Fund.

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 for 2011-2013 to tackle them, as well as the targets of Latvia for 2020 in the context of the *Europe 2020 strategy* and main measures for 2011-2013 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 is mainly focused on eliminating the macro-structural bottlenecks, thus creating also preconditions for successful achievement of targets of Latvia for 2020 in the context of the *Europe 2020 strategy*.

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 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.

The NRP of Latvia identifies the following macro-structural bottlenecks:

- reducing the high general government structural deficit;
- ensuring a well-functioning and stable financial sector in the light of the ongoing deleveraging of the private sector;
- promoting rebalancing the economy towards the tradable sectors and raising productivity levels;

– avoiding high unemployment from becoming structural and ensuring better matching in the labour market;
– addressing the weaknesses in the business environment, ensuring efficient use of EU structural funds and adequate access to finance for companies in order to favour productive investment.

According to the European semester process, on April 27, 2012, the Cabinet of Ministers approved the ***Progress Report on the Implementation of the National Reform Programme of Latvia within the Europe 2020 Strategy*** (*Progress Report on the Implementation of the NRP of Latvia*) and the updated *Convergence Programme of Latvia for 2012-2015*. Both abovementioned documents have been submitted to the European Commission on April 29, 2012.

The Progress Report on the Implementation of the NRP of Latvia contains 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 *Euro Plus Pact* commitments and the Council recommendations, as well as it provides a detailed description of the NRP of Latvia policy directions, including the key measures and priority directions of the NRP of Latvia for 2012-2013:

– *developing sustainable budget* (budget deficit targets: in 2013 – 1.4% of GDP, in 2014 – 0.8% of GDP, in 2015 – 0.3% of GDP according to the ESA'95 methodology);
– *promoting competiveness* (developing and implementing industrial policy, etc.);
– *improving business environment*, including reduction of labour taxes, combating the shadow economy;
– *reforms in education* (developing a new financing model of education, reforms in vocational education, etc.);
– *reducing the risk of structural unemployment* (active labour market policy, lifelong learning).

On July 10, 2012, the EU Council approved the recommendations for the EU Member States, including Latvia. The recommendations for Latvia in 2012–2013 are the following:

– Ensure planned progress towards the timely correction of the excessive deficit. To this end, implement the budget for the year 2012 as envisaged and achieve the fiscal effort specified in the Council recommendation under the excessive deficit procedure. Thereafter, implement a budgetary strategy, supported by sufficiently specified structural measures, for the year 2013 and beyond, to make sufficient progress towards the medium-term objective, and to respect the expenditure benchmark. Use better than expected cyclical revenue to reduce government debt;
– Implement measures to shift taxation away from labour to consumption, property, and use of natural and other resources while improving the structural balance; ensure adoption of the *Fiscal Discipline Law* and develop a medium term budgetary framework law to support the long-term sustainability of public finances; restore contributions to the mandatory funded private pension scheme at 6% of gross wages from 2013;
– Take measures to reduce long-term and youth unemployment by fighting early school leaving, promoting more efficient vocational education and training and its apprenticeship component, enhancing the quality, coverage and effectiveness of active labour market policy and its training component and through an effective wage subsidy scheme;
– Tackle high rates of poverty and social exclusion by reforming the social assistance system to make it more efficient, while better protecting the poor. Ensure better targeting and increase incentives to work;
– Further encourage energy efficiency by implementing measures and providing incentives for reducing energy costs and shifting consumption towards energy-efficient products, including vehicles, buildings and heating systems. Promote competition in major energy networks and improve connectivity with EU energy networks;
– Take measures to improve management and efficiency of the judiciary, in particular to reduce the backlog and length of procedures. Take steps to improve the insolvency regime and the mediation laws;
– Continue reforms in higher education, inter alia, by implementing a new financing model that rewards quality, strengthens links with market needs and research institutions, and avoids fragmentation of budget resources. Design and implement an effective research and innovation policy encouraging companies to innovate, including via tax incentives, upgrading infrastructure and rationalising research institutions.

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*.

On October 16, 2012 the Cabinet of Ministers approved the ***Informative Report on Bilateral Meeting with the European Commission*** prepared by the Ministry of Economics that assesses the adequacy of measures to implement the abovementioned recommendations and risks related to implementation of the measures, as well as proposals for the *Annual Growth Survey 2013* and improvements of organizing the European Semester in 2013.

Looking at the implementation of the Council's recommendations for Latvia in general, the informative report draws a conclusion that the planned measures are sufficient enough to start implementing the recommendations in 2012-2013, yet, the recommendations cannot be fully implemented in a short-term. Certain recommendations are going to be implemented in a longer period of time, for example, the rate of mandatory contributions in the state-funded pension scheme is expected to be increased gradually, thus ensuring an overall increase of 6% in 2016.

Competition will not be fully ensured in the natural gas and heat supply sectors, as well as the new model for financing of higher education will not be introduced in 2013 (expected to be introduced in 2014).

The informative report has found a risk of deteriorating general economic situation due to uncertain ways of overcoming the eurozone crisis and the overall external environment that may have a negative impact on labour market in Latvia. This might also lead to an increase in the number of people at risk of social exclusion and poverty. Overall, the planned measures of Latvia comply with the recommendations of the Council regarding better protection of poor people and they will be updated to ensure well targeted social assistance and work incentives.

The risks in implementation of the Council's recommendations are related also to possible deviations in adoption of certain important laws (for example, the new *Construction Law,* the *Mediation Law*, etc.) from the expected schedule.

The Ministry of Economics will continue supervising implementation of measures and information on the implementation progress will be included in the *Progress Report of 2013 on the Implementation of the National Reform Programme of Latvia within the Europe 2020 Strategy*.

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

6.2.1. Utilisation 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.

Programming period 2004-2006

In the period of 2004-2006, the total available financing for Latvia in the framework of the SF programmes was EUR 625 million or LVL 439.3 million

Looking at the SF funds absorption indicators in the programming period 2004-2006, it can be concluded that the investments made in the EU fund projects have considerably contributed to the economic growth in 2004-2007 and the objective set in the planning documents have been achieved.

Overall, projects for EUR 673.3 million or 107.6% of the total SF funding available for Latvia have been approved and completed in the programming period 2004-2006.

The sum of the approved projects exceeds the available SF funding due to the undertaken overcommitments under decrees of the Cabinet of Ministers providing for a possibility to undertake overcommitments in the SF projects exceeding the available funding in the European Regional Development Fund (ERDF), the *European Agricultural Guidance and Guarantee Fund* (EAGGF) and the *Financial Instrument for Fisheries Guidance* (FIFG) activities by 12%, as well as exceeding the available funding in the European Social Fund (ESF) activities by 5%. At the same time, state budget funding was allocated for the ERDF projects for the purpose of covering increased costs.

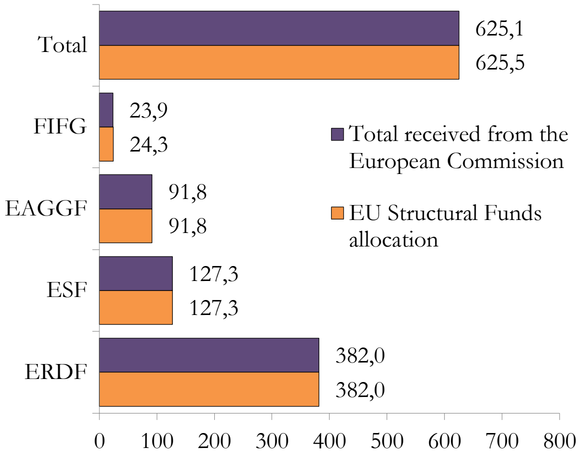
Overall, a total of EUR 659 million or 105% of total SF funding available for Latvia has been paid for the SF projects in the programming period 2004-2006. In breakdown by funds, the most funding in terms of percentage and amount has been paid to funding beneficiaries within the ERDF – EUR 408.7 million or 107% of available ERDF funding.

Yet, upon considering the SF funds absorption rates, it should be noted that a considerable amount of payments has been paid to funding beneficiaries at the end of the programming period, i.e. in 2008, as well as in early 2009. Based on the experience of the programming period 2004-2006, detailed plans for the EU funds absorption by years and quarters have been prepared in good time for the new programming period, thus allowing to ensure timely and balanced absorption of the EU funds.

Figure 6.3 reflects the total declared costs of the EU Structural Funds for the programming period 2004-2006 from the European Commission.

Figure 6.3

Summary of the EU structural fund payments received from the European Commission in the period of 2004-2006
(million EUR, till November 30, 2012)



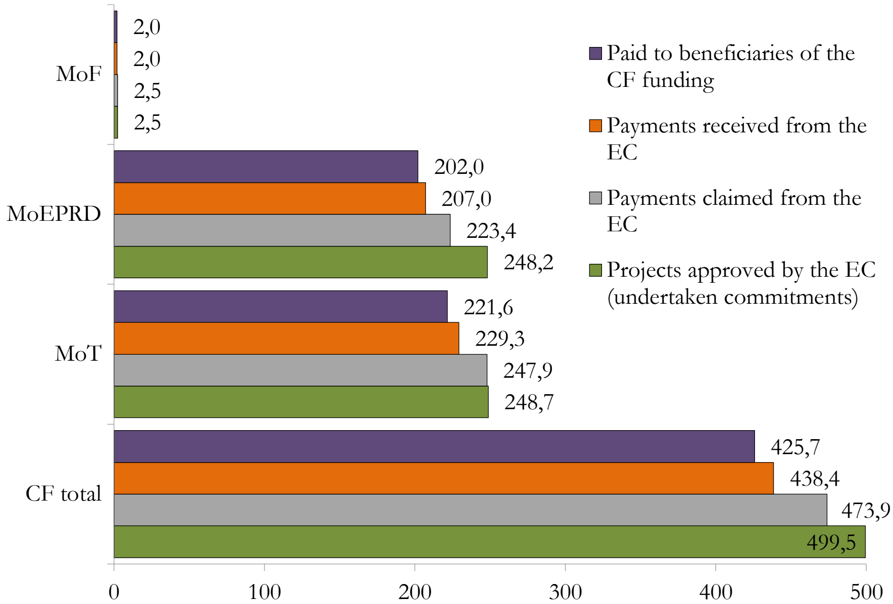
In the period of 2004-2006, the total available funding for Latvia for implementation of the CF projects was LVL 499.5 million.

CF projects for the programming period 2004-2006 were implemented until December 31, 2010. Altogether, 46 large-scale projects for the total funding of the CF in the amount of LVL 499.5 million were approved. Furthermore, 34 out of 46 approved projects were implemented in the environment sector, 24 – in the transport sector, and 2 projects were implemented as technical support projects by the Ministry of Finance for building administrative capacity of the implementation system. Works of 45 projects were completed and one project was terminated.

By September 30, 2012, the CF funding beneficiaries had received LVL 425.7 million or 85.2% of the CF funding. LVL 473.9 million or 94.9% of the CF funding has been claimed from the European Commission. LVL 438.4 million or 87% of the CF funding have been received from the European Commission.

Figure 6.4

EU Cohesion Fund absorption in the programming period 2004-2006 (full financial flow) by the end of September 30, 2012
(million LVL)



Programming period 2007-2013

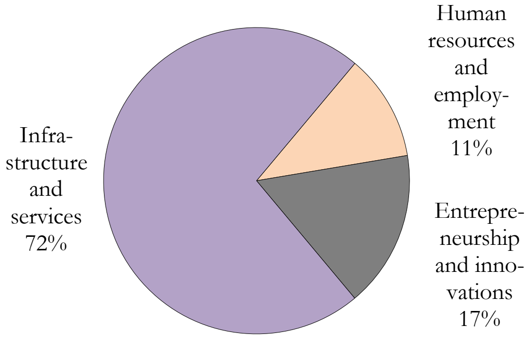
In the programming period of 2007-2013, the SF support is mainly directed towards education of inhabitants, technological excellence and flexibility of enterprises, as well as towards development of science and research in order to promote knowledge-based economy and strengthen other prerequisites for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

Figure 6.5

Breakdown of funding among OP's in the programming period 2007-2013
(per cent)



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.

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 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 October 31, 2012

	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	million LVL
ESF	409.8	416.1	101.5	306.0	74.7	289.7	70.7
ERDF	1 692.0	1 514.8	89.5	867.4	51.3	790.7	46.7
CF	1 082.1	1 025.8	94.8	496.1	45.8	463.1	42.8
Total	**3 184.0**	***2 956.7***	**92.9**	**1 669.6**	**52.4**	**1 543.6**	**48.5**

As of October 31, 2012, projects for the amount of more than a half (or 92.9%) 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 2 956.7 million had been concluded. As of October 31, 2012, the funding beneficiaries have received LVL 1 669.6 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.

Box 6.3 continued

<u>Contracts concluded until November 30, 2012 within the framework of activities under the responsibility of the Ministry of Economics:</u>

- 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 contractual sum of LVL 16.9 million.
- Within activity *Support to Individually Organised Trainings for Entrepreneurs*, 84 contracts have been completed for the total contractual sum of LVL 2 million.
- Within activity *Attraction of Highly Qualified Employees*, 3 contracts have been completed for the total contractual sum of LVL 100.9 thousand.
- Within activity *Competence Centres* 6 contracts have been concluded for the total contractual sum of LVL 37.3 million.
- Within activity *Technology Transfer Contact Points*, 8 contracts have been concluded for the total contractual sum of LVL 1.8 million.
- Within activity *Development of New Products and Technologies*, 81 contracts have been concluded for the total contractual sum of LVL 5.8 million.
- Within activity *Introduction of New Products and Technologies into Production*, 128 contracts have been concluded for the total contractual sum of LVL 33 million.
- Within activity *Development of New Products and Technologies – Support to Strengthening Industrial Property*, 5 contracts have been concluded for the total contractual sum of LVL 71.8 thousand.
- Within activity *High Value Added Investments*, 38 contracts have been concluded for the total contractual sum of LVL 80.2 million.
- Within activity *Access to International Trade Markets – External Marketing*, 1100 contracts have been concluded for the total contractual sum of LVL 5 million.
- Within activity *Development of External Markets – Strengthening International Competitiveness of Industry Sectors,* 2 contracts have been concluded for the total contractual sum of LVL 4.9 million.
- Within activity *Support for Self-employment and Business Start-ups* until November 20, 2012, 857 start-up projects for over LVL 9.9 million, as well as grants in the amount of LVL 3.4 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. By October 31, 2012 *BaltCap Management Latvia* has made 8 venture capital investments in the amount of EUR 5.4 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 is expected to amount to EUR 6.4 million By October 31, 2012 *Imprimatur Capital Baltics* has made 9 seed capital investments in the amount of EUR 650 thousand and 2 start-up capital investments in the amount of EUR 562 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 36 loan agreements for LVL 11.8 million have been signed within the programme.
- Within activity *Guarantees for Improvement of Enterprise Competitiveness* until September 30, 2012 292 credit guarantee contracts have been concluded for the total amount of LVL 6.3 million.
- Within activity *Loans for Improving Enterprise Competiveness* until November 20, 2012, 295 loans have been granted for the total amount of LVL 169.3 million, including 82 loan agreements have been granted for LVL 79.8 million within the ERDF part of the programme.
- Within the activity *Measures to Encourage Innovations and Business Start-ups* 1 contract has been concluded for the total 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 Latvian regions and 1 contract on providing business incubation services to creative industry enterprises in Riga have been concluded. 513 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*, 109 contracts have been concluded for the total contractual sum of LVL 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 4.2 million (ERDF).
- Within activity *Improvement of Heat Insulation of Multi-apartment Residential Buildings*, 1140 contracts have been concluded for the total contractual sum of LVL 69.3 million (ERDF).
- Within activity *Improvement of Heat Insulation of Social Residential Buildings*, 56 contracts have been concluded for the total contractual sum of LVL 4.2 million (ERDF).
- Within activity *Measures for Raising Efficiency of Central Heat Supply Systems,* 58 contracts have been concluded for the total contractual sum of LVL 34.2 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 21.3 million (CF).

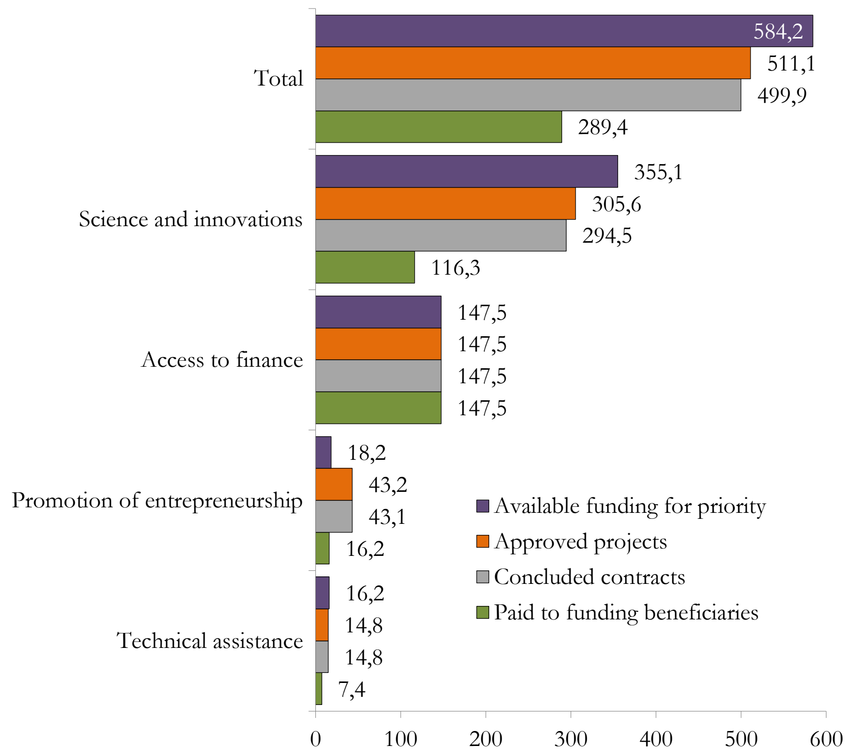
Absorption of the EU funds in operational programmes *Human Resources and Employment, Entrepreneurship and Innovations,* and *Infrastructure and Services*

In the framework of the OP *Human Resources and Employment*, the most rapid progress of implementation has occurred in administrative capacity building activities, as well as professional and social inclusion activities where the highest increase percentage-wise in the amount of payments for funding beneficiaries has been recorded.

The most significant progress in percentage in the field of approved projects and concluded agreements by September 30, 2012 among the operational programmes has been observed in the field of employment *Human Resources and Employment,* where contracts have been concluded for LVL 467.2 million (93.4%), within the priority *Promotion of Employment and Health at Work*, where contracts have been concluded for LVL 217.7 million (96.3%), within the priority *Education and Skills,* where contracts have been concluded for the amount of LVL 99.1 million (90.1%), within the priority *Higher Education and Science*, where contracts have been concluded for LVL 85.7 million (89.3%) of the public financing available to priorities. Contracts on financing from the EU funds in the amount of LVL 35.8 million (93.3%) have been concluded within the priority *Promotion of Social Inclusion*, and within the priority *Administrative Capacity Building*, contracts on financing from the EU funds in the amount of LVL 16.3 (96.5%) million have been concluded. Payments made within programme *Human Resources and Employment* constitute LVL 342.5 million (68.5%), but in the priorities *Promotion of Employment and Health at Work* – LVL 156.4 million (69.2%), *Higher Education and Science* – LVL 72.2 million (75.2%), *Education and Skills* – LVL 70.7 million (64.3%), *Promotion of Social Inclusion* – LVL 24.9 million (65%), and *Administrative Capacity Building* – LVL 10.4 million (61.7%).

Figure 6.6

Absorption of EU funds in the operational programme *Entrepreneurship and Innovations* till September 30, 2012
(million LVL)



Overall, activity implementation in the OP *Entrepreneurship and Innovations* exceeds the expected. Within the OP until September 30, 2012, payments in the amount of LVL 289.4 million have been made to funding beneficiaries thus constituting 49.5%. Yet, projects have been approved for LVL 511.1 million. By September 30, 2012 the number of projects has increased the most in entrepreneurship and science and in innovation activities.

In order to improve the absorption of the EU funds available within the OP *Entrepreneurship and Innovations*, in 2012 implementation of projects was launched in the activity 2.1.2.4 *High Added Value Investments* (projects in the second selection round) and the activity 2.3.2.3 *Cluster Programme*. For the purpose of enhancing absorption within the activity 2.2.1.1 *Holding fund for the investment in guarantee, high-risk loans, and venture capital funds and other financial instruments (Holding fund)* additional financial instruments are planned to be implemented – growth capital fund with the expected budget in the amount of EUR 30 million, a microloan fund with the expected budget in the amount of EUR 5 million and a seed capital fund with the expected budget in the amount of EUR 1-2 million for supporting those, who complete acceleration programme.

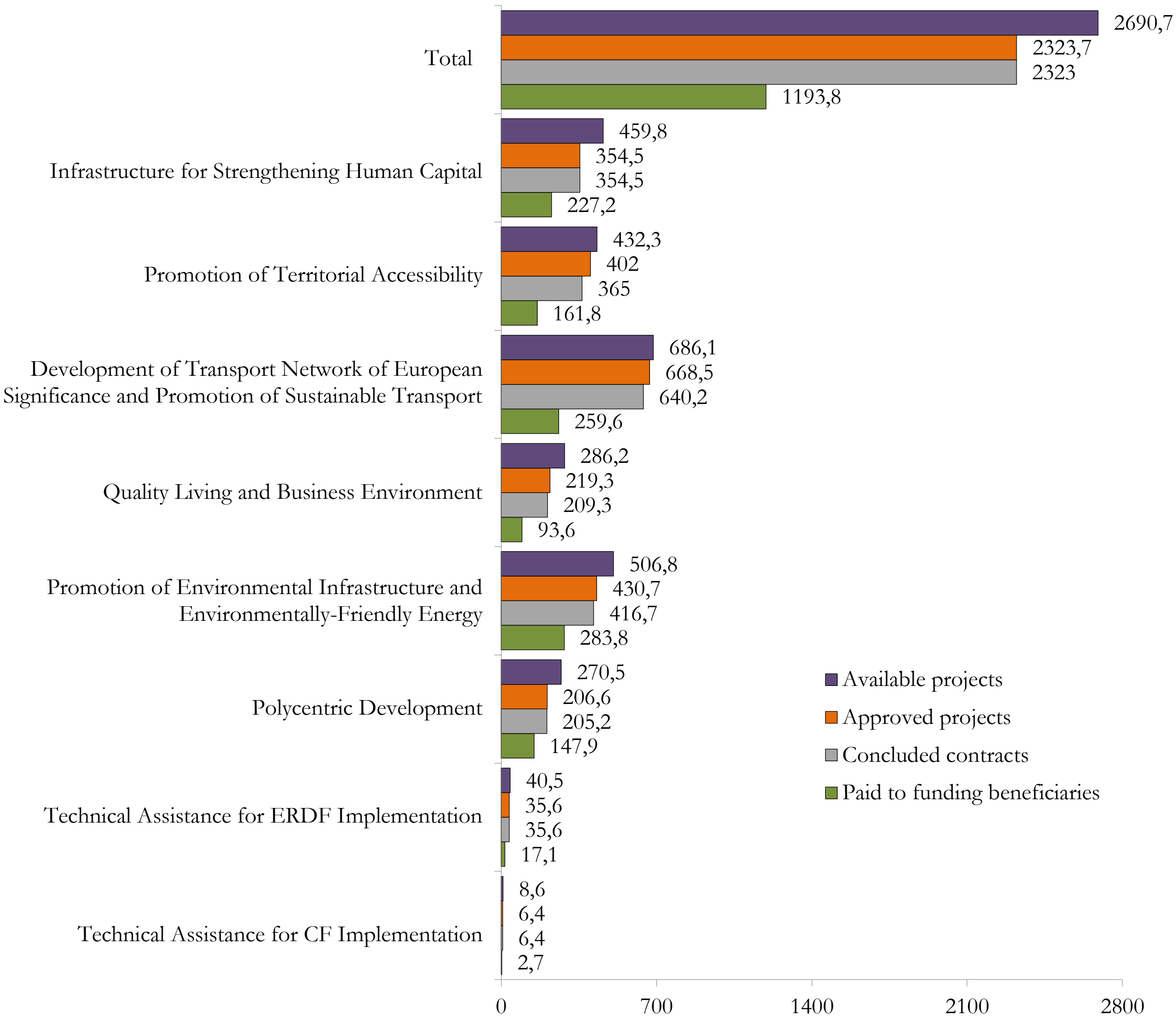
Information regarding the fund absorption in the operational programme *Entrepreneurship and Innovations* by September 30, 2012 is reflected in Figure 6.6.

Within the OP *Infrastructure and Services* the most of programme projects are being implemented at the moment. Payments are made by over 44% more than expected, mainly to projects in the field of road, transport, ports, ICT, health, energy efficiency and culture. The most significant progress has been achieved in the priority of improving environmental infrastructure and promoting environmentally friendly energy constituting LVL 283.8 million or 56%, as well as LVL 227.2 or 49.4% in the priority of strengthening human capital.

Figure 6.7

Absorption of EU fund financing in the operational programme *Infrastructure and Services* till September 30, 2012

(million LVL)



The main factors delaying project implementation are procurement issues (complaints, procurements ending without any results, problems occurring in procurement procedures), identified nonconformities within the framework of the projects in relation to the regulations of the Cabinet of Ministers regarding excessive expenditures determined for implementation of activities and increasing prices in road construction and water management projects, as well as extended deadlines for project implementation.

Information regarding the fund absorption in the operational programme *Infrastructure and Services* is reflected in Figure 6.7.

6.2.2. Foreign Trade Policy

In 2012, there was a range of topical issues within the EU common trade policy, among them the development of common framework for the EU investment policy, restricting protective measures in export markets, the EU bilateral trade agreement negotiations with certain third countries, etc.

Multilateral relations

Year 2012 has been remarkable for the World Trade Organization (WTO) since the number of its members rose to 157 countries[1], because of the accession of Russian Federation and Vanuatu in August 22 and August 24, 2012 respectively. It should be noted that on October 26, 2012 the WTO General Council approved the accession of the Lao People's Democratic Republic and on December 3 – that of Tajikistan to the WTO. 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.

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 year 2013 when among other things the WTO's 9th Ministerial Conference is going to be held in December in Bali (Indonesia).

In order to further develop multilateral trade system conditions, the WTO members in various formats (bilaterally, regionally, multilaterally, etc.) are working on improving specific trade conditions. One of such initiatives involves the idea of several countries[2] to develop a global framework for efficient restriction of counterfeit and pirated goods and services related to distribution thereof according to the WTO standards by signing the *Anti-Counterfeiting Trade Agreement (ACTA)*.

After the EU and majority of its member states had signed the *ACTA* on January 26, 2012, there were wide discussions in a number of the EU member states, including Latvia about a possible threat to human rights arising out of the ACTA. On July 4, 2012 the European Parliament rejected the *ACTA*, thus suspending its approval in the EU. In order to eliminate similar public concerns on other future EU trade agreements with third countries, before any further enforcement of intellectual property rights therein, the EC is planning to wait for the ruling of the Court of Justice of the EU regarding the ACTA, which is expected to be available in 2013/2014.

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[3], European Economic Area countries[4], San Marino, Switzerland, Chile, South Africa, South Korea[5], Mexico and Turkey.

In the second half of 2012, the topical issues of the EU bilateral relationships with third countries included the decisions on launching the EU-Japan *Free trade agreement (FTA)* and the EU-Morocco FTA negotiations made on November 29 by the EU Council, the work in the EU-US High-Level Working Group on Jobs and Growth on possibilities to deepen trade relations between both parties, including possible signing of the FTA in future.

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. The active EU *FTA* negotiations and overall successful progress of negotiations with Armenia, Georgia and Moldova should also be noted. Yet, the progress of the EU-India *FTA* negotiations to a great extent depend on the readiness of India to carry out internal reforms oriented towards economic integration, while the future of the *FTA* negotiations with the Common Market of the South *BTL*[6] (*Mercosur*) is still uncertain considering the different positions of *Mercosur* countries regarding economic integration with the EU.

[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, EU, Japan, Mexico, Morocco, New Zealand, Singapore., South Korea, Switzerland, and USA

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

[4] Iceland, Liechtenstein and Norway

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

[6] Argentina, Brazil, Paraguay, Uruguay and Venezuela

At the same time, the EU is holding *FTA* negotiations also with Malaysia, Vietnam the Gulf Cooperation Council countries[1] *(GCC)* and Mediterranean countries[2], as well as negotiations about economic partnership agreements with the majority of African, Caribbean and Pacific Group of States (ACP).

Promotion of accessibility to the third country markets

In order to ensure efficient access of exporters from the EU, including Latvia, to the third country markets, in the second half of 2012, measures for identifying, eliminating, and preventing barriers were implemented according to the updated *EU Market Access Strategy* approved in April 2007. Within the strategy, 12 working groups[3] and 33 market access teams[4], were established to deal with issues specific for the EU enterprises in relation to situations of trade limits in the third countries, as well as matters of various sectors and regions. The groups and teams include also economic representatives from Latvia in Israel, Kazakhstan, Russia, Turkey, Ukraine, and the USA.

Since launching the supervision of trade policy instruments of countries around the globe in 2009, the most trade restrictions have been imposed not only in such markets important to the Latvian export as Russia, Ukraine, Belarus, and Kazakhstan, but also in the markets of the strategically important trade partner countries of the EU-USA, Argentina, Brazil, China, India, and Japan.

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 1-2, 2012 approved the second annual *Trade and Investment Barriers Report*. It covers the trade restrictions important for the EU enterprises, including the prohibition of Russian to import live pigs form the EU member states that is important to Latvia as well. The European Commission is going to prepare the third report for submission to the European Council in the first half of 2013.

Economic cooperation agreements of Latvia and third countries and regions of third countries

The *Council* for the *Coordination* of External *Economic Policy* was established in May 2012 for closer coordination of external economic policy matters (see Box 6.4).

Box 6.4

Council* for the *Coordination* of External *Economic Policy

A 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 representing economic interests of Latvia abroad. A five-party meeting was held on January 4, 2012 that resulted in a decision to establish the *Council* for the *Coordination* of External *Economic Policy* for the purpose of ensuring coordinated cooperation of the parties in successful development and implementation of economic policy to increase competiveness of Latvian national economy. The Council is managed by the Minister of Foreign Affairs, while the Minister for Economics serves as the vice-chairman of the Council.

Two 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, as well as issues were discussed regarding developing and introducing an integrated information system and developing a single database of priority markets for exporters of Latvian goods and services, as well as preparations of proposals on developing and implementing an indicator system for evaluating the economic performance of the Foreign Economic Missions and the Diplomatic and Consular Missions of Latvia.

In order to activate the bilateral economic cooperation after the accession to the EU, Latvia has concluded bilateral economic cooperation agreements with Russia, China, Belarus, Ukraine, Kazakhstan, Azerbaijan, Georgia, Moldova, Uzbekistan, Kyrgyzstan, Turkmenistan, Tajikistan, and Armenia. Within the framework thereof, Intergovernmental Commissions (IGC) and a Joint Committee (JC) have been established, ensuring supervision of validity of agreements and analysing opportunities for improvement of further cooperation.

Latvia-Russia

It is important for Latvia to develop mutually favourable economic relations with the regions of Russia. At the moment agreements on economic cooperation with the Omsk Oblast, Vologda Oblast, the Pskov Oblast and Kirov Oblast, as well as the Republic of Karelia and the Chuvash Republic are in force.

The Pskov Oblast is particularly important to Latvian entrepreneurs as it is the only frontier region.

[1] Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates

[2] Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian Authority, Syria and Tunisia

[3] 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

[4] EU Market Access Teams are acting 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

Taking into account the mutual interest in active cooperation, as soon as the agreement of economic cooperation with the Pskov Oblast was signed, the parties agreed on developing a work programme for its implementation for the next three years. The programme was prepared by summarizing the proposals of the line ministries, non-governmental organizations, local governments, etc. and signed on May 2, 2012 in Riga.

At the moment, the work of agreeing on the development and coordination of the implementation programmes of economic cooperation is carried out with the governments of Kirov Oblast and Vologda Oblast.

In addition, coordination of the agreements of economic cooperation projects with other regions of Russia is continued – Ivanovo, Yaroslavl Oblasts and the Republic of Bashkortostan. Work programmes for implementation thereof are going to be developed after signing of these agreements.

Taking into account the current potential and the interest of Latvian entrepreneurs, the Ministry of Economics is constantly looking for opportunities to expand the cooperation in other regions of the Russian Federation, for example, Leningrad Oblast, Perm Oblast, Novgorod Oblast, etc.

Latvian-Russian IGC

On June 26, 2012, the annual meeting of the IGC working group for Economic matters was held in Moscow, during which the results of bilateral trade and economic cooperation and further prospects in different areas, including foreign trade, energy, statistics and tourism were discussed.

Within the framework of the 5th meeting of the Latvian-Russian IGC, the *Declaration on Modernization Partnership of the Republic of Latvia and the Russian Federation* was signed on June 10, 2011 in Liepāja. The declaration is aimed at facilitating mutual investments in innovation technologies, development and promotion of up-to-date competitive products, supporting improvements of business environment, developing contractual framework, expanding and diversifying trade of goods and services, promoting strengthening of political system and law institute, eliminating corruption and developing civil society, as well as promoting dialogue between business society and public institutions of both countries, establishing contacts between economic operators in both countries, scientific and technical cooperation, cooperation in the field of energy, information technology and environmental protection. During the IGC meeting, the parties also agreed to prepare the *Action Plan for Implementing the Declaration* by the next meeting.

The draft action plan is currently being prepared and coordinated with the interested line ministries, local governments and non-governmental organizations of Latvia. The bilateral expert consultations in 2012 discussed the Latvian-Russian cooperation within the partnership modernization and harmonised the vision of the parties for content and further progress of the action programme.

Latvian-Kazakhstan IGC

On June 27, 2012, the 4th meeting of Latvian-Kazakhstan ICG was held in Astana, addressing trade and economic cooperation, cooperation in the transport sector, changes in customs laws, as well as directions of Kazakhstan international cooperation after creating the customs union of Kazakhstan, Russia and Belarus, cooperation in the field of education and science, health protection, laboratory diagnostics issues, in the field of tourism, regional policy planning and implementation, etc.

Along with the 4th IGC meeting, the second meeting of the Latvian-Kazakhstan Business Council was held, addressing cooperation in the transport sector, including rail freight and civil aviation, education and science, internet media, as well as in the field of public transport development in Astana.

Latvian-Ukrainian IGC

The 5th meeting of the Latvian-Ukraine IGC was held on July 4-5, 2012 in Riga (Latvia). The meeting addressed trade and economic cooperation between both countries so far and further cooperation possibilities. Latvia received recognition for the opening of external economic representation of Latvia in Ukraine in October 2011, as well as the *Economic Cooperation Programme 2012-2013 between Latvia and Ukraine* signed on February 10, 2012 and the *Round table discussion for Latvian and Ukrainian entrepreneurs*, during which the parties approved their interest in further development of cooperation in the field of transit, automotive, information and communication technology, energy efficiency and other. A round table discussion took place with participation of official representatives from Ukrainian delegation and representatives of enterprises from Lugansk region representing food production, metal industry and automotive enterprises, along with the IGC, aimed at identifying new niches for cooperation.

Latvian-Turkmenistan IGC

The 1st meeting of the Latvian-Turkmenistan IGC was held on September 10, 2012 in Riga. During the meeting both parties discussed possibilities to promote bilateral economic cooperation and identified transit, logistics, information and communication technology, infrastructure construction, textile industry, pharmacy, education, culture sectors, and export of agricultural products as the most perspective cooperation areas. The parties also addressed cooperation possibilities in the fields of agriculture, construction, education and science, and health care.

Latvia-Japan

On September 20-21, 2012, IDAL in cooperation with the *JETRO (Japan External Trade Organization)* organized the Latvia Industrial Tour in Riga for representatives of Japanese enterprises operating in Japan and Europe. The event was aimed at introducing Japanese entrepreneurs to the priority economic sectors in Latvia and visiting Latvian enterprises and evaluating their performance and offered cooperation possibilities in order to develop mutually beneficial cooperation in the future. Representatives from 18 Japanese enterprises participated in the tour taking the opportunity to visit such enterprises as the Baltic Container Terminal, Riga Freeport, Plockmatic, TTS-AVIO, Grindeks, Riga IT Demo Centre, Exigen Services and DB Schenker.

Latvia-China

On October 21-23, 2012, the Vice Minister of Commerce of China and a delegation of Chinese entrepreneurs visited Latvia. During the visit, all parties identified the cooperation areas – transport, logistics, information technology and telecommunications, biotechnology, life sciences, electrical engineering, high technologies, etc. The visit led to signing of the Memorandum of Understanding between the Ministry of Economics and *Ministry of Commerce of the People's Republic of China* on establishing a joint working group on promoting investments within the framework of the Latvian-Chinese Joint Committee. A working group has been assigned by this memorandum, having the following main tasks: preparing proposals for promoting bilateral investments and economic cooperation, providing consultations to investors, exchange of information, as well as dealing with other issues.

On November 25-26, 2012, the Global China Business Meeting of 2012 took place in Riga. The event involved over 400 participants – high level entrepreneurs from China and other countries, about 100 of them represented Latvian enterprises of various sectors.

By offering the venue of the meeting, Latvia has proved its accomplishments and economic growth; it will promote Latvia's visibility abroad, as well as give the Latvian entrepreneurs a possibility to directly establish contacts with potential cooperation partners from China and other countries.

Latvian-Belarusian IGC

The 8th meeting of the Latvian-Belarusian IGC was held on October 25, 2012 in Molodechno (Belarus). The meeting addressed the possibilities to enhance cooperation in the field of business and industry, transport, transit and logistics, agriculture, communication, energy, education and science, tourism, transborder and cross-border cooperation, regional development and planning, as well as standardization, accreditation, conformity assessment, metrology, etc. The meeting of the Latvian-Belarusian Business Council was held along with the 8th IGC meeting, addressing the topical issues in order to improve the business environment in both countries, including eliminating obstacles that entrepreneurs face in both countries, as well as paying particular attention to transit and logistics issues and transborder cooperation.

Latvia-Sweden

On November 5-7, 2012, the Minister for Economics and 20 entrepreneurs were on a visit to Sweden to participate in the International Trade Fair for subcontractors and suppliers within the engineering industry *Elmia Subcontractor – 2012* in Jönköping. This year Latvia was the national partner country at the fair. The visit was aimed at promoting possibilities and the wide offer of metal industry and automotive and paving the way for new cooperation and developing economic cooperation between both countries.

<u>Sectoral issues of the EU foreign trade</u>

Steel

Flexibility and multiple processing potential of steel make it one of the most widely used industrial raw materials in the world. The metal industry forms a part of the general European competitiveness in all links of the value chain.

The sector all over the world has recovered more rapidly than expected; yet, there has been a decrease in volumes in 2012, if compared to the previous year.

The EU currently applies quantitative restrictions on import of particular steel products from Kazakhstan alone. It is subject to autonomous measures and the import quota has been defined in the amount of 0.2 million tons.

Additionally, for the purpose of steel flow monitoring system, the EU applies the prior surveillance system that will operate until December 31, 2012.

Textiles

Products of the textile industry are among the most marketed goods in the global economy. The EU is the second largest exporter of textile goods in the world after China, dominating in the world in markets of high income and high quality textile goods and clothing. The main EU trade policy activities also in 2012 regarding textiles and clothing are related to breaking down trade barriers to the European textile goods export in markets of rapidly developing third countries.

The textile and clothing sector was an exception for the progressive trade liberalization of industrial goods in the multilateral negotiations of the WTO for a long time until 1995, when the developing countries made the WTO member states to pledge on gradual implementation of a complete trade liberalization of textile goods. Thereby the EU is currently applying quantitative restrictions only to the import of certain textile goods from Belarus and North Korea (not the WTO member states).

Timber

Taking into account the accession of Russia to the WTO on August 22, 2012 and its commitments, a tariff quota system with lower export tariffs has been applied to import of certain round coniferous timber 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. Before the increase in Russian export tariffs in 2008–2009, timber industry of Latvia was one on the largest importers of Russian round coniferous timber in the EU, taking the 2nd position after Finland. Thus, Latvian timber enterprises have always been interested in the import of Russian round coniferous timber and the use of this system.

Trade Defence Instruments

The EU applied trade defence measures

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 and safeguard measures of domestic market.

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. 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.

In the second half of 2012, the EU has applied a total of 110 anti-dumping measures and 10 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 second half of 2012, among the TDI inspections important to Latvia are:

- the antidumping inspection concerning import of organic coated steel products from the *People's Republic of China*. In this inspection, Latvia took a position against introducing the antidumping duty to maintain alternative sources of raw materials to importers of goods for reasonable prices;
- the antidumping inspection concerning import of ceramic tableware and kitchenware from the *People's Republic of China*. In this inspection, Latvia also took a position against introducing the antidumping duty on mass-consumption product used by every household.

Third country applied trade defence measures

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 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, which might result in complete cancelation of the duty.

Involving small- and medium-sized enterprises in TDI inspections

In order to encourage small and medium-sized enterprises to get involved in TDI inspections, since 2012 the European Commission, in cooperation with the responsible institutions of the member states, has established the SME Helpdesk and developed guides on initiating anti-dumping and anti-subsidy inspections, as well as a guide on TDI[1] 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 the first half of 2012, as of May 2012 aimed at making the EC TDI inspections more transparent and simplifying participation of interested

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

parties in the TDI inspection procedures, 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 the second half of the year.

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 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 taking place successfully, and good results have been achieved in the efficiency of transposition of directives. In 2012, Latvia has improved the result even more with a deficit of directive transposition of 0.1% and has been ranked the 1st among the 27 Member States, together with Malta (0.1%), 2nd place – Estonia (0.2%), 3rd place – Denmark, thus achieving the Lisbon objective of 2009 to transpose 99% of directive requirements or allow transposition deficit of 1 per cent.

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 envisage 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)*. Since the inception of the activity, the Product Information Contact Point has replied to requests for information on national requirements regarding various products received from merchants of 37 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 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 delay 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 clear 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 another 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 104 requests for information: 7 – in the field of services, 12 – in the field of employee secondment, 85 – 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 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 30 cases. 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 issue of residence permits, entrepreneurs – restrictions of free movement of services.

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 exports are 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 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.

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.

The NIP strategic framework envisages implementing two types of activities aimed at overcoming both global and local obstacles within planning of and afterwards implementing of the *National industrial policy*. First of all, activities related to identifying functional obstacles of the economy and instruments for elimination thereof, in other words, base industrial policy activities. Second of all, activities related to improving economic profitability or increasing productivity of tradable sectors. It means that there is a need for support instruments to stimulate enterprises already manufacturing products with high value added or providing services with high value added and eliminate relevant market failures, as well as enterprises that might manufacture products with high value added or provide services with high added value and eliminate market failures preventing the transitions to products and services with higher value added.

Elaboration of *the National industrial policy* is 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.

The aim of the *National Industrial Policy of Latvia* is to promote 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.

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.

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.

Along with an analysis of functional obstacles, the main obstacles to production and advantages of dominant advantages of producers need to be identified and understood.

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 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 6.5).

Box 6.5

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. Access to specialists of higher professional qualification is particularly critical. Entrepreneurs have drawn attention to some occupations, which are not possible to obtain in the higher education system of Latvia and there already work mainly employees in pre-retirement age or retirement age;
– **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;

Box 6.5 continued

- **Limited access to finance** – according to information provided by respondents, the current range of services mismatches the actual needs or the enterprise 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 factors;
- **Limited availability of industrial areas and premises** – primarily outside 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 increasingly important role;
- **Rise in costs, particularly energy costs** – according to information provided by respondents, the risk of maintain the price advantage is a critical medium-term obstacle on a condition that costs of different resources are expected to increase;
- **Cooperation with 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 mainly 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* should be directed towards:

- **Issues related to access to and skills of labourforce** 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.

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 continuous consultation process with constant adjustments to policy actions.

The Guidelines on the National industrial policy for 2013-2020 will be announced at the meeting of State Secretaries in the 1st quarter of 2013 and submitted to the Cabinet of Ministers for consideration by mid-2013.

6.4. Energy Policy

The main approaches to the energy policy are directed at increasing security of energy supply of the country by encouraging diversification of supplies of the 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 energy sector development – *Long-term Energy Strategy 2030-competitive energy for society* has been developed based on its key objective – a positive impact of the energy sector on national economy of Latvia and two sub-objectives - safe and sustainable energy supply.

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 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.

Box 6.6

Energy Sector in Latvia

Both the imported (natural gas, electricity, petroleum 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 2011, energy resource generation and recycled products in Latvia reached 86.9 PJ, but import of energy resources was 165.7 PJ, out of which 59.1 PJ was the import of natural gas.

In 2011, the total consumption of primary energy resources in Latvia amounted to 188.7 PJ, and self-security in the total consumption of primary energy resources was 33.1%. In the total consumption of primary energy sources, firewood with its total consumption forming 46.9 PJ was the most widely used local energy resource, electricity generated in hydropower stations and wind power stations constituted 10.6 PJ.

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 are operating actively in the electric energy market having signed contract on use of the system with JSC "Sadales tīkls".

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 for 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 18500 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 which means that as of September 1, 2013 the electricity price will no longer be regulated in Latvia and households have to choose their own electricity trader and agree on the best service for them and thus the price thereof.

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".

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 to face 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.

Table 6.2

Consumption of Primary Energy Resources in Latvia, PJ

	2005	2006	2007	2008	2009	2010	2011
Total consumption * including:	**191.9**	**199.0**	**204.6**	**196.5**	**189.0**	**200.5**	**188.7**
coal and coke	3.3	3.6	4.4	4.4	3.5	4.5	5.0
peat	0.1	0.1	0.1	0.1	0.0	0.1	0.0
petroleum products	61.9	67.5	73.3	69.3	62.4	64.6	62.9
natural gas	56.9	58.9	56.9	55.8	51.4	61.3	54.0
firewood	49.4	49.8	48.7	46.0	52.6	51.4	46.9
electricity **	19.9	18.9	20.8	20.5	18.6	16.0	15.1
other energy resources ***	0.5	0.4	0.4	0.5	0.5	2.7	4.8

* 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

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 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 6.7

Electricity and centralized heat supply 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 2011, the JSC "Latvenergo" generated 72% of the total electricity supply, it purchased 11% from small electricity energy producers and net imports of electric energy constituted 17%. Compared to the previous year, the total electric energy supply has decreased by 2.1 per cent.

In 2011, 2888 GWh (10.40 PJ) of electricity was produced by **high efficiency cogeneration** which is 92% of the total electricity produced by cogeneration. This high indicator was fostered by mandatory electricity procurement. The existing heat energy production plants are gradually replaced with efficient cogeneration plants using local energy resources. Their replacement and efficient use of energy resources greatly contribute to the reduction of greenhouse gas emissions.

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 2011, 1.3% of the total generated heat energy has been supplied to the industrial sector, 70.4% – to households, 28.3% – to other consumers. However, the breakdown of heat energy distributed by regions is the following: Riga region – 56.3%, Pieriga region – 9.9%, Vidzeme – 5.6%, Kurzeme – 9.7%, Zemgale – 7.2% and Latgale – 11.3 per cent.

In 2011, heat energy for sale was produced in 663 boiler houses and 83 cogeneration plants having generated 6.94 TWh 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 80.9%, woodchips – 12.1%, firewood – 2.2%, heavy fuel oil – 1.9% and other types of fuel – 2.9 per cent.

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

Table 6.3

Electricity Supply in Latvia, TWh

	2005	2006	2007	2008	2009	2010	2011
Total electricity supply	**7.1**	**7.4**	**7.8**	**7.8**	**7.2**	**7.5**	**7.3**
Gross electricity generation including:	**4.9**	**4.9**	**4.8**	**5.3**	**5.6**	**6.6**	**6.1**
from renewable energy resources:	3.4	2.8	2.8	3.2	3.6	3.6	3.1
large HPPs *	3.3	2.7	2.7	3.1	3.4	3.5	2.8
small HPPs	0.1	0.0	0.1	0.1	0.1	0.1	0.1
biomass and biogas power stations	0.0	0.0	0.0	0.0	0.1	0.1	0.1
wind power stations	0.1	0.1	0.1	0.1	0.1	0.1	0.1
from fossil energy resources:	1.5	2.1	1.9	2.1	2.0	3.0	3.0
large CHPs **	1.3	1.7	1.5	1.5	1.5	2.4	2.4
other CHPs	0.2	0.4	0.5	0.5	0.5	0.6	0.6
Net electricity imports	**2.2**	**2.5**	**3.0**	**2.5**	**1.7**	**0.9**	**1.3**

* 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 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 November 15, 2012, the *Nord Pool Spot* announced the intention to open Latvian price zone within the exchange on June 3, 2013. On January 1, 2012, the Regulations of the Cabinet of Ministers *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.

The biggest consumers of natural gas in 2011 were CHP and heat supply enterprises of the JSC "Latvenergo" – 66.5%, manufacturing – 13.5%, other consumers – 17.3%. Riga region consumes about 70% of natural gas utilised 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 the LLC "Itera Latvija" which is controlled by the 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 July 13, 2009 concerning common rules for the internal market in natural gas and repealing *Directive 2003/55/EC.* A part of the requirements for regulation of natural gas market of the European Union under this and previous directive it repeals (*Directive 2003/73/EC*) are currently being transposed into the *Energy Law. Directive 2003/73/EC,* considering the situation in Latvian natural gas market with only one supplier of natural gas and no competition at all, moreover, according to the privatisation agreement of the JSC "Latvijas Gāze" no access to natural gas supply infrastructure can be granted to any third party until 2017, as well as considering that under the abovementioned *directive 2003/73/EC*, the Latvian natural gas market falls into the category "new market", which has performed its first gas supply under the long-term contract less than 10 years ago, Latvia is a subject to the derogation from several requirements of the directive that are included also in the new directive of 2009. Therefore, the *Law on Procedure for Entering into Force of Some Sections of the Energy Law* stipulates that those requirements that Latvia has derogated from – unbundling of distribution system operators, separate accounts for natural gas transmission, distribution and storage in internal accounts, as well as third person access to transmission and distribution system and liquefied natural gas objects – shall be transposed by April 4, 2014.

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 discussed 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 results are going to be used in the final decision-making process.

Renewable energy resources

Latvia, similarly as 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 is one of 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.

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 transport and implement additional measures oriented towards development of public and private electric transport infrastructure, for example, electrification and private electric vehicle charging.

The criteria for sustainable biofuel and biological liquid fuel, implementation mechanism and supervision and its monitoring procedure in Latvia are regulated by the Cabinet of Ministers Regulation of July 5, 2011 *Regulations Regarding the Sustainability Criteria for Biofuels and Bioliquids, the Mechanism for their Introduction and the Procedure by which they Shall Be Supervised and Monitored.*

In 2011, elaboration of common criteria for **development of wind parks** has been launched to avoid uncontrolled establishment of offshore wind parks, thus significantly affecting the end tariff of electricity for consumers. Construction of offshore wind parks should be carried out in a planned and determined manner and in compliance with requirements of environmental protection, fishery, navigation and national defence, as well as interests of the population of Latvia.

Box 6.8

Renewable energy in Latvia

In 2011, the total share of renewable energy (RE) has increased by 0.6 percentage points in comparison with 2010, and constituted 33.1%, while the share of RE in producing electric energy increased by 2.7 percentage points reaching 44.7 per cent.

In 2011, the electricity production volume reached 6095 GWh, which is by 8% less than in 2010. 50.5% (3078 GWh) of total produced electricity volume was generated from renewable energy (HPPs, wind, biogas, biomass, etc.). While total installed capacity for electricity production from renewable energy in 2011 increased by 20 MW, constituting 1642 MW in comparison with 2010.

The share of RE in transport increased in 2011 mainly due to the introduction of the mandatory 5% biofuel addition to fossil fuel reaching the share of 4.8%. Contribution of electricity produced from renewable energy sources to transport was small in 2011: a total of 1.2 million tons of fuel have been sold and used for own consumption in Latvia in 2011, including pure biofuel or mixture of fossil fuel and biofuel – 50.4 thousand tons. In 2010, the final energy consumption consisted of bioethanol – 350 TJ and biodiesel fuel – 787 TJ, experiencing an increase in 2011 (bioethanol – 318 TJ and biodiesel fuel – 1432 TJ).

In 2001, the share of biofuels in the final energy consumption in the transport sector was 4%. It has increased by 1.4 percentage points in comparison with 2010.

According to the amendments to the *Regulations of the Cabinet of Ministers of March 16, 2010 Regulations Regarding the Production of Electricity Using Renewable Energy Resources and the Procedures for the Determination of the Price* (approved by the CoM on August 28, 2012), the Ministry of Economics shall organize no tender for the right to sell electricity produced in biomass, biogas, sun or wind power plants within public procurement until January 1, 2016, while the producer shall not be qualified to sell electricity within public procurement and obtain the right to receive guaranteed payment for the installed energy production capacity, and therefore no tender for the to sell electricity produced from renewable energy resources within public procurement was organized in 2012.

According to *Regulations Regarding Electricity Production and Price Determination Upon Production of Electricity in Cogeneration,* 316 decisions on granting the right to sell electricity produced in a cogeneration power plant within the mandatory procurement for power plants with the total installed electric capacity of 475.82 MW and the total volume of electricity of 3713477.794 MW were issued in 2012 including:

– on the use of biogas as fuel – 128 decisions (163.449 MW/ 1270600.874 MWh);
– biomass – 188 decisions (312.371 MW/ 2442876.92 MWh).

According to the amendments to the *Regulations No 221 of the Cabinet of Ministers of March 16, 2009 Regulations Regarding Electricity Production and Price Determination Upon Production of Electricity in Cogeneration* (approved by the CoM on August 28, 2012) granting of the right to sell electricity produced in an cogeneration power plant has been suspended until January 1, 2016.

Energy efficiency

The Energy Efficiency Monitoring Report for 2010–2011 has been developed in accordance with the requirements of Section 11 of the *Procedures by Which State Energy End-use Savings Shall Be Measured and the Operation of the Energy Efficiency Monitoring System Shall Be Ensured*. The results show that services and manufacturing sectors have failed to achieve significant energy savings, while the household sector has achieved considerable energy savings (935 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. The energy efficiency monitoring is aimed at summarizing and systemizing information about all state supported measures to improve energy efficiency and their results, including also other information related to improvement of energy efficiency.

The *Directive 2012/27/EU* of the European Parliament and of the council of October 25, 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, involved 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. 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

The European Commission 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 European Commission 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 European Commission 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 *NordBalt project*. The European Commission 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 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 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 Resources*** 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. Regulatory framework for building contractors is just as important as access to an adequate infrastructure and support.

The Saeima continues considering and has conceptually approved the first reading of the new ***Construction Law*** that the 10th Saeima did not manage to review, the law 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 second 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 according to which 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 quality living-space;
- The principle of engineering quality according to which 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 according to which the construction process creates the quality aspect of living environment for 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 according to which such environment is created in the construction process that is suitable for people to get around conveniently and use the buildings according to their function.

On July 31, 2012, the European Commission published the *Strategy for the sustainable competitiveness of the construction sector and its enterprises*. It identifies the main challenges that the sector faces today and up to 2020 in terms of investment, human capital, environmental requirements, regulation and access to markets, and proposes initiatives to support the sector for this purpose. In the short term, emphasis is put on the need to support growth and employment in the construction sector in response to the crisis. In the long term, the challenges the industry faces will require a concerted and coordinated approach at the European level to improve the functioning of the value chain, particularly through voluntary partnerships between the private and public sector and a suitable regulatory framework, where necessary.

A number of issues discussed in the Strategy have also been defined as important during preparation of development documents of the Latvian construction sector, among them the *Guidelines for Development of Construction Sector* to be prepared by the Ministry of Economics laying down the basic policy principles, objectives and priorities for balanced development of the construction sector in the coming years. The launched initiatives for implementing energy efficiency of buildings, improving education quality of construction specialists, implementing *Eurocode Design Standards* and sustainable construction will be continued in the forthcoming years.

Box 6.9

Data characterising the construction sector

Data of the Central Statistical Bureau shows that in the 3rd quarter of 2012 the construction production volumes (in current prices) were LVL 354.5 million, reaching a total of LVL 715.3 million in the nine months of 2012.

In the 3rd quarter of 2012, the construction production volume according to calendar adjusted data in comparable prices has increased by 8.3% compared to the 3rd quarter of 2011. Out of this, the construction of buildings has increased by 6.2%, while construction of civil engineering structures has increased by 9.6 per cent.

In the nine months of 2012, the construction production volumes according to the calendar adjusted data in comparable prices have increased by 17.8% compared to the nine months of 2011. Out of this, the construction of buildings has increased by 14.3%, construction of civil engineering structures – by 19.4 per cent.

The most considerable increase in construction and repair works has been observed in construction of administrative buildings, as well as street and road construction – by 60.9% and 21.8%, respectively, compared to the same period of the previous year. Construction volumes have shrunk in construction of bridges and tunnels and construction of main pipelines and cable lines – by 57.1% and 38.1%, respectively.

In the 3rd quarter of 2012, building authorities have issued 333 construction permits construction of single-apartment buildings of the total area of 76.4 thousand m^2 (in the 3rd quarter of 2011 – 382 and 82.9 thousand m^2, respectively); whereas for construction of industrial buildings and warehouses of the total area of 54.5 thousand m2 58 construction permits have been issued (in the 3rd quarter of 2011 – 51 construction permits and 94.6 thousand m^2).

In the 3rd quarter of 2012, the volume of construction work (in current prices) performed by Latvian builders abroad was LV 18.7 million, if compared with the 3rd quarter of 2011 (LVL 21.2 million), the volume of performed construction works has decreased by LVL 2.5 million or 12%. However, in the 3rd quarter of 2012, foreign builders in Latvia have performed construction works in the amount of LVL 3.6 million, which is by LVL 0.6 million or 20% more than in the 3rd quarter of 2011 (LVL 3 million).

In the 3rd quarter of 2012, the construction costs have increased on average by 8.5% compared to the 3rd quarter of 2011. Wages of workers have increase by 21.1%, while the costs for machinery and machines' maintenance and use increased by 11.1% and the costs for construction materials – by 2.1 per cent.

In 2012, several **changes have been introduced in normative acts regulating the construction sector**, and proposals have been submitted for improving the public procurement system.

The prepared amendments to the Latvian Construction Standard LBN 211-08 *Multi-Storey Multi-Apartment Residential Buildings* (CoM Regulations No 231 of April 3, 2012) prescribe detailed standards arising out of the Latvian Construction Standard LBN 201-10 *Fire Safety of Buildings* (CoM Regulations No 498 of June 28, 2011), and room insulation requirements stipulating that the insulation applies to residential premises alone instead of the entire apartment. Yet, in order to improve availability of housing environment and ensure free access to a building for any person, further on construction of new buildings must meet accessibility requirements for the entrance block of a building, access to the first floor or elevator of a building irrespective of the funding source of construction.

Along with new construction materials entering the market, there is a need to increase market supervision as well. In order to make the supervision process easier and more transparent, Regulations of the Cabinet of

Ministers of April 30, 2001 *Procedures for the Conformity Assessment of Construction Products in the Regulated Sphere* was amended by clarifying the application of national standards of other EU Member States regarding conformity of construction materials and clearly defining the circulation of documentation regarding conformity of construction materials.

In order to improve the business environment and promote fair competition within the public procurement system for construction, as well as to provide equal conditions for tender applicants, the Ministry of Economics in cooperation with the Procurement Monitoring Bureau and non-governmental organizations has developed proposals for criteria of evaluating construction tenders to select the economically most beneficial ones. The proposals contain recommendations intended for the state and local government public procurement commission in applicant selection and evaluation of tenders. The proposals recommend evaluating experience of applicants in implementing relevant scale projects during the applicant selection, as well as lawfulness of previous activities to eliminate violations of legal nature. As regards selection of the economically most beneficial tender, the proposals provide such criteria as deadline, guarantee terms, energy efficiency and environmental impact, thus limiting the share of the criterion "proposed price" in evaluating the tender.

As regards the **housing policy**, the development of *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 permanently to 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 the 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.

The Ministry of Economics has developed and submitted to the Cabinet of Ministers a draft informative report on heat supply services in 2012. Despite the rise in tariffs and thus increased payments compared with the previous heating season, an improvement in discipline of paying invoices made out during the heating season of 2011/2012, i.e. 91.1% of the issued invoices for heating services have been paid in the major cities, while 83.6% – in local governments. For comparison, in the previous heating season 89.7% of the issued invoices for heating services were paid in the major cities and 78.5% – in local governments.

In order to promote competiveness in the residential building management market and quality management of residential buildings, as of January 1, 2012, the Ministry of Economics has developed and operates the **Register of Residential Building Managers**

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. Records from the manager register regarding services offered by a manager, service territory, qualification of the manager or his/her personnel and practical working experience in management of residential buildings is published on the website of the Ministry of Economics, moreover, the register contains a reference to the rights of a manager to offer management services in the market depending on the obtained professional qualification and practical working experience in management of residential buildings.

On November 22, 2012, in the second reading, the Saeima approved the draft ***Law on the Energy Performance of Buildings***. The draft law is mainly based on effective regulation defined in the *Law on the Energy Performance of Buildings* by adding the updates introduced to the revised *Directive 2010/31/EU* 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 to issue an additional CoM regulations regarding methodology for calculating the energy performance of buildings, the procedure for energy certification of buildings, samples of energy certificate of buildings and temporary energy certificate of buildings, registration procedure, benchmarking system of energy efficiency of buildings, classification system of energy efficiency of buildings, requirements for energy performance and requirements for use of high efficiency systems in nearly zero-energy buildings, procedure for inspecting and deadlines for heating systems with the effective rated output of boilers exceeding 20 kW, and air-conditioning systems with the effective rated output over 12 kW and requirements for competence of an independent expert and the procedure for confirming the competence, the procedure for registration and supervision of independent expert, as well as the procedure for the content and use of the data stored in the register of independent experts.

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. At the moment, the informative report is being harmonized and later it will be forwarded to the CoM for consideration.

In 2012, implementation continued 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 this activity in April 2009 until November 30, 2012, 1140 project applications have been considered, 134 of which have been completed; contracts on implementation of 502 projects have been concluded with the IDAL. 58 project applications have been approved (to be launched after signing the contract), while 48 project applications are under evaluation.

Upon analysing the number of submitted projects by regions, it can be concluded that the most active region is Kurzeme with 311 submitted projects, followed by Vidzeme region with 266 project applications. Two regions have maintained medium activity – Zemgale region has submitted 186 project applications, while Riga region – 221 project applications. The lowest number of projects has been submitted from Latgale – 49 project applications. Considering the large number of population and housing, the activity in Riga city with 96 submitted projects is still rather low.

The total funding available within the activity is LVL 62.75 million. As of November 30, 2012, LVL 45.59 million (73%) have been distributed or reserved, the remaining available amount is LVL 17.16 million (27%).

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 significant energy performance of multi-apartment residential buildings. Moreover the housing facilities are improved 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 40 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; its main goal is to improve competiveness of tourism products and services in the medium term, stimulating changes in the structure of demand and supply.

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 now is a uniting idea and a common element for public and private sector products and marketing development activities.

In order to promote development of tourism sector, the following economic objectives have been set for the time period to 2015:

– increasing the share of foreign tourists staying 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.

In order to ensure constant involvement of sectoral partners in implementation of the tourism policy, the Latvian Tourism Advisory Council has been established and continues its activity, and the Advisory Council of Latvian Tourism Development Agency (LTDA) 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 also is working actively.

Box 6.10

Tourism development indicators

According to the data of the UN World Tourism Organization there were a record number of international arrivals in the first half of 2012 – 467 million. Despite the concerns about global economy, tourism has managed to keep its status of being one of the most flexible economy sectors. In January-June 2012, the number of tourists around the globe has grown by 5%, compared to the corresponding period of 2011. International arrivals are expected to exceed one billion by late 2012.

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 2011, the number of border crossings by foreign tourists in Latvia reached 5.54 million, which is by 9.9% more than in 2010. Comparing to 2010, the average duration of visits of tourists in Latvia has increased to 1.3 days. At the same time the average expenses of one tourist per day have slightly decreased – in 2011 it was LVL 53. Despite the decrease, the total expenses of foreign tourists in Latvia have increased to LVL 379.5 million.

In 2011, the tourism balance of payments has improved, though it is still negative. The total expenses of Latvian tourists abroad in 2010 have exceeded the expenses of foreign tourists in Latvia by LVL 23.1 million.

At the end of 2011, there were 641 tourism campsites in Latvia, which is by 13 more than at the end of 2010. At the same time, also the number of persons served in hotels and other tourist campsites in 2011 has increased by 21 per cent.

Support measures

The key priorities of the LTDA which is subordinated to the Ministry of Economics is related to tourism marketing in local and foreign market, development of tourism products and local tourism development of Latvian tourism service quality system and improvement of service quality provided by tourism service providers, 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 the remote markets (see Box 6.11).

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:

- organising 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 2012, the total amount of funding (state budget funding and the ERDF co-funding, as well as funding for implementation of projects *AGORA 2.0* and *EDEN VI*) for tourism marketing is LVL 1.5 million.

Box 6.11

Activities of the LTDA in 2012

For the purpose of implementing the tourism policy, the LTDA carried out the following activities in 2012:

- Maintained and developed Latvian tourism portal *www.latvia.travel*, as well as developed mobile applications of *www.latvia.travel* for Iphone and Android smart phones.
- Organized a range of measures in tourism forum *Russian focus* (round table discussion and introductory visit of sports infrastructure for Russian representatives) during the international travel trade fair ***Balttour 2012.***
- Organized 25 foreign journalist visits from Germany, Finland, Sweden, Lithuania, Estonia, the Netherlands, Italy, Ukraine, Russia, United Kingdom, and the United Arab Emirates.

Box 6.11 continued

- Organized 5 foreign tourism operator visits from Russia and Germany.
- Ensured single online statistical data management and analysis system for tourism information centres and conducted foreign tourist survey by inquiring over 3000 foreign tourists all over Latvia.
- Introduced the Latvian tourism service quality system *Q-Latvia* by granting quality labels to 30 tourism enterprises.
- Implemented information and education measures for local society about tourism in cooperation with Latvian mass media - newspaper "Dienas Bizness", Radio Latvia 1 and Radio Latvia 4.
- Organized 12 training and development measures of tourism products.
- Organizes 3 LTDA information days for professionals of the sector about the latest projects and cooperation in the sector.
- Implemented competition *Best tourism product 2012*, awarding the best products in three categories: culture tourism, nature tourism and health tourism.
- Launched local tourism promotion campaign *Rediscover Latvia (Atklāj Latviju no jauna.*)
- Implemented international cooperation and representation of national interests by ensuring participation in the Joint Tourism Committee of the Baltic States and the Baltic Marketing council and the European Travel Commission.
- Implemented marketing activities in the Japanese market – organized a Latvian stand in the exhibition *JATA 2012*, organized three information seminars about Latvia, 1 tourism operator visit and 3 journalist visits from Japan to Latvia.
- Implemented joint activities of the Baltic States in foreign markets – according to the *Baltic Marketing Plan for 2012* in cooperation with Estonian tourism organization the Baltic tourism maps have been issued and the Baltic press conference has been organized within the exhibition *ITB 2012* in Berlin. Organized Chinese journalist and tourism operator visits to the Baltic States.
- Implemented promotion measures of high added value and specialized tourism products aimed at promoting medicine and health tourism in Russia, Finland, and Sweden.
- Organized participation in 7 international tourism exhibitions in Finland. Estonia, Lithuania, Germany, Russia, Sweden, and the United Kingdom.
- Issued 10 types of tourism information materials in 8 languages.
- Implemented measures for promoting Latvian tourism brand, issued brochure about the greatest events in Latvia, developed a micro-page for displaying tourism information materials – video, interactive presentations and electronic brochures on data storage devices. A total of 52 tourism information stands have been placed on category A roads in Latvia.
- Implemented advertising campaigns in high priority tourism markets – Germany, Russia, Sweden, Finland, Lithuania and Estonia.
- Issued monthly electronic tourism newsletter *www.greetingsfromlatvia.lv* and sent to 12 500 subscribers on a regular basis.
- Organized an introductory visit for foreign tourism operators to Latvia within the international tourism business workshop *BalticConnecting 2012*.
- Implemented marketing activities for professional audience and consumers in Finland. Sweden, Russia, and Germany.
- Implemented the cross-border cooperation project of the European Union *Agora 2.0*, involving partners for the Baltic Sea Region countries and the project *European Destinations of Excellence VI* (*EDEN VI*).
- Ensured participation in about 100 different sectoral cooperation measures in Latvia.

Improvement of the legal framework

The *By-law of the Latvian Tourism Development Agency* will come into force as of 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.

For the purpose of improving exportability of Latvian health tourism services, the Ministry of Economics continues developing the legal framework for resorts. The draft regulations of the Cabinet *Procedure for Granting and Annulling the Resort Status* have been developed in cooperation with representatives from the Latvian Resorts Association, the Latvian Balneology Association, the Latvian Association of Local and Regional Governments, the Ministry of Environmental Protection and Regional Development, the Ministry of Health, the State Environmental Service and the Nature Conservation Agency.

The amendments to the *Tourism Law* came into force on July 19, 2012 that among other things specify the liability of tourism agents for offering and sale of complex tourism service envisaging that tourism agents are allowed to offer of sell only complex tourism services that have been secured by a guarantees of paid customer's money.

The *Amendments to the Cabinet Regulations No. 353 of April 13, 2010 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* have been prepared 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 tourism agent and operator activity in the *Database of Tourism Agents and Tourism Operators*.

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.go.lv*. Overall, 508 entrepreneurs were registered in the database by November 30, 2012, 37 of them were registered as tourism operators, 133 – as tourism agents and operators, but 338 – as tourism agents.

International cooperation in the field of tourism

Latvia develops 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 promotion of cooperation in the field of tourism are regularly included on the agenda of foreign visits of intergovernmental commissions and chief state officials, marketing activities are being actively implemented in the high priority target markets.

Since 2005, Latvia is also a full member of the United Nations World Tourism Organization (UNWTO). However, having analysed benefits from being a member of the UNWTO and the amount of annual membership fee, it was concluded that further participation in the organization no longer is a critical factor for Latvia to implement the set objectives and tasks for the development of tourism sector. On May 31, 2012 the Law *On Denouncement of the Statutes of the World Tourism Organization* came into force denouncing the UNWTO statutes. The Law on Statutes of the World Tourism Organization ceased to be valid at the same time. Considering the abovementioned, documents concerning withdrawing of Latvia from the UNWTO and denouncing its statutes was submitted to the UNWTO depository. The UNWTO depository has confirmed the withdrawal of Latvia from the UNWTO as of December 22, 2012. It should be noted that after withdrawing from this organization, Latvia will still be able to continue cooperation with the UNWTO through cooperation mechanisms offered by the European Union.

Representation of Latvian interests in the tourism sector at 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.

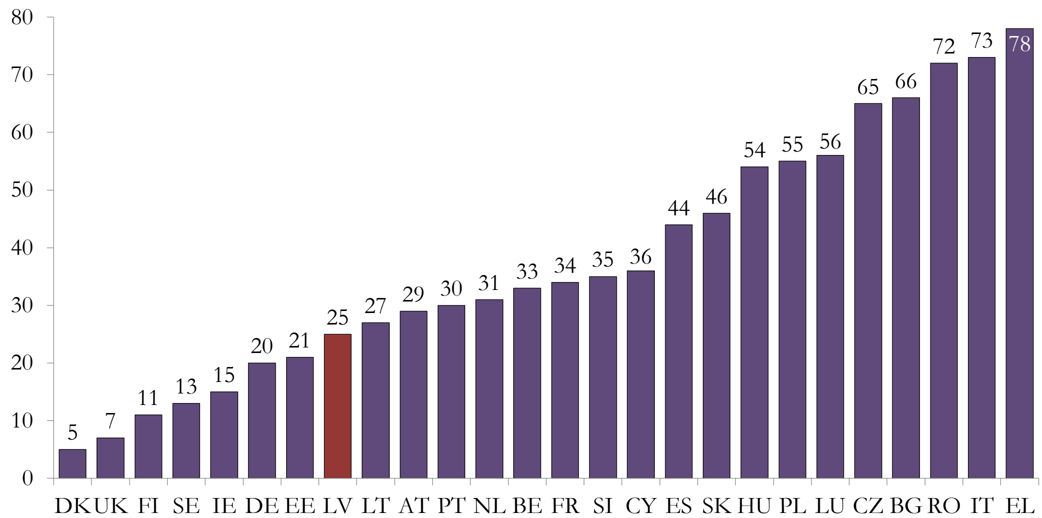
6.7. Improvement of Business Environment

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 6.8

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 research 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 6.4

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

* Every year, the data of the preceding year are recalculated according to latest methodology prior to publishing the new *Doing Business* rating.

According to the research *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 Plan 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 29, 2012, the website *www.latvija.lv* offers an option to submit an application for registering a new enterprise at the Register of Enterprises electronically, as well as to notify changes, reorganization, insolvency, liquidation and termination of a contract for registration. The application for registration can be submitted using a secure e-signature issued in Latvia (online bank, eID card, electronic signature smart card eME). Thus Latvia has significantly simplified the procedure for starting a business by reducing the time and costs needed for entrepreneurs to start a business. In addition, a differentiated (reduced) state fee is expected to be defined for an applicant, who submits applications to the Register of Enterprises electronically using the special online form under its supervision and expressing a wish to receive the decision of public notary using the special online form or by electronic mail using a secure electronic signature. The relevant draft laws and regulations on defining the reduced state fee are expected to enter into force as of April 1, 2013.

In addition, the new *Law on Added Value Tax* (VAT) will enter 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). The meeting of the Cabinet of Ministers on July 10, 2012 approved the draft laws and regulations envisaging continued application of a relief to microenterprises for making entries regarding increase in the share capital in the Commercial Register – in the amount of 50% of reduced fee.

In **Construction process** – adoption of the new *Construction Law* in urgent envisaging reduced number of procedures for obtaining construction permits, simplified harmonization procedures, remove public discussions, as well as exclude a possibility to suspend construction at late stage of its implementation. Adoption of the *Construction Law* in 2014 would ensure a significant rise in the rank of Latvia in the area of construction in the *Doing Business* research. The *Draft Construction Law* is currently being considered by the Saeima in the 2nd reading. As soon as the 2nd reading of the *Draft Construction Law* is approved, the amendments to the Cabinet regulations related to the draft Construction Law are expected to be developed to ensure complete improvement of construction process, as well as to start operating the Construction information system.

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.

Registering property – on May 31, 2012, the meeting of State Secretaries announced amendments to the *Immovable Property State Cadastre Law, the Land Register Law and the Law On Recording of Immovable Property* to introduce the one stop shop principle to registration of property data and corroboration of the title. According to the decision made by the Committee of the Cabinet of Ministers on November 26, 2012 the draft law is currently being harmonised with the Latvian Association of Local and Regional Governments. The draft law is expected to be considered by the Cabinet of Ministers until April 1, 2013.

Paying taxes – since October 1, 2012, entrepreneurs having tax debt on September 1, 2011 which has not been paid by October 1, 2012 are entitled to preferential tax payment. Under the *Law on Tax Support Measure*, taxpayers have an opportunity to apply for the Tax Support Measure. The *Law on Tax Support Measure* envisages cancellation of late payment fees and 90% of penalty provided that the taxpayer shall pay the main tax debt and related penalty in the amount of 10% by a certain date. The new *VAT Law* is going to enter into force on January 1, 2013 and sets 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 – developed amendments to the Civil Procedure Law envisaging a special procedure for legal proceedings concerning declaring decisions of members (shareholders) of capital companies null and void, as well as a special procedure for legal proceedings at first instance and cassation courts – district (city) court. At the same time, amendments to the *Commercial Law, the Civil Procedure Law and the Law on Combating Raiderism of the Register of Enterprises* have been developed. On September 13, 2012 the given draft laws were approved by the Saeima in the 2nd reading.

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, thus significantly simplifying for entrepreneurs to deal with administrative procedures and reducing costs, as well as providing transparency of payments made by entrepreneurs to the state budget.

Information on the progress of the Action Plan to Improve Business Environment in 2012 is available on the website of the Ministry of Economic: *http://www.em.gov.lv/em/2nd/?cat=30209*.

Continuing improving business environment, in late 2012, the Ministry of Economics in cooperation with organizations representing entrepreneurs and line ministries was working on preparation of the draft plan for 2013. The draft plan for 2013 is expected to be submitted to the Cabinet of Ministers for approval by February 15, 2013.

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 6.12

The number of small and medium-sized enterprises in Latvia

According to the information of the CSB, 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 characteristic. 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.

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. While till December 11, 2012, 17 780 subjects were registered and 4078 subjects were excluded from the registers of the Register of Enterprises.

Box 6.12 continued

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;
- total sum of annual balance is under 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 6.13

Activities of the EU in promoting entrepreneurship

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.

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.

In order to provide exchange of experience and new knowledge for further business development to potential and existing enterprises, conferences, regional and thematic seminars on such issues as protection of intellectual property rights, internet marketing strategy, collaboration of sectors, intercultural communication, 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 entrepreneur skills, thus increasing the share of entrepreneurs in the total number of working population. The Concept is being successfully implemented.

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. According to the data of the Register of Enterprises, 41056 limited liability companies were registered within the time period from May 1, 2010 until December 10, 2012, 67% or 27 349 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. A total of 24 483 micro-enterprise tax payers were registered at the State Revenue Service from September 1, 2010 until October 31, 2012 (including, out of which 16 698 micro limited liability companies). These micro enterprises are subject to simplified SRS formalities (declarations 4 times a year), and they also have an opportunity to use free-of-charge accounting software – about 4000 enterprises have used the offered opportunity from September 1, 2010 until December 1, 2012.

In order to prevent tax optimisation schemes allowed by the *Micro-enterprise Tax Law* that are mainly related to transforming employment contracts into staff secondment services, thus subjecting the employees to a rather unfavourable position, amendments to the *Law on Personal Income Tax* came into force on January 1, 2012, envisaging that in case such micro-enterprise services comply to certain criteria, they shall be deemed as staff secondment and thus imposing an obligation on the party seconding the personnel to apply the personal income tax and the mandatory state social insurance contributions from the income of the personnel on loan in accordance with the general procedure.

As of January 1, 2010, in compliance with Cabinet Regulations No 1646 of December 22, 2009, **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 specific profession (mainly for craft services). Relevant social guarantees are ensured to all payers of the patent fee. A total of 4500 applications for patent fees have been submitted to the State Revenue Service from January 1, 2010 until December 10, 2012. The number of the patent fee payers on average is 210 patent fee payers per month. Typically patent fee payers are persons performing such economic activity as gathering gifts of the nature – berries, mushrooms, wild herbs, photographers, hair stylists, nail care specialists, dressmakers.

In continuation of simplifying the legal framework and ensuring transparency thereof regarding small enterprises, on September 24, 2012, the Cabinet of Ministers conceptually supported the concept *On Consolidation and Simplification of Small Enterprise Taxpaying System*, developed as a part of the *Action Plan for Combating the Shadow Economy and Ensuring Fair Competition for 2010–2013*. 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 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;
- introducing general anti-evasion rules in the *Law on Taxes and Fees* by applying the given rule to general regimes and simplified regimes;
- 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;
- simplifying the procedure for termination of economic activity under the legislation;
- reviewing the requirements applied to the small economic operators for organising accounting;
- creating a special section on the SRS website for persons planning to start an economic activity and providing a link to this section on website of the Register of Enterprises, the State Employment Agency and other websites;
- 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 informative report *On Practical Implementation of the Micro-enterprise Tax Law and Results Thereof* annually until September 1, 2020 and include 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 ***Development of Business Incubators in Latvia***[1] co-financed by the European Regional Development Fund.

The aim of the project is to foster establishment and development of new, viable, and competitive micro, small, and medium-sized enterprises in the regions of Latvia by ensuring the environment and consultancy services necessary for business activity.

Currently, the following business incubators are operating in Latvia:

- Ventspils High Technology Park located in Ventspils and Talsi;
- Kurzeme Business Incubator located in Liepāja, Saldus, and Kuldīga;
- JIC Business Incubator located in Jelgava and Dobele;
- JIC Business Incubator located in Aizkraukle and Jēkabpils;
- Valmiera Business Incubator located in Valmiera, Gulbene, and Valka (provides virtual incubation services);
- Business Incubator "Cēsis" – Magnus located in Cēsis, Madona, and Alūksne (provides virtual incubation services);
- Latgale Machinery Technology Centre located in Rēzekne, Balvi, and Ludza (provides virtual incubation services);
- Latgale Machinery Technology Centre located in Daugavpils and Līvāni;
- Riga Region Business Development Incubator located in Ogre, Limbaži, and Tukums;
- Creative Industry Incubator "HUB – Riga" located in Riga, Andrejosta.

In the 3rd quarter of 2012, 513 micro-, small, and medium-sized enterprises (including 104 enterprises have received virtual incubation services) providing (maintaining) 1251 jobs have received services at business incubators. According to the provisions of the project *Development of Business Incubators in Latvia,* the IDAL will support micro, small, and medium-sized enterprises until October 31, 2014. In the three quarters of 2012, a total of LVL 1.6 million has been used for providing the support services of business incubators within the programme, while the total available funding within the programme until the end of 2014 is LVL 20.2 million.

A programme providing complex support to business start-ups and new enterprises has been launched since 2009. The programme ***Supporting self-employment and entrepreneurship*** (see Box on the Mortgage and Land Bank of Latvia) is implemented at the Mortgage and Land Bank of Latvia.

Providing access for enterprises to financing

The Mortgage and Land Bank of Latvia (the Mortgage Bank), which is 100% state-owned bank and performs the functions characteristic for a development bank.

In 2012, the Mortgage Bank implemented 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 by means of the amount of credit 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 5 million) and current assets loans (up to LVL 2.5 million) are granted, with the maximum loan amount per one enterprise not exceeding LVL 7.5 million. The loans are mainly intended for implementing projects of enterprises operating in the processing sector and for enterprises attracting funding of the EU Structural Funds grant programmes.

[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 6.14

<u>Transformation of the Mortgage Bank into a Development Bank</u>

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.

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 "Swedbank līzings" purchased LLC "Hipolīzings". "SEB Wealth Management", in its turn, purchased the management package of the 2nd level pension plans. Potential investors are negotiating on the remaining two packages – a package containing loans granted to real estate developers and a package consisting of *bad* asset development company LLC "HipoNIA". These packages are expected to be sold in the 1st quarter of 2013.

On November 26, 2012, the data of the commercial customers were successfully transferred to Swedbank, thus these customers are now serviced by Swedbank. Overall, the Mortgage Bank has transferred customer deposits or commitments in the amount of LVL 147.7 million to Swedbank, moreover 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 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 servicing 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.

On October 2, 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 one, 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. After assessing legal aspects, a detailed plan for establishing single DFI is planned to be prepared by March 2013, while the single DFI will be established by the end of 2013.

It is envisaged that until December 2013 the Mortgage Bank will grant loans for improvement of enterprise competitiveness in the amount of LVL 210 million[1]. Since the launching of the Support Programme on Improvement of Competitiveness of the Enterprises until the end of November 2012, 395 loans have been granted in the amount of LVL 169.4 million, among which loans in the amount of LVL 116.4 million have already been issued. 82 loans in the amount of LVL 79.8 million were granted from the part of the programme funded by the ERDF including granted loans in the amount of LVL 42.6 million[2]. The sectors receiving the most funding are timber processing, electrical power industry, production of pharmaceutical products, and food production.

The programme *<u>Support for Self-employment and Business Start-ups</u>* 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. Within the meaning 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 –

[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 November 29, 2011.

[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).

for grants, trainings, 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 3147 interested entrepreneurs have been concluded, 1657 clients have submitted business plans, including 857 start-up projects that have already been supported for the total loan amount of LVL 9.9 million. In cases of 802 projects, also grants have been awarded for the total amount of LVL 3.4 million.

Since January 2010, in 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[1]. 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. So far, 1624 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 November 2012, 663 loans in the amount of LVL 31.2 million have been granted, including the loans in the amount of LVL 26.9 million that have already 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 1 year, 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. So far, 741 loans in the amount of LVL 23.9 million, including loans for LVL 23.4 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 4.7 million[2], including LVL 4.3 million that are earmarked for micro-loans, investments and liquid assets of up to LVL 10 thousand, as well as LVL 400 thousand – for grants to repay the loans[3]. The programme will function until June 2015 when up to 650 micro-enterprises are expected to receive funding within the framework of the programme. So far, micro-loans have been granted to 546 micro-enterprises in the amount of LVL 3.2 million including granted loans in the amount of LVL 2.8 million.

In May 2012, the Cabinet of Ministers approved the regulations of the *Crediting Programme for Purchasing Agricultural Land*. Up to LVL 100 thousands 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

[1] Training in Riga region is provided by association of companies "Accounting and Finance College" and "Business Complex"; in Vidzeme and Latgale regions – association of LLC "Education and Consultation Centre ABC" and SIA "Mensarius"; in Kurzeme un Zemgale regions – LLC "Stockholm School of Economics in Riga".

[2] 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.

[3] 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.

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 a total of 46 loans in the amount of LVL 1.9 million have been granted so far.

SIA "Latvian Guarantee Agency" (LGA) is a state-owned capital company aiming to promote access to funding for enterprises registered in Latvia. Currently, LGA offers seven 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.

A number of instruments are being developed at the moment.

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 <u>*Guarantees for improving enterprise competitiveness*</u>. At the moment the ERDF financing available within the activity is LVL 20 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 <u>*Loan Guarantee Programme*</u> since launching the activity until September 30, 2012:

- the number of applications – 1386 applications from 425 enterprises;
- the amount applied for – LVL 254.7 million;
- the number of issued guarantees – 292 guarantees for 196 enterprises;
- the amount of issued guarantees – LVL 73.5 million;
- the amount of guaranteed credits – LVL 168.7 million.

In May 2009, the Cabinet of Ministers adopted regulations *On Short-term Export Credit* establishing coverage and beneficiaries of <u>short-term export credit guarantees</u>, 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 in another currency. The deadline of the deferred payment may not exceed 2 years.

Guarantees issued within the framework of the Export Loan Guarantee Programme since launching the activity until November 28, 2012:

- the number of applications – 187 applications from 54 enterprises;
- the number of issued guarantees – 100 guarantees to 30 enterprises;
- the amount of issued guarantees – LVL 6.3 million.

All enterprises which signed the agreement represent the manufacturing industry (for example, manufacture of communication equipment, manufacture of consumer electronics, manufacture of veneer sheets and wood-based panels, manufacture of soap and detergents, cleaning and polishing preparations, manufacture of food products, etc.). In the breakdown by countries, most of the guarantees are issued for the CIS country markets – Russia (49%) and Belarus (17%), as well as such countries as Nigeria (8%), Kazakhstan (7%), Germany (6%), Ukraine (3%), Azerbaijan (3%) and others.

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 minimum 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 September 30, 2012, 1 mezzanine loan has been granted in the amount of LVL 700 thousand and 5 applications for mezzanine loans have been submitted. Mezzanine loans are 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 related to establishing a new enterprise, expanding an existing one, diversifying production with new additional products or introducing a significant change in the general 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 (Holding Fund)* was taken over from the European Investment Fund.

By September 30, 2012, 36 loan contracts in the amount of LVL 11.8 million have been concluded within the framework of the *Holding Funds* loan instrument and 19 venture capital investment contracts of different stages in the amount of LVL 6.2 million have been concluded within the framework of venture capital instruments.

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 (refined EIF's previous instrument that was suspended in the second half of 2011) with the expected budget in the amount of EUR 30-40 million, a microloan fund with expected budget in the amount of EUR 5 million and a seed capital fund with expected budget in the amount of EUR 1-2 million for supporting those who complete acceleration programme. In 2012, these financial instruments were developed and launched for growth capital funds, while implementation for all of the three new instruments is expected to be finished and practical operation launched in 2013.

On May 29, 2012 the Cabinet of Ministers approved implementation of a new venture capital state support programme – the Growth Capital Fund 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.

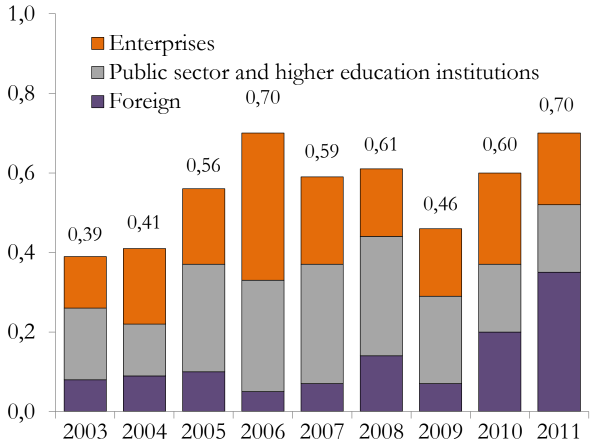
The Growth capital funds will invest in micro-, small- and medium-sized enterprises operating in Latvia. An enterprise will be able to receive investments up to LVL 1 million to provide financing for pre-investigation, assessment and development of a product or a business idea concept, development of products, growth and expanding the activity by increasing production capacity, developing sales markets and products. Growth capital funds will invest in enterprises with high growth potential. 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).

6.9. Innovation and New Technologies

The total financing for research and development in Latvia in 2011 was 0.7% of GDP or LVL 99.4 million which is by 22.5% more than in 2010 (LVL 77 million). Analysis of the investment structure and dynamics in research and development leads to a conclusion that investments in 2011 have increased the most for foreign financing, including the EU structural funds financing – by 49.3% which is by 0.35% of GDP or LVL 50.7 million (in 2010 – 0.2% of GDP or LVL 25.7 million). In 2011, a significant decrease has been observed in private sector investments in research and development activities, which in actual figures decreased by 17.4%, constituting LVL 24.7 million (in 2010 – LVL 29.9 million) or 0.18% of GDP.

Figure 6.9

Funding for research and development for 2003-2011
(% of GDP)



It should be noted that Latvia's indicators in the area of investments in research and development are still behind the objective set in the *National Reform Programme of Latvia for the implementation of the "EU 2020" strategy* envisaging that the total investments in research and development constitute 1% of GDP in Latvia by 2015 (in 2020 – 1.5% of GDP).

According to the CSB data, within the time period from 2008-2010, about 29.9% of the enterprises in Latvia were innovative (within the survey period from 2006-2008 – 24.3%), while in the EU countries this indicator was on average 52%. It should also be highlighted that the turnover of enterprises actively operating in the field of investments constituted 54.5% of the total turnover of enterprises in 2010.

In 2012, just like in 2011 the key innovation activities were implemented according to the main directions for enhancing innovation system set in the *National Reform Programme of Latvia for the implementation of the "EU 2020" strategy*:

- developing scientific activity potential;
- establishing a long-term platform for cooperation between enterprises and scientists;
- supporting development of innovative enterprises.

In 2012, implementation of several measures were continued to develop **scientific activity potential** with an aim to increase the number of the employed in science and research, establish competitive scientific institutions with state-of-the-art materially-technical provision by consolidating the state scientific institutions and strengthening their infrastructure, encouraging involvement of human resources in science, and increasing competitiveness of scientists.

In 2012, the Ministry of Education and Science continued to support 5 *State research programmes* for cross-sectoral scientific research commissioned by the state within five priority scientific directions approved by the Cabinet of Ministers. Financing in the amount of LVL 4 million has been earmarked for implementation of the programmes in 2012. The annual conference aimed at assessing the results achieved within the State research programme in 2012 was held in November 2012. Implementation of existing state research programmes will be completed in 2013.

In order to improve scientific and research equipment, by developing proper infrastructure and ensuring state-of-the-art material-technical base for research activities in leading research centres of national importance, the Ministry of Education and Science continued to implement EU Structural Funds activity *Development of Science Infrastructure* in 2012. The activity was implemented in two selection stages with the total public co-funding in the amount of LVL 102.7 million. Since the late 2011, 9 projects are being implemented within the first selection stage; as a result, 9 research centres of national importance are going to be modernized and properly equipped thus covering 27 public scientific institutions. Scientific equipment was purchased and buildings and rooms were reconstructed within the projects in 2012. As a result of the second selection stage in 2012, 10 contracts have been signed with enterprises for LVL 45.2 million. The projects foresee development of research infrastructure that fosters development of research in the private sector and research service rendering to the private sector. A total of LVL 23.2 million has been paid for the purpose of improving scientific infrastructure since the launch of the projects until December 1, 2012.

In 2012, the Ministry of Education and Science continues implementing the EU Structural Funds activity *Support to Research and Development* thus supporting implementation of practical research projects in the state priority science directions. Overall, decisions on approval of 122 projects for the total EU funds financing in the amount of LVL 37.8 million have been adopted in the activity. So far, 155 world known publications have been issued and 12 international patents have been applied within the projects, while funding beneficiaries have received LVL 25.9 million since the launch of the projects.

Fostering long-term cooperation between enterprises and scientists

In order to enhance efforts to engage in joint projects oriented towards commercialization of research results, the main activities in 2012 have been implemented within the state support programmes *Competence Centres* and *Technology Transfer Contact Points*.

The key activity for cooperation between scientists and entrepreneurs aimed at carrying out joint large-scale industrial researches and developing new products and technologies is the state support programme *Competence Centres* co-funded by the EU structural funds. At the beginning of 2012, the conditions of the programme were revised in order to improve the procedures for research service procurements and conditions for cooperation between enterprises and the research sector. 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.

The activity of 8 *Technology Transfer Contact Points* at higher educational institutions were continued to support in 2012, namely, 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. Technology transfer contact points are structural units established by higher education institutions supporting and promoting the activity of knowledge and technology transfer, for example, identifying the results of commercially accomplished researches gained by higher education institutions and its institutes, gathering information on demand of entrepreneurs regarding research results, bearing responsibility for maintenance of external relations and provision of information about research activities and experience of organizations, as well as providing services of industrial property rights protection. The total EU structural funds financing available for the programme until 2013 constitutes LVL 1.7 million. As a result of activity of the eight Technology transfer contact points, in the three quarters of 2012, commercialization offers of 75 research projects were prepared, 16 patent applications were submitted in Latvia, as well as 26 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 thereof.

In September 2012, the IDAL signed contracts on implementation of 11 cluster projects within the *Cluster Programme* co-funded by the EU funds. Within the Cluster programme the EU structural funds co-funding is going to be granted to Latvian Timber construction cluster, Pharmacy and associated sector cluster, Latvian Information technology cluster, Metal industry cluster, Latvian Electrical engineering and electronics industry cluster, Space technology and service industry cluster, Food quality cluster, Clean technology cluster, Industrial energy efficiency cluster, Latvian sustainable tourism cluster and Gauja National Park tourism cluster. The Cluster Programme is aimed at promoting cooperation between mutually unrelated enterprises, research, educational and other institutions to improve competiveness of sectors and enterprises, export volumes, promote innovation and new products. The total financing available for the programme until 2015 constitutes LVL 3.4 million and it is expected to attract private financing over LVL 0.5 million. The Cluster Programme funded by the EU structural funds consequently originates from the cluster support activities funded from state budget resources and implemented by the Ministry of Economics in 2009–2011.

In 2012, the IDAL and the Ministry of Economics continued work in the high level working group of the *Transnational Leading Programme for Innovations, Clusters and SME Networks in the Baltic Sea Region (BSR Stars)* established within the *EU Baltic Sea Strategy*. BSR Stars is aimed at strengthening competitiveness and economic growth by fostering transnational linkages between specialized research and innovation nodes, leading to strategic innovation alliances – clusters and SME networks. Moreover, the IDAL is involved in implementation of the *StarDust project* developed within the BSR Stars programme that has been approved and financed from the funding available for the *Baltic Sea Region Programme 2007–2013* until 2014. The *StarDust project* aims at making the Baltic Sea region more attractive and competitive by fostering cooperation of research institutions, clusters and SME networks. The project has led to developing 5 international cluster pilot projects in the field of telecommunications (Latvian partner – Latvian IT cluster), water treatment technologies, design of comfortable living for elderly people (Latvian partner – Art Academy of Latvia), involving elderly people in social activities, logistics and water transport (Latvian partner – Latvian Logistics Association). As a partner in the *StarDust project*, the IDAL is responsible for identifying financing mechanisms for fostering transnational cooperation between enterprises, clusters and enterprise networks and developing joint projects.

Supporting development of innovative enterprises

In 2012, implementation of measures launched in previous years was continued and work on development of new programmes was continued to support investments in developing and introducing the new products in production, as well as support investments in developing new production plants and promote development of "green" technologies.

In 2012, IDAL continued providing financing to projects of enterprises 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. Within both programmes, 209 contracts for the total EU structural funds financing of LVL 38.9 million have been concluded, and 156 projects for LVL 19.8 million have been completed by December 1, 2012. The approved projects are expected to attract co-funding in the amount of LVL 74.4 million from the private sector.

In 2012, IDAL implemented the second selection stage of project applications in the *High Added Valued Investments Programme* for the total available EU structural funds financing of LVL 26 million. The second selection stage of project applications supported project applications submitted by 16 enterprises for the requested amount of LVL 31.4 million. At the same time, implementation of 22 projects was continued for the total financing of LVL 48.8 million approved within the first selection stage of project application that might attract additional financing in amount of LVL 78.8 million from the private sector. The programme aims at increasing the potential of Latvian production enterprises to invest in knowledge or technology-based projects, including attract 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.

On December 3, 2012 the IDAL started accepting projects within the *Development Programme of New Products and Technologies of Micro-, Small and Medium-Sized Enterprises*. The programme aims at promoting activities oriented towards developing innovations, new products or technologies and strengthening technology transfer competiveness of micro-, small- and medium-sized enterprises. The programme provides support for outsourcing of researches, protection of industrial property rights and certification of new product or technology. 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%. 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.

On August 20, 2012, the Ministry of Foreign Affairs of Norway approved the programme "*Green" Industry Innovation* under the Norwegian Financial Mechanism, and the Ministry of Economics in cooperation with the IDAL started working on the programme implementation. The programme is aimed at increasing competiveness of "green" enterprises by promoting environmentally friendly solutions in different sectors and developing "green" innovations and "green" business. A Technology Incubator is planned to be established within the framework of the programme as a cooperation platform for developing new innovative and technology-based ideas, products and technologies, including cooperation between scientific institutions and early-stage innovative enterprises. The programme also envisages an open call for project applications aimed at providing support to enterprises for purchasing equipment that help reducing waste and emissions and promote introducing environmentally friendly solutions in production process. The total financing of the programme is LVL 8.8 million, out of which LVL 7.9 million is co-financing from the Norwegian financial instrument and LVL 0.9 million – public financing from Latvia. The planned activities of the programme (launching Technology incubator, open call for project applications) are expected to be launched by the mid-2013.

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 development and application of innovative solution, IDAL continued implementing the EU structural funds programme *Measures to Encourage Innovations and Business Start-ups* in 2012. In 2012, informative and educational measures have been implemented within the programme, for instance, series of practical seminars for authors if innovative business ideas and seminars on commercialization of technologies, Mentoring programme for new entrepreneurs and training course *Become an Entrepreneur in 5 days*. In 2012, the innovative business idea competition *Idea Cup 2012* and filming of the season 2 of TV business show for new entrepreneurs *Firmas noslēpums (Trade Secret)* have been organized, as well as opened Latvian innovation portal *www.innovativelatvia.lv*. The total EU structural funds financing available for the programme until 2013 is LVL 2.1 million.

6.10. Information Society

Information society is a social development phase based on free mutual information exchange, developing a knowledge-based economy. Information society consists of the technological base (infrastructure, software), a range of information services available to the society, and of the level of individual skills and knowledge. As a result of development of information and telecommunication technologies[1] (ICT), information and knowledge are more increasingly used in work and labour relations, education and everyday life (see Box 6.15).

Box 6.15

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%). 70% of inhabitants in the age group of 16-74 years used a computer and internet on a regular basis (at least once a week). 67% of all households had a broadband internet connection.

At the beginning of 2012, 95% of all companies having 10 and more employees had computers, 91% of such companies had 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 2010/2011, the number of computers per 100 pupils in general education schools was 10.9, in vocational education institutions – 13 computers per 100 pupils, in higher education institutions and colleges – 15.4 computers per 100 full-time students. At the beginning of the academic year 2010/2011, out of the total number of all education institutions, all higher education institutions and colleges, 99.6% of general education schools, and 89.8% of vocational education institutions had an internet connection.

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. 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 *Guidelines "e-Health in Latvia", Public Administration Policy Development Guidelines for 2008–2013, 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.

[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).

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"",* 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 6.16). The Ministry of Environmental Protection and Regional Development was appointed the responsible institution for coordination of the programme.

Box 6.16

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 ultra fast 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 ultra fast internet access*. In order to ensure equal access to electronic communication services all across Latvia: national implementation plan for broadband network must be developed and implemented, relevant laws and regulations must be adopted to facilitate investments in broadband networks, fully absorb the EU structural funds and the Rural Development fund financing (see Sub-chapter "Broadband internet") and implement 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 SME's and disadvantaged groups; to implement 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 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 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.

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 6.17).

Box 6.17

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.

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.

A total of 48 agreements on project implementation for the total amount of LVL 73.7 million have been concluded by August 31, 2012, LVL 43.8 million of the total amount have been already used.

Considering the slow absorption of the funding and the approaching deadlines, on November 13, 2012, the MEPRD informed the Cabinet of Minister about the project implementation progress by submitting the *Informative report "On Implementation Progress of the Sub-activity 3.2.2.1.1 "Development of Information Systems and Electronic Services" of the Operational Programme "Infrastructure and Services" and Assessments of the Project Implementation Plans"*. The informative report identified the risk of non-implementation of all projects and measures to be taken to prevent the risk. All projects were divided into high, medium and low risk groups. The customers of high risk projects were asked to strengthen administrative capacity and competence, as well as organize project supervisory boards.

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 2080 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 the first half of 2012, the public and local government institutions have purchased goods in the *Electronic Procurement System* for about LVL 7.6 million (in 2011 – LVL 13.4 million thus achieving savings in the amount of about LVL 3.5 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. 106190 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 2012 reached 20.4 (the EU average – 27.7) 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).

According to the data published on the internet speed measurement website *speedtest.net* of the internet research company "Ookla Net Metrics", at the end of December 2012, Latvia with the download speed of 28.5 Mbit/s is ranked 9th and upload speed of 18.9 Mbit/s is ranked 6th among 178 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.

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.

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 fixingand market sharing taking into account territory, consumers, suppliers or other conditions. The CC detected a breach of this particular norm in the activities of a non-productive pet food and medicine wholesaler LLC "Pet Pro Service" (see Box 6.18).

Box 6.18

The CC fines a wholesaler of pet feed and medicine for a prohibited agreement

On September 28, 2012, the CC adopted a decision to fine a wholesaler of non-productive pet food and medicine LLC "Pet Pro Service" for prohibited agreement. A fine in the amount of LVL 18 033 has been imposed on the company for fixing a minimum resale price and market sharing that restricts opportunities of consumers to buy specific products in specialised pet shops and veterinary clinics at lower prices.

LLC "Pet Pro Service" applied the prohibited agreement for six years, thus fixing the minimum price in contracts with about 250 cooperation partners for reselling non-productive pet food and MERIAL animal medicine distributed by LLC "PetProService" at pet shops and veterinary clinics as well as in wholesale.

The company also imposed a prohibition on retailers to sell products purchased from LLC "Pet Pro Service" in wholesale, while wholesalers were prohibited to sell MERIAL animal medicine outside Latvia.

Such action is a severe violation of the competition law hindering competition between enterprises and restricts the possibility of consumers to buy certain goods for lower price as the lowest price level is artificially maintained, thus making it impossible for the involved enterprises to compete with each other by offering a lower price.

The involved traders also share responsibility as they must defend their rights to freely fix the price for goods in such situations – they must reject any offer to include conditions in the minimum prices for goods in contracts, as well as in case of any dispute they should turn to the CC. It should be noted that in case if the traders agree to the requirements of wholesalers on fixing the minimum resale price without any objection, they also may be subject to a fine for prohibited agreement.

The CC obtained information on restricting conditions that LLC "Pet Pro Service" included in contracts with cooperation partners within the framework of market supervision.

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 LLC "Forum Cinemas" (see Box 6.19).

Box 6.19

The CC fines LLC "Forum Cinemas" for abuse of market power

On September 17, 2012, the CC made a decision identifying that LLC "Forum Cinemas" has abused its dominant position to get an advantage on the film distribution market. A fine in the amount of LVL 30993 has been imposed on the company.

The CC detected signs of violation in the activities of LLC "Forum Cinemas" already in 2009, though at that time it closed the investigation after receiving a written commitment of LLC "Forum Cinemas" to take all steps to immediately prevent factors hindering competition and negative consequences thereof. The CC investigated the activities of LLC "Forum Cinemas" in 2011 at its own initiative and concluded that the company has failed to fulfil the commitment and continued abusing its dominant position.

The CC concluded that LLC "Forum Cinemas" has requested other cinemas to whom it delivers movies more detailed reports than LLC "Forum Cinemas" needed to prepare own reports for film studios. Thus, LLC "Forum Cinemas" obtained commercial information of competing companies that gave it competitive advantages.

The CC also concluded that LLC "Forum Cinemas" as film distributor has restricted the possibilities of competing cinemas to carry out campaigns and offer lower prices. The reason for not allowing to offer lower prices was that film studios would not receive their planned revenue. LLC "Forum Cinemas" was not taking into account that usually during marketing campaigns, although the price for one ticket has been reduced, along with the increasing number of sold tickets, total income is not increasing. .Thus, the possibility of competing cinemas to carry out marketing events and the possibility of consumers to buy tickets at lower prices were unreasonably restricted.

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*. In case of failing to do so, the CC is entitled to impose a fine (see Box 6.20).

Box 6.20

The CC fines LLC "Palink" for failure to notify a merger

On October 12, 2012, the CC adopted a decision to impose a fine on LLC "Palink" for failure to notify the merger that involved takeover of assets of a competing company by opening a new supermarket that was previously used by LLC Rimi Latvia. A fine in the amount of LVL 25 725 has been imposed on the company.

On April 4, 2011, a food and daily consumer goods store IKI of LLC "Palink" was opened at Daugavpils trade park "SOLO". Before then, there was a RIMI supermarket, thus the company needed the CC permit to open a new store.

According to *the Competition Law* such activities involving acquisition of rights to use assets of another company (commercial space in this case) are considered as a merger because the asset recipient increases his competition market share.

Such failure to notify the merger is a subject to fine because such activity of an enterprise by not notifying the merger makes it impossible for the CC to efficiently implement the preventive measures to protect competition defined in the law. Application of the fine prevents the particular company and other companies from similar violations in the future.

Having evaluated the merger, the CC found it is acceptable and causes no harm to competition. This conclusion and the fact that LLC "Palink" provided the required information for evaluation of the merger upon a repeated request of the CC, made it possible to reduce the fine to be imposed on the company.

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 in 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 performed in the non-productive pert food market (see Box 6.21).

Box 6.21

The CC has completed supervision of productive pet food market

The supervision of wholesale and retail of the most popular food-producing animal food market in Latvia was launched in late 2010 resulting in assessing the competition, structure and development tendencies, as well as price dynamics and exiting barriers to production and distributions of animal feed.

No violations of competition law were detected during the supervision.

Within the supervision the CC concluded that the structure of productive animal food market shows sufficient competition – there are strong producers in Latvia, consumers have an opportunity to buy also imported products, besides, recently a number of producers of agricultural products (pork, eggs, broiler meat) started to produce animal food themselves.

The largest producers of animal feed in Latvia are JSC "Dobeles dzirnavnieks", LLC "Rīgas kombinētās lopbarības rūpnīca", LLC "LRS Mūsa", JSC "Tukuma straume", JSC "Saldus labība", JSC "Daugavpils dzirnavnieks" and LLC "Lielzeltiņi".

Depending on the producer, 60%-99% of the production is sold to industrial customers to whom animal food is usually produced according to a special recipe that often is based on the animal species, gender, age and health condition.

The share of import in the particular market is low, while export exceeds import and is tended to grow from year to year.

Market sales in tonnes and lats decreased in 2009, compared to 2008; however, it started to grow again in 2010. The average price in 2009 and 2010 decreased but in 2011 reached and even exceeded the price level of 2008. At the same time the CC concluded that the average prices significantly differs among different producers – the difference between the highest and lowest prices in 2008 was 40%, in 2009 and 2010 – 53%, while in the first half of 2011 – about 43 per cent.

Producer profit in the Latvian market does not exceed 10%. Producers gain higher profit from export, though it also does not exceed 10 per cent.

Information obtained within the supervision of productive animal food market is available in the final report of the supervision for publicity on the website of the CC. For the protection of market participants' interests, the publicity version of the report does not contain information of restricted access obtained and analysed within the supervision.

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. The survey results are going to be used to improve the CC performance and mutual cooperation with market participants and the public. High competition culture can only be achieved if entrepreneurs know their rights and obligations and understand the nature thereof. Therefore, polling results will help the CC develop an accurate dialogue with entrepreneurs and plan improvement of performance of the institution.

Market participants and other interested persons can study the information about the most significant events of competition supervision institutions of the *European Competition Network* (ECN) member states, including Latvia – the most interesting examined cases, performed researches and market supervision, latest laws and other important issues related to competition policy included in the ECN newsletter. It is prepared every 2 months and is available on the Competition Council home page (*http://www.kp.gov.lv/?object_id=522*) and the European Commission home page.

6.11.2. Regulation of Public Utilities

The Public Utilities 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 members of the Commission's Board 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 efficient procedure for consideration of 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 members of the Commission's Board.

6.12. Export Promotion and Foreign Investment Attraction Policy

Guidelines for Export Promotion of Latvian Goods and Services and Attraction of Foreign Investment in 2010-2016 define the basic principles, aims, and results to be achieved in export promotion and foreign investment attraction policy. The guidelines define three main directions of action:

– increase of export competitiveness;
– availability of support instruments;
– contractual security (see Chapter 6.2.2.).

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 in 2010-2011*.

Attraction of Foreign Direct Investments

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.

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.

On August 25, 2011, the meeting of the Coordination Council for Large and Strategically Important Investment Projects approved the *Strategy for Foreign Direct Investment Attraction* defining the target sectors, target countries, strategic activities directions, support stimuli, and a plan of measures for 2011-2017.

In order to focus the available resources and increase return to FDI attraction, the following main principles for further activities are set:

– extended and active FDI attraction methodology – *POLARIS process*, according to which further investment attraction-related activities are implemented;
– investment attraction marketing activities.

Considering the limited resources, activities for FDI attraction in 2012-2013 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.

With the present tax stimuli, at the beginning of 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. In addition, a new support programme is being developed for construction or reconstruction of production premises aimed at promoting development of manufacturing companies.

The IDAL activities have resulted in making a decision on implementation of 9 investment projects in Latvia (for example, investments from Germany/Italy in a yacht building project; investments from Germany in production of cast agglomerated stone surfaces and timber industry; investments from US in timber industry, as well as development of IT solutions; investments from Norway and Denmark in establishment of shared service centres; investments from Russia in automotive project, etc.). Project implementation is expected to attract investments in the amount of EUR 17.6 million thus creating over 940 jobs.

Additional information on attracted foreign direct investments is available in Chapter 4.3.3.

Export support instruments

Latvian exporters are offered a wide range of direct export support services, covering consultations on export-related issues, including foreign markets, specific trade requirements and search for business partners. Furthermore, export skills and informative seminars about external markets are organized and identification and fostering of export and investment projects is carried out.

In the 9 months of 2012, IDAL has provided over 1900 consultations on export related issues including consultations on foreign markets, and search for business partners, 28 informative seminars (including seminars organized by the Enterprise Europe Network) about external markets and foreign trade related issues have been organized, as well as 19 sectoral market reports have been prepared. Furthermore, 24 trade missions have been organized (the number of participating entrepreneurs – 165) to China, Gulf countries, Sweden, Poland, USA and other countries and 50 individual visits to potential cooperation partners abroad. Identification and implementation of export and investment projects is being carried out as well.

By September 30, 2012, participations in 12 international sectoral (manufacturing, IT, metal processing and automotive and construction) exhibitions have been ensured (the number of entrepreneurs – 85).

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, and Poland, Lithuania and Ukraine and China, a Foreign Economic Representative Offices of Latvia is expected to be soon opened also in 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 the IDAL are provided to the entrepreneurs according to the one-stop agency principle: when looking for business partners abroad, entrepreneurs can access 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 the 9 months of 2012, the Representations have organized 48 individual business visits, supported participation of enterprises in 26 international exhibitions abroad, processed 415 export requests/projects in fields of construction, metal processing, wood processing, trade, pharmacy and other sectors. 142 consultations have been provided/applications processed in the field of foreign investment attraction.

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 – External Marketing* is implemented within the framework of the measure *Entrepreneurship Support Activities* of the Operational Programme of the EU Structural Funds for 2007-2013 *Entrepreneurship and Innovations*. Within the framework thereof, merchants are offered extensive support in implementation of external marketing measures – participation in exhibitions, business matchmaking, trade missions, organizing seminars and conferences. In the 9 months of 2012, 222 new cooperation agreements have been concluded with enterprises 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.

In order to appreciate and honour the most successful Latvian entrepreneurs for producing both new and exportable products and providing high quality local products to the domestic market, the Investment and Development Agency of Latvia and the Ministry of Economics have hold the annual *Export and Innovation Award 2012* in 2012 as well; this year 114 applications were submitted for the award (see Box 6.22).

Box 6.22

<u>Export and Innovation Award *2012*</u>

Already for the eighth year, the Ministry of Economics in cooperation with the IDAL organizes the annual Export and Innovation Award evaluating the leading exporters and most innovative companies in Latvia and their products in the following categories:

– Best exporter in large/medium partnership group;
– Best exporter in small partnership group;
– Import substitute product;
– Most innovative product;
– Industrial design.

The winner of the category, *Leading exporter* is found by evaluating the largest Latvian exporter based on data and contribution to sustainable growth.

114 applications were submitted for participation in the award *Export and Innovation Award 2012*.

The winners of the Export and Innovation Award 2012 are following:

– category *Best exporter* in <u>large/medium</u> partnership group:
  1. *GroGlass LLC* (flat glass forming and processing*);*
  2. *Lauma Fabrics LLC* (production of knitted and crocheted fabric*);*
  3. *Arčers LLC* (construction of residential and non-residential buildings).

– category *Best exporter* in <u>small</u> partnership group:
  1. *Zabbix LLC (computer programming);*
  2. *PureChocolate LLC* (production of cocoa, chocolate, sweets and other sugar confectionary*);*
  3. *Aloja-Starkelsen LLC* (production of starch and starch products and wholesale of other food products).

– category *Most innovative product*:
  1. *Tilde LLC* (machine translation technology "LetsMT");
  2. *Spodriba JSC* (ecologic washing and cleaning product line "Eco Seal for Nature");
  3. *Madara Cosmetics LLC* (anti-aging cosmetic product line "TimeMiracle").

Box 6.22 continued

– category *Import substitute product*:
  1. *Dobeles Dzirnavnieks JSC* (pasta "Presto" and "Dobeles Dzirnavnieks");
  2. *Evopipes LLC* (plastic pipes for construction and wiring of external engineering communication infrastructure);
  3. *Smiltenes Piens JSC* (whey protein concentrate "Piena spēks").

– category *Industrial design*:
  1. *Rīgas Krēslu fabrika LLC* (stool "BLOOM");
  2. *A.DEW LLC* (HUGU bear);
  3. *Daiļrades koks LLC* (home office furniture "Elf").

The Leading Exporter in 2012 is **LLC "Mikrotīkls"**.

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 consumer rights protection, 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 consumer rights observation in draft contracts and contracts concluded by consumers and producers, sellers, or service providers), considers consumers' complaints, provides information and consultations to consumers and entrepreneurs, implements supervision measures of unfair commercial practice, e-commerce, and advertisements, supervision measures of safety and conformity of goods and services, carries out national metrological supervision, supervision of dangerous equipment and investigation of dangerous equipment accidents.

Box 6.23

Performance of the CRPC in the nine months of 2012

Within the framework of its activities in the nine months of 2012, the CRPC has rendered 26455 consultations to consumers and legal entities. The number of rendered consultations has increased by 384 consultations or 1.5% compared to the corresponding period a year ago. When requesting a consultation, consumers most often have been interested in issues related to their rights if they have purchased a product or received a service of poor quality, as well as actions to be taken in case of failure to duly deliver the product or provide the service. A number of consumers have been interested also in issues beyond the competence of the CRPC or issues on which the CRPC have no right to make a binding decision, for instance, quality of electronic communications, food products, payments of insurance compensation and public utilities services.

Within the report period the CRPC has received 1659 consumer complaints. Most often consumers have filed complaints concerning the purchased goods and services incompliant with contract provisions. A large number of complaints have been about commercial practice, advertising and e-commerce, as well as failure to observe the principle of legal equality of the contracting parties. Out of all received complaints, the majority have been about footwear quality, followed by electronic goods and mobile phones. In the field of services, the majority of complaints have been about distance contracts that might be explained with the Internet trends and availability. Consumers have often complained about aviation, electronic communication services and rent/public utilities services.

For supervision of consumer rights in 2012, the CRPC has set such priority areas as protection of collective interests of consumers in the field of electronic communication services, consumer crediting contracts, vehicle rental services, supervision of commercial practice applied outside regular point of sales or service provision place, supervision of commercial practice in the volatile oil 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 request for consultations, the observance of consumer rights in collective online shopping portals is set as priority. In the nine months of **2012, the CRPC has launched implementing 8 surveillance projects.**

In 2012, the CRPC continued supervisory activities in the field of electronic communication services launched in 2011. A total of 37 contracts signed between providers of electronic communication services and consumers and proposed draft contracts have been already evaluated. In 35 cases, the CRPC asked service providers to voluntarily eliminate the nonconformities in the proposed draft contracts and signed contracts. 25 providers of electronic communication services have submitted a written resolution to the CRPC not to apply the unfair contract provisions included in contracts already signed with consumers, as well as make amendments to the draft contracts proposed to consumers, thus voluntarily eliminating violations. As regards supervision of commercial practice, the CRPC has initiated 9 administrative cases in the nine months of 2012**. Considering the identified trends in the field electronic communications, the CRPC in cooperation with the involved sector companies and the** Public Utilities Commission **has prepared supplements to the** *Guidelines on Fair Commercial Practices in the Field of Electronic Communications Services* and Guidelines *on Drawing Up a Fair Electronic Communications Service Contract*, containing recommendations for service providers on drawing up an electronic communications service contract in compliance with laws and regulations. The project has also resulted in *Consumer Tips for Signing an Electronic Communications Service Contract* that is available on the institution's website.

Considering the large number of requested consultations and the growing number of consumer complaints in 2012, the CRPC launched a surveillance project of commercial practice and contract provisions when signing contracts with consumers and applied commercial practices in the field of collective online shopping. Having analysed identified trends and received consumer complaints so far, as well as the experience of other countries (United Kingdom, France, New Zealand and others), the CRPC has developed a draft plan for surveillance measures in the particular field at national level. Within the project implementation, the CRPC has initiated inspections of 31 collective shopping websites/websites offering consumers to buy e-coupons for purchasing various products and services. As a result of the inspections of websites the CRPC has detected nonconformities in all websites, including unfair (non-compliant with professional diligence, misleading) commercial practices, advertising noncompliant with legislation and unfair/unclear contract provisions.

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. In the nine months of 2012, the ECC Latvia has rendered 453 consultations to consumers concerning cross-border issues in the EU and reviewed 127 complaints on cross-border issues in the EU. One of the most important measures implemented by the ECC Latvia in 2012 is the informative campaign *Shopping online? Be smart and careful!* aimed at improving consumer understanding of positive and negative aspects related to purchasing goods and services online, reflecting general opinion on risks and benefits. Considering the increasing number of complaints regarding aviation services the Air Passenger Rights Day has been hosted at the airport "Riga" aimed at surveying and educating air passengers, as well as implementing other activities.

In 2012, the CRPC in the field of **market surveillance** has identified such priority directions as safety and conformity improvement of such goods as vehicle components, electric goods, toys, personal protective equipments and machinery. In the field of dangerous equipment and state metrological supervision, surveillance project of 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. The surveillance project of construction products launched in 2011 is also continued. *The Surveillance Project of Vehicle Components* has been completed in 2012. Conformity improvement projects of such product groups as personal protective equipments, toys, machinery (lawn mower PROSAFE), construction products (heat insulation materials) have been launched as well. Within the framework of the *Market Surveillance Project of General Safety of Goods and Services* subprojects have been launched for the following product groups – food imitation products, informative inspections of candles, oil lamps and trampolines, inspections of baby walking frames (walkers), highchairs for children and office supplies. In addition, an informative project has been carried out in the field of construction products (small wastewater treatment systems for up to 50 PT).

In the field of **state metrological supervision**, the CRPC has assessed conformity of measurement equipments to the normative requirements at the place of use in 62 manufacturing, trading, and service rendering enterprises in the nine months of 2012. 2647 units of measurement equipment (including metrological tests carried out to 14 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 statistical control tests of pre-packed goods batches and conformity of labeling with the requirements of legislation.

Box 6.24

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 for interinstitutional coordination on October 25, 2012. 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 2012 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 all, the draft law envisages amendments in respect of consumer crediting contracts for enterprises to avoid granting credits without assessing sufficiently consumer's ability to pay.

In July 2012, the Cabinet of Ministers approved a package of draft laws that will considerably improve **the activity of supervisory institutions in the field of commercial practice and advertising**. Thus, the *Unfair Commercial Practice Prohibition Law*, the *Advertising Law* and the *Latvian Administrative Violations Code* are expected to be amended. The draft laws have been developed with an aim to improve the activity of supervisory institutions, to solve significant sectoral issues, and grant supervisory institutions a right to examine violations in accordance with the *Administrative Procedure Law*. The draft laws revise the existing approach to assessing violations – the new regulation will ensure implementation of preventive measures regarding compliance of advertising and commercial practices with specific requirements and makes it possible for enterprises to voluntarily eliminate violations without imposing fines, thus saving resources of the supervisory institution and allowing spending the resources on elimination of material violations.

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 ability of particular person to fulfil commitments. According to the assignment laid down in the law, the Ministry of Economics has prepared two draft regulations – draft *Regulations Regarding the Procedure by Which a Special Permit (Licence) for the Provision of Debt Recovery Services Shall Be Issued, Re-Registered, Suspended and Cancelled and the State Fee for the Issue and Re-Registration of a Special Permit (Licence) Shall Be Paid, as well as the Requirements for a Debt Recovery Service Provider to Receive a Special Permit (Licence)* and draft *Regulations Regarding the Acceptable Amount of Debt Recovery Costs and Non-recoverable Costs*. The regulations shall enter into force by January 31, 2013.

For the purpose of ensuring conformity to the European Union requirements for **toy safety**, the Cabinet of Ministers *Regulations on the Safety of Toys* of February 15 2011, have been amended. The regulations will enter into force on July 20, 2013.

The Cabinet *Regulations Regarding the Procedures by Which a Special Permit (Licence) for the Provision of Consumer Credit Services Shall Be Issued, Re-Registered, Suspended and Cancelled and the State Fee for the Issue and Re-Registration of a Special Permit (Licence) Shall Be Paid, as well as the Requirements for a Capital Company for the Receipt of a Special Permit (Licence)* of March 29, 2011 also have been amended for the purpose of specifying the application procedure of Subparagraph 9.1 of the regulations.

In the second half of 2012, discussions continued regarding the European Commission 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 approved in November 2011. Both draft laws have been developed to strengthen **consumers' and entrepreneurs' confidence in cross-border transactions** in the EU single market. The draft 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 draft 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. An agreement on both proposals with the European Parliament is expected to be reached in early 2013.

Furthermore, 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 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.

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 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 to protect 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 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 activity by LVS 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 November 1, 2012, 36787 standardization documents have been registered in the LVS, including 30 688 European standards adapted to the status of a Latvian standard. A new Standardization Technical Committee LVS/STK 51 "Electrical energy" has been established. In 10 months of 2012, 51 standardization technical committees and 4 working groups coordinated by the LVS have adapted 1134 European standards, 46 mandatory applicable standards and Eurocodes have been translated into Latvian. Standardization information services have been provided to 3083 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 540 regular customers in fields of their interest.

In order to link legislation with standards and make information searching easier, a contract has been signed with the official journal of RL *Latvian Herald (Latvijas Vēstnesis)* on exchange of information and interlinking portal *www.likumi.lv* and website of the Standardization Bureau *www.lvs.lv*, as well as information on the applicable standards regarding Latvian legislation has been updated.

In order to support small- and medium-sized enterprises and to promote a broader use of standards, prices for purchase of standards have been reduced as of January 1, this year.

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 as such 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 229 accredited institutions. New accreditations have been awarded to one laboratory in Kazakhstan and one laboratory in Azerbaijan and Russia. 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 implementing a Twinning project together with German Federal Institute for Material Research BAM and other consortium partner and 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*.

In order to maintain conformity of national measurement standards to current EU requirements, a set of standard mass scales of E1 precision class was purchased in June.

The national inter-laboratory comparison calibration project on mass measurements SP3-2012 *Calibration of Non-automatic Scales* has been prepared and implemented.

The 11 National measurement standards were calibrated and standard maintaining procedures of the standards were performed according to the schedule in the national metrology institutes (NMI) of the European Union.

Calibration of the national electrical resistance standard (from 1 mΩ to 100 MΩ), national DC standard 7000 and multi-functional calibrator 4808 has been carried out at the Finnish NMI. In August, calibration of national length standards and surface unevenness standards was carried out at the National Metrology Institute of Finland MIKES. The national mass standards were calibrated at the Danish National Metrology Institute.

In the first half of 2012, stability analysis and drift assessment of national electric measurements and length standards were carried out over a period of the calibration. 8 reliability validation procedures for calibration results have been fulfilled in the field of CMC (Calibration and Measurement Capabilities).

In 2012, conformity of 23 measurement equipment types was evaluated and certified, including re-evaluated conformity of measurement equipment types and extended certificates for 9 types. The list of approved types available on the website of the Metrology Bureau is updated on a regular basis. 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. 74 reference standards, as well as 4 mass comparators of SIA "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 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 (Law on the Completion of Privatization)* 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 6.25).

Box 6.25

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 might 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 November 30, 2012, 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, in the Register of Privatization Proposals those privatization proposals were registered, 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 to 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 apply to the court or a notary on behalf of the state in order to take all necessary steps to recognize it as a property without an owner or an heir. 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 to 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 November 30, 2012, the privatization provisions in the statutory procedure have been approved for 2501 state property objects (excluding land). 94 companies were transformed to 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 selling of shares and alienation of capital shares emerged as a result of capitalization of debts) amounted to LVL 1.668 billion, of which LVL 401.08 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 November 30, 2012, 5103 state land lots were privatized (purchase agreements signed). The total sales price for the privatized state land constitutes LVL 201.17 million, of which LVL 98.11 million was in cash and LVL 103.06 million in property compensation certificates. On November 30, 2012, income from privatization of these land lots amounted to LVL 190.71 million, of which LVL 92.67 million was in cash and LVL 98.04 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 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 December 1, 2012, the Ministry of Economics has reviewed and accepted for information 3314 privatization projects for the total estimated price of LVL 160.2 million (*inter alia* payments in certificates for the nominal value of LVL 58.61 million).

From January 1, 1997 until December 1, 2012, 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).

The 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, the 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 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 by the *Law on Privatization of State and Local Government Residential Houses*.

On November 30, 2012, 420 residential buildings and 1736 state apartment properties were in the possession and under management of the Latvian Privatization Agency, out of which 993 state apartment properties are placed in residential buildings in possession of the Latvian Privatization Agency and 743 state apartments are placed in residential buildings that are handed over to management apartment owners.

The privatization process of the state residential houses – decisions on bringing 5 128 residential houses to the privatization have been made by November 30, 2012, within time period from June 1, 2012 to November 30, 2012 – 8 decisions. By November 30, 2012, privatization announcements have been sent to 50 180 tenants of state apartments to be privatizes 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 June 1, 2012 to November 30, 2012 – 11 announcements. By November 30, 2012, 44 347 state apartments have been privatized, and from June 1 2012 until November 30, 2012, 39 contracts on purchasing state apartment properties have been concluded.

The privatization process of local government residential buildings – data on the privatization process of local government residential buildings and their transfer to the possession of apartment owners are currently no longer being updated, therefore the data stored in the databases of the Latvian Privatization Agency does not reflect the actual situation.

The management of state residential buildings and apartments – 3815 state apartment building have been handed over to owners of apartment properties in possession by November 30, 2012, within time period from June 1, 2012 to November 30, 2012 – 24 residential buildings. Within the period from June 1, 2012 to November 30, 2012, 189 state apartment properties have been handed over to the possession of local governments of republic cities, towns and counties.

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 had 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. The most of 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 in the activity of land users until 2004 as only 6% of all concluded agreements have been signed during this period. 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 which similarly to the *Law On Completion of Land Reform in Rural Areas* 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 to 2011, about 9% of all persons having concluded 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, in their turn, 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.

The Section 16(1) of the *Law On Completion of Land Reform in Rural Areas* envisaged that the former land owners or their heirs 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 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 right.

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 right to select land in all rural territory of Latvia. The CLC granted 194 third priority claimers rights to select land in all territory of Latvia for restoration of ownership right 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 late 2012, the state level commission for the completion of land reform of the State Land Service had examined applications for restoration of ownership right to 117 selected land units of 693 hectares submitted by 33 third priority claimers. Out of which 10 claimers were allocated the land of 296 hectares claimed for restoration of ownership right (21 land units).

According to the Section 16(3) of the *Law On Completion of Land Reform in Rural Areas* (version until December 14, 2012) the CLC was entrusted with the decision making (recognition) on restoration of ownership right to the land allocated for completion of land reform until December 30, 2012.

However, since claimers often changed the land units they have selected or delayed the selection, the deadline for restoration of ownership rights to land allocated for completion of land reforms was also delayed.

Considering all the above, on November 15, 2012, the Saeima approved the law *Amendments to Law On Completion of Land Reform in Rural Areas* (in force since December 14, 2012) stipulating that the CLC shall make a decision on recognising restoration of ownership rights to land allocated for completion of land reform by December 30, 2013.

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 November 30, 2012, 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 of November 30, 2012, 422 property compensation certificates have been issued to 3 heirs of former owners.

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.

Table 6.5

Use of Privatization Certificates

(as of November 30, 2012)

Type of property	Amount	Number of privatization certificates	including property compensation certificates
		(million)	(thousand)
Residential buildings	446 thousand apartment privatization units	37.97	589.8
Enterprises and other properties	no exact data	7.32	109.6
Capital shares (stocks)	no exact data	44.46	954.0
including:			
in public offering	128.7 million shares	37.14	858.0
Land	317.1 thousand land lots	17.34	5162.5
Total:		**107.09**	**6815.9**
% of total certificates issued		95.3%	85.1%

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 November 30, 2012. Compensations in the total amount of LVL 17.45 million have been paid to 8411 persons, thus cancelling 0.62 million property compensation certificates.

As part of cancelling 0.16 million privatization certificates for political repressions, compensations in the total amount of LVL 4.64 million have been paid to 26.2 thousand politically repressed persons by November 30, 2012. According to the 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 November 30, 2012, 107.09 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 6.5). From April 1, 2008 until November 30, 2012, instead of 470.74 thousand property compensation certificates 598.1 thousand privatization certificates have been used.

In November 2012, holders of privatization certificates could use services of 8 licensed intermediary capital companies for transactions in the market of privatization certificates. The total amount of monthly transactions with privatization certificates (buying from natural persons and selling) performed by intermediary capital companies on November 30, 2012, varied from 4.06 thousand privatization certificates in July to 56.44 thousand privatization certificates in March and from 0.59 thousand property compensation certificates in April to 5.48 thousand property compensation certificates in November.

According to Paragraph 2 of the Cabinet Regulations No 712 of October 16, 2007 *Regulations Regarding the Use of Privatization Certificates* privatization certificate accounts shall be opened and serviced by joint stock company "Latvijas Krājbanka" and the Mortgage Bank, as well as other credit institutions eligible to accept cash deposits of natural persons (Subparagraph 31.9 of the Regulations No 712) and which have coordinated their internal rules (Paragraph 3 of the Regulations No 712) with the Commission for Licensing Mediation Companies of Privatization Certificates.

On December 1, 2012, 2.009 million privatization certificates or 1.9% of the total number of granted privatization certificates, including 0.111 million property compensation certificates were stored on the accounts of 380.5 thousand natural persons.

On December 1, 2012, 0.718 million privatization certificates or 0.6% 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 joint stock company "Latvijas Krājbanka". On December 13, 2011, Riga Regional Court announced 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 the 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 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 the Paragraph 2 of the *Regulations Regarding the Use of Privatization Certificates*, only the Mortgage Banka 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 a 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, the authorities responsible for 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 the Cabinet Regulations No 712 of October 16, 2007 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 the first half of 2013.

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 particular administrative territory.

In late 2012, the state holds 100% shares in 68 capital companies; it has decisive influence over 5 capital companies and holds less than 50% shares in

75 companies. The state holds shares directly in a total of 148 companies. The state has indirect holding in 28 companies. Overall, the state has direct and indirect holding in 176 companies.

There are 323 capital companies in the Republic of Latvia, in which 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.

Based on the information provided in the *Annual Report of Latvian enterprises for 2010*[1], the total turnover of state-owned capital companies reached LVL 2.12 billion in 2010. The total profit of capital companies was LVL 74 million at the end of 2010. The total assets of capital companies constituted LVL 8.09 billion in 2010. In late 2010, partially or fully state-owned companies employed over 50 thousand people.

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 prosperity. All the limitations of commercial activity under the *State Administration Structure Law* are set for 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 to 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*** developed by the Ministry of Economics and the ***Concept for Management of State Capital Shares*** developed in cooperation with the Latvian Privatisation Agency in the meeting of May 15, 2012.

By approving the *Concept for Management of State Capital Shares* the Cabinet of Ministers has given the green light to implementation of partially centralised model for state capital shares management, as well as implementation of the principle of good corporate management in state-owned capital companies including disclosure of information, flexible dividend policy to increase the value of capital companies, motivating remuneration policy, apolitical p*rocedure for appointing the administration members of capital companies*, defining objectives and assessing performance of capital companies, etc.

The proposed model envisages establishing a centralized management institution. In a partially centralised model, state capital shares management is shared by: (1) 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 defines specific, non-financial objectives of capital companies; (2) centralized management institution responsible for monitoring financial performance and introduction and implementation of corporate governance principles.

By adopting the Concept for Commercial Activity of Public Persons the Cabinet of Ministers has approved the following proposed options:

1. capital companies of public persons which: (a) Issue administrative acts or administer state fees, as well as revenue of which consist of grants (subsidies) or provided services within

[1] *http://www.mk.gov.lv/files/latvijas_valsts_uznemumu2010gada_parskats.pdf*

the scope of delegated state administration tasks, shall be reconstructed into a direct administration institution; (b) provide public services and (or) implement projects on behalf of a public person, and revenue of which consists of the provided service within the scope of delegated state administration tasks, shall be reconstructed into public agencies;

2. a public person shall analyse the need for maintaining ownership in certain capital companies on a regular basis, i.e. at least once every 3 years, including the ownership of the capital company of public person in other company, its conformity to the framework of commercial activities of public persons. If the state ownership is no longer required, capital shares shall be sold (fully or partially), the state or local government capital company shall be liquidated or reconstructed into a public agency by adopting relevant Cabinet or local government decision. The given decision shall be adopted in the field of public law as an administrative act and the individuals shall have the right to appeal the decisions of a public person as a general administrative act for the purpose of ensuring public control;
3. a public person is entitled to perform commercial activity in a strategically important sector or in case of market failure, including if natural monopoly exists;
4. capital companies of public persons may acquire interest in other companies on a condition that its activity conforms to the conditions for commercial activity of public persons or shareholding is required for achieving the objectives of commercial activity defined by the public person, as well as it has been concluded that shareholding of a public person in other company ensures rational and economically reasonable use of the resources of capital company according to the principles of good corporate governance.

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 six draft laws which is being coordinated with interested institutions (non-governmental organizations) in accordance with the specified procedure, 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 narrowing the number of conditions giving rights to public persons to establish a capital company or acquire interest in an existing capital company.

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 policy of favourable business environment 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 drafting 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.

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.

Box 6.26

<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.

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 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.

A representative 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 participates in the NEC meetings as an observer.

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 provided by the Secretariat of the National Economy Council, activity of which is ensured by the Ministry of Economics. Between NEC meetings, the NEC Managing Committee makes the recommending decisions of NEC.

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, 16 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).

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.

Box 6.27

NEC on priorities of economic policy

NEC believes that Latvia should continue work on development of 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 taxation policy and administration, labour force education, macroeconomic stability, and non-predictability of amendments to the legislation as the most problematic spheres.

The normative acts must be assessed already during their drafting process, in order to identify and prevent possible violations of 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 of 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.

In 2012, 10 National Economy Council meetings and 9 NEC Managing Committee meetings were held, in which the following main issues have been considered:

– The EU multiannual financial framework for 2014-2020;
– *Report on National Competition*;
– Development of *industrial policy;*
– *Tax Policy Strategy for 2012-2014*;
– Development of the priorities of *the National Development Plan*;
– Priorities for the next planning period, priorities of the *National Development Plan* and a system of financing absorption for implementation of priorities;
– Efficiency of the judicial system and improvements thereof;
– *Fiscal Policy Guidelines for 2013-2015*;
– Medium-term and long-term labour market forecasts prepared by the Ministry of Economics;
– Framework of cross-industry employment policy;
– The plan for establishing a development financial institution and existing model;
– Tax relief for research and development;
– Implementation and progress of *the Action Plan to Improve Business Environment for 2012*;
– The state budget for 2013;
– The interim report on the progress of *the Nation Development Plan*;
– Green vision;
– *Guidelines for Promoting Export of Latvian Goods and Services and Attracting Foreign Investments for 2012-2020*;
– *Latvian Energy Long-term Strategy 2030* – competitive power industry for the society;
– Evaluation on business environment in Latvia (*Doing Business 2013*) and Global Competiveness Index).

7. RECOMMENDATIONS

Currently, a transition to sustainable economic model is taking place in the economy of Latvia, in which exports are 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* 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 total revenues of the country.

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 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, particularly in the identified perspective product market for Latvia. 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, promoting cooperation and improving skills;
– **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 workers 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. Stable macroeconomic environment should be maintained and fulfilment of the Maastricht criterion on the budget deficit should be ensured in order for Latvia to be ready to introduce euro in 2014.

Taking into account the abovementioned, in our opinion, the immediate tasks of the economic policy are as follows:

- **for improving 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 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 dominant position. As regards the abovementioned violations, particularly identification of cartels, preventive measures are of big 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 in production;
  - to support more actively the development of science potential by concentrating it in areas where Latvia has comparative advantages;
  - to improve the laws regulating research activity by establishing that research institutions can be the owners of the intellectual property resulting from state-funded research;

- **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 absorption 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 in 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 develop a set of specific support measures aimed at those people and their families, who have emigrated for various reasons from the country in the previous years, but would be ready to return to Latvia to live and work here;
  - 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 pay particular attention to the youth who are neither studying nor working aimed at involving them back to the education system for obtaining qualification and practice;
  - to encourage active involvement of employers in improving quality of education – developing in-study practice 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 develop 1st stage professional higher education (college) – reduced study duration, saved state and private resources;
  - 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 in other policy areas, for example, regional and urban development, transport, manufacturing policy, agriculture, as well as stress it in international relations, education and training;
  - to improve and support energy efficiency in multi-apartment buildings, as well as to evaluate improvement of energy efficiency in public buildings;
  - 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 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 integrate the Latvian and Northern electricity market;
  - to complete risk assessment for possible liberalization scenarios of the natural gas market of Latvia;
  - to ensure implementation of 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 revival 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.