Ministry of Economics
Republic of Latvia

ECONOMIC DEVELOPMENT OF LATVIA

REPORT

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Comments, questions or suggestions are welcomed:

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Dear reader,

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

It should be noted with satisfaction that the government has accomplished its core task over the last two years – the state insolvency risk has been prevented, the hardest moment of economic crisis has been managed, and stabilisation of state finances and economics has been achieved. We have returned to economic growth and considerably changed the economic structure – now the key driver of economics is manufacturing and export. Labour market also is gradually recovering from consequences of the crisis. The number of employed is gradually increasing and the unemployment is reducing, the future vision of entrepreneurs is becoming more optimistic. Economic recovery of Latvia has been recognized internationally; the Latvian credit rating was raised by an international rating agency.

Export will be the key driver of economy also in 2011. Based on an analysis of the economic situation, the experts of the Ministry of Economics expect GDP growth in the amount of at least 3.5% in 2011, increase of goods and services export volumes – by 10%, increase of investment volumes – by 18%, and increase of the number of employed – by 2-3%.

The main tasks at the moment are to foster competitiveness of national economy and create pre-conditions for a successful transition to a more effective production level and higher productivity, at the same time ensuring balance between budget expenditures and opportunities provided by revenues. In order to further improve competitiveness of Latvian manufacturers, the ability to increase productivity will play a crucial role, therefore competitiveness of the main export sector – manufacturing industry in both foreign and domestic markets is very important for ensuring growth.

In order to raise competitiveness of Latvian entrepreneurs, it is planned to shift the main state support instruments and foster access to the EU funds financing for the priority sectors of national economy which already prove their competitiveness: wood industry, food processing, metal processing, chemistry and pharmaceutics, production of electric equipment, etc. Currently, these national economy sectors constitute nearly 80% of the manufacturing industry.

Support from the state and EU funds is available for business start-ups and development, personnel education, export promotion, improvement of the tourism infrastructure, improvement of centralised heat supply system efficiency, establishment of cogeneration power plants, as well as renovation of social and multi-apartment buildings. By attracting financing from the EU Structural Funds, several state support programmes have been launched or are continued, such as *Development and Introduction of New Products and Technologies into Production, Support to Technology Transfer Contact Points, Support to Business Incubators,* which are aimed at promotion of knowledge-based economy.

New quality investment attraction has been launched by establishing the Coordination Council for Large and Strategically Important Investment Projects and implementing the strategy *Polaris* for investment attraction for efficient coordination of joint activities of state and local government authorities and non-governmental organisations aimed at improving investment attraction. In order to set clear objectives and tasks for raising state competitiveness, evaluation of state competitiveness is performed, as well as strategy for attraction of foreign direct investment is developed which will improve the existing investment attraction model, and stimuli of investment attraction will be defined within the framework of strategy.

Important work has been done by establishing favourable environment for micro-enterprises and by encouraging people with ideas to start a business, thus reducing unemployment. An enterprise can be founded by investing only LVL 1 in its fixed capital, the tax system of micro-enterprises is simplified by introducing a single rate. Patent fees have been introduced for individual work performers, thus allowing them to work without any bureaucratic obstacles.

In 2011, we will evaluate the available financial instruments for micro- and small-sized enterprises, for example, by developing a range of offered micro-credits and by continuing to develop the programme *Support for Self-Employment and Business Start-Ups* implemented by the Mortgage and Land Bank of Latvia.

At the same time, the government implements a range of measures to eliminate administrative barriers in areas of tax policy and administration, insolvency process, real property registration, tourism, construction, etc. In comparison with the previous year, Latvia has moved up by 3 positions in the World Bank *Doing Business 2011* index and is ranked 24th among 183 countries and 9th among the EU Member States. The Ministry of Economics has developed the *Action Plan to Improve the Business Environment* for 2011, which is mainly focused on overcoming the deficiencies and the weakest points identified in the *Doing Business* survey. The plan is prepared in cooperation with experts from jointly responsible ministries and non-governmental organisations.

Currently, in the field of energy it is most important to continue the launched development projects oriented towards promoting Latvian energy independence and energy supply security, as well as integration of Baltic energy markets into the common EU market.

In order to achieve the set objectives, we will continue the dialogue with our social partners – entrepreneurs and non-governmental organisations representing them.

The Report comprises information about the main economic and social indicators, development of national economy sectors and foreign economic environment, the economic policy of the government for promoting growth and employment, as well as the key instruments for implementing the policy, including application of the EU Structural Funds.

In the conclusion of the Report, the authors provide recommendations regarding improvement of the state economic policy.

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

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

June 2011

Artis Kampars
Minister of 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
IMF	International Monetary Fund
JSC	Joint Stock Company
LGA	Latvian Guarantee agency
LLC	Limited Liability Company
LNAB	Latvian National Accreditation Bureau
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	Luxemburg
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	EU	SE	Sweden
FI	Finland	SI	Slovenia
FR	France	SK	Slovakia
HU	Hungary	UK	United Kingdom

Symbols

–	Magnitude zero / absent	...	Data not available or too uncertain

1. ECONOMIC SITUATION: BRIEF OVERVIEW

The global financial crisis has affected national economy of Latvia particularly severely. The GDP during the crisis reduced by ¼ (the 4th quarter of 2009 compared to the 4th quarter of 2007, which was the last quarter with positive growth), the unemployment rate grew from 5.3% in the 4th quarter of 2007 to 19.7% at the end of 2009. Due to the substantial decrease of budget revenues, the overall state budget deficit reached nearly 10% in 2009.

Since the beginning of 2010, the economic recession in Latvia has stopped, and the growth has resumed. Already for six quarters in a row the GDP amounts are gradually increasing. Since the lowest point of economy at the end of 2009 until the 1st quarter of 2011 the GDP has increased by 3.8%. Yet, taking into account that the growth resumed from a rather low level the GDP amounts in 2010 was by 0.3% lower than a year before.

Improvement of the economic situation is determined by the increase in export volumes and growth of tradable sectors, thus partially allowing to compensate still weak domestic demand and development of domestic market-oriented services sectors.

Table 1.1

Latvia: Economic Development Key Indicators

	2007	2008	2009	2010	2011e
(growth, in comparison with the previous year, %)					
Gross domestic product	10.0	-4.2	-18.0	-0.3	3.5
Private consumption	14.8	-5.2	-24.1	-0.1	4.5
Public consumption	3.7	1.5	-9.2	-11.0	0.4
Formation of total equity capital	7.5	-13.6	-37.3	-19.5	18.3
Exports	10.0	2.0	-14.1	10.3	10.0
Imports	14.7	-11.2	-33.5	8.6	14.0
Consumer prices	10.1	15.4	3.5	-1.1	4.3
(% of GDP, unless indicated otherwise)					
General government sector balance	-0.3	-4.2	-9.6	-7.6	-4.5
General government debt	9.0	19.7	36.7	44.7	48.0
Export/import balance	-20.0	-13.6	-1.5	-0.8	-1.1
Changes in the number of employed (aged 15-74 years)	2.9	0.5	-12.2	-4.6	2.2
Unemployment rate (share of job-seekers of economically active persons aged 15-74 years, %)	6.0	7.5	16.9	18.7	16.0

e – estimation

In 2010, goods export volumes in actual prices increased by 30.3%, and since the 3rd quarter the export volumes already exceed the pre-crisis level. Increase in volumes is observed in all groups of goods export. Export of wood and its products ensured nearly one third of the total export increase in 2010. Also, increase in export of metal and its articles, as well as export of agricultural and food products contributed a lot to the export. It is important to note that not only the growth of external demand is crucial for expanding export potential, but also the increase of Latvian producers' competitiveness, which is achieved owing to the cuts in labour costs and to an increase in productivity.

The expansion of export possibilities is a good basis for growth of manufacturing, which exceeded the level of 2009 by 15.4% in 2010. Wood processing contributed the most to the growth of the sector as the production volumes in 2010 were by 33% higher than a year before. Volumes of metal and metal articles manufacturing sectors have increased by more than 24%. Positive tendencies are observed also in such sectors as paper publishing industry, production of electrical and optical equipment, as well as production of vehicles and engineering industry.

In 2010, the growth was observed also in agriculture, sectors of electric energy, gas, and water supply, transport and communications, as well as trade services. Yet, the output amount of other service sectors in 2010 still lagged behind the level of 2009. In 2010, the production volumes continued to decrease in the construction sector.

Private consumption is gradually stabilizing, as indicated by the dynamics of the increase in retail trade turnover. The improving situation in the labour market has positive impact on the private consumption. At the same time, the public consumption or consumption of state administration institutions decreased due to the implemented budget consolidation measures in 2010.

Investment activities during the last year were also very low, and recovery thereof is quite slow. In 2010, the investments in the national economy of Latvia were by nearly 20% lower than in 2009.

The weak domestic demand affects the import dynamics. The import volumes considerably lag behind the pre-crisis level; and the export/import balance of Latvia has significantly improved. In 2010, the export/import balance was -0.8% of GDP, within the years of rapid growth the negative export/import balance was at the level of 20% of GDP.

Statistical data on economic development in the first half of 2011, show that the recovery is in progress. In the 1st quarter of 2011, the GDP increased by 3.5% in comparison with the corresponding period of the previous year, including export – by 14.7%, private consumption – by 3.6%, public consumption – by 0.6%, formation of the total equity capital – by 28.4%. The Ministry of Economics expects **the total GDP amount in 2011 to exceed the level of 2010 by 3.5%**.

After the deflation caused by the crisis, when 12-months inflation of consumer prices reached -4.2% in February 2010, **the prices are growing again**. During 2010, the level of consumption prices increased by 2.5%, including for goods – by 4.3%, but for services prices reduced by 2.1%. Yet, taking into consideration the deflation of 2009, the average price level in 2010 was 1.1% below the level of the previous year.

Within the six months of 2011, the consumer prices increased by 4.1%. The total growth in the level of consumption prices in the six months of 2011 was mainly determined on the rise in price for fuel and food products, which is related to the price tendencies in the world. One of the reasons for rise in prices is also the increase in taxes, increased electricity tariffs and inflation expectations.

Producers' prices have resumed growing since the end of 2009. Prices for exported production increase mainly due to the rise in prices for export goods, including wood materials, metal articles, and food products in global markets resulting in the rise in prices for the production sold in local market. It should be noted that the rise in producers' prices became more moderate in the last months of 2010 and at the beginning of 2011.

The Ministry of Economics forecasts that the **total price level in 2011 might increase by 4.3%** in comparison with the previous year along with 12-months inflation by 3.8% (December over December).

After facing the financial market crash at the end of 2008 and at the beginning of 2009, the **monetary indicators of Latvia are stabilising**. As of the 4th quarter of 2009, an increase can be observed in deposits attracted from residents.

Since the end of 2009, the **interest rates have stabilised**. The weighted-average interest rate of short-term loans granted in LVL was 6.4% in the 1st quarter of 2011 (in the 2nd quarter of 2009 – 24.4%). However, **the credit balance granted to residents continues to decrease**. At the end of the 1st quarter of 2011, the credit balance granted to residents was by 8.7% lower than a year before. Since the end of 2008, the commercial credit balance (for raising the current assets of enterprises) decreased, and at the end of the 1st quarter of 2011, it was by 13.9% lower if compared to the corresponding period of 2010. Due to the gradual increase in economic activity, particularly in relation to expanding export possibilities, the balance of industrial loans (for purchasing fixed assets and long-term investment project funding) increased quite rapidly since January 2010; however, in the 1st quarter of 2011, a decrease can be observed. The balance of mortgage loans is still continuing to decrease, and at the end of the 1st quarter of 2011, it was by 8.9% lower than in the corresponding period of 2010.

The deterioration of the economic situation has significantly affected the fiscal condition of Latvia. The general government sector budget deficit in Latvia in 2009, was LVL 1258 million or 9.6% of GDP, and in 2010, it decreased to LVL 974 million or 7.6% of GDP

Significant budget consolidation measures have been carried out in Latvia implementing cumulative fiscal adjustment form 2008 to 2011 in the amount of 16.6% of GDP, including both cutting down the expenditures and increasing revenues. Reforms for optimization of public administration structure have been carried out – secretariats of the special assignment ministers have been liquidated, the Ministry of Regional Development and Local Government has been incorporated into the Ministry of Environment, the number of public agencies is reduced by 50%, as well as savings in the area of support functions are carried out by centralizing these functions.

On December 21, 2010, the Saeima adopted the budget for 2011 envisaging the general government budget deficit in the amount of 5.4% of GDP, which is far below the set budget deficit objective of 6% of GDP (pledges of Latvia expressed upon conclusion of the Memorandum of Understanding with the EU and signing the Letter of Intent with the IMF). On April 14, 2011, the Saeima adopted the amended budget for 2011, thus reducing the general government budget deficit to 4.2% of GDP; however, taking into consideration the provisions stipulated in the law on budget on possibility to increase additionally the appropriation for unforeseen events if necessary, the estimated budget deficit for 2011 is 4.5% of GDP. Overall, consolidation measures in the amount of LVL 350 million have been included in the budget for 2011, thus allowing correspondence with the budget deficit objective.

The fiscal policy objective of Latvia for 2012 is to prepare a budget that would ensure general government deficit below 3% of GDP (according to ESA '95 methodology), at the same time striving to achieve the deficit objective in amount of 2.5% of GDP to prove the commitment to observe the fiscal discipline and ensure sustainable government debt.

The general government deficit is expected to be below 1.9% of GDP in 2013 and 1.1% of GDP in 2014. By achieving these objectives the excessive budget deficit will be prevented, and the Maastricht criterion on budget deficit will be fulfilled in a sustainable manner.

The economic downturn has significantly worsened the situation in the labour market. During 2009, the number of the employed has decreased by 137.4 thousand or 12.2%, but the unemployment rate has increased by 9.4 percentage points.

The labour market reached the lowest point in the 1st quarter of 2010, when there were 916 employed persons, but the unemployment rate reached 20.5% of the economically active population. During the following quarters of 2010, the situation in the labour market gradually improved due to the gradual increase in economic activities. However, the average number of the employed in 2010, was by 4.6% lower than in 2009, because the employment growth resumed from a very low level.

944 thousand people were employed in the 1st quarter of 2011, which is by 3.1% more than in the 1st quarter of 2010. The unemployment rate is decreasing correspondingly. According to the labour survey data, the unemployment rate in the 1st quarter of 2011 was 16.6%. The rate of registered unemployment continues to decrease, and at the end of June 2011, it was 12.6%. Since December 2010, the number of registered unemployed has reduced by 20 thousand, however there still are huge regional differences – the rate of registered unemployment at the end of May in Latgale region was 20.9%, while in Riga – 9.4%.

According to the evaluation of the Ministry of Economics, the total **number of employed in 2011 is expected to exceed the level of 2010 by 2-3%.** The unemployment is likely to decrease correspondingly to the increasing employment. The unemployment rate in 2011 will range from 16% to 17%.

The situation in the labour market is expected to gradually improve in the upcoming years; however the increase in employment is likely to be moderate (on average 2% per year), because the growth will mainly depend on the increase in productivity. It should be noted that the labour supply will reduce due to the impact of demographic factors. The unemployment rate will continue to decrease and is expected to range from 10% to 11% of the economically active population in 2014.

Also in the upcoming years, export will still be the key economic driving force therefore the growth will be related to development of global economy and sufficiently efficient structural policy for improving economic competiveness. It is particularly important to maintain competiveness of Latvian producers in the main export sector – manufacturing.

Although the global economy recovers faster than expected, the future perspectives should be evaluated carefully. The key political priority in the global economy is still related to recovery of the financial sector, also taking into account the indirect impact caused by the downturn of the real sector. Further development of the European Union can be negatively affected by financial problems in the government sector of several countries and by the necessity to reduce the excessive budget deficit in order to ensure sustainability of finances of the countries.

The scenario of rapid growth, taking into consideration the impact of planned policy measures, envisages that **the growth rate of Latvia is expected to increase constantly and may reach stable an annual increase in the amount of 4% in a medium-term**. However, the scenario of slower growth envisages slower recovery from consequences caused by the crisis due to the failure to successfully implement the launched reforms and losing competitiveness.

2. DEVELOPMENT OF THE WORLD ECONOMY[1]

According to the forecasts of the International Monetary Fund (IMF), world economy is expected to grow by about 4.5% both in 2011 and 2012. Just like in the previous years, the growth of developed countries will be considerably slower than that of developing countries.

Within two years, more successful development was experience in the countries where economy was more balanced before the crisis, which during the crisis suffered less than others, as well as those countries which had better chances to implement economic support policy in the post-crisis period.

Table 2.1

GDP Growth
(percent in comparison with the previous year)

	2009	2010	2011f	2012f
World, including:	**-0.5**	**5.0**	**4.4**	**4.5**
USA	-2.6	2.8	2.8	2.9
Japan	-6.3	3.9	1.4	2.1
EU including:	-4.1	1.8	1.8	2.1
Eurozone countries	-4.1	1.7	1.6	1.8
CIS	-6.4	4.6	5.0	4.7
China	9.2	10.3	9.6	9.5

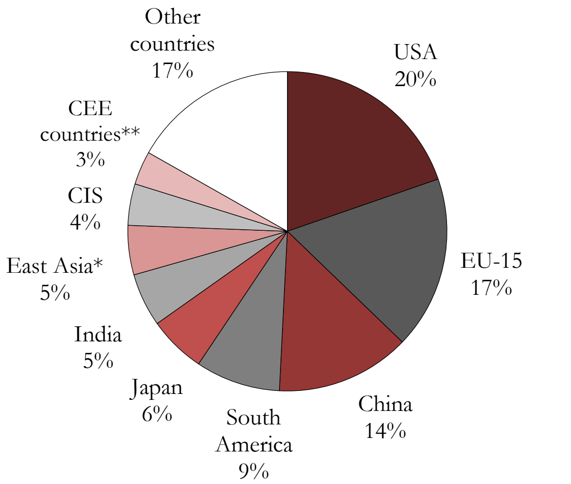
Source: *The World Economic Outlook April 2011*, International Monetary Fund; f – forecast

Concerns about possible relapse into recession related to the risk that the growth in developed countries is mainly based on stock restoring cycle and budget support measures might not be sustainable have not been realized. Yet, due to private consumption which lately has been the key driver of the growth, completion of stock restoring cycle and transition to budget consolidation measures create no barriers to further economic growth.

Production volumes in majority of the developed countries are significantly below their potential level. The unemployment rate is high, and the weak growth provides evidence that it will remain this way in the upcoming years. The weak growth is still based on the weak housing market, on the necessity to implement significant fiscal consolidations, as well as on weak bank balances. However, the developing countries are recovering more successfully – export volumes have resumed, decreasing external demand is compensated by stable domestic demand.

Figure 2.1

Breakdown of the World's GDP by Groups of Countries in 2010
(structure, GDP by purchasing power parity units)



Source: *The World Economic Outlook April 2011*, International Monetary Fund;
* South Korea, Malaysia, Singapore, Thailand, the Philippines
** 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

The economy of **USA** continues recovering mainly due to private demand. Although creation of new workplaces is fostered, it is slow due to the extensive reduction of workplaces during the crisis. Further transition from domestic to external demand is likely to speed up the economic growth of USA and allow reducing the big gap between potential and actual production volumes.

After the growth at the end of 2009 and at the beginning of 2010 which was based on positive changes in stocks, the economic growth rate slowed down. In the second half of 2010, growth resumed on the account of private consumption (the most rapid increase of private consumption over the last five years). Although the overall crediting is weak and household debt commitments continue growing, financial conditions in general are improving, loan rates for enterprises still are very low, bank crediting conditions are no longer that strict not only for large but also for small and medium-sized enterprises.

[1] In the preparation of the section, periodicals *World Economic Outlook April 2011* published by the International Monetary Fund and *European Economy 1/2011* published by the European Commission have been used.

Due to increased economic activities and reduced monetary restrictions, the stock market has recovered nearly two thirds of the capital lost during the crisis. It partially helped restoring consumer confidence which still is very low because of the high unemployment and weak mortgage sector.

As the private consumption is gradually strengthening, growth of the USA economy is expected to be slightly below 3% in 2011 and 2012. The unemployment will remain rather high, slightly decreasing to the rate of approximately 7.4% in 2012 while inflation is likely to be moderate – 2.2% in 2011 and 1.7% in 2012.

Table 2.2

The Main Macroeconomic Indicators of the EU Member States
(percent)

	GDP growth			Consumer prices			Current account balance (% of GDP)			Unemployment		
	2010	**2011f**	**2012f**	**2010**	**2011f**	**2012f**	**2010**	**2011f**	**2012f**	**2010**	**2011f**	**2012f**
EU, total including:	**1.8**	**1.8**	**2.1**	**2.0**	**2.7**	**1.9**	**-0.1**	**-0.2**	**-0.1**	**...**	**...**	**...**
Austria	2.0	2.4	2.3	1.7	2.5	2.0	3.2	3.1	3.1	4.4	4.3	4.3
Belgium	2.0	1.7	1.9	2.3	2.9	2.3	1.2	1.0	1.2	8.4	8.4	8.2
Denmark	2.1	2.0	2.0	2.3	2.0	2.0	5.0	4.8	4.8	4.2	4.5	4.4
Finland	3.1	3.1	2.5	1.7	3.0	2.1	3.1	2.8	2.6	8.4	8.0	7.8
France	1.5	1.6	1.8	1.7	2.1	1.7	-2.1	-2.8	-2.7	9.7	9.5	9.1
Germany	3.5	2.5	2.1	1.2	2.2	1.5	5.3	5.1	4.6	6.9	6.6	6.5
Greece	-4.5	-3.0	1.1	4.7	2.5	0.5	-10.4	-8.2	-7.1	12.5	14.8	15.0
Ireland	-1.0	0.5	1.9	-1.6	0.5	0.5	-0.7	0.2	0.6	13.6	14.5	13.3
Italy	1.3	1.1	1.3	1.6	2.0	2.1	-3.5	-3.4	-3.0	8.5	8.6	8.3
Luxemburg	3.4	3.0	3.1	2.3	3.5	1.7	7.7	8.5	8.7	6.1	5.9	5.8
The Netherlands	1.7	1.5	1.5	0.9	2.3	2.2	7.1	7.9	8.2	4.5	4.4	4.4
Portugal	1.4	-1.5	-0.5	1.4	2.4	1.4	-9.9	-8.7	-8.5	11.0	11.9	12.4
Spain	-0.1	0.8	1.6	2.0	2.6	1.5	-4.5	-4.8	-4.5	20.1	19.4	18.2
Sweden	5.5	3.8	3.5	1.9	2.0	2.0	6.5	6.1	5.8	8.4	7.4	6.6
United Kingdom	1.3	1.7	2.3	3.3	4.2	2.0	-2.5	-2.4	-1.9	7.8	7.8	7.7
Bulgaria	0.2	3.0	3.5	3.0	4.8	3.7	-0.8	-1.5	-2.0	10.3	8.0	6.7
Cyprus	1.0	1.7	2.2	2.6	3.9	2.8	-7.0	-8.9	-8.7	6.8	6.5	6.3
Czech Republic	2.3	1.7	2.9	1.5	2.0	2.0	-2.4	-1.8	-1.2	7.3	7.1	6.9
Estonia	3.1	3.3	3.7	2.9	4.7	2.1	3.6	3.3	3.1	16.9	14.8	12.8
Hungary	1.2	2.8	2.8	4.9	4.1	3.5	1.6	1.5	0.9	11.2	11.5	10.9
Latvia	-0.3	3.3	4.0	-1.2	3.0	1.7	3.6	2.6	1.5	19.0	17.2	15.5
Lithuania	1.3	4.6	3.8	1.2	3.1	2.9	1.8	-0.9	-2.9	17.8	16.0	14.0
Malta	3.6	2.5	2.2	2.0	3.0	2.6	-0.6	-1.1	-2.3	6.5	6.5	6.4
Poland	3.8	3.8	3.6	2.6	4.1	2.9	-3.3	-3.9	-4.2	9.0	9.0	8.7
Romania	-1.3	1.5	4.4	6.1	6.1	3.4	-4.2	-5.0	-5.2	7.6	6.6	5.8
Slovakia	4.0	3.8	4.2	0.7	3.4	2.7	-3.4	-2.8	-2.7	14.4	13.3	12.1
Slovenia	1.2	2.0	2.4	1.8	2.2	3.1	-1.2	-2.0	-2.1	7.2	7.5	7.2

Source: *The World Economic Outlook April 2011*, International Monetary Fund;
f – forecast

Rapid growth is continuing in the majority of **Asian countries**. It is based on export development, strong domestic demand, and increase of crediting in some of the countries. The growth rates in Asian region still are ahead of other regions. Actual production volumes are close to the potential ones in the majority of Asian countries, except Japan. At the same time, inflation is increasing, thus raising concerns about overheating of the region's economy. External balance is recovering slowly. The rapid growth will move the actual production output even closer to the potential level, and inflation is likely to increase in almost all parts of the region in 2011 due to the remaining favourable monetary conditions.

In general, the growth of the Asian region is forecasted to be slightly below the level of 7% in 2011 and 2012. More rapid growth is still expected in China and India.

The developed EU Member States are recovering relatively slowly. Overall, growth of the region is still below its potential. The unemployment remains high. There still are significant growth rate differences among the EU-15 countries – GDP is shrinking in Greece and Portugal, and weak growth remains in Ireland, Spain, and Italy. However, rapid growth rates of GDP in the EU-15 countries group are observed in Sweden, Finland, and Germany.

The growth rates of Germany are expected to be slightly weaker, mainly due to reduced fiscal support mechanisms, as well as slowed down growth rates of external demand. The growth rates in France will remain the same because the increase of consumption and export is expected to be moderate. But the growth of United Kingdom will be restricted by fiscal consolidation measures which will hinder the increase of domestic demand.

The economic growth of **the Baltic States** in the post-crisis period is based on external demand. After the sharp decline in foreign trade volumes in 2009, they have reached the pre-crisis level again in 2011, mainly due to improving competitiveness. However, domestic demand remains rather weak. Situation in the labour market is gradually improving but the unemployment is still high though reducing quite rapidly.

Further growth of the Baltic States is forecasted to be quite rapid in comparison with the average EU level. External demand will be the key driver of the growth in the coming years, however, the growing investment and private consumption will foster the domestic demand.

Recovery in **the CIS countries** is even and stable. Considering the decline in economic activities during the crisis, the growth in this region is significantly below the potential level.

Recovery of the CIS region in the post-crisis period is based on the high prices for resources and restoring capital flows. The growth in Russia has favourable impact on economic development of other CIS countries – foreign trade volumes, capital flows, and investment are increasing. Besides, trade and capital flows from other regions are also gradually becoming normal. However, development of the region still depends to a great extent on external finances. Also, the vulnerability of the banking sector hinders the growth in several CIS countries.

Having regard to the above mentioned, the growth in the CIS countries group is forecasted to be increased by 5% in 2011 and by 4.7% in 2012.

The growth in Russia is expected to be similar to that of the entire region. Demand of the private sector is more likely to remain moderate, but problematic bank credits will limit restoring crediting and increase of consumption.

Table 2.3

Main Macroeconomic Indicators of the CIS

(percent)

	2010	2011f	2012f
GDP growth	4.6	5.0	4.7
including Russia	4.0	4.8	4.5
Consumer prices	7.2	9.6	8.1
including Russia	6.9	9.3	8.0
Current account balance (% of GDP)	3.8	4.7	3.2
including Russia	4.9	5.6	3.9

Source: *The World Economic Outlook April 2011*, International Monetary Fund; f – forecast.

In general, the recovery of the global economy is successful, and in order to keep it stable also in future in the countries having huge budget deficits, it is important to implement successful fiscal consolidation. In order to reduce global economic imbalances, the developed countries must base their growth more on increase of export, but the developing countries must foster increase of domestic demand.

3. Growth

3.1. Gross Domestic Product Dynamics and Aggregate Demand

3.1.1. Development Trends

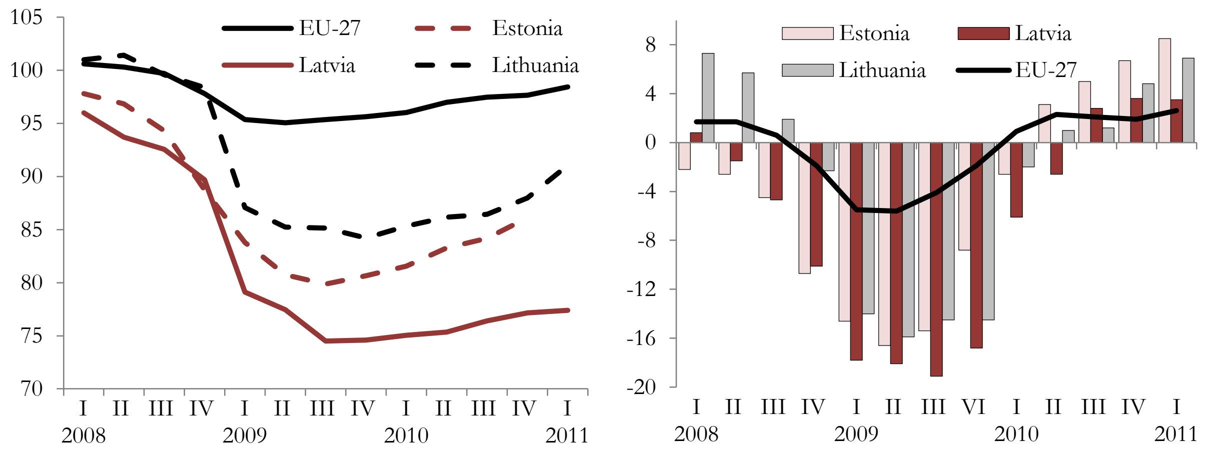
The global financial crisis severely affected the national economy of Latvia. The GDP decreased by 4.2% in 2008, but in 2009 – by 18%.

As the global economic situation gradually improved and the demand in our main partner countries increased, as well as the competitiveness of Latvian producers lost during the years of the rapid growth had been regained during the crisis, exports became the main driving force of the economy.

Figure 3.1

GDP Dynamics by Quarters

Seasonally adjusted data, 4th quarter of 2007 = 100 | Against the respective period of the previous year, %



Since the 4th quarter of 2009, the volumes of GDP started growing and in 2010 they increased on average by 0.9% every quarter. In the result, the average GDP level of 2010 just slightly lagged behind from the indicator of 2009.

Table 3.1

GDP of Latvia by Expenditure Items

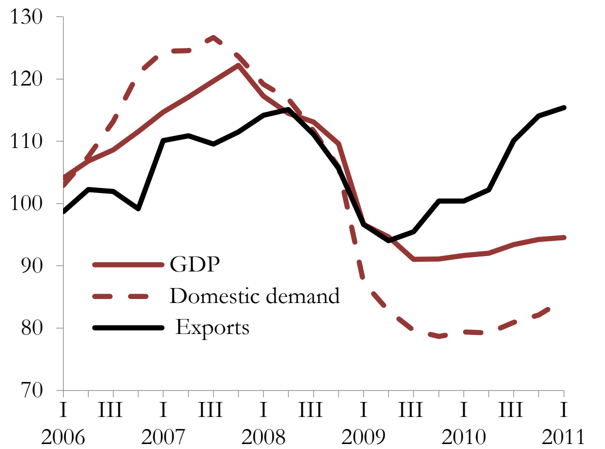
	2008	2009	2010	2011 Q1	2008	2009	2010
	changes compared to the corresponding period of the previous year, %				contribution to changes, %		
Private consumption	-5.2	-24.1	-0.1	3.6	-3.8	-17.3	0.0
Public consumption	1.5	-9.2	-11.0	0.6	0.2	-1.3	-1.8
Gross fixed capital formation	-13.6	-37.3	-19.5	28.4	-4.9	-12.1	-4.8
Inventories	–	–	–	–	-4.1	-1.5	5.8
Exports	2.0	-14.1	10.3	14.7	0.8	-6.3	4.8
Imports	-11.2	-33.5	8.6	20.7	7.4	20.5	-4.3
GDP	**-4.2**	**-18.0**	**-0.3**	**3.5**	**-4.2**	**-18.0**	**-0.3**

The recovery of the economy was based mainly on the increase of exports of goods and services, the volumes of which reached in 2010 almost the pre-crisis level. The demand for exports of Latvian goods had positive impact on the growth of tradable sectors – particularly development of manufacturing, as well as agriculture and transport and communications sectors.

Private consumption started stabilizing gradually in 2010. It was positively affected by the improvement of the situation in the labour market – moderate increase in employment and rise in wages.

Figure 3.2

Quarterly Changes in GDP and Major Expenditure Items
(4th quarter of 2005 = 100)



The GDP increased by 3.5% in the 1st quarter of 2011 compared to the corresponding period of the previous year. This increase was still based on the growth of exports.

Domestic demand also continues increasing gradually. It was by 3% higher in the 1st quarter of 2011 than in the corresponding period of the previous year.

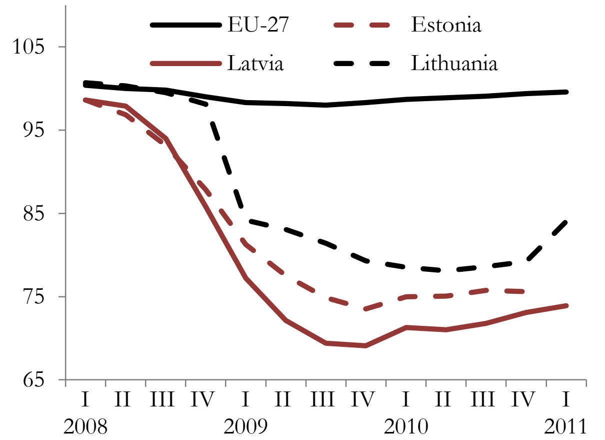
Along with the improvement of the situation in the labour market, private consumption also continues increasing. Private consumption has increased by 3.6% in the 1st quarter of 2011 compared to the 1st quarter of 2010.

3.1.2. Private and Public Consumption

The decrease of **private consumption** started at the beginning of 2008 and reached the lowest point in the 4th quarter of 2009, when private consumption reduced by 31% (if compared with the 4th quarter of 2007). Private consumption shrunk faster than GDP.

Figure 3.3

Changes in Private Consumption by Quarters
(seasonally adjusted data, 4th quarter of 2007 = 100)

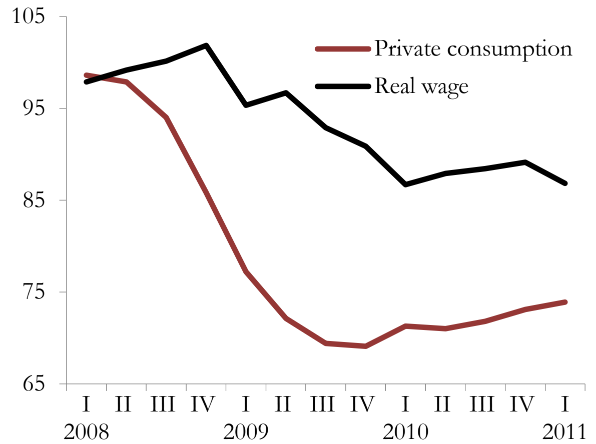


The decrease in private consumption was based not only on the decreasing income but also on narrowing household crediting.

Private consumption resumed gradual growing at the beginning of 2010, when the situation in the labour market improved (increase in employment and wages). Volume of private consumption increased on average by 1.3% every quarter, and the average annual private consumption corresponded to the level of the previous year.

Figure 3.4

Dynamics of Real Wage and Private Consumption by Quarters
(4th quarter of 2007 = 100)



More rapid recovery of private consumption is restricted by growing food and fuel prices and increase in tax rates reducing purchasing ability.

In near future, changes in private consumption are expected to be mainly determined by further improvement of situation in the labour market. However, both increase in employment and wages is likely to be moderate.

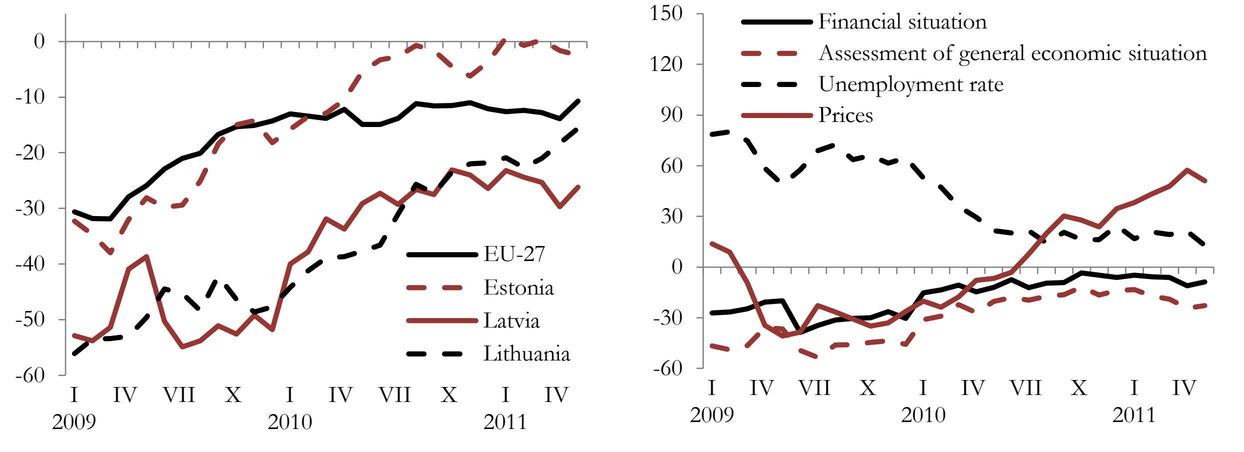
Since 2009, consumer confidence indicator has been gradually improving, and overall consumers are no longer that pessimistic. As from August 2009, consumer confidence indicator has been rapidly growing, but its growth rate gradually slowed down in the middle of 2010. At the beginning of 2011, consumer confidence slightly worsened.

Since the end of 2009, consumers estimated that both their family financial state and general economic situation in the state will improve in 12 months, despite the increasing inflation expectations.

Overall, consumer evaluation in 2011 regarding improvement of their family and state economic situation in near future is not significantly improving. The number of major purchases might also gradually increase in the next 12 months; however, inflation expectations are growing at the same time. Consumer optimism about further decrease in unemployment still remains.

Figure 3.5

Consumer Confidence Indicator* (seasonally adjusted data) | **Consumer evaluation for the next 12 months** (seasonally adjusted data)



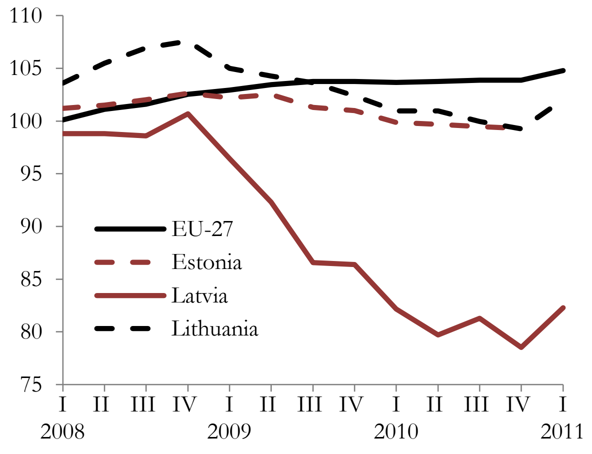
* Consumer confidence indicator is calculated as the average balance amount of responses to the 4 questions regarding financial situation, general economic situation, evaluation of unemployment and savings for the following 12 months.

Public consumption or public services amount to approximately one fifth of the aggregate domestic demand, and its value is determined by the volume of the provided public services. During the years of rapid growth, the volume of public services increased at a slower pace than private consumption.

Public consumption started decreasing in 2009, when the budget consolidation measures were implemented. In 2009, its volume was by 9.2% lower than in 2008, and it was at the level of 19.6% of GDP.

Figure 3.6

Changes of Public Consumption by Quarters
(seasonally adjusted data, 4th quarter of 2007 = 100)



Also in 2010, the dynamics of public consumption was related to implementation of the state budget consolidation measures. Public consumption continued decreasing, and its amount was by 11% lower than in 2009, and its share in the GDP structure reduced to 17.2% of GDP.

Budget consolidation measures are continued also in 2011, therefore the amount of public services practically is not increasing.

3.1.3. Investments

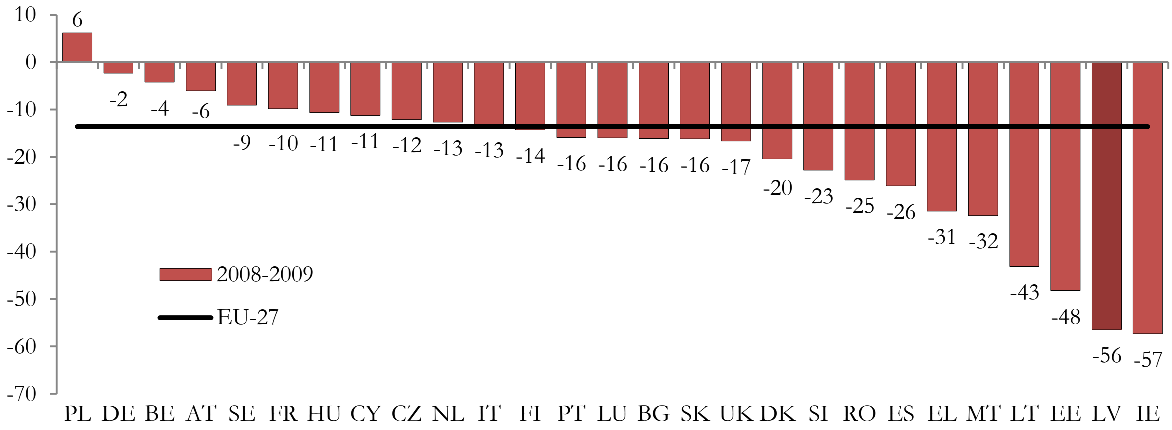
Since the end of 2010, investment activities in Latvia have been gradually increasing though they are still at a very low level. In 2010, investments in the national economy of Latvia were by 19.6% lower than in 2009. But in the 1st quarter of 2011, in comparison with the corresponding period of the previous year, investments increased by 28.4%. The investment adjustment over the course of three years has been much more intense than the GDP adjustment. Since 2008, the investment volumes have decreased by a half and in 2010 constituted only 18% of GDP (in 2007 – 33.7% of GDP). Sensitivity of investors to economic fluctuations was to a great extent determined by worsening financial situation of companies due to a rapidly narrowing market.

A significant decline in investments was observed also in the EU Member States. Since 2008, investments in EU countries have decreased on average by 13.5% within three years, i.e., almost ten times faster than GDP. It should be noted that the only EU Member State with positive investment dynamics is Poland (in 2010 comparing to 2007, investments increased by 6.2%,). However, the decrease of investment volumes in the Baltic States and Ireland has exceeded the EU average almost four times.

Figure 3.7

Changes in Investment Volumes in the EU Member States from 2008 to 2010

(percent)



The severity of investment adjustment in Latvia was intensified by the huge debts of enterprises accumulated during the rapid growth years, as well as by worsening solvency of the Latvian banking system. In 2008, the investment volumes in the national economy of Latvia were by 13.6% lower than in 2007. Worsening investment environment, low level of domestic and foreign demand, as well as manufacturing capacity load negatively affected the investment processes in 2009. Investment volumes were by 37.3% lower than in 2008. It should be noted that in 2009, the investment dynamics was negative in all EU Member States. But in 2010, positive investment dynamics was restored in numerous EU Member States, while investment volumes in Latvia reached 80% of the level of the previous year.

Table 3.2

Gross Capital Formation

	2004-2007 (average annually)	2008	2009	2010	2011 Q1
	growth in percent				
GDP	10.4	-4.2	-18.0	-0.3	3.5
Gross Capital Formation	15.3	-23.6	-44.8	4.54	28.4
– gross fixed capital formation	17.8	-13.6	-37.3	-19.5	28.4
	% of GDP				
Gross Capital Formation	37.6	31.2	20.3	20.7	19.6
– gross fixed capital formation	31.7	29.3	21.5	18.0	14.6
– changes in inventories	6.0	1.8	-1.2	2.7	4.9

The decrease of private investments in Latvia was intensified also by the decrease of public investment volumes due to the necessity to implement budget consolidation measures. Public investments in 2008 and 2009 decreased by 15.4% and 24% respectively. In 2010, public investments constituted 80% of the level of 2009. Overall they shrunk by half in three years. Despite the fact that the decrease of public investment volumes to a certain extent intensified recession of total investment, the state still plays an important role in the investing process as the state ensures significant support to private investment through the EU Structural Funds co-funding. Moreover, the share of public investments in the total investment volume in the national economy of Latvia in 2010 reached 20%, i.e., almost 3 percentage points more than in 2007.

Latvian entrepreneurs consider the low demand and financial difficulties as the main factors limiting investments. In 2010, influence of these factors slightly decreased; however, the restoration of private sector crediting channels is slow, but domestic means for investment financing are insufficient. On the other hand, the capacity load level in manufacturing has been gradually increasing since the beginning of 2010. In June 2011, it reached 67%, which is just 5 percentage points below the level of the end of 2007. It indicates that the current manufacturing volume is approaching its potential. Increase of demand, as well as entrepreneurs' positive future vision 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 in the desire to consolidate positions in foreign and domestic markets including by technologically renewing the existing capacity loads.

Structure of the investment sectors.[1] Though the total investment volumes decreased more in 2008 than in the years before the crisis, the changes if considered by sectors appear to be very different.

The majority of sectors have maintained the 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. Yet, the investment volumes in other sectors were lower in comparison with 2007. A particularly significant decrease of investment volumes was observed in the energy sector – by 28.5%, financial services – by 32.2%, manufacturing – by 23.6%, and construction – by 14.7%. In total, investments in the goods manufacturing sector decreased by 18%, but in the services sector increased by 6%.

As the economic crisis intensified, in 2009, the investment activities continued to decrease in all sectors, including the sector of production of goods– by 45.6% and in the services sector – by 28% in proportion to the 2008. The most significant decrease of investments was observed in the construction sector (by 46.1%), finances and insurance operations (by 55.2%), and manufacturing (by 53.1%).

According to provisional data, the investment process also in 2010 has been weak in all sectors. Investments in both service and goods production sectors were by almost 20% lower than in 2009. Yet, investments in real estate transactions have increased (by 8.3%), transport and storage sector (by 2%), mining industry (by 19.1%) in comparison with the previous year.

Stabilizing economic situation positively affected the investing process in Latvia. In the 1st quarter of 2011, almost all sectors saw more investments than a year before. Investments in service sectors increased by 20.5% and constituted almost 60% of total investments in the national economy of Latvia. Investments in goods production sectors in the 1st quarter of 2011 were almost one and a half times more than before. It was mainly due to the extensive investments in the energy sector.

Table 3.3

Dynamics and Structure of Investment Sectors

	Growth rates				Structure			
	2004-2007 (average annually)	**2009**	**2010***	**2011 3 months***	**2004-2007 (average annually)**	**2009**	**2010***	**2011 3 months***
Primary sectors	7.6	-41.0	-19.0	30.2	4.4	3.8	4.5	4.9
Manufacturing	17.9	-53.1	-5.6	11.7	16.2	9.3	16.7	19.2
Electricity, gas, and water supply	13.2	-35.3	-33.6	154.7	7.8	8.2	12.5	14.4
Construction	26.1	-46.1	-37.0	88.5	7.2	9.1	1.5	1.9
Trade	5.0	-50.6	-38.6	-2.3	13.2	8.0	6.6	8.8
Transport and communications	3.0	-40.1	-7.0	40.0	13.2	11.5	20.9	25.0
Other commercial services	22.8	-30.9	-16.9	2.8	23.4	25.0	8.5	7.4
Public services	19.5	0.0	-24.6	19.6	14.7	25.1	28.8	18.3
Total	**15.6**	**-34.4**	**-20.7**	**29.8**	**100**	**100**	**100**	**100**

* estimated by using quarterly data

Investments in the manufacturing are gradually increasing, though the investment level in the sector still is rather low. Due to the financial crisis investments in the manufacturing in 2008 and 2009 decreased by 23.6% and 53.1% respectively. It was determined to a great extent by the decrease of investments in food production, wood processing, and production of chemical substances and its products.

Also in 2010, investments in manufacturing continued decreasing, though slower than in 2009. Investment volumes in 2010 were by almost 6% lower than in 2009. Overall, investments in the manufacturing industry have shrunk by almost 70% within three years (2008-2010). Yet, despite the overall negative dynamics of investing process, an increase of investment was observed in some manufacturing sectors in 2010.

In 2010, investments in wood processing had almost doubled in comparison with the previous year. Positive investing tendencies in 2010 were observed also in metal processing and production of vehicles. Investments in the sector of production of automobiles, trailers, and semi-trailers and production of metals increased almost 3 times. Also in the 1st quarter of 2011, investments in these sectors exceed the level of the corresponding period of the previous year.

[1] Investments in sectors are presented according to the non-financial investment statistics that do not include all investments in fixed assets.

Since 2004, extensive investments were made in production of construction materials. Though the investment volumes in production of construction materials have decreased (annually by almost 20%) since 2008, when the situation in the real estate market deteriorated, investments in this sector constituted almost a half of the total investments in the manufacturing industry.

Table 3.4

Dynamics and Structure of Investments in Manufacturing Industry
(percent)

	Growth rates				Structure			
	2004-2007 (average annually)	2009	2010*	2011 Q1*	2004-2007 (average annually)	2009	2010*	2011 Q1*
Food industry	-1.8	-52.0	-18.9	8.3	21.8	15.1	14.5	14.2
Light industry	-13.3	-32.8	-65.7	87.9	2.7	2.5	1.1	1.1
Wood processing	18.2	-88.3	98.0	483.5	26.4	8.4	16.3	26.2
Paper industry and publishing	20.2	-71.5	99.6	334.6	7.2	2.5	2.7	3.5
Chemical industry and related industries	24.3	-11.4	-39.3	-23.6	7.6	12.2	10.5	5.1
Production of other non-metallic mineral products**	79.0	-19.7	-15.8	-70.0	14.4	39.3	39.2	17.4
Production of metals and metal articles**	20.5	-59.4	133.6	300.0	7.1	7.0	10.1	20.0
Production of machinery and equipment	9.0	-43.7	-25.3	12.4	2.1	2.0	0.6	0.6
Production of electrical and optical equipment	7.1	-53.7	15.8	-1.3	2.5	1.1	1.1	1.3
Production of vehicles	25.0	0.4	43.2	175.4	2.3	4.5	2.3	4.9
Other industries	20.9	-27.0	-23.7	42.1	5.8	5.4	1.5	2.2

* estimated by using quarterly data; ** Evaluation of the Ministry of Economics

In the near future, investment volumes in the national economy of Latvia are likely 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. Export and Import

Export and import of goods

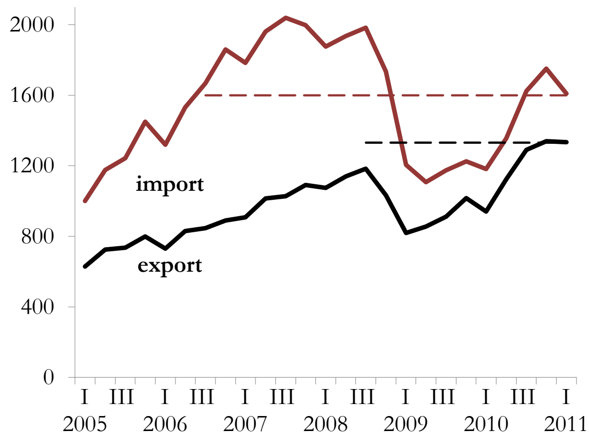
In 2010, volumes of Latvian export goods increased in actual prices by 30.3% (in comparable prices – by 19.6%), thus export of goods already exceeds the pre-crisis level. Also from January until April 2011, volumes of export significantly exceed the corresponding period of the previous year (by 37.7% in actual prices).

However, despite the rapid increase in import of goods in 2010 (by 25.5% in actual prices and by 15.6% in comparable prices), it still significantly lags behind the highest point of the pre-crisis level reached in 2007. Just like export, also import of goods has rapidly increased in the four months of 2011 comparing to the period from January until April 2010 (by 34.5% in actual prices).

As shown in Figure 3.8, volumes of export and import have come significantly closer to each other, and in 2010, import exceeds export by 26% (at the end of 2006, import was double the export).

Figure 3.8

Export and Import of Goods by Quarters
(million LVL)



In 2010, changes in the trading conditions positively influenced **export of goods**, as the prices of export rose slightly more rapidly than those of import. The most significant increase of an export unit value was for metal and metal articles, as well as timber. But the export unit value for food industry products has slightly decreased. Also in the 1st quarter of 2011, trade conditions have improved. The most rapid rise in export prices was observed for metal and metal articles, as well as wood and wood products.

In 2010, export volumes of goods increased in all product groups; and this increase was mostly due to wood and wood products, metal processing products, as well as agricultural and food product export. All together, these groups ensured almost 2/3 of the total export increase in 2010.

From January until April 2011, growth was observed in all goods export groups (in total by 37.7%), if compared to the four months of 2010. One fourth of the total export increase was ensured by metal and metal articles export. Increase of wood and timber products export, as well as chemical industry goods export contributed significantly to the export.

Figure 3.9

Export Dynamics of Goods by Months
(million LVL)

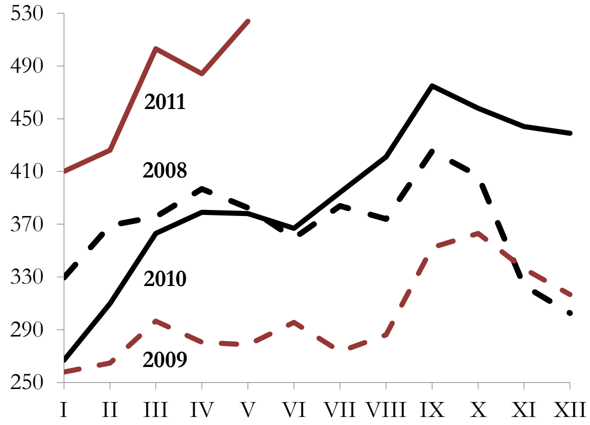


Table 3.5

Main Commodity Groups for Export
(%, in actual FOB prices)

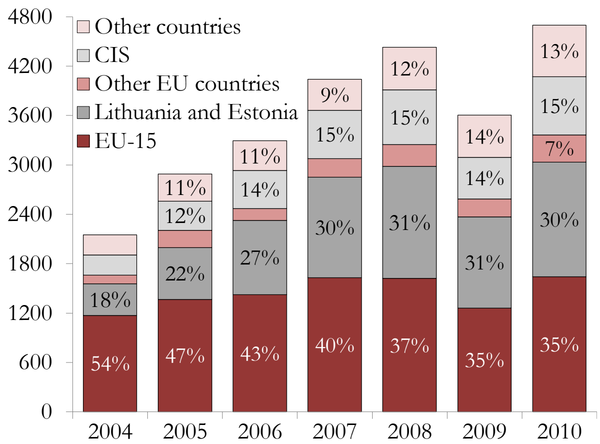
	2010		2011 January-April	
	structure	increase compared to the previous year	increase compared to the corresponding period of the previous year	contribution in changes of volume
Total including:	**100**	**30.3**	**37.7**	**37.7**
wood and wood products	19.0	49.5	28.1	5.5
metal and metal articles	13.8	45.2	78.0	9.8
light industry products	5.0	14.8	28.1	1.5
agriculture and food products	17.9	25.3	18.3	3.2
products of chemical industry and related industries, plastics	10.7	22.7	46.2	4.9
machinery products	13.0	19.6	30.1	3.7
minerals	6.0	41.8	54.9	3.8
vehicles	6.0	11.2	31.0	2.0
other goods	8.6	29.4	37.6	3.3

Export to the EU Member States increased by 30% in 2010, but in the four months of 2011 – by 42.2%, in comparison with the four months of 2010. Thus, the pre-crisis level of export to the EU countries has been fully reached again. Considering the large share of the EU countries in the Latvian export, the group of these countries was the main influencing factor on the overall tendencies (80% of the total increase of export).

The largest export increase to the EU countries was observed for metal and metal articles, timber products and chemical industry export product groups (in total about 60% of all increase of export), just like in the overall export of Latvia.

Figure 3.10

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



In 2010, export to the CIS countries increased by 40%, similarly also from January until April of 2011 – by 47%, in comparison with the same period a year ago. The largest contribution to export increase of the four months of 2011 to the CIS countries was on the account of agricultural and food products group, as well as machinery industry group, altogether constituting more than a half of all export increase to the CIS countries.

Also the **import of goods** rapidly increased in 2010 (by 25.5%). Increase was observed in all product groups, especially in metal and metal articles, machinery and chemical industry product groups. From January until April 2011, import of goods has increased even more rapidly – by 34.5% in comparison with the corresponding period of the previous year. Metal processing products, minerals, as well as vehicle and machinery manufacturing product import groups contributed to import the most in this period, altogether constituting 3/4 of the total import increase.

Import from the EU and CIS countries has increased equally rapidly.

Figure 3.11

Import Dynamics of Goods by Months
(million LVL)

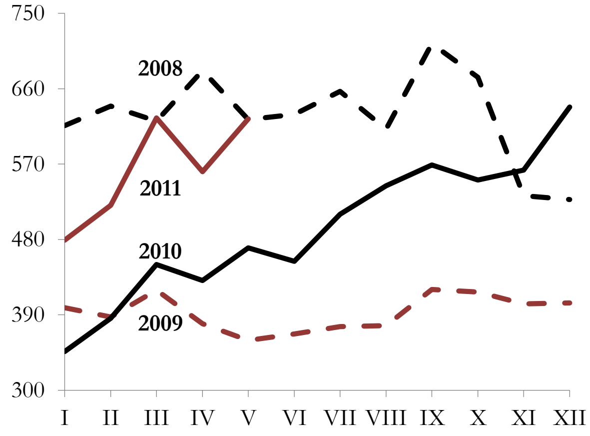


Table 3.6

Main Commodity Groups of Import
(%, in current CIF prices)

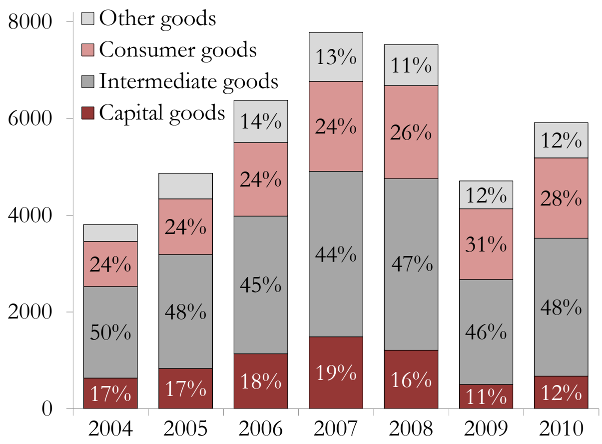
	2010		2011 January–April	
	structure	increase compared to the previous year	increase compared to the corresponding period of the previous year	contribution in changes of volume
Total including:	**100**	**25.5**	**34.5**	**34.5**
wood and wood products	1.6	45.7	29.1	0.5
metal and metal articles	11.6	79.9	76.9	7.0
light industry products	5.7	13.6	17.8	1.1
agriculture and food products	16.3	11.6	11.1	2.0
products of chemical industry and related industries, plastics	16.9	25.3	19.2	3.6
machinery products	16.4	31.3	38.3	5.6
minerals	15.4	12.2	40.2	7.0
vehicles	7.2	39.2	114.5	6.0
other goods	9.0	16.9	18.9	1.7

The share of import of capital goods tended to decrease until 2009, which is related to the decrease of investments. However, an opposite tendency is observed in the post-crisis period; the import of capital goods and intermediate goods is increasing more rapidly. Nevertheless, it should be noted that import volumes of these goods are considerably lower than in the pre-crisis period. The share of import of consumer goods is accordingly reducing as import volumes of these import groups remain at the level of 2009.

Figure 3.12

Import by Classification of the Broad Economic Categories

(relating to the basic sections of national accounts, in actual CIF prices, million LVL)

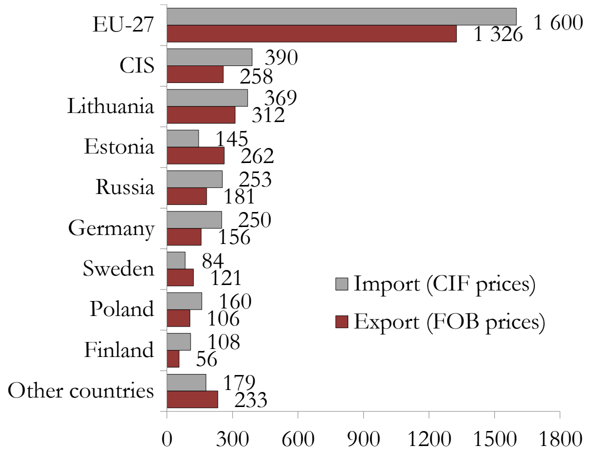


The biggest **trade partners** of Latvia from January until April 2011 were Lithuania – 17.1% of the total foreign trade turnover, Russia – 10.9%, Estonia and Germany – 10.2%, Poland – 6.7%, Sweden – 5.1%, as well as Finland – 4.1%.

Figure 3.13

Foreign Trade Turnover of Latvia in January-April 2011

(million LVL)

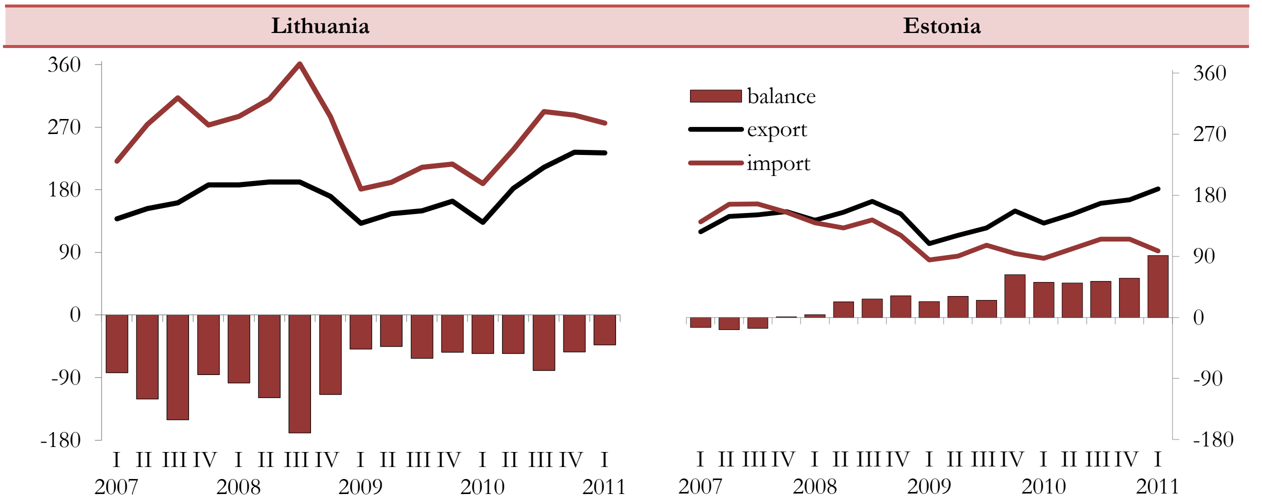


The most important foreign trade partner countries of Latvia are **Lithuania** and **Estonia**. Significant deterioration of the Latvian trade balance with both countries was observed during the rapid growth of the Baltic States. Yet, starting with the second half of 2008, when the total import volumes reduced, the foreign trade balance with Lithuania and Estonia gradually started to improve.

Figure 3.14

Foreign Trade Turnover of Latvia with Lithuania and Estonia by Quarters

(million LVL)



Since 2008, the foreign trade balance with Estonia has been positive and has a tendency of increasing, while with Lithuania it is still negative. The import from Lithuania from January until April 2011, exceeded the export by 18% (in 2010, overall – by 32%), while the export to Estonia almost twice exceeded the import (in 2010 – by 50%). Overall, the trade balance with both countries is positive – export exceeds import by 12%. The main groups of products exported to Estonia and Lithuania are agricultural and food products, machinery products, as well as chemical industry products. Minerals, agricultural and food products, as well as chemical industry products constitute the largest share in imports from Lithuania and Estonia.

Export and import of services

The positive balance of services in 2010 covered the negative goods trade balance by 96%. If compared to 2009, volumes of export and import services slightly increased, thus maintaining a marked positive balance of services. Also in the 1st quarter of 2011, the balance of services is similar due to growing export and import.

The revenues from transit transport still constitute slightly more than a half of the services export. Although the revenues from sea and air transport have decreased, the overall transport export is growing on the account of rapid increase of revenues from land transport.

Table 3.7

Export and Import of Services
(percent)

	2010				From January until March 2011			
	structure		changes compared to the previous year		structure		changes compared to the corresponding period of the previous year	
	export	import	export	import	export	import	export	import
Services – total	**100**	**100**	**1.4**	**2.7**	**100**	**100**	**8.3**	**11.8**
including:								
Transport services	49.2	29.5	-1.5	19.6	53.7	30.9	8.9	29.5
– sea transport	14.8	7.7	-16.3	5.2	14.3	7.3	-14.4	29.1
– air transport	9.3	10.6	13.9	32.4	6.7	10.3	-13.8	22.1
– other transport	25.1	11.2	4.0	19.9	32.7	13.4	31.6	36.0
Travel	17.3	29.2	-6.4	-14.6	15.0	25.3	6.2	2.5
Commercial services	32.2	39.9	10.6	8.3	30.0	42.6	6.8	8.0
Other services	1.3	1.4	22.5	-18.6	1.3	1.2	56.4	-17.1

The revenues from tourists coming to Latvia and export of commercial services have increased just like the overall export of services.

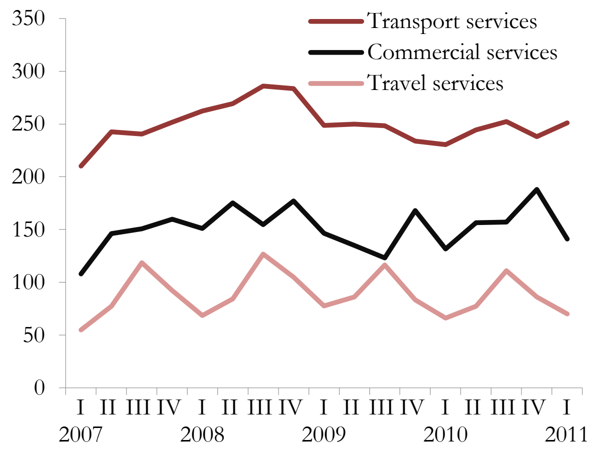
Export of services to the EU countries constitutes about a half of the total export of services of Latvia. From January until April 2011, export of services volumes slightly decreased (by 2.7%). They shrunk similarly also in 2010 (by 3.2%). In the 1st quarter of 2011, transport volumes to the EU countries have increased significantly, as well as revenues from tourists coming to Latvia have slightly increased. However, export of commercial services has slightly decreased.

As volumes of service export to the CIS countries rapidly increased in 2010 (by 67%), its structure in the total export of services grew from 9% to 15%. Also from January until March 2011, export of services to the CIS countries continues increasing, yet not as fast (by 20.3%). The largest contribution to this increase was on the account of the increase of transport export. Revenues from visiting tourists coming from the CIS have also slightly increased.

Export of services to Lithuania and Estonia constitutes respectively 7% and 6%. Export of services to Estonia has decreased from January until March 2011 (by 12%), however it was completely compensated by the increase of export of services to Lithuania (by 15%). The main service export groups to both countries are commercial services, as well as services related to transport.

Figure 3.15

Export of Services by Quarters
(million LVL)



3.2. Contribution of Sectors

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

During the years of rapid growth (2005-2007), GDP increased by more than 11% annually, and the growth was mainly promoted by increase in domestic demand. The growth of construction, trade, and commercial services sectors ensured over 75% of the total GDP growth during these years. Thus, the share of service sectors considerably increased in the structure of national economy. From 2005 until 2007, contribution of the manufacturing constituted only 5% of the overall growth. A very low share of the manufacturing appeared in the national economy of Latvia, lagging behind the average EU level by 6 percentage points in 2007.

The structure of the sectors by the number of employed slightly differs from that by the value added, which is due to the explicitly different productivity level in the sectors of national economy.

Table 3.8

Structure of the National Economy
(percent)

	By value added			By number of employed		
	2005	**2009**	**2010**	**2005**	**2009**	**2010**
Primary sectors	4.3	3.8	4.7	12.3	9.4	9.8
Manufacturing	12.6	9.9	12.2	14.9	13.5	14.2
Electricity, gas, and water supply	2.5	3.6	4.1	2.2	1.7	1.9
Construction	6.1	6.6	5.0	8.8	7.7	7.0
Trade, hotels, and restaurants	21.5	16.6	17.7	17.9	19.6	19.3
Transport and communications	13.9	11.4	12.5	9.1	9.9	9.9
Public services	15.0	17.1	15.6	22.2	22.3	21.8
Other commercial services	24.1	30.9	28.3	12.6	15.9	16.1
Total	**100**	**100**	**100**	**100**	**100**	**100**

Output volumes of all economy sectors and rendered services significantly decreased due to the influence of the global financial crisis. Demand-oriented sectors experienced the most intensive decrease during the economic crisis – the volume of services rendered in trade, hotel, and restaurant sector shrank the most in 2009 (by 35%) if compared to 2007, but construction volumes decreased by 35.3%. Other service sectors experienced more moderate decrease during the economic crisis.

The decrease of external demand during the crisis (2008-2009) resulted in significant decrease of the manufacturing output (by 24.5%). However, as the growth gradually resumed in our trade partner countries at the end of 2009 and as the competitiveness was restored as a result of cost reduction, the situation in the manufacturing started improving.

Due to the improving situation in world economy and increasing external demand, the tradable sectors played a more important role in the national economy in 2010 allowing to compensate the still weak domestic demand and development of domestic demand-oriented service sectors.

The growth in 2010 was observed in all sectors of goods production. In 2010, the manufacturing increased by 15.4%, electric energy, gas, and water supply sector – by 12.7%, and primary sectors – by 3.8%. Overall, the growth of these sectors ensured contribution of 1.6 percentage points to the growth of GDP. The growth rates of these sectors remained steady also in the 1st quarter of 2011.

The construction sector is experiencing the deepest decline in production volumes. Construction production volumes in 2010, if compared to 2009, have decreased by 24.2% along with the decrease of investments. Tendencies in construction influenced the decrease of GDP by 1.2 percentage points.

Table 3.9

Dynamics of GDP

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

	2005-2007*	2008	2009	2010	2010				2011
					I	II	III	IV	I
changes in volumes									
Primary sectors	5.3	0.5	3.0	3.8	4.9	4.9	1.6	4.8	8.2
Manufacturing	4.2	-6.5	-19.2	15.4	6.8	15.3	20.2	17.9	14.6
Electricity, gas and water supply	3.1	-2.4	-7.2	12.7	17.4	11.0	15.1	7.8	3.9
Construction	17.5	-2.6	-33.6	-24.2	-43.2	-35.3	-13.1	-9.6	-15.1
Trade, hotels, and restaurants	16.2	-8.4	-29.0	3.2	-8.4	-0.2	11.0	10.4	7.5
Transport and communications	8.7	0.5	-14.8	3.0	2.3	2.5	5.4	1.6	6.6
Public services	4.2	1.3	-6.3	-7.8	-13.4	-12.0	-6.3	-1.0	-0.5
Other commercial services	13.2	0.0	-5.5	-3.6	-7.8	-3.4	-4.2	0.5	0.3
GDP	**10.9**	**-4.2**	**-18.0**	**-0.3**	**-6.1**	**-2.6**	**2.8**	**3.6**	**3.5**
contribution to changes in volumes									
Primary sectors	0.2	0.0	0.1	0.1	0.2	0.2	0.1	0.2	0.3
Manufacturing	0.6	-1.1	-2.4	1.2	0.7	1.5	2.3	1.9	1.4
Electricity, gas, and water supply	0.1	-0.1	-0.2	0.3	0.7	0.2	0.3	0.3	0.2
Construction	1.3	-0.3	-3.2	-1.2	-2.3	-2.3	-1.0	-0.5	-0.4
Trade, hotels, and restaurants	3.7	-3.0	-7.4	0.4	-1.7	0.0	2.3	1.7	1.3
Transport and communications	1.3	0.1	-2.3	0.3	0.3	0.3	0.8	0.2	0.8
Public services	0.6	0.2	-0.9	-0.8	-1.7	-1.6	-0.8	-0.2	0.0
Other commercial services	3.2	0.0	-1.6	-0.7	-2.2	-0.9	-1.2	0.1	0.1
GDP	**10.9**	**-4.2**	**-18.0**	**-0.3**	**-6.1**	**-2.6**	**2.8**	**3.6**	**3.5**

* average per year;

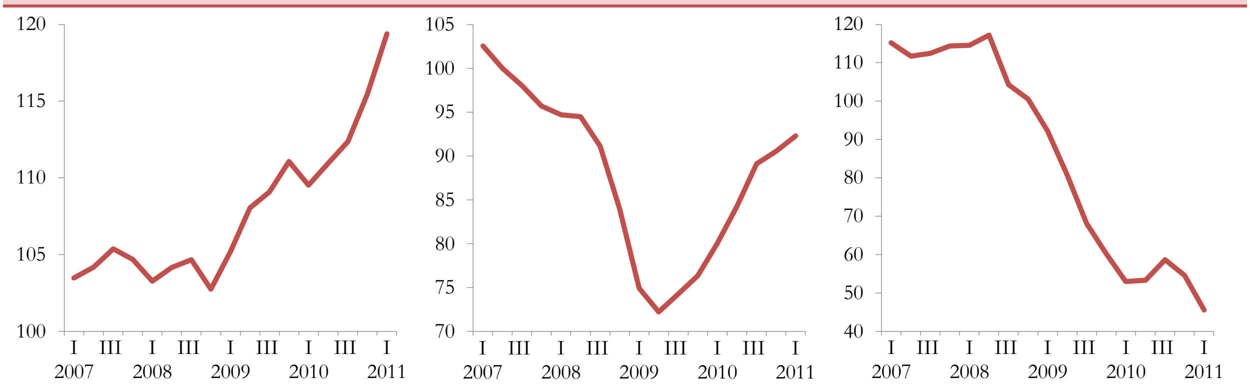
In the 1st quarter of 2011, construction volumes were 15.1% below the level of the 1st quarter of 2010. Despite the stabilising situation in the sector observed during the previous quarters, a decrease of construction volumes was observed at the end of 2010 and at the beginning of 2011 caused by bad winter weather, especially in engineering construction (roads, bridges, etc.). At the beginning of 2011, the number of issued construction permits has increased, as well as large state and municipal investment projects are launched or continued, which proves that the construction sector is gradually recovering from the crisis (additional information is given in Section 6.3.2).

Figure 3.16

Agriculture and forestry Value added changes, seasonally adjusted data, 4th quarter of 2006 = 100

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

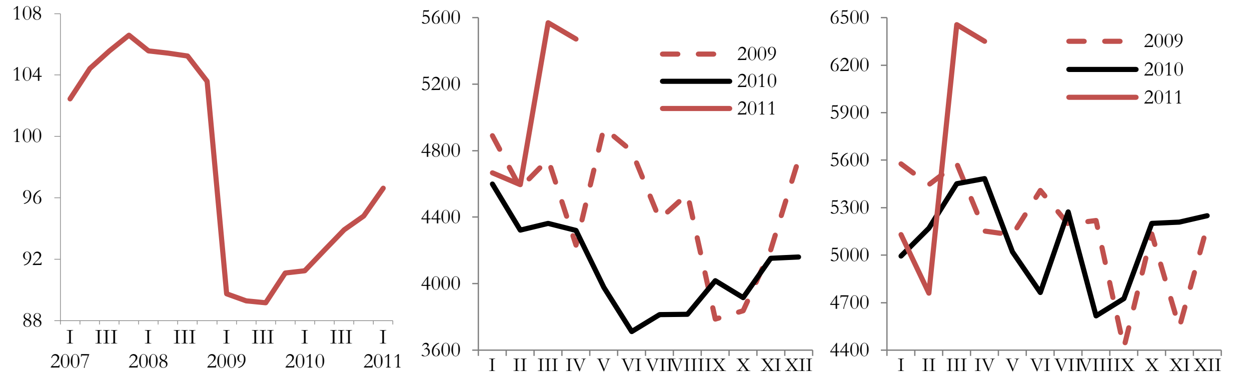
Construction Value added changes, seasonally adjusted data, 4th quarter of 2006 = 100



Despite the reduced freight turnover on railroads (by 8.4%) and through ports (by 1.3%), the growth in 2010 was observed in the transport and communication sector (increase by 3%). The increase was mainly based on rise in volumes of freight by road transport vehicles (by 23.8%), in comparison with 2009.

Figure 3.17

Transport and communications Value added changes, seasonally adjusted data, 4th quarter of 2006 = 100	**Freight on railroads,** Freight turnover, thousand t	**Delivered and received freight in ports,** Freight turnover, thousand t



The situation in the transport and communication sector has been improving also in 2011. An increase of 6.6% was observed in the sector during the 1st quarter, if compared to the corresponding period of the previous year. Freight shipments have increased for all transport types. In the four month of 2011, freight shipment by railway has grew by 15.3%, but freights delivered and received in ports – by 7.6%, in comparison with the corresponding period of the previous year. Just like in 2010, also in 2011 the growth of transport sector was mainly based on the increase of export freight shipments.

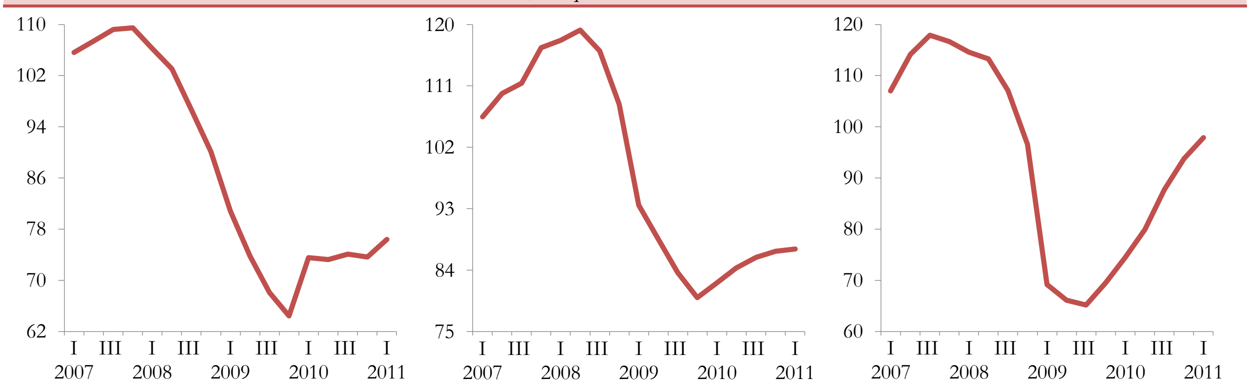
Volumes of services provided in the trade, hotel, and restaurants sector increased by 3.2% in 2010. Considering the large share of the sector in national economy, the increase had an impact on the growth of GDP by 0.4 percentage points. The growth of trade sector is achieved mainly on the account of increase of wholesale volumes (in 2010 – by 24.4%) which is based on increase of export transactions volumes.

As the domestic demand became more stable, the situation in retail trade also improved in 2010. Volumes of retail trade turnover increased by 7.8% from December 2009 until December 2010 (in comparable prices, according to seasonally adjusted data). However, overall in 2010, they still were by 2% lower than in 2009 as the growth resumed from a very low level. It should be noted that turnover of food product trade shrank by 5.3%, and volumes of fuel retail trade shrank by 6.5% in 2010, while turnover of non-food products increased by 2.4 percent.

Similar tendencies remained also at the beginning of 2011. In the first quarter, the trade, hotel, and restaurant sector exceeded the level of the 1st quarter of the previous year by 7.5%. Wholesale turnover is rapidly growing (by 31.5% if compared to the corresponding period of the previous year) due to the continuing increase of export volumes. Retail trade turnover is increasing in line with the gradually improving situation in the labour market and rising wages, and from January until April 2011, it exceeded the level of the corresponding period of 2010 by 1.2%.

Figure 3.18

Trade Value added changes, seasonally adjusted data, 4th quarter of 2006 = 100	**Retail trade turnover** in comparable prices, seasonally adjusted data, 4th quarter of 2006 = 100	**Wholesale turnover** in comparable prices, seasonally adjusted data, 4th quarter of 2006 = 100



Output volumes of other commercial service sectors in 2010 still lagged behind the level of 2009. Volumes of services provided in the commercial service sector shrank by 3.6%, but the volume of services provided in public service sectors was by 7.8% lower than in 2009 due to consolidation measures of the government expenditures.

The role of tradable sectors is expected to continue growing due to the remaining positive increase of export tendencies and, as the domestic demand increases, growth stimuli for domestic market-oriented sectors will also appear.

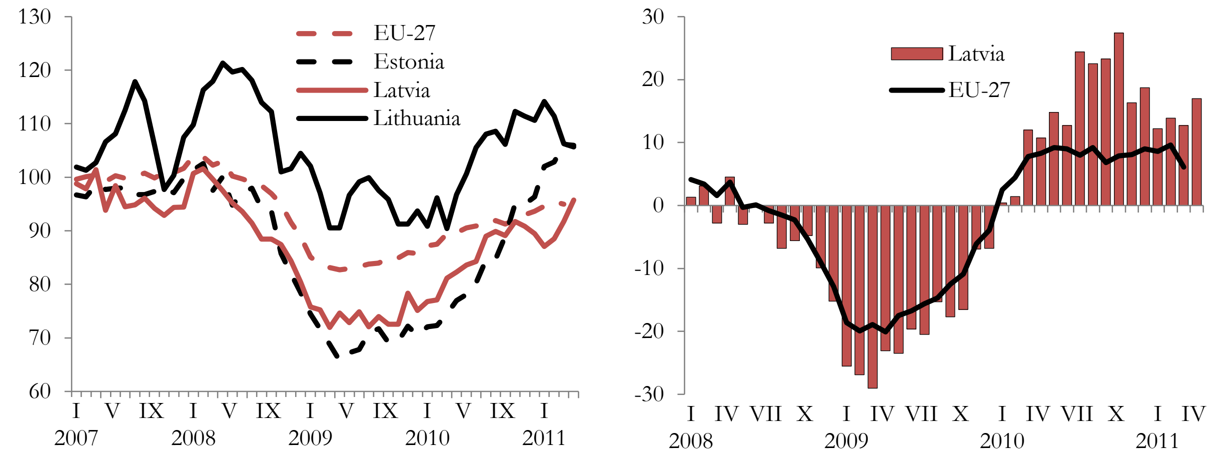
3.2.2. Manufacturing

The growth of manufacturing lagged considerably behind the average growth rate of national economy during the years of rapid economic growth. From 2005 until 2007, the manufacturing grew only by 4.2% per year, but annual growth rates in such sectors as construction and trade exceeded 16%. During these years, the manufacturing lost both its relative competitiveness to other sectors of national economy and competitiveness in foreign markets due to the rapid increase in production costs. Already in 2007, production volumes of the sector had practically stopped growing.

Figure 3.19

Manufacturing Production Volume Index

Seasonally adjusted data, December 2006 = 100	Data adjusted by number of business days, % compared to the corresponding period of the previous year



In 2008 and in the first half of 2009, when domestic and external demand significantly shrank, production volumes of manufacturing also experienced a rapid decrease – in the 2nd quarter of 2009, production volumes of the sector constituted only 70% of the level of the 1st quarter of 2007. Decrease of manufacturing production volumes was typical not only in Latvia, but also in majority of the EU Member States. In the second half of 2009, growth resumed in the majority of trade partner countries of Latvia, and increase of external demand provided positive growth stimuli to Latvian producers – production volumes have been gradually increasing since the second half of 2009.

Recovery from crisis consequences in the sector was rather rapid, and at the end of 2009, production volumes in separate sectors of manufacturing (especially wood processing) already exceeded the level of respective period of the previous year. It should be noted that not only increase of demand in trade partner countries, but also increase of competitiveness achieved by significant cuts in expenses during the crisis play an important role in growth of the manufacturing.

Table 3.10

Structure of Manufacturing in 2010

percent

	By value added	By number of employed	Share of export in the sales of sector
Manufacturing – total	**100**	**100**	**59.4**
Food industry	18.6	23.5	27.5
Light industry	4.9	11.7	81.6
Wood processing	26.3	18.0	74.8
Paper industry and publishing	9.2	6.6	53.1
Chemical industry and related industries	9.4	6.0	73.7
Production of other non-metallic minerals	4.2	3.8	49.0
Production of metals and metal articles	11.3	9.6	72.8
Production of electrical and optical equipment	3.2	4.0	84.3
Production of machinery and equipment	4.5	3.6	84.7
Production of vehicles	4.1	6.4	87.7
Other industries	4.3	6.9	52.5

The expansion of export opportunities determines rather rapid growth of the manufacturing – production volumes in 2010 were by 16.5% higher than in 2009. In 2010, production volumes of the sector increased on average by 1.4% monthly. Turnover of exported production in 2010 increased by 28%, while due to the remaining weak domestic demand, turnover volumes in the domestic market increased only by 3.2%.

Table 3.11

Changes of Production Volumes in Manufacturing*

(percent, compared to the corresponding period of the previous year)

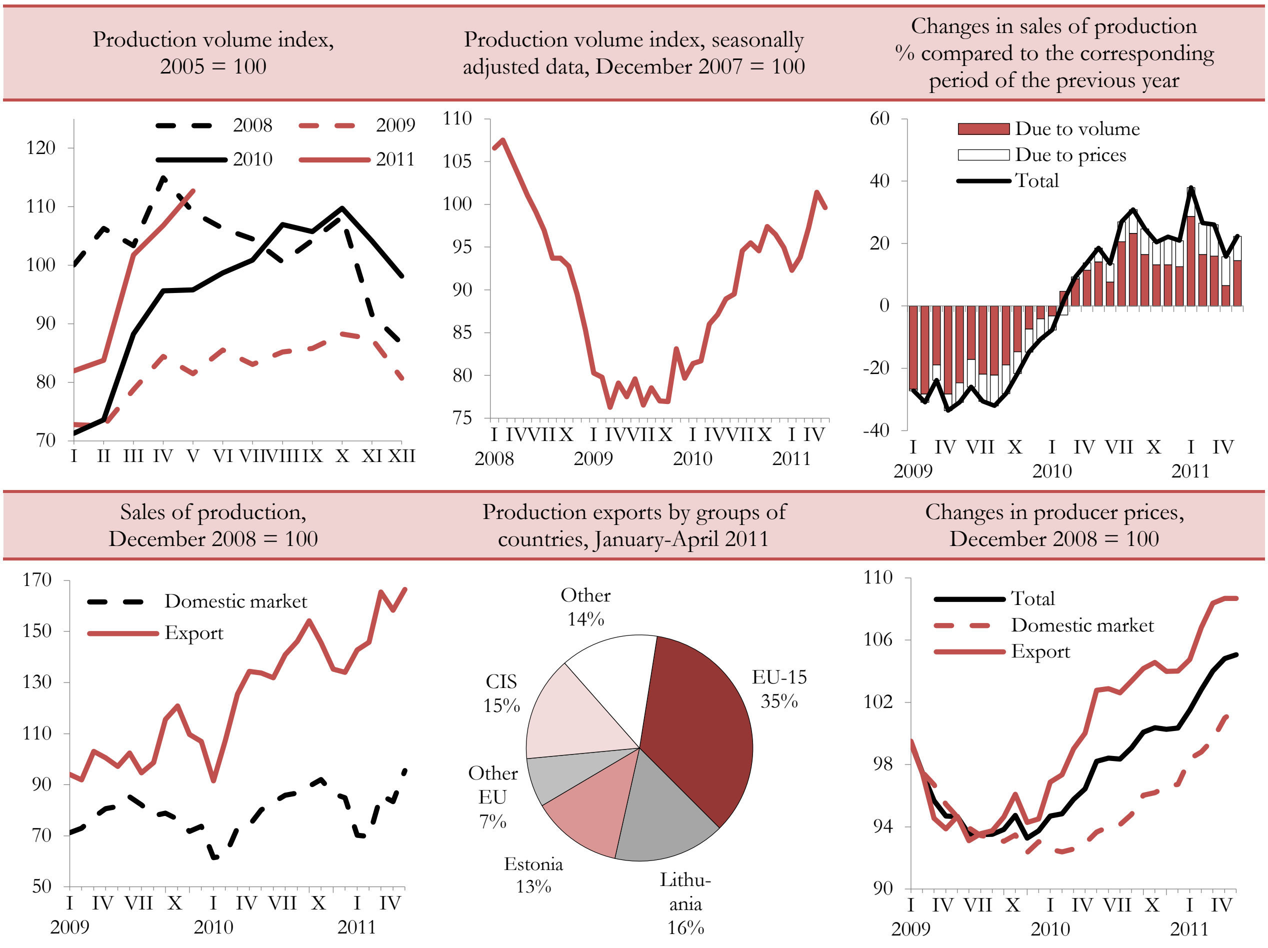
	2007	2008	2009	2010	2011 I-IV
Manufacturing – total	**0.3**	**-3.4**	**-20.2**	**16.5**	**13.9**
Food industry	1.3	-2.0	-16.1	-0.1	-0.4
Light industry	0.3	-12.2	-38.6	19.4	40.3
Wood processing	-6.0	-12.1	1.6	33.0	16.2
Paper industry and publishing	0.2	-3.9	-17.1	19.8	6.3
Chemical industry and related industries	3.1	-2.0	-18.5	5.2	3.8
Production of other non-metallic minerals	-17.1	-14.4	-40.1	17.6	35.9
Production of metals and metal articles	11.5	1.4	-27.1	24.2	30.6
Production of electrical and optical equipment	3.8	14.1	-34.8	33.2	29.6
Production of machinery and equipment	5.0	10.4	-35.5	17.8	38.9
Production of vehicles	10.7	5.8	-49.7	59.0	66.6
Other manufacturing industries	3.0	-5.5	-20.1	-4.9	1.1

* according to NACE (Rev. 2) statistical classifier of economic operations

Recovery after the crisis is uneven in manufacturing sectors. Wood processing (increase in production volumes by 33%) and metal and metal articles sectors (increase by 24.2%) have contributed the most to the growth of the sector in 2010. Significant production volumes increase was also in paper industry and publishing, electric and optical equipment, as well as vehicles manufacturing, and machinery sectors. However, due to the remaining weak domestic demand, production volumes of food industry practically remained at the level of 2009. Increase in the chemical industry was slower than the average in the sector in 2010 (by 5.2%), but furniture production volumes in 2010 shrunk by 2% due to the low demand in both domestic and foreign markets.

Figure 3.20

Indicators Characterising Manufacturing



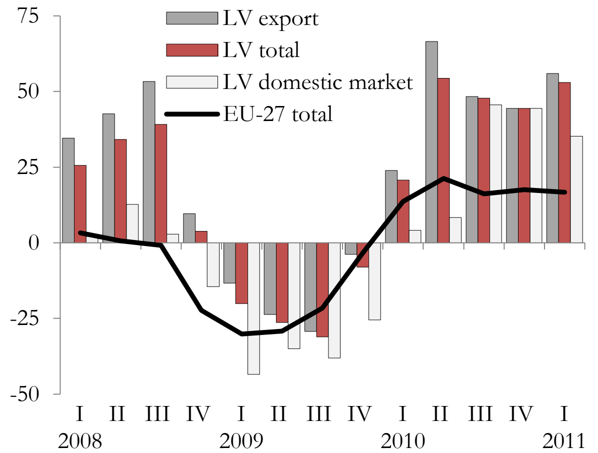
Manufacturing continues growing also in 2011 – production volumes in the five months of the year exceed the level of the corresponding period of the previous year by almost 14.7%. Wood processing (increase by 17%) and metal processing (increase by 32.2%) still contribute the most to the growth.

In the five months of 2011, turnover of manufacturing production has significantly increased (by 25%) based not only on increase in production volumes but also on considerable rise of producer prices that started already at the end of 2009 (especially for exported production).

Figure 3.21

New Orders in Manufacturing

(total in manufacturing industry sectors mainly oriented towards orders, % compared to the corresponding quarter of the previous year, seasonally unadjusted data)



In May 2011, manufacturing producer prices for the exported production grew by 5.7% and for products sold in the domestic market increase was more rapid – by 8.4% than a year ago. The highest rise in producer prices is observed in those sectors of manufacturing, which are subject to rapid increase in demand in foreign markets or depending on the fluctuations in the world prices. Producer prices in metal processing in May 2011 were by 10% higher than a year ago. Producer prices in wood processing increased by 4% within 12 months, but producer prices in food industry increased by 9.7% in a year.

Along with the rapid increase in export volumes, the share of export sales of the sector also has significantly increased. In the first five months of 2011, 63% of total production of the sector is being exported. The structure of manufacturing export has not changed significantly over the recent years. About 70% of total export are sold in the markets of the EU countries, but 15% of all production exported is to the CIS countries.

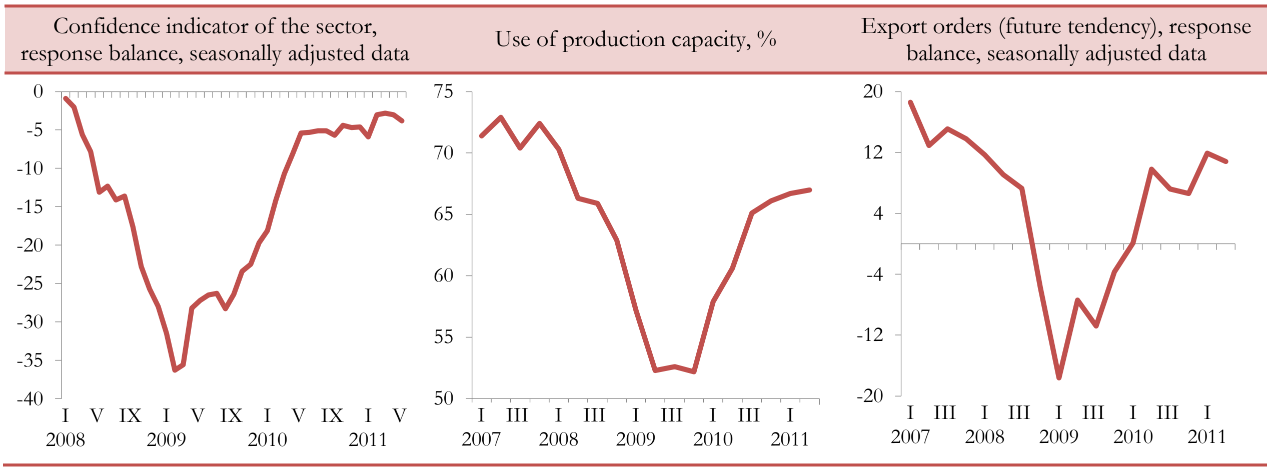
Like in 2010, the volume of new orders continues increasing steadily also at the beginning of 2011. Besides, the increase is based not only on the growing demand in export markets but also considerable increase in the number of orders in the domestic market – especially in the sectors of metal and metal articles, electrical and optical equipment, as well as engineering.

Since 2010, the level of production capacity load has been significantly increased in line with the rapid increase of production volumes. In the 2nd quarter of 2011, it was within 67%, lagging behind the average level of production capacity load of 2007 only by 3 percentage points.

The results of conjuncture surveys show that evaluation of entrepreneurs regarding further growth possibilities improves very moderately. The overall confidence indicator of manufacturing in May 2011 was -3.8 points, yet, it is by 32 points more than the one in February 2009 when the indicator reached the lowest level. It should be noted that entrepreneurs are much optimistic about export development possibilities. Overall, the dynamics of manufacturing confidence indicators relies on uncertainty about development perspectives of the main trade partner countries, as well as more cautious attitude towards future perspectives related to the budget consolidation measures implemented by the government.

Figure 3.22

Development Tendencies of Manufacturing



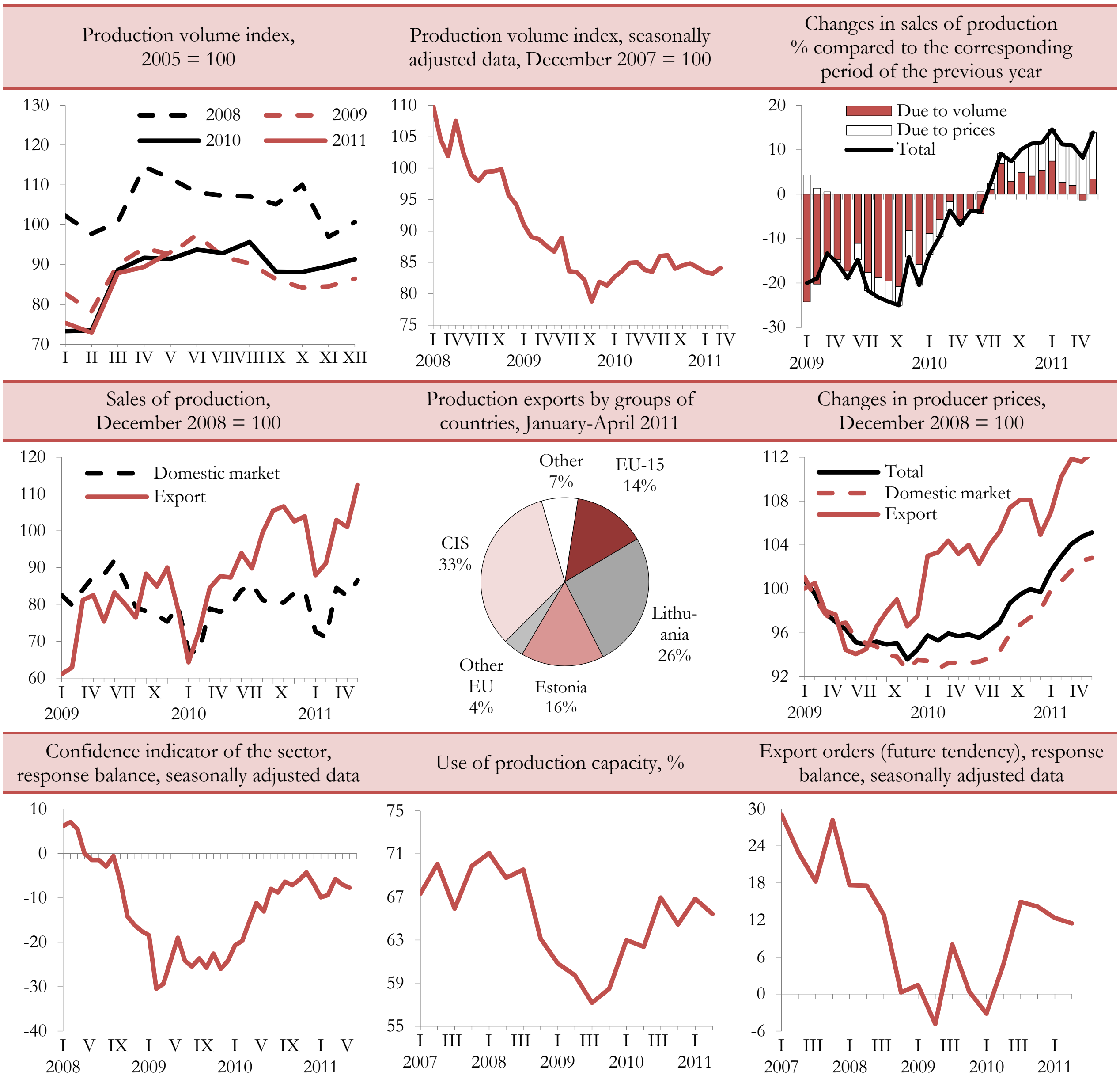
About ¼ of all persons employed in manufacturing is employed in ***the food industry***. The sector is mainly oriented towards the domestic market where slightly more than 70% of all production is sold. Therefore along with the decreasing domestic demand during the crisis, production volumes of the sector decreased rapidly, and the sector recovery is slow.

In 2009, production volumes of the food industry decreased by 17.8% in comparison with 2007. Growth resumed at the end of 2009, yet it was very moderate and mainly related to expanding export possibilities. Overall, production volumes of the food industry in 2010 still lagged behind the level of 2009. In the four months of 2011, production volumes have practically remained at the level of the corresponding period of the previous year. Increase of production volumes in 2010 and in the first months of 2011 can be observed only in fruit and vegetable processing, production of dairy products, as well as production of beverages.

Despite the weak growth of production volumes of the sectors, the realization of products in export markets is increasing (in 2010 – by 16.2%, and in the five months of 2011 – by 25%). Increase of turnover is related to the rise in producer prices, because rise in price for food products in the world was reflected also in the changes in Latvian food producer prices. In May 2011, producer prices were by 9.7% higher than in May 2010. Despite the rather weak domestic demand, 12-month changes in producer prices for production sold in domestic market was 10.3% in May 2011. However, producer prices for exported production have been increasing since the middle of 2009, and in May 2010, they exceeded the level of June 2009 by 19.5%.

Figure 3.23

Indicators Characterising Food Industry



The sector of ***light industry*** is mainly oriented to export. Over 80% of manufactured production is sold in foreign markets. The key markets of light industry are the old EU Member States. During the economic crisis, production volumes of the sector significantly narrowed when external demand decreased. A particularly rapid decline in production volumes was observed at the end of 2008 and at the beginning of 2009.

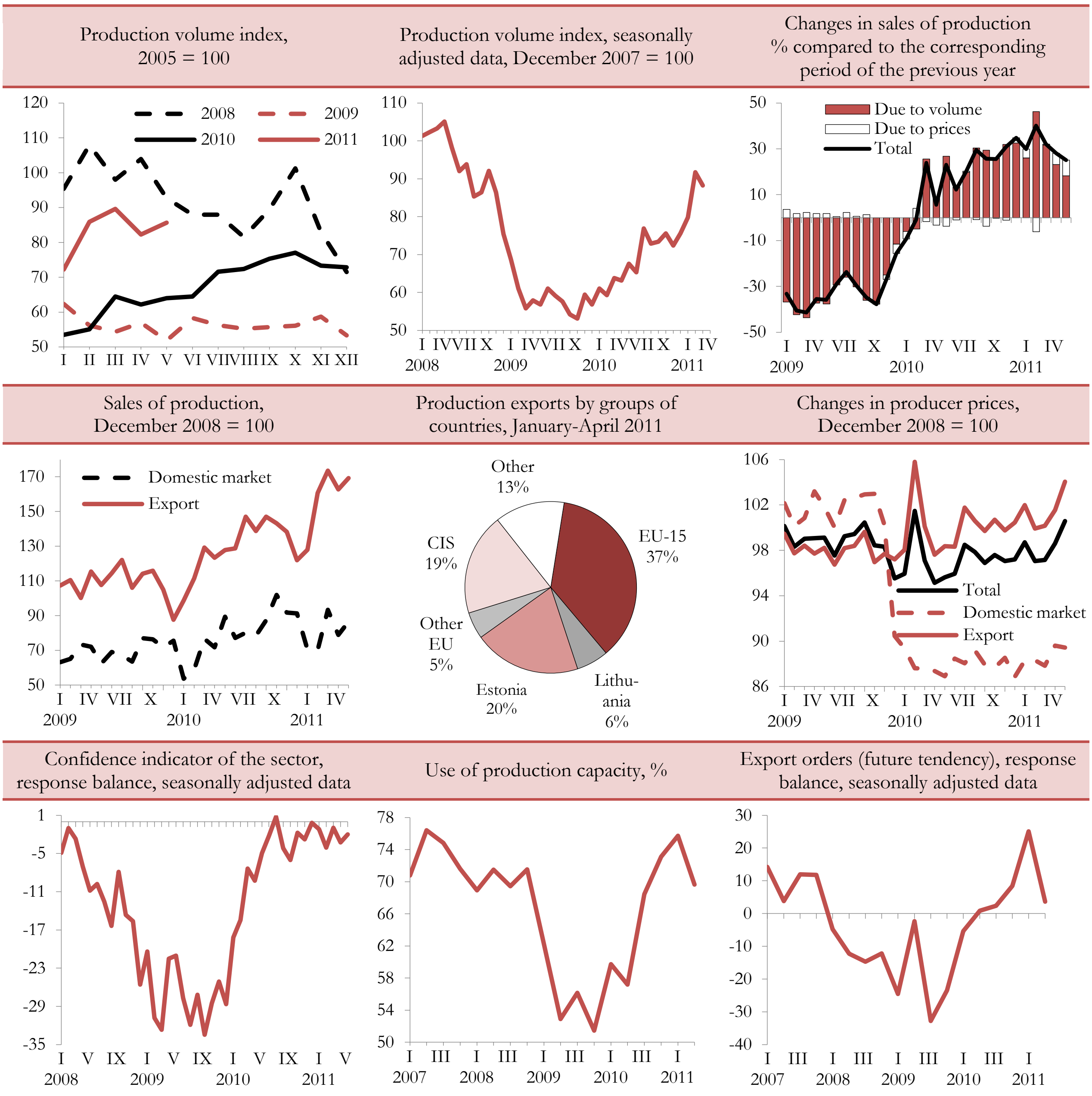
The light industry is recovering quite rapidly by both improving competitiveness during the crisis and being able to enter new market niches. In May 2011, production volumes increased by almost 60% in comparison with March 2009, yet still slightly lagging behind the pre-crisis level. At the same time, the level of production capacity load at the end of 2010 already exceeded the level of 2007.

The growth of the sector is mainly based on export increase. In 2010, sales revenue of exported production exceeded the level of 2009 by 19%. Export volumes are rapidly increasing also in 2011. In five months, export of the sector already exceeds the level of the corresponding period of the previous year by 34.5%. It should be noted that turnover of the sectors is gradually increasing also in the domestic market.

Revenues of the light industry are mainly based on increase of production volumes, and to a lesser extent on prices. The economic crisis had almost no impact on prices for exported production. Prices for production sold in the domestic market, on the contrary, decreased due to a huge decline in the domestic demand. Producer prices in the sector experienced moderate increase in a year – in May 2011, they were by 5.2% higher than in May 2010.

Figure 3.24

Indicators Characterising Light Industry



Wood processing is the largest sector of manufacturing, and it plays an important role in national economy of Latvia. Since the beginning of 2009, the sector has been experiencing rapid growth, and production volumes are already exceeding the pre-crisis level.

Production volumes in the sector shrunk already in 2006, when the demand for wood processing production in Europe decreased significantly. Lost competitiveness in foreign markets also was an important factor. At the beginning of 2009, production volumes of the sector have shrunk by 1/3 in comparison with the average indicators of 2006.

The sector is rapidly recovering after the crisis – in May 2011, production volumes have increased by nearly 80% comparing to January 2009 (according to seasonally adjusted data). The growth of wood processing is mainly based on expanding export opportunities – volumes of exported production in 2010 increased by 45 percent.

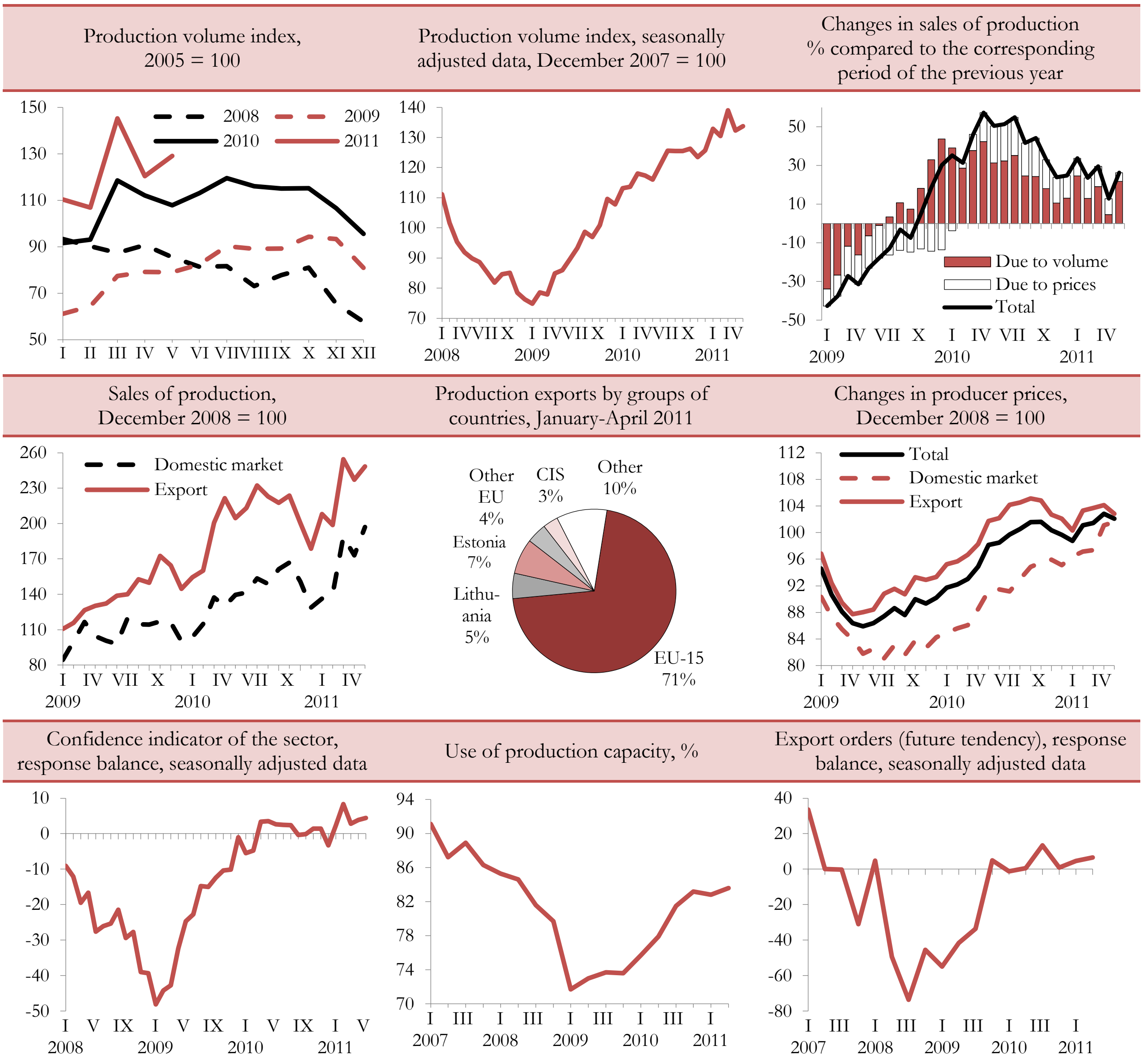
Almost 1/4 of wood and timber product export is considered to be the export of high or medium high value added goods – veneer and plywood, cellular wood panels, etc. The wood processing sector exports ¾ of production, and the main export markets are the EU-15 Member States.

The increase of turnover in the sector is influenced also by the rise in producer prices which have been growing since the middle of 2009. In May 2011, producer prices have increased by 4% within a year. Prices for production sold in the domestic market have increased faster, while prices for exported production have stabilised over the last months.

Further sector development depends on the ability to increase production capacity. At the beginning of 2011, the level of production capacity load exceeded 80% thus being the highest indicator in comparison with other sectors of manufacturing.

Figure 3.25

Indicators Characterising Wood Processing



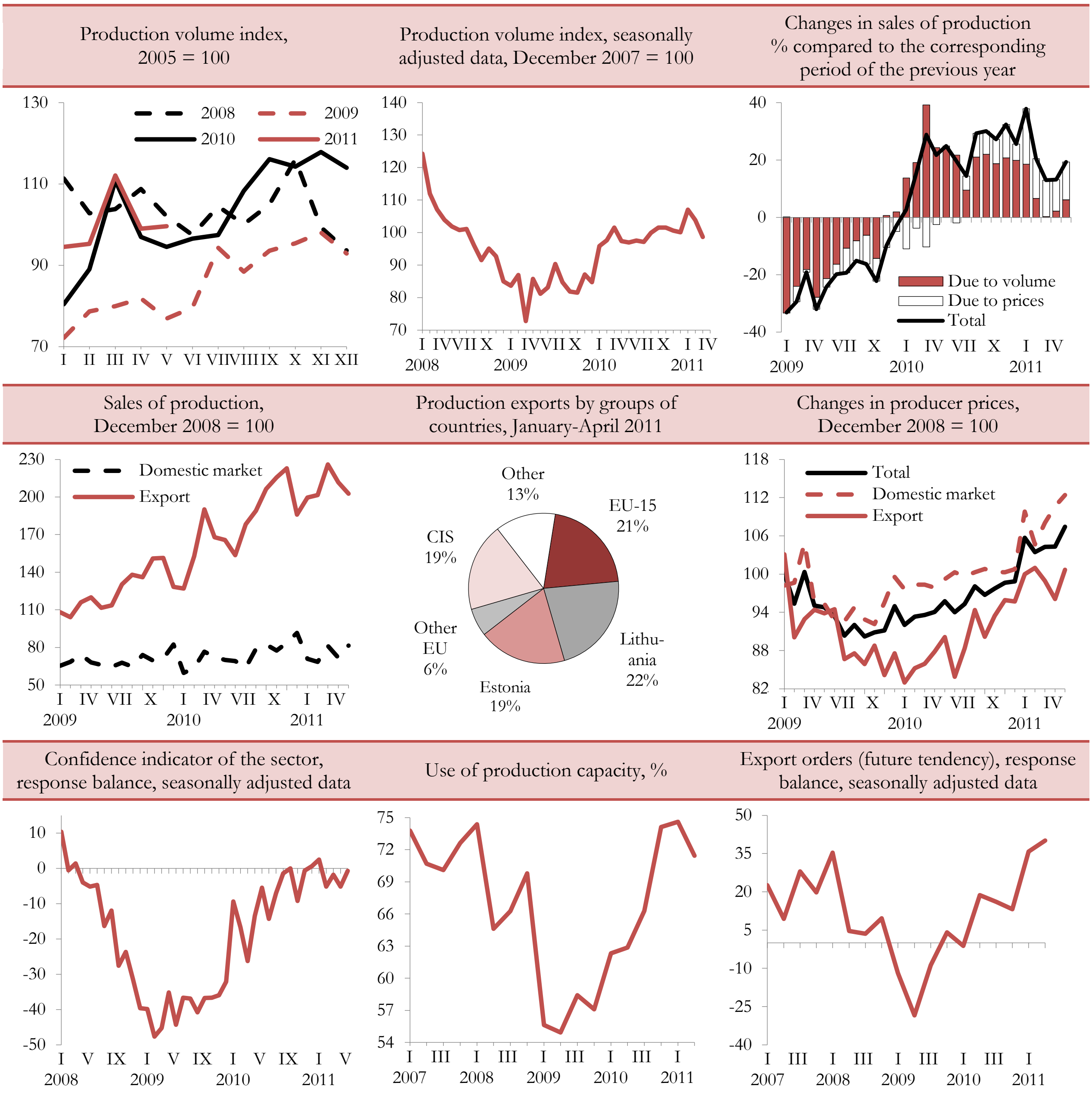
Paper industry and publishing constitute slightly more than 9% of the value added to the manufacturing. During the rapid growth period (2005-2007), the sector was mainly oriented towards the domestic market; however, despite the huge increase of domestic demand during these years, the growth rates of the sector were moderate. Export possibilities were mainly related to Lithuania and Estonia where 60% of all exported production were sold. During the economic crisis, when both domestic and external demand significantly shrank, production volumes of the sector decreased by over 20 percent.

In the post-crisis period, the sector has managed to successfully increase its export share in the total turnover. In the pre-crisis years, export in the total turnover of the sectors was below 40%; in 2010, it already constituted almost 55%. In 2010, production volumes increased by 19.8%, and output volumes of paper industry and publishing continue increasing, though slower, also in 2011.

As the demand shrank, the paper industry and publishing experienced decrease of producer prices. When economic situation became stable, producer prices resumed growing, besides, despite the weak domestic demand, prices for production sold in the domestic market are higher than those for exported production. In May 2011, the level of producer prices for production sold in domestic market was by 13.3% higher than a year before, whereas prices for exported production have increased by 11.7% in a year.

Figure 3.26

Indicators Characterising Paper and Publishing Industry



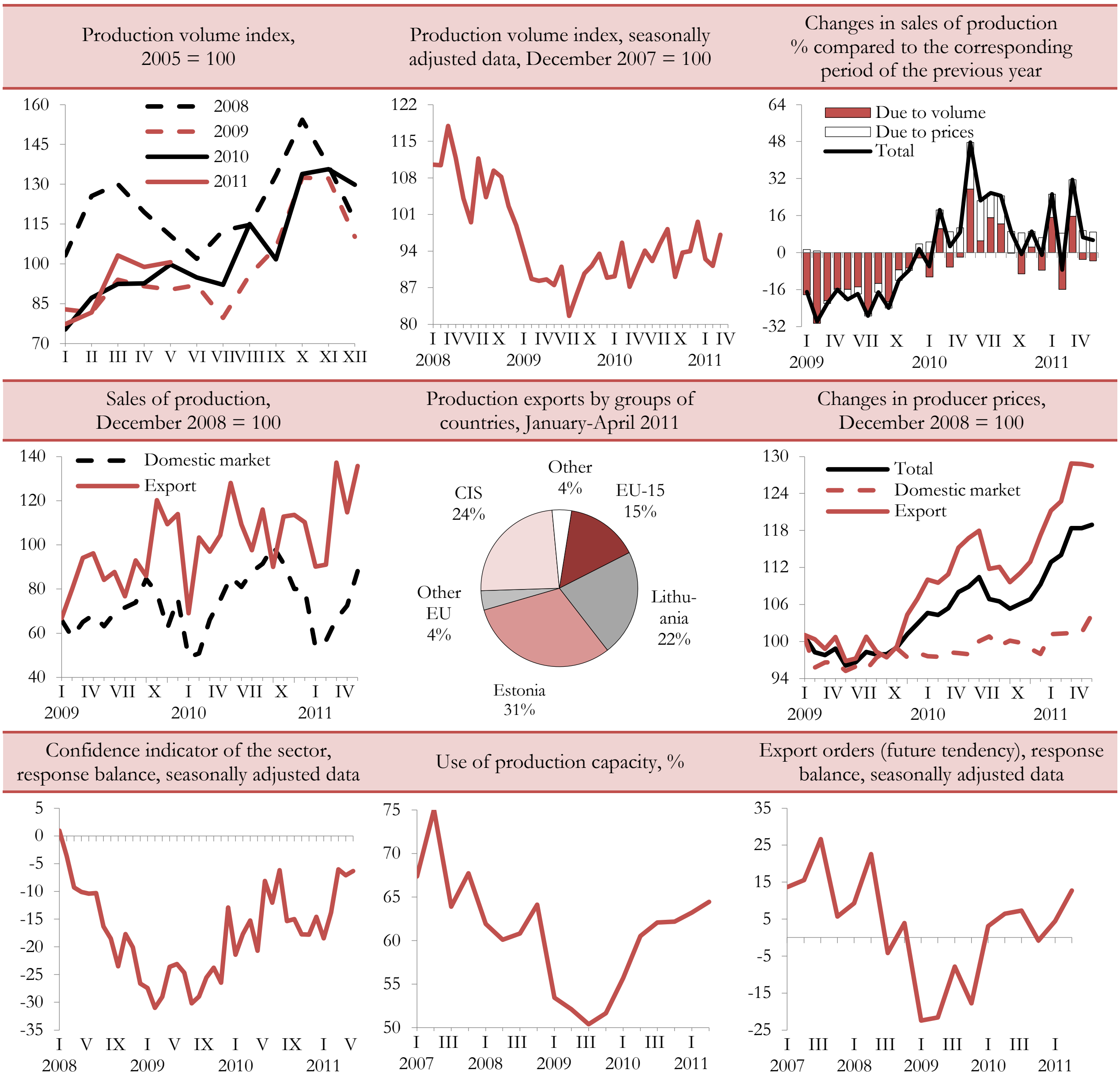
The chemical industry in Latvia has settled stable traditions, highly qualified specialists, and for a long time it has been producing a wide range of production for end-consumption and intermediate consumption. The share of chemical industry in the total value added to the manufacturing industry constitutes almost 10%. Over ¾ of production is exported, mainly to Lithuania and Estonia. Almost ¼ of exported production is sold in the markets of the CIS countries.

Development tendencies of chemical industry sub-sectors differ during the economic recession and in the post-crisis period. In 2009, production volumes of chemical industry shrank by 20% in comparison with 2007. Production volumes of pharmaceutical base stock and preparations shrank by 16.8% and production volumes of rubber and plastic articles – by almost 40%. At the same time, production volumes of chemical substances and products increased by 15%. In 2010, due to increasing demand in foreign markets, the output of chemical industry increased by 5.2%. Production volumes increased for both chemical products and rubber and plastic articles, but in 2010, production volumes in the pharmaceutical industry were by 3.3% lower than in 2009. In five months of 2011, production volumes of chemical industry increased by 3.2%, in comparison with the corresponding period of the previous year.

During the economic recession, decline in producer prices of the chemical industry was very moderate; yet, since the end of 2009, producer prices are growing, especially for exported production. In May 2011, the level of producer prices exceeded the level of December 2009 by 15.6%. Prices for production exported in this period have increased by 20.2%, while prices for production sold in the domestic market – by 6.4%.

Figure 3.27

Indicators Characterising Chemical Industry and Related Industries



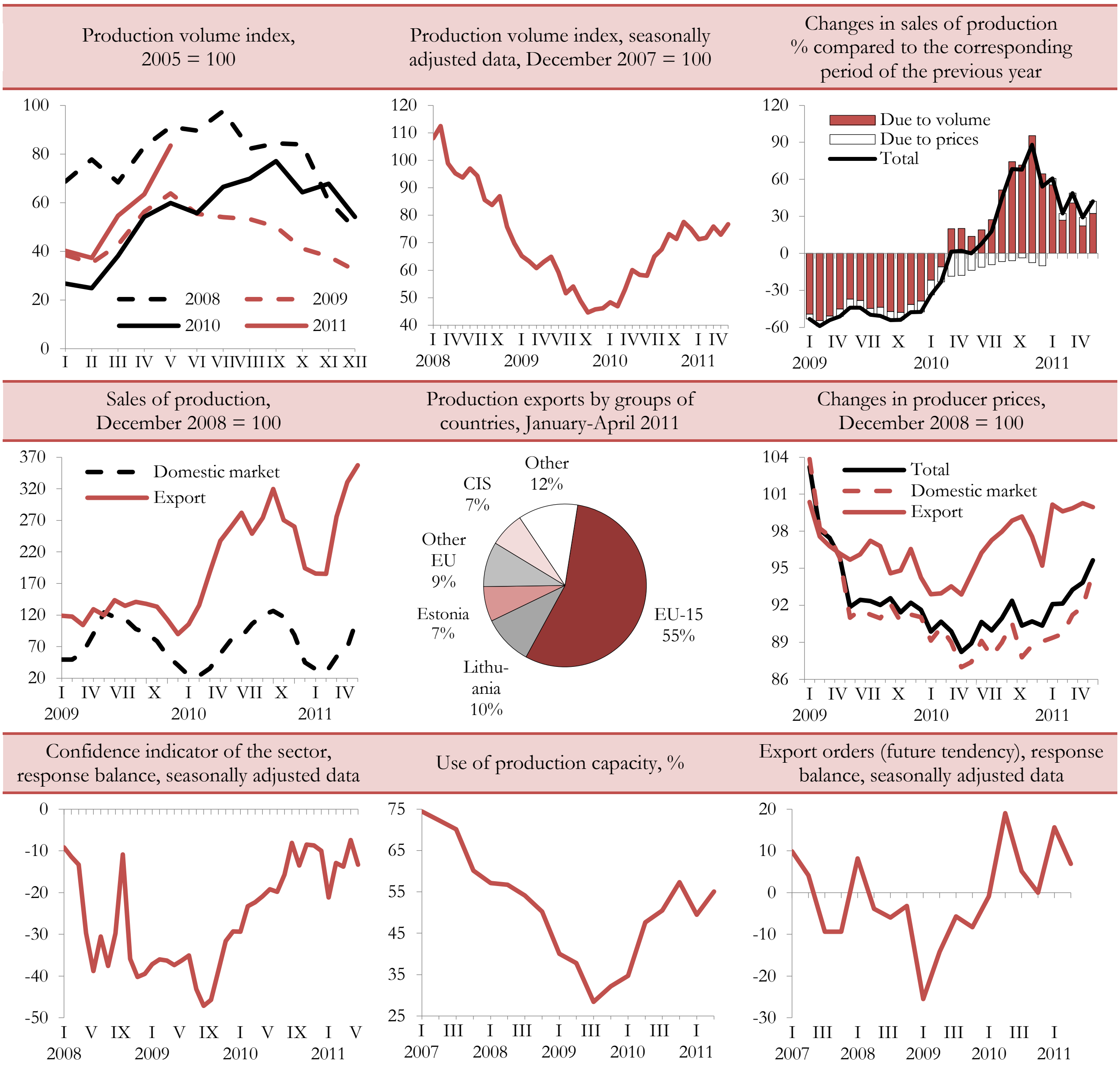
The growth rates of ***other non-metallic minerals*** sector depend on fluctuation of domestic demand, mainly in relation to demand for construction materials. In the pre-crisis period, about 20% of sector's production were exported. Therefore, during the economic crisis, when construction volumes significantly decreased, the production of non-metallic minerals considerably decreased. In 2009, the production output of the sector decreased by almost a half in comparison with 2007.

The successful recovery of the sector after the crisis is mainly related to the ability to reorient towards foreign markets – mainly to the old EU Member States. In 2010, the share of exported production constituted already almost a half of the total turnover. Production volumes of the sector in 2010 increased by 17.6% and turnover – by 24.4% comparing to 2009. Sales volumes of production exported in this period increased by almost 90%. At the same time, product sales in the domestic market continued shrinking at the beginning of 2010 due to the remaining low domestic demand. As the economic situation gradually improved, the domestic turnover increased as well; however, the total annual turnover in the domestic market was below the level of 2009. In the first five months of 2011, production volumes sold in the domestic market exceeded the level of the corresponding period of the previous year by more than 36%.

Significant decrease of demand during the crisis caused a significant decrease of producer prices. In 2010, according to changes in demand of the construction sector in both domestic and foreign markets, the production prices resumed growing. In May 2011, producer prices have increased by 7.6% within a year, including for production sold in the domestic market – by 8.3%, whereas for the exported production – by 5.8 percent.

Figure 3.28

Indicators Characterising Production of Other Non-metallic Minerals



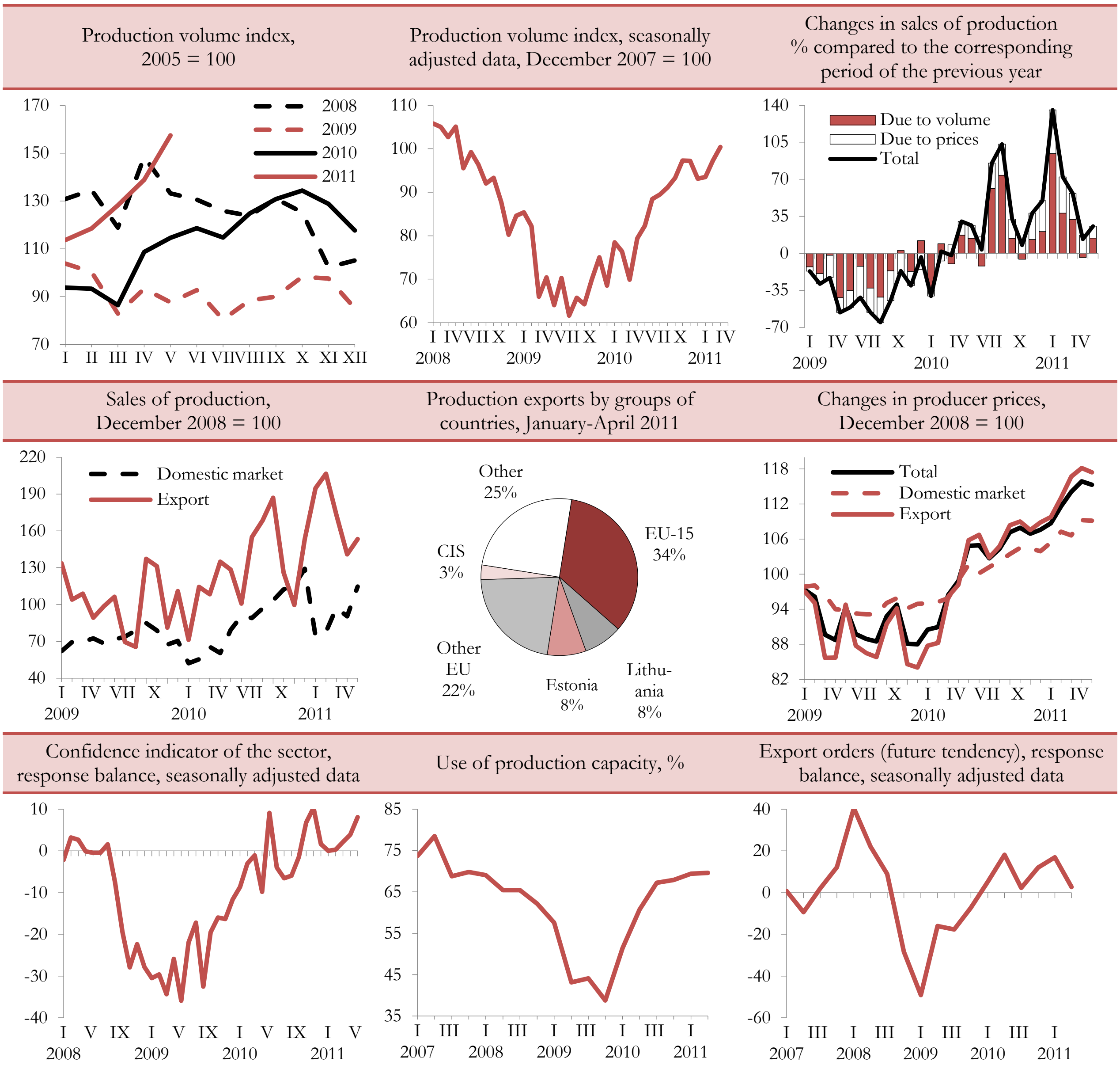
Production of metals and metal articles constitutes 11% of the value added to the manufacturing industry. The sector exports about 70% of production. Taking into account the comparatively large export share in the product sales, the global economic recession considerably influenced development of the sector. In 2009, output of the sector decreased by 27%, and the sales volumes decreased by almost 40%.

As the economic situation in the main trade partner countries stabilised, production volumes of the metal processing sector have been increasing since the middle of 2009. The recovery of the sector after the crisis is relatively fast, and already at the end of 2010, production volumes reached the level of 2008. In 2010, production volumes of metal and metal articles increased by 24%. It should be noted that in 2010, not only the turnover of exported production (by 25%), but also production volumes sold in the domestic market (by 20%) experienced a significant increase, despite the remaining low demand in the domestic market. Rapid growth of the sector remained also at the beginning of 2011. In the five months of the year, turnover of production sold for export exceeds the level of the corresponding period of 2010 by 56% while turnover in the domestic market in this period has increased by 45%.

As a result of the global economic crisis and the rapidly decreasing demand for metals and metal articles, a considerable decline in producer prices was observed at the end of 2008 and at the beginning of 2009. Since the beginning of 2010, increase in producer prices for production both sold in domestic market and exported can already be observed. In May 2011, producer prices were by 10% higher than a year ago, including prices for exported production increased by 11% in this period.

Figure 3.29

Indicators Characterising Production of Metals and Metal Articles



Electrical and optical equipment production sector developed rather successfully during the rapid growth period. During the economic crisis, when the demand reduced significantly, production volumes of the sector shrank by ¼. The most rapid output decline in the sector was in 2008 and at the beginning of 2009. In the middle of 2009 situation was stabilizing gradually. Since the beginning of 2010, the production volumes have been gradually increasing determined mainly by the increase of external demand.

In 2010, output of the sector exceeded the level of 2009 by more than 33%. Increase in production volumes of electronic equipment has contributed the most to the growth (by 37%) of the sector. Production volumes of computer, electronic and optical equipment have increased by 27% in 2010.

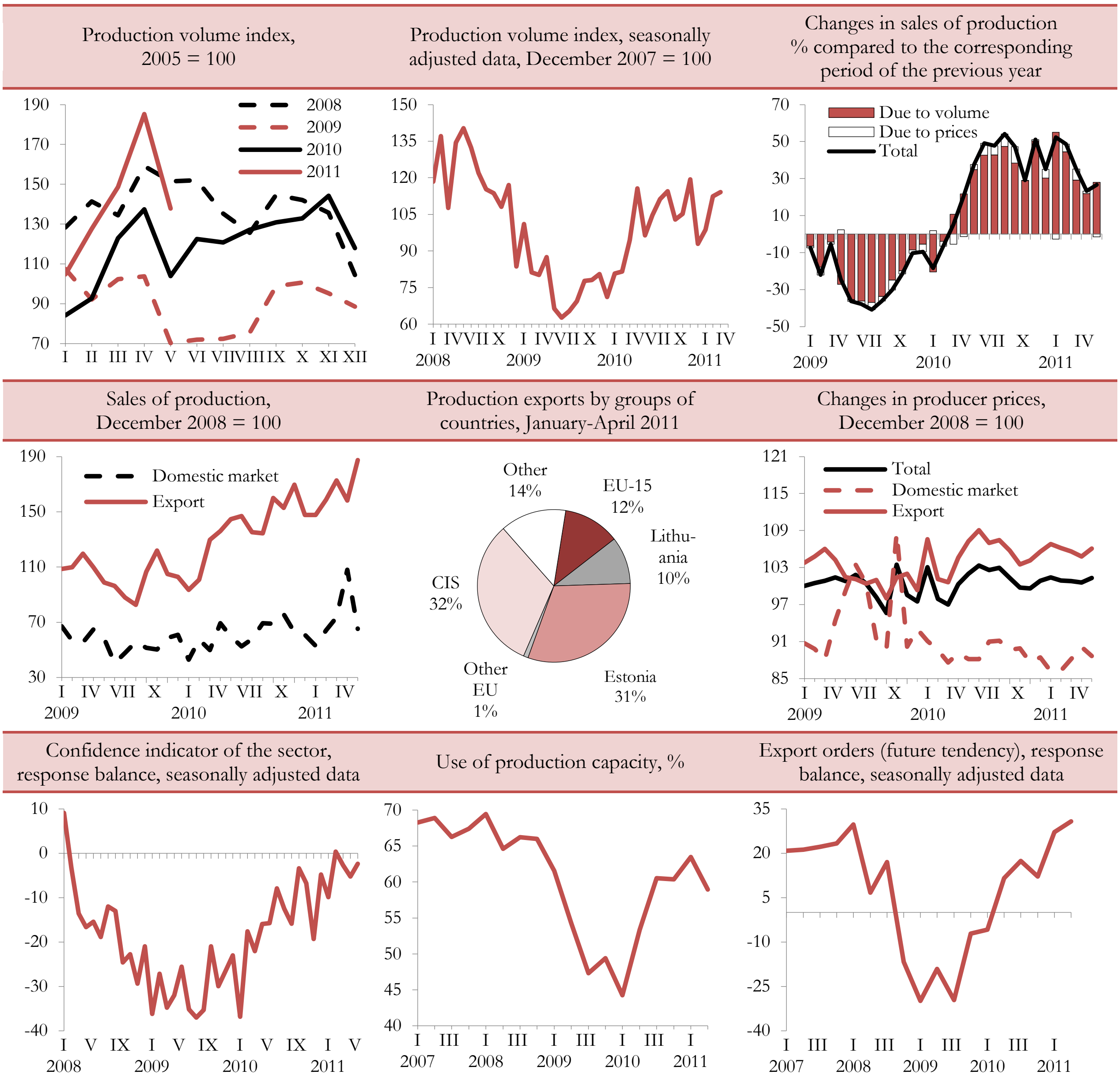
Export constitutes almost 85% of total turnover of the sector. In 2010, sales revenues from exported production increased by 32%. Sales volumes have been gradually increasing also in the domestic market (in 2010 – by 6%). At the beginning of 2011, growth rates of electronic and optical equipment production sector remained among the highest in the sector.

The dynamics of the sales revenues of the sector is mainly determined by changes in production volumes, whereas producer prices have no significant impact on changes in turnover. After experiencing marked fluctuations during the crisis, producer prices have stabilised and have remained practically unchanged since the beginning of 2010. In May 2011, producer prices have decreased by 0.7% within a year.

Also future development opportunities of the sector are mainly related to export. It is proven by the optimistic evaluation of entrepreneurs regarding export orders.

Figure 3.30

Indicators Characterising Production of Electrical and Optical Equipment



The sector of machinery and equipment production is the supplier of production means and technologies to other sectors, thus the economic crisis has hit this sector particularly severely. As a result of the economic recession, the turnover of the sector has equally rapidly shrunk both for exported production and production sold in the domestic market. In the middle of 2009, situation in the sector stabilised; however, the overall production level during the crisis reduced by half.

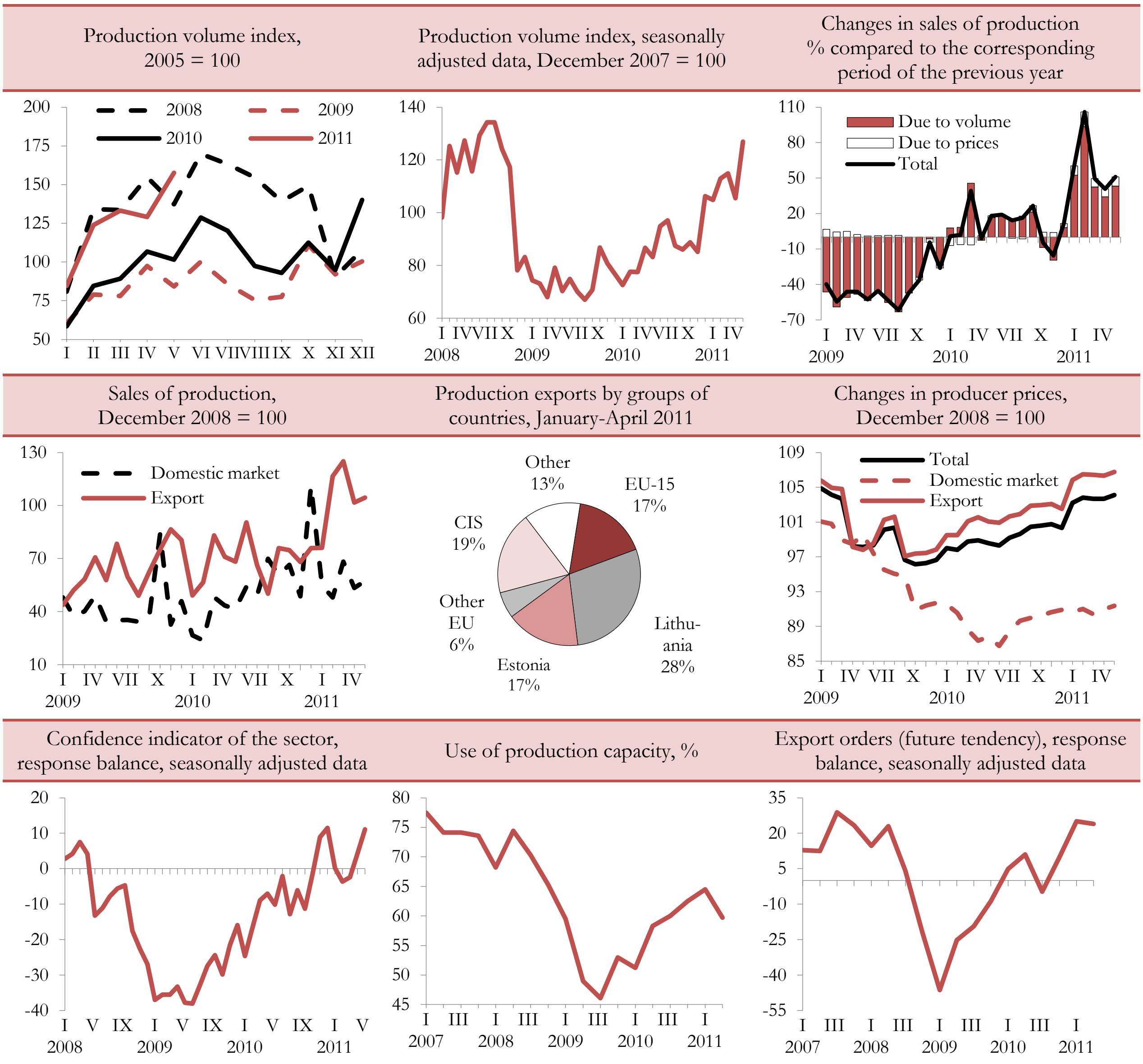
Like the majority of sectors, also development of machinery and equipment production is closely related to the changes in external demand. Along with the improvement of economic situation in trade partner countries, positive tendencies in the sector continued also in 2010, when production volumes increased by 17.8%. Over 85% of all production of the sector is sold in foreign markets. The key trade partners are Lithuania and Estonia drawing 45% of all exported production.

Since the end of 2009, when the demand in global market increased, producer prices for exported production have been growing, yet the increase is moderate. In April 2010, producer prices for exported production were by 4.7% higher than a year ago. However, due to the weak demand, producer prices for production sold in the domestic market continued decreasing until the middle of 2010 followed by a moderate rise in prices. In May 2011, producer prices have increased by 5.5% within a year. Tendencies of producer prices have an impact on sector sales revenues which in 2010 increased only by 10 percent.

Positive future development tendencies of the sector are proven by relatively low production capacity load, if compared to the pre-crisis level, and by the expected increase of consumption in the main trade partner countries – Lithuania and Estonia, as well as by an increase of new orders, including in the domestic market.

Figure 3.31

Indicators Characterising Production of Machinery and Equipment



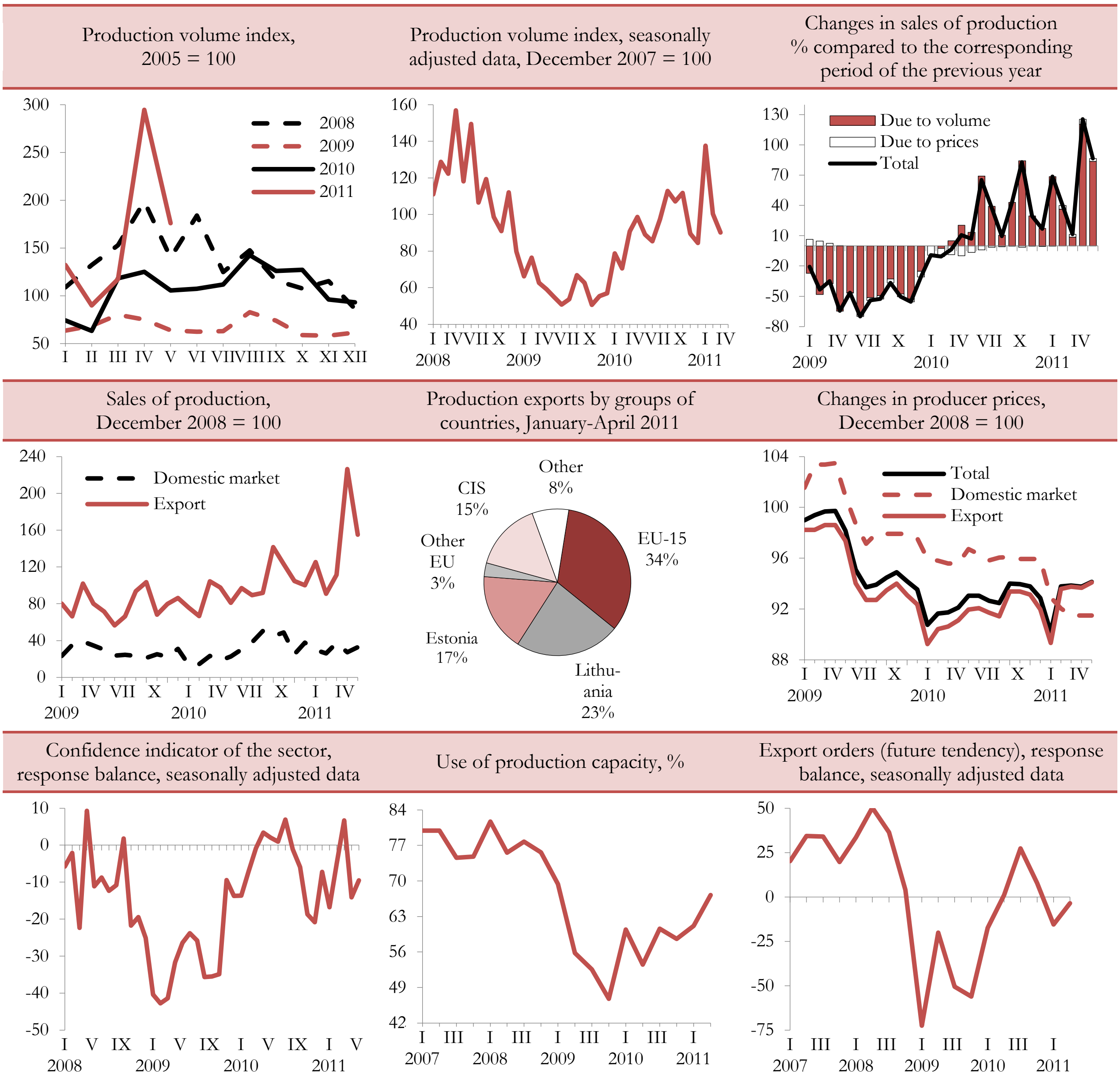
The sector of vehicles production is characterised by marked fluctuations of production volumes closely related to changes in new orders. As almost 90% of production is exported, fluctuations of external demand have a significant impact on development of the sector. ¾ of all exported production is sold in the EU market, more than a half of it – in Lithuania and Estonia.

During the economic crisis (2008-2009), production volumes of the sector decreased by almost 50%. Since the middle of 2009, along with the improving situation in foreign markets, the growth has resumed, and in 2010, production volumes exceeded the indicator of 2009 by 59%. The sector has been experiencing rapid growth also in 2011 mainly due to increase in turnover of exported production – the turnover of the sector in the five months of the year already exceeds the level of the corresponding period of 2010 by 66.7%. It should be noted that despite the rapid increase of volumes, the level of production capacity load in the first half of 2011 lags behind the average level of 2008 by approximately 10 percentage points.

During the crisis, especially in the first half of 2009, the decrease of demand resulted in decline in producer prices. In 2010, despite the gradual increase of demand in both foreign and domestic markets, producer prices did not grow. After the decrease at the end of 2010, producer prices for exported production increased in the first months of 2011, whereas the prices for production sold in the domestic market is still decreasing. In May 2011, producer prices for exported production exceed the level of May 2010 by 2.3%, while producer prices for production sold in the domestic market have decreased by 5.4%.

Figure 3.32

Indicators Characterising Production of Vehicles



3.2.3. Energy Sector

Both the imported (coal, coke, petroleum products, natural gas, electricity energy, etc.) and local (used tyres, municipal waste for heating, peat, firewood, charcoal, straw, biogas, bioethanol, biodiesel, hydropower, 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 other part is imported. Mainly the imported fuels (natural gas and residual fuel oil) and local fuels (firewood) are used in heating energy generation.

In 2010, energy resource generation and recycled products in Latvia formed 87.8 PJ. The import of energy resources was 129.9 PJ, out of which 37.9 PJ was the import of natural gas.

In 2010, the total consumption of primary energy resources in Latvia amounted to 199.8 PJ, and self-security in the total consumption of primary energy resources was 33.2%. In the total consumption of primary energy sources, firewood with its total consumption forming 50.6PJ was the most widely used local energy resource, electricity generated in hydropower stations and wind power stations constituted 12.8PJ.

Table 3.12

Consumption of Primary Energy Resources in Latvia, PJ

	2003	2004	2005	2006	2007	2008	2009	2010
Total consumption*	**184.3**	**188.4**	**191.9**	**199.0**	**204.6**	**196.5**	**183.3**	**199.8**
including:								
coal and coke	2.8	2.8	3.3	3.6	4.4	4.4	3.5	4.5
peat	0.9	0.1	0.1	0.1	0.1	0.1	0.0	0.1
petroleum products	59.3	61.0	61.9	67.5	73.3	69.3	56.7	64.6
natural gas	56.4	55.8	56.9	58.9	56.9	55.8	51.4	61.3
firewood	47.0	49.4	49.4	49.8	48.7	46.0	52.6	50.6
electricity	17.8	18.9	19.9	18.9	20.8	20.5	18.6	16.0
other energy resources**	0.2	0.3	0. 5	0.4	0.4	0.5	0.5	2.8

Source: CSB;
* all energy resources have been calculated based on the lowest calorific value;
** used tyres, municipal waste for heating, charcoal, straw, biogas, bioethanol, biodiesel.

The volume of ***electricity*** generation depends on the flow rate in the Daugava River. After closing Ignalina NPP at the end of 2009, the situation in electric energy market in the Baltic States has changed. Latvia is no more 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.

Table 3.13

Electricity Supply in Latvia, TWh

	2003	2004	2005	2006	2007	2008	2009	2010
Total electricity supply	**6.6**	**6.8**	**7.1**	**7.4**	**7.8**	**7.8**	**7.2**	**7.5**
Electricity generation including:	**4.0**	**4.7**	**4.9**	**4.9**	**4.8**	**5.3**	**5.6**	**6.6**
HPPs*	2.2	3.0	3.3	2.7	2.7	3.0	3.4	3.4
CHPs**	1.4	1.2	1.3	1.7	1.5	1.5	1.5	2.4
Other CHPs	0.3	0.3	0.3	0.4	0.5	0.6	0.6	0.6
Small HPPs	0.1	0.1	0.1	0.0	0.1	0.1	0.1	0.1
wind power plants	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Net electricity imports	**2.6**	**2.1**	**2.1**	**2.5**	**3.0**	**2.5**	**1.7**	**0.9**

Source: AS "Latvenergo", the Ministry of Economics, CSB;
* Daugava cascade and Aiviekste HPP (HPP of AS "Latvenergo");
** CHP of AS "Latvenergo"

In 2010, AS "Latvenergo" generated 78% of the total electricity supply, it purchased 10% from small electricity energy producers and 12% – constituted net import of electricity energy. Comparing to the previous year, the total electricity energy supply has increased by 4%.

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%. 1.6% of the total generated heat energy has been supplied to manufacturing, 70.2% – to households, 28.2% - to other consumers. In its turn, the breakdown of heat energy distributed by regions is the following: Riga region – 53.1%, Pieriga reagion – 10.7%, Vidzeme – 6.1%, Kurzeme – 10.9%, Zemgale – 7.5%, and Latgale – 11.8%.

In 2010, heat energy for sale was produced in 668 boiler houses and 71 cogeneration plants having generated 7.96 TWh heat energy for sale.

In 2010, 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 81.4%, woodchips – 11%, wood – 3.6%, residual fuel oil – 2%, and other fuel types – 2%.

The largest consumers of ***natural gas*** are AS "Latvenergo" CHP and heat supply enterprises – 61.7%, manufacturing sector – 16.5%, other consumers 21.8%. Riga region accounts for about 70% of the total natural gas consumed in Latvia.

3.3. Forecasts

The Ministry of Economics has prepared medium-term forecast scenarios of rapid and slower economic development for the period until 2016. The basic assumptions of the developed scenarios are based on different global economic recovery variants and on the ability of Latvian producers to maintain competitiveness restored during the crisis.

The European Commission's publication *European Economy, 1/2011,* as well as the International Monetary Fund's publications *World Economic Outlook, April 2011,* and *World Economic Outlook Update, June 2011,* were used in preparing the forecasts of the Ministry of Economics for the analysis of foreign markets and for evaluation of global economic development tendencies.

Global economy continues growing. According to experts of international institutions, concerns about global economy possibly relapsing into recession did not come true. However, recovery rates of economies of the world's countries are uneven.

The key risks to growth are still related to the remaining tension in several financial market segments and its possible reverse effect on the real sector. The economic recovery also might be prevented by continuing to increase energy prices, especially considering the existing geopolitical tension and pressure of protectionism.

Economic Development in 2011 and 2012

Like in 2010, export will be the key economic driver also this year. Therefore the highest risk to the growth of Latvia is related to global economic development.

No significant increase in the domestic demand is expected in 2011 and 2012. Although private consumption will gradually recover, rapid increase will be limited by the extensive household debt commitments and, despite further improving situation in the labour market, also by the relatively high unemployment rate.

The investment dynamics will be affected by cautious crediting policy of commercial banks. The awaiting behaviour of entrepreneurs regarding future perspectives which is influenced by the still weak overall demand will have a certain impact on the investments in the private sector.

Rates of changes in export and import will be equivalent, as the growth of manufacturing will increase the import on intermediate goods. The increase of import will be determined also by increased investments, mainly in the private sector. However, the remaining low level of private consumption will cause no extra pressure on the increase of import.

The overall growth in 2011 will be positive, and GDP volume might exceed the level of 2010 by 3.5%. The growth of 2012 is likely to be faster (increase in GDP by 4%) if good export perspective remains and investments increase faster. Otherwise the growth might slow down (increase in GDP by 2.5%).

In 2011 and 2012, almost all sectors of economy will experience positive growth rates; but the growth rates of export-oriented sectors (manufacturing, agriculture and forestry, and transport services) will be faster than the average in the national economy. However, it should be noted that the growth rate of the manufacturing industry in 2011 will not be as fast as in 2010. Meanwhile, the reduction of the state budget expenditures will affect the public services sectors where the output practically will remain at the level of 2010.

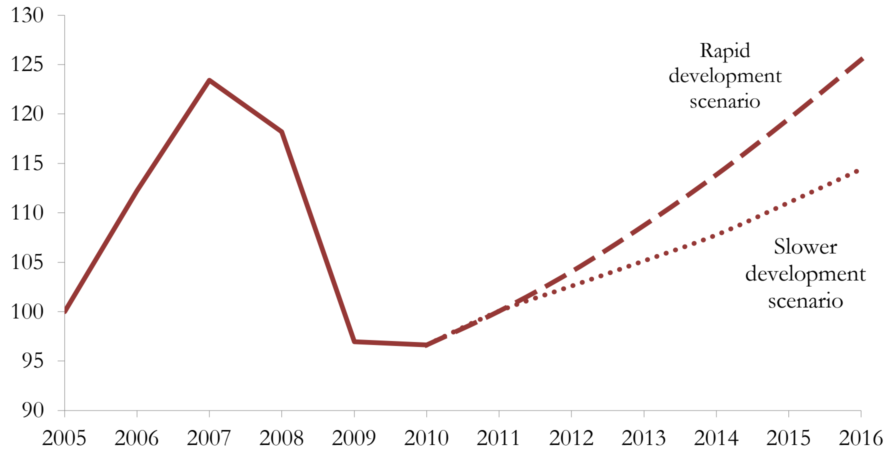
Development Perspectives in 2013-2016

The main risk to further growth is an insufficiently effective structural policy for improving competitiveness of the economy under circumstances of limited access to finances, including state budget. It is particularly important to continue improving (or maintaining) competitiveness of Latvian producers in the main export sector – manufacturing.

Figure 3.33

Forecast of Latvian GDP *

(2005 = 100)



* actual data by 2010

The rapid development scenario envisages that growth rates of the manufacturing (and accordingly also of export) will remain comparatively rapid also after 2011, but the slower development scenario assumes that competitiveness of tradable sectors will not improve in a medium-term. Thus, annual growth rates of GDP would not exceed 3%.

Table 3.14

Forecast of Latvian GDP Expenditure

	2011	2012	2013-2016* (average annually)
growth rates, % to the previous year			
Gross domestic product	**3.5**	**4.0 / 2.5**	**4.8 / 2.7**
Private consumption	4.5	4.8 / 2.8	5.0 / 2.7
Public consumption	0.4	-0.1 / -1.4	0.4 / 0.1
Gross fixed capital formation	18.3	12.9 / 8.0	9.0 / 5.0
Export	10.0	5.1 / 2.5	5.5 / 2.9
Import	14.0	6.3 / 2.6	5.6 / 3.7
structure, %			
Gross domestic product	**100**	**100**	**100****
Private consumption	64.1	64.4 / 64.0	65.7 / 64.7
Public consumption	15.6	14.7 / 14.7	11.9 / 12.7
Gross fixed capital formation	21.1	23.3 / 22.6	28.3 / 25.7
Changes in inventories	0.2	-0.5 / -0.1	-3.4 / 0.6
Export	59.7	60.0 / 59.3	61.8 / 59.7
Import	60.7	61.9 / 60.6	64.2 / 63.4
Export-import balance	-1.1	-1.9 / -1.3	-2.5 / -3.7

* numerator – rapid development scenario, denominator – moderate development scenario;
** structure in 2016

Competitiveness of Latvian manufacturing is based mainly on relatively cheap labour and low total costs. Due to the rise of labour costs and prices in 2006 and 2007, these advantages to a great extent were lost. In 2008-2010, the significant decrease of overall demand and the strict budget limitations, when wages in the public sector were considerably reduced, decreased the overall level of wages and prices in the domestic market, thus partly improving the competitiveness of Latvian producers. Currently, this impact has been reduced, and wages have started to increase again. It should be taken into consideration that under circumstances of free movement of labour force it will not be possible in a long-term to continuously maintain low wages in the Latvian economy, therefore a corresponding productivity increase and increased diversity of export products will play a critical role, allowing to compete in the international markets more successfully.

Table 3.15

Forecast of Latvian GDP by Sectors

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

	2011	2012*	2013-2016 (average annually)*
Gross domestic product	**3.5**	**4.0 / 2.5**	**4.8 / 2.7**
Primary sectors	8.9	7.2 / 6.7	4.1 / 2.4
Manufacturing	10.0	6.0 / 2.6	6.7 / 3.0
Electric energy, gas, and, water supply	1.9	1.5 / 0.2	2.3 / 0.6
Construction	-3.4	8.8 / 6.3	8.3 / 4.6
Trade, hotels, and restaurants	8.4	6.8 / 4.3	5.1 / 3.2
Transport and communications	6.7	5.3 / 3.7	5.6 / 4.2
Other commercial services	0.4	0.9 / 0.6	4.5 / 2.5
Public services	-0.6	0.0 / -0.8	0.4 / 0.1

* numerator – rapid development scenario, denominator – slower development scenario

According to the rapid growth scenario, in order to ensure the average annual growth of 4.8% in 2013-2016, the production volumes of manufacturing should increase by at least 6-7% annually.

The medium-term growth will not be as rapid as it has been in 2005-2007, since its driving force no longer will be the large financial inflows that have stimulated domestic demand and fostered mainly the development of service sectors.

4. Macroeconomic Stability

4.1. Public Finances

4.1.1. Fiscal Policy and Public Debt

As shown in Table 4.1, deterioration of the economic situation has had a significant impact on the fiscal condition of Latvia. The general government sector budget deficit in Latvia was LVL 1258 million or 9.6% of GDP in 2009, and it slightly decreased by LVL 974 million or 7.6% of GDP in 2010.

Table 4.1

General Government Budget

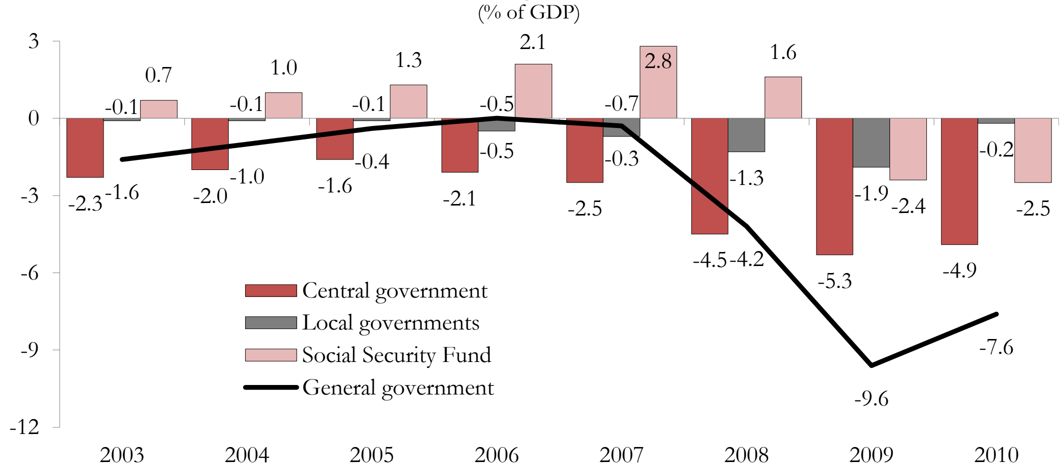
	2006	2007	2008	2009	2010
Revenues (million LVL)	4208.0	5236.7	5605.9	4522.9	4484.3
(% of GDP)	37.7	35.4	34.6	34.6	35.2
Expenditures (million LVL)	4261.2	5283.1	6287.0	5780.5	5458.4
(% of GDP)	38.1	35.7	38.8	44.2	42.9
Balance (million LVL)	-53.1	-46.5	-681.0	-1257.7	-974.1
(% of GDP)	-0.5	-0.3	-4.2	-9.6	-7.6

In 2009 and 2010, the general government budget deficit was constituted by the deficit in both the central government budget and the local government budget, as well as in the Social Security Fund (sees Figure 4.1). The social insurance budget had a surplus in the previous years. However, the deficit has appeared over the last two years.

Figure 4.1

General Government Budget Balance by Sub-Sectors

(% of GDP)



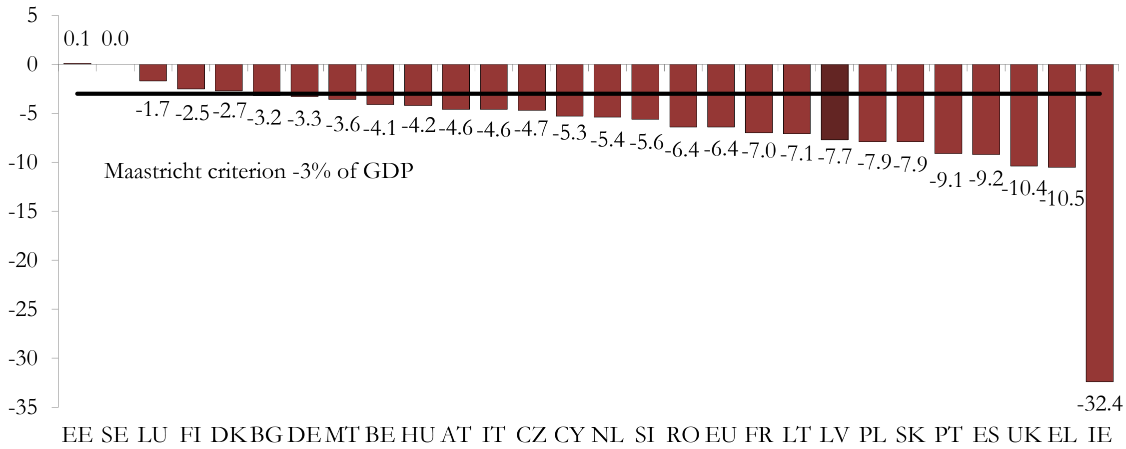
The budget deficit had been observed in 2010 almost in all 27 EU Member States. The average budget deficit level of the EU Member States in 2010 was 6.4% of GDP (in 2009 – 6.8% of GDP, in 2008 – 2.4% of GDP). The budget condition of 21 EU Member States has worsened in 2010. Only Estonia had a budget surplus (0.1% of GDP), but expenditures and revenues in Sweden were balanced. Ireland, Greece, the United Kingdom, Spain and Portugal had the highest government budget deficit in 2010. The budget deficit in these countries exceeded 9% of GDP.

According to the forecasts of the European Commission published in spring 2011, the budget situation in the EU Member States is expected to continue improving both in 2011 and 2012. In 2011, the average budget deficit level of the EU Member States is forecasted to be in the amount of 4.7% of GDP, but in 2012 – 3.8% of GDP.

In 2011, the highest budget deficit that could exceed 8% of GDP is expected in Ireland, Greece and the United Kingdom.

Figure 4.2

General Government Budget Deficit/Surplus in the EU Member States in 2010
(% of GDP)



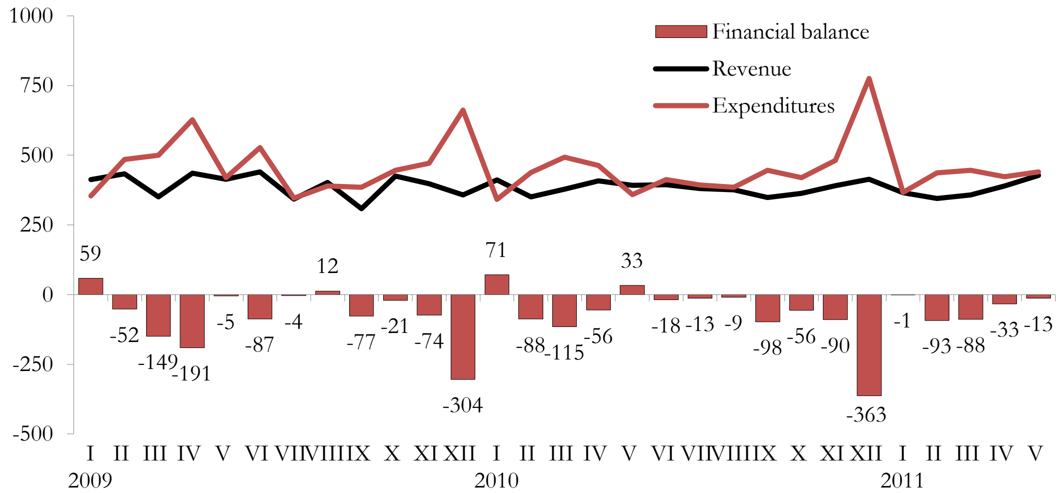
Significant budget consolidation measures have been carried out in Latvia implementing the cumulative fiscal adjustment in 2008-2011 in the amount of 16.6% of GDP, among them by both reducing expenditures and increasing revenues. Reforms for optimization of the public administration structure have been carried out, by liquidating secretariats of special assignments ministers, incorporating the Ministry of Regional Development and Local Government into the Ministry of Environment, reducing the number of public agencies by 50%, as well as by carrying out savings in the area of support functions by means of centralizing.

On December 21, 2010, the Saeima adopted the budget for 2011 envisaging the general government budget deficit in the amount of 5.4% of GDP, which is considerably below the set budget deficit target of 6% of GDP (commitments of Latvia expressed upon conclusion of the Memorandum of Understanding with the EU and signing the Letter of Intent with the IMF). On April 14, 2011, the Saeima adopted the amended budget for 2011, thus reducing the general government budget deficit to 4.2% of GDP. However, taking into consideration the provisions stipulated in the Law on Budget concerning the possibility to increase additionally the appropriation for unforeseen cases if necessary, the estimated budget deficit for 2011 is 4.5% of GDP. In total, consolidation measures in the amount of LVL 350 million have been included in the budget for 2011, thus allowing fulfilment of the budget deficit target.

Dynamics of financial indicators of the government consolidated budget is shown in Figure 4.3. In the five months of 2011, the financial deficit in the total general government consolidated budget according to the national methodology was LVL 227.7 million or 1.7% of GDP.

Figure 4.3

Financial Indicators of the Government Consolidated Budget
(million LVL)



The fiscal policy target of Latvia for 2012 is to prepare a budget that would ensure general government deficit below 3% of GDP (according to the ESA'95 methodology), at the same time striving to achieve the deficit target in the amount of 2.5% of GDP to prove the commitments to observe the fiscal discipline and ensure sustainable government debt. Regarding revenues about 0.5% of GDP is expected to be gained by improving tax collection, implementing real estate tax reform, as well as continuing implementation of comprehensive strategies for combating informal economy. Concerning expenditures – the wage fund of the public sector employees and state subsidies will be reduced by about 0.5% of GDP, and measures ensuring sustainable state special budget will be implemented, etc. Moreover, the provisions allowing the Saeima to increase additional appropriations for unforeseen cases to 0.2% of GDP might be excluded from the state budget for 2012, thus limiting any possible deviation from the budget deficit target.

The general government deficit is expected to be below 1.9% of GDP in 2013 and 1.1% of GDP in 2014. By achieving these objectives, the excessive budget deficit will be prevented, and the Maastricht criterion on the budget deficit will be fulfilled in a sustainable way.

In order to ensure development of sustainable and counter-cyclical fiscal policy, the *Draft Law on Fiscal Discipline* has been developed stipulating binding fiscal conditions for both the annual state budget and 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. In addition to these legislative proposals, also amendments to the *Law on Budget and Financial Management* have been prepared in order to improve the budget quality and its link to planning documents.

Application of the new legal regulation is expected as of 2012, envisaging transitional provisions until 2015. The Ministry of Finance expects the *Draft Law on Fiscal Discipline* along with the eventual amendments to the Constitution (*Satversme*) to be submitted to the Saeima by the end of November 2011.

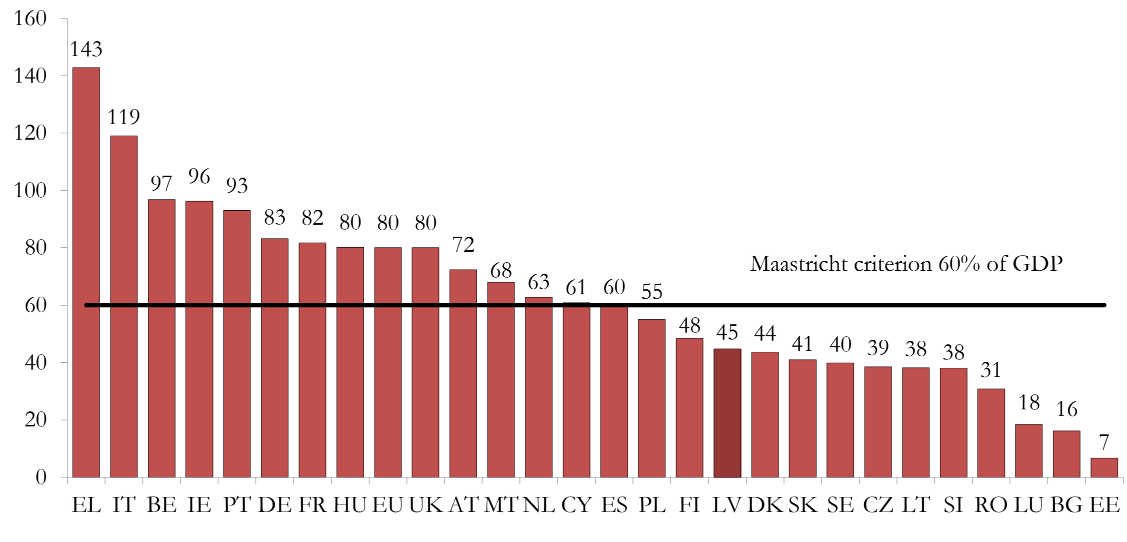
The level of **the general government debt** in Latvia is still one of the lowest in the EU (see Figure 4.4).

In 2010, the EU average level of the public debt was 80% of GDP (74.4% of GDP in 2009, 62.3% of GDP in 2008). The public debt exceeded the Maastricht criterion that is 60% of GDP in 14 EU Member States in 2010. In 2010, the highest public debt was observed in Greece, Italy, Belgium and Ireland, while the lowest general government debt was registered in Estonia, Bulgaria and Luxembourg. According to the European Commission forecasts published in spring 2011, the average level of the general government debt in the EU will reach 82.3% of GDP in 2011.

Figure 4.4

General Government Debt in the EU Member States in 2010

(% 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 5693.6 million or 44.7% of GDP at the end of 2010 (see Figure 4.5). The level of the general government debt is mainly influenced by the central government debt.

At the end of 2008, on the basis of the *Economic Stabilization and Growth Revival Programme of Latvia,* the IMF, the European Commission, the World Bank, the European Bank for Reconstruction and Development, and several EU Member States have agreed on providing financial support to Latvia from 2008 until

2011 in the amount of LVL 5.3 billion (EUR 7.5 billion).

According to the concluded agreements, the funding of the international loan programme is envisaged for covering the financial obligations of the government budget (including financing the government budget deficit and loans, refinancing of public debts) and ensuring stability of the financial sector.

In the framework of the international assistance programme, the total financing in the amount of LVL 3.1 billion (EUR 4.4 billion) has been received from 2008 until the end of 2010) – slightly more than a half of the total initial amount of the programme.

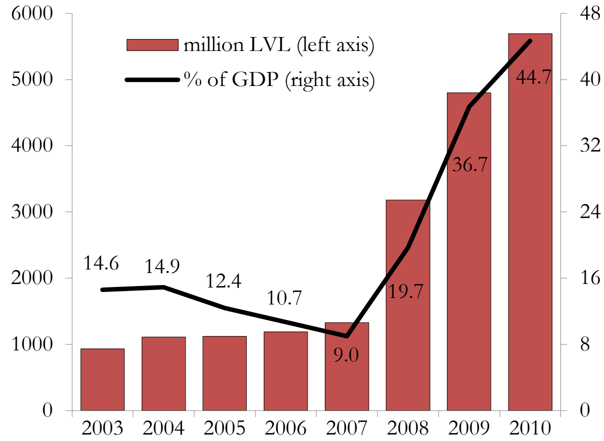
Financing received in the framework of the international assistance programme constitutes the largest part of the current central government debt structure, and repayment of the loans granted in the framework of the programme has to be started already in 2012.

In order to prevent the refinancing risk of the public debt in the medium term and to ensure preconditions for due repayment of government external debt obligations (including funding received in the framework of international assistance programme) in 2014 and 2015, already starting from 2011 borrowing in international financial markets is planned to be gradually started, by organizing regular (annual) public emissions of public debt securities and ensuring priority diversification of investor base (in Europe, USA and Asia), as well as by achieving an optimal level of borrowing costs according to the assessed credit rating of Latvia (see chapter 4.4.2.).

Taking into consideration the planned borrowing strategy, the central government debt at the end of 2013 is forecasted to be approximately 50% of GDP. In case the debt level of local governments does not significantly rise in the upcoming years, it is expected that the debt level of the general government in the medium term will not exceed the Maastricht criterion – 60% of GDP.

Figure 4.5

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



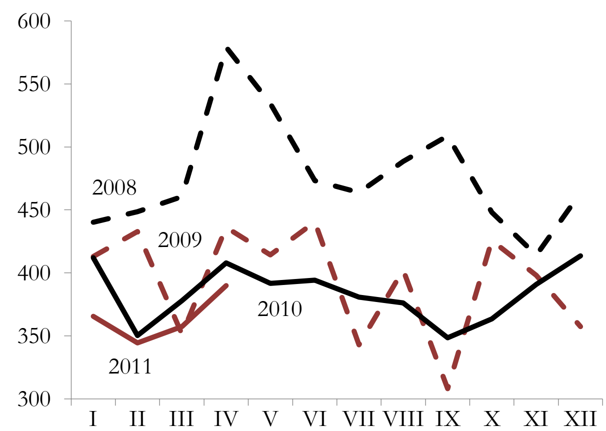
4.1.2. Budget Revenues

Revenues of the general government consolidated budget in 2010 were LVL 4607 million, which have decreased by LVL 121.1 million or 2.6% in comparison with 2009. The share of tax revenues in the total revenues in 2010 has slightly reduced. From January to May 2011, revenue of the general government consolidated budget were LVL 1884.7 million, which is by LVL 54.9 million or 2.8% less than in the corresponding period of the previous year.

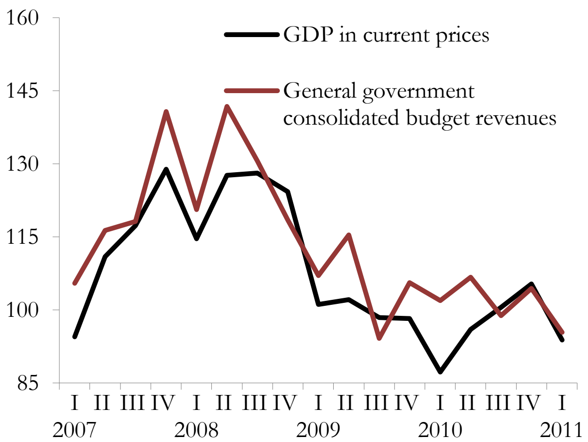
The decrease of revenues of the general budget is mainly related to the decrease of foreign financial aid and non-tax revenues as tax revenues in this period have increased.

Figure 4.6

General Government Consolidated Budget Revenues by Months*
(million LVL)



GDP and General Government Consolidated Budget Revenues by Quarters
(4th quarter of 2006, = 100)



* According to official data of monthly reports of the Treasury

Almost 80% of all tax revenues consist of three taxes – mandatory state social insurance contributions, personal income tax, and value added tax.

Taxes collected in the 2010 constituted 74.1% of all budget revenues. In 2010 comparing to the previous year, the total tax revenues decreased by 2.8% and amounted to LVL 3415.2, however tax revenues planned in 2010 were exceeded, and it was mainly influenced by the increase in value added tax revenues.

Table 4.2

Budget Revenues*
(% of GDP)

	2007	2008	2009	2010
General government consolidated budget revenues	**36.2**	**35.4**	**36.2**	**36.2**
I Tax revenues	**29.5**	**29.3**	**26.9**	**26.8**
1. Indirect taxes	*11.4*	*10.4*	*10.1*	10.2
– value added tax	8.1	6.9	6.1	6.5
– excise tax	3.0	3.3	3.9	3.6
– customs duty	0.2	0.2	0.1	0.1
2. Income taxes and property taxes	9.2	9.9	7.6	7.8
– corporate income tax	2.7	3.1	1.5	0.9
– personal income tax	6.0	6.4	5.6	6.2
– real estate tax	0.5	0.4	0.6	0.7
3. Social insurance contributions	*8.6*	*8.7*	*8.9*	8.6
4. Other taxes	*0.4*	*0.3*	*0.2*	0.2
II Other revenues	**6.7**	**6.1**	**9.3**	**9.4**

* Data of the Treasury

From January to May 2011, tax revenues increased mainly on the basis of an increase in the mandatory state social insurance contributions and value added tax in comparison with the corresponding period of the previous year. Revenues from real estate tax and corporate income tax also increased significantly.

Figure 4.7

Tax Revenues by Months*
(million LVL)

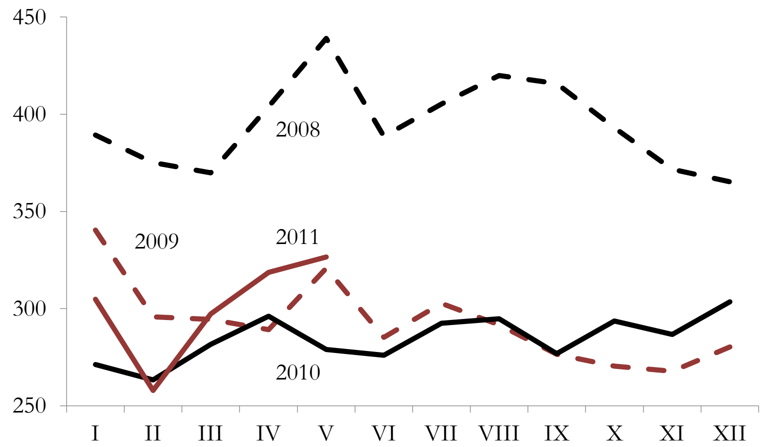


Figure 4.7 continued

* According to official data of monthly reports of the Treasury

The share of **employment taxes** in 2010 constituted almost 55.2% of all tax revenues. In 2010, in comparison with the previous year, the share of employment taxes in the total tax revenues has increased by 1.2%.

The personal income tax standard rate has been reduced from 26% to 25% as of January 1, 2011. At the same time, the monthly non-taxable minimum of the personal income tax payer has been raised from LVL 35 to LVL 45, as well as dependent care tax credit of personal income tax from LVL 63 to LVL 70 per month.

In 2010, the personal income tax levy amounted to LVL 791.2 million, and it has been increased by 8.5%

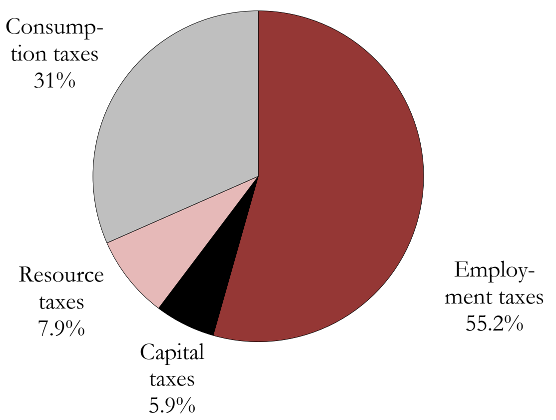
in comparison with the corresponding period of 2009; however, the personal income tax collected in the first five months of 2011 amounted to LVL 316.8 million which is by 3.7% less than in the corresponding period of the previous year.

Yet, the standard rate of state mandatory social insurance contributions has been increased from 33.09% to 35.09% as of January 1, 2011, accordingly by increasing the employee rate from the former 9% to 11%.

Figure 4.8

General Government Consolidated Budget Tax Revenues by Tax Groups in 2010

(%)



The revenues from mandatory state social security contributions in 2010 were LVL 1093.2 million which is by 6.3% less than in the corresponding period of 2009, but the revenues from mandatory state social security contributions from January to May 2011, were LVL 475.7 million which is by 9.6% more than in the corresponding period of 2010. The increase in revenues is related to the increase in the standard rate of state mandatory social insurance contributions and of the minimum monthly wage.

The share of **the consumption taxes** in the tax structure has reduced from 33.7% in 2007 to 31% in 2010.

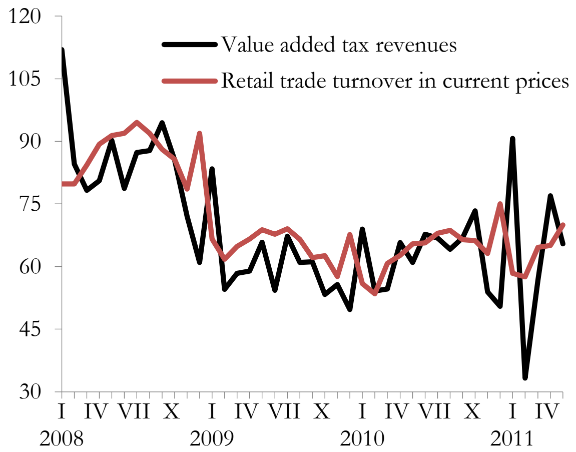
On January 1, 2011, the standard rate of the value added tax was increased from 21% to 22%, but the reduced tax rate applicable to particular goods and services was increased by 2% (from 10% to 12%). The clause specifying that the reduced tax rate must be applied to electric energy supply for inhabitants was deleted from the law, which means that the standard rate in the amount of 22% is applied to electric energy supply for inhabitants starting from January 1, 2011.

Consumption tax revenues increased significantly during the rapid growth period. It was promoted by the growing domestic demand and high inflation. Since the end of 2008, due to the decreasing domestic demand and consumer price pressure, the consumption tax levy started to decrease. Due to the increase in import volumes and changes in retail trade turnover amount, the value added tax levy in 2010 was LVL 825.2 million which is by 3.4% more than in the corresponding period of 2009. In 2010, the expected value added tax revenues were exceeded by 19.5% or LVL 134.7 million having a positive impact on the total amount of tax revenues. From January to May 2011, the value added tax revenues were LVL 356.6 million which is by 6.1% more than in the corresponding period of the previous year.

Figure 4.9

Retail Turnover and Revenues from Value Added Tax

(December 2007 = 100)



The revenues from the excise duty consumption share in 2010 most rapidly shrank for tobacco products. The standard tax rate is expected to be applied to fuel containing 5% of biofuel blends, and excise duty is to be raised for non-alcoholic beverages in 2011. The new rates for particular tobacco products set on October 28, 2010 came into force on January 1, 2011. Also a common procedure regarding the application of excise duty to food supplements containing alcohol was established in 2011. The excise duty rate for alcoholic beverages and fuel was raised, as well as a gradual increase of the excise duty for tobacco products was established.

The increase of the excise duty rates for almost all excise goods introduced at the beginning of 2009 and overall economic recession caused a rapid decline in the sales amount of excise goods, thus reducing the revenues from the excise duty. In 2010, the revenues for the excise duty were LVL 458.1 million, which is by 9.1% less than in 2009. From January to May 2011, the excise duty tax revenue was LVL 177.8 million which is by 1.2% less than in the corresponding period of the previous year. The decrease in revenues from the excise duty was affected by the decline of alcohol and cigarette sales amount.

The share of **the capital taxes** in the total tax revenues in 2010 constituted 5.9% which is by 1.8% less in comparison with 2009.

It must be noted with respect to the corporate income tax that starting with 2010, the norm of representation expenses that can be deducted from the taxable income is reduced (from 60% to 40%); for the purposes of corporate income tax calculation, the share of costs that are not related to the economic activity and losses resulting due to maintenance of the social infrastructure objects, which is not included in the expenditures, has increased 1.5 times, hence the opportunities for the taxpayer have been expanded with respect to deciding whether to set reduced advanced payments if the profits have decreased.

The reducing business activities and the increasing number of insolvent enterprises in 2010 caused a significant decrease of the corporate income tax levy which was LVL 112.2 million in 2010 or by 43.1% less than in 2009. Despite the significant decrease, the plan of corporate income tax for 2010 was implemented with surplus of 45.7% or LVL 35.2 million. The decrease of corporate income tax was mainly affected by the financial service sector. The corporate income tax levy increased rapidly from January to May 2011, and constituted LVL 76.9 million which is by 34.9% more than in the corresponding period of the previous year.

In 2010, the real estate tax levy has significantly increased reaching LVL 89.8 million, which is by 22.9% more than in the corresponding period of the previous year. A significant increase of real estate tax revenues was observed also from January to May 2011, when reaching LVL 62.6 million and was by 61% more than in the corresponding period of the previous year. It is mainly related to the doubling of real estate tax for dwelling space (depending on the cadastral value the rate is defined in the amount of 0.2%, 0.4%, and 0.6%).

The share of **resource tax group** in 2010 constituted 7.9% of all tax revenues. Changes in the resource tax group are mainly related to the excise duty for oil products. In 2010, the excise duty for oil products was collected in the amount of LVL 260.9 million which is by 8.2% less than in 2009. The excise tax revenues for oil products collected in 2010 were by 3% or LVL 8.1 million less than expected. The decrease in levy of this tax is related to the decrease of oil product consumption that corresponds to the current economic situation in the country. However, the natural resources tax in 2011 increased significantly in comparison with the previous year, and the plan of natural resources tax for 2010 (including special budget of local governments) was exceeded by 26.9% in total reaching revenues of LVL 8.7 million which is by 18.3% more than in 2009.

4.1.3. Budget Expenditures

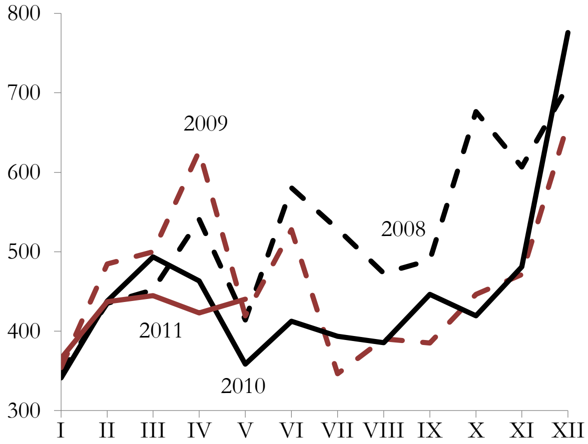
A slight increase in the general government consolidated budget expenditures has been observed in the first five months of 2011. Also in 2012, government budget consolidation has to be implemented, which might cause extra pressure on decrease of domestic demand which is mainly determined by worsening financial state of enterprises oriented towards domestic demand.

In 2010, the general government consolidated budget expenditures constituted LVL 5409.7 million which is by 6.4% less than in the previous year. From January to May 2011, the general government consolidated budget expenditures constituted LVL 2112.4 million, which is by 0.8% more than in the respective period of 2010.

Figure 4.10

General Government Consolidated Budget Expenditures by Months*

(million LVL)

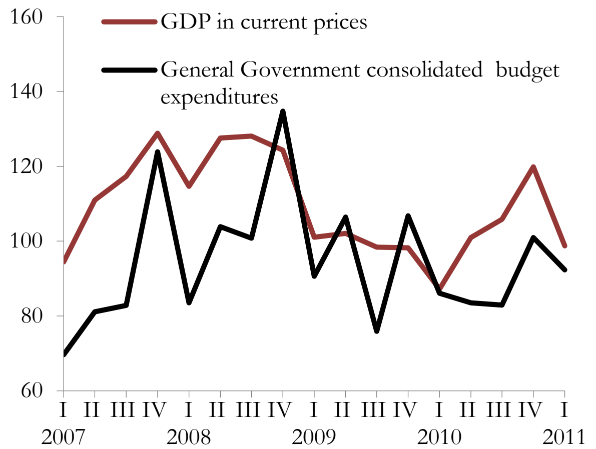


* according to official monthly report data of the Treasury

From January until May 2011, expenditures for subsidies and grants decreased by 7.5% but current expenditures increased by 3.6% in comparison with the respective period of 2010. At the same time, the capital expenditures increased significantly (by 54.8%), constituting LVL 138.9 million in the period from January until May 2011.

Figure 4.11

GDP and General Government Consolidated Budget Expenditures by Quarters
(4th quarter of 2006, = 100)

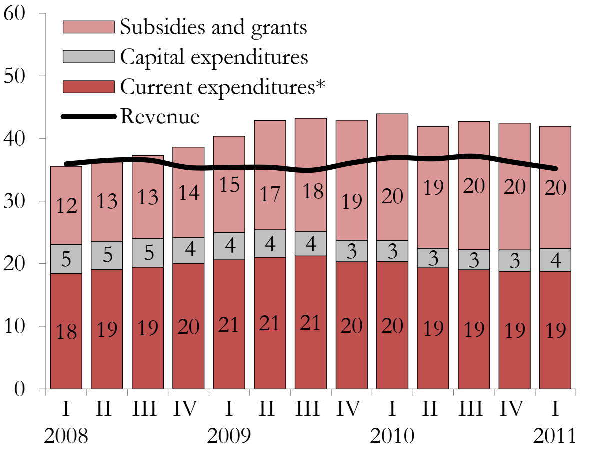


Current expenditures and subsidies and grants maintain a high share in expenditures.

According to the expenditures by functional categories, the highest share from January until May 2011, was for social security (31.4% of all expenditures) followed by education (16.7%), economic affairs (16.1%), and expenditures for general government services (14.7%), but the lowest share of all expenditures was for defence (1.7%), environmental protection (1.9%), and management of municipal territories and housing (2.2%).

Figure 4.12

General Government Consolidated Budget Revenues and Expenditures
(moving mean of 4 quarters, % of GDP)



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

Table 4.3

Expenditures of the General Government Consolidated Budget by Functions*
(percent)

	2008		2009		2010		2011 Q1	
	structure	**of GDP**	**structure**	**of GDP**	**structure**	**of GDP**	**structure**	**of GDP**
Expenditures – total	**100**	**38.6**	**100**	**42.9**	**100**	**42.5**	**100**	**40.7**
General public services	13.6	5.3	14.8	6.3	13.4	5.7	16.1	6.5
Defence	3.5	1.3	2.4	1.0	2.0	0.9	1.7	0.7
Public order and safety	5.0	1.9	4.5	1.9	4.4	1.9	4.3	1.7
Economic affairs	18.1	7.0	15.7	6.7	16.0	6.8	15.8	6.4
Environmental protection	2.4	0.9	2.2	0.9	1.1	0.5	1.7	0.7
Management of municipal territories and housing	3.6	1.4	2.1	0.9	2.5	1.1	2.1	0.8
Health	8.1	3.1	7.5	3.2	7.2	3.1	7.5	3.0
Recreation, culture, and religion	4.0	1.5	3.4	1.5	2.9	1.2	2.8	1.2
Education	20.2	7.8	19.6	8.4	16.7	7.1	16.1	6.5
Social security	21.5	8.3	27.9	12.0	33.8	14.4	31.9	13.0

* according to the official data of the Treasury

The public demand is made 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 outlay using the budget resources.

In 2008, the public demand decreased slightly slower than GDP. The reduced demand was determined mainly by reduction of central government expenditures in gross fixed capital formation by almost 40%. At the same time, the expenditures of municipalities for investments increased by 7.7% in 2008.

Table 4.4

Public Demand

	% of GDP				Changes in comparison with the previous year, %			
	2007	2008	2009	2010	2007	2008	2009	2010
Public Demand	**23.1**	**24.4**	**23.9**	**20.4**	**10.0**	**-3.6**	**-13.1**	**-14.3**
Public consumption	*17.4*	*19.6*	*19.6*	*16.9*	*3.7*	*1.5*	*-9.2*	*-12.6*
– central government*	9.5	10.7	11.0	9.9	1.4	0.8	-6.4	-8.4
– local government	7.9	8.9	8.6	7.0	6.6	2.4	-12.5	-17.9
Gross fixed capital formation	*5.7*	*4.8*	*4.3*	*3.6*	*27.8*	*-15.4*	*-24.0*	*-20.0*
– central government*	2.8	1.8	1.5	1.1	-3.7	-38.2	-25.3	-32.4
– local government	2.8	3.1	2.7	2.5	91.3	7.7	-23.2	-12.9

* with the Social Security Fund

Also in 2009, the public demand decreased at a slower rate than GDP. If compared to 2008, public consumption decreased by slightly more than 9%. Similarly, the expenditures for public investments continued decreasing rapidly. Overall in 2009, the public demand decreased by 13.1%. In 2010, the public demand decreased even more rapidly – by 14.3%. Like in the previous years, the decrease of the public demand was mainly based on cutting down central government gross fixed capital formation (by 32.4%). Municipal expenditures for investments were significantly reduced in both 2009 and 2010.

4.2. Prices

4.2.1. Private Consumer Prices

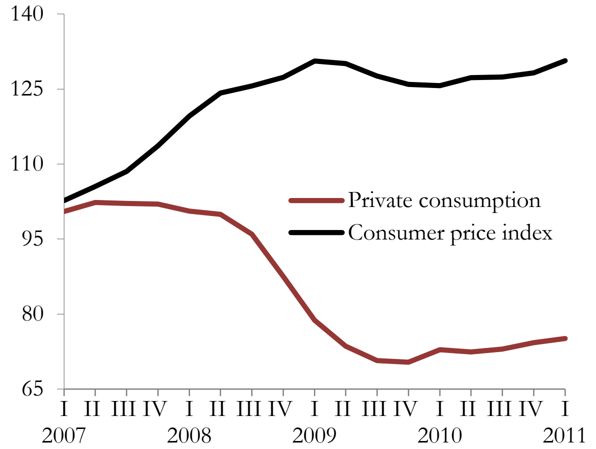
After deflation of consumer prices which was mainly caused by the rapid decrease of private consumption, since the end of 2009 the prices began to increase gradually as private consumption no longer declined and the price level was ever more significantly affected by external factors.

In 2010, the consumer prices increased by 2.5% (12-month inflation), but, considering the deflation in 2009, the average price level in 2010 was by 1.1% lower than a year ago. The price rise in 2010 was mainly affected by the rise in world prices for food and oil products. The rise in prices for food products determined the increase of the total consumer price index by 2 percentage points, heat energy price – by 0.8 percentage points, and fuel price – by 0.9 percentage points. Changes of other product and services groups generally slightly reduced the consumer price index in 2010.

Figure 4.13

Private Consumption and Consumer Price Index

(4th quarter of 2006 = 100)



At the beginning of 2011, consumer prices continued increasing. Within the first six months of 2011, consumer prices increased by 4.1% which was faster than in the corresponding period of previous two years. It was determined by both the situation in the domestic market and the global rise in prices:

– significant rise in food prices which exceeded seasonal fluctuations by 1 percentage point. In June prices in the food products group increased by 6.3% in comparison with December 2010 affecting the increase of total consumer price index by 1.6 percentage point;
– rise in fuel prices significantly affected by the rise in world prices for oil products. Fuel prices in June 2011 by 12.8% exceeded the level of December 2010;
– rise in prices for clothing and footwear. In the first two months prices for clothing and footwear reduced, however in March, April, and May untypically high rise in prices for this product group was observed (by 14.4% in May compared to February), which determined the increase in total consumer price level by 0.45 percentage points. The rise in prices for this product group to a great extent can be explained by the global rise in prices for cotton related to reduction of cotton crop due to floods;
– tax increase. Increase in the value added tax rate in January 2011 caused the rise in consumer prices by 0.9%;
– inflation expectations in relation to rise in prices for energy resources and increase in retail trade turnover.
– increase in electricity tariffs in April amounted to 14.1% thus increasing the total price level by 0.46%.

Table 4.5

Consumer Price Changes by Months
(percentage)

		Compared to the previous month	Compared to the respective month of the previous year	Average during the year
2010	January	0.2	-3.1	2.5
	February	0.0	-4.2	1.3
	March	0.5	-3.9	0.3
	April	0.9	-2.7	-0.4
	May	-0.1	-2.3	-1.0
	June	0.4	-1.4	-1.4
	July	0.2	-0.6	-1.6
	August	-0.7	-0.3	-1.8
	September	0.4	0.4	-1.8
	October	0.4	1.0	-1.6
	November	0.2	1.9	-1.4
	December	0.1	2.5	-1.1
2011	January	1.3	3.7	-0.5
	February	0.3	4.0	0.2
	March	0.7	4.2	0.8
	April	1.1	4.5	1.5
	May	0.4	5.0	2.1
	June	0.3	4.8	2.6

Figure 4.14

Consumer Price Index
(December of the previous year = 100)

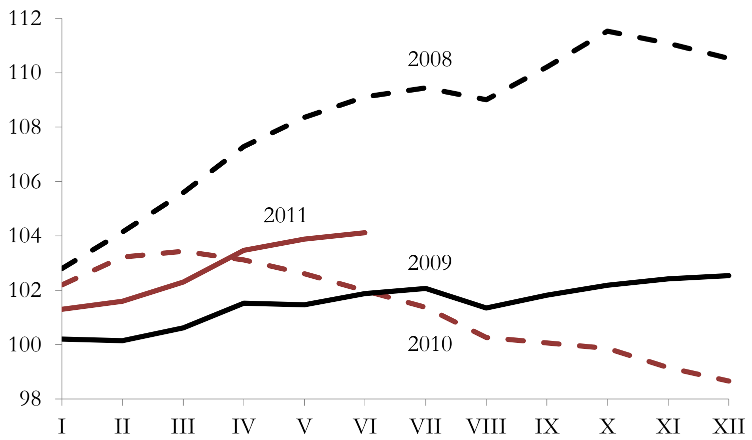
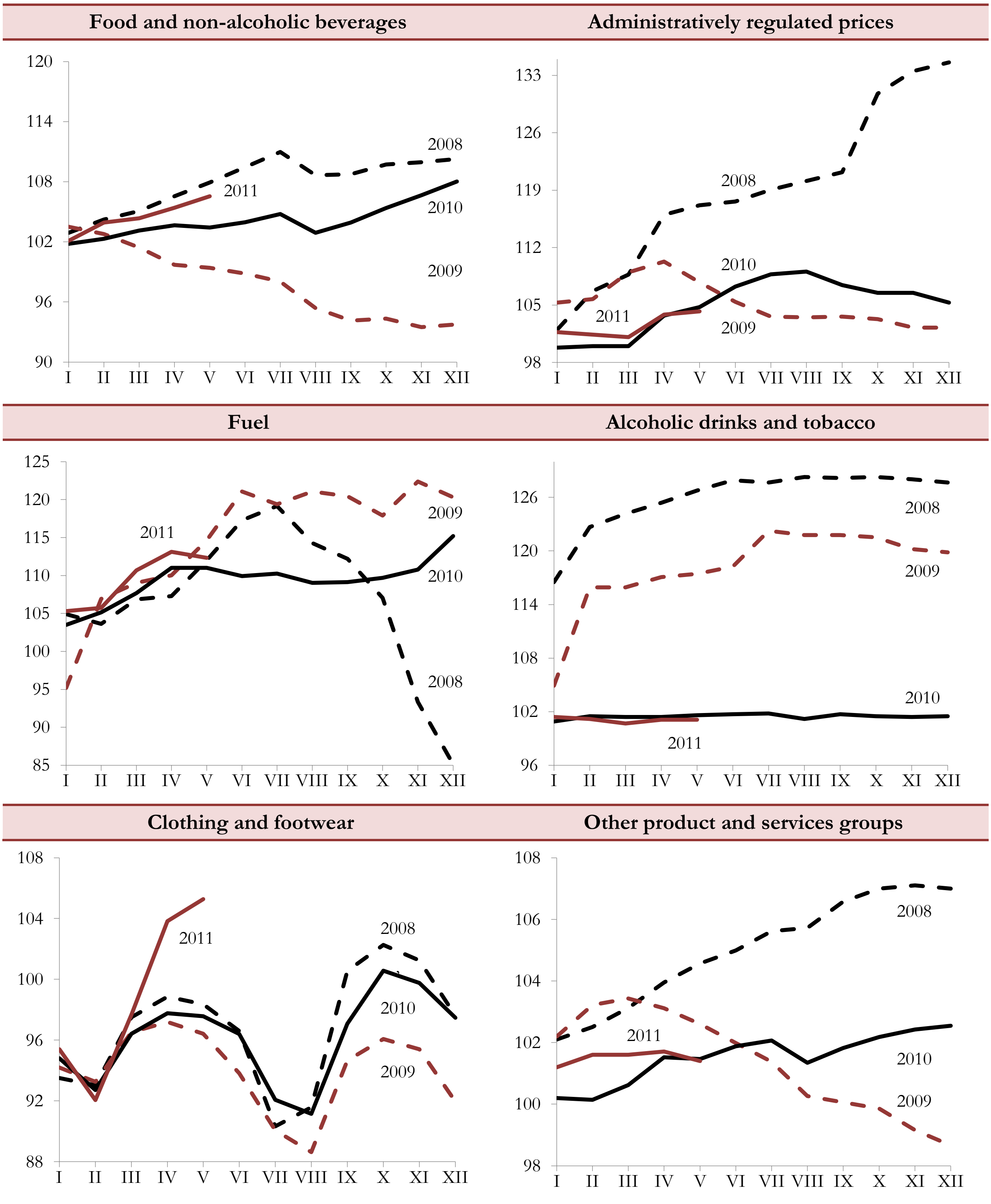


Figure 4.15

Consumer Price Index by Groups and Sub-groups

(December of the previous year = 100)

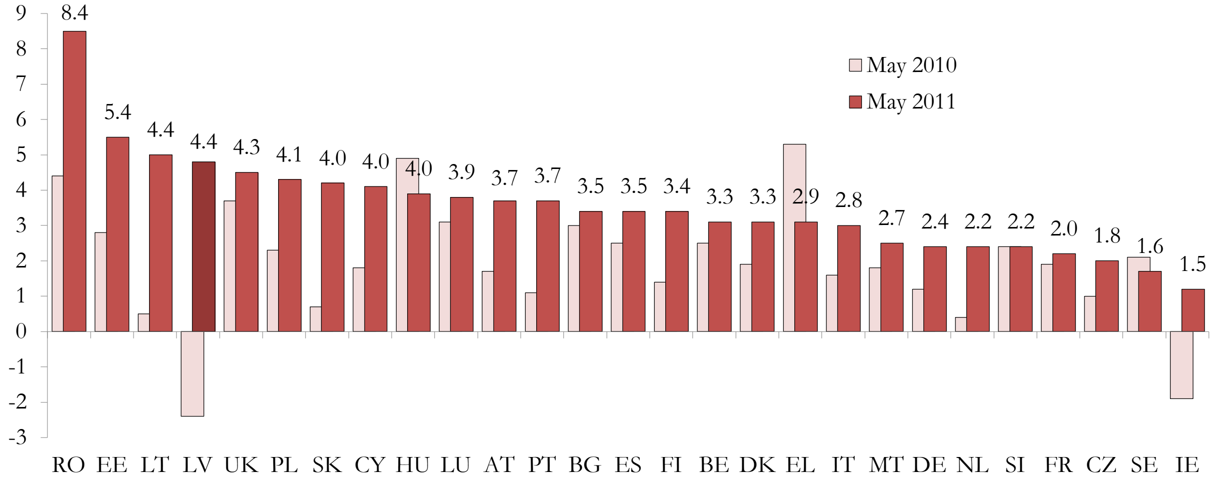


In 2010 in comparison with 2009, the average price level in the European Union has increased faster than in Latvia – by 2.6%. Just like in Latvia, it was determined by a rise in prices for food products and energy. The rise in prices for oil products had an indirect impact on increase of producer prices in manufacturing.

In May 2011 if compared to May 2010, the average price level in the European Union has increased, but the price level in Greece, Hungary, and Sweden has decreased.

Figure 4.16

Changes of the Harmonised Index of Consumer Prices in the EU Member States in May 2010 and May 2011
(12-month inflation, %)



Source: *Eurostat*

In May 2011 the highest inflation level was observed in Romania, the Baltic States, as well as in Great Britain, Poland, and Slovakia. But the lowest inflation was in Ireland – 1.2%, Sweden – 1.7% and the Czech Republic – 2%. In May 2011, as compared to May 2010, price level in Latvia increased by 7.2 percentage points (from -2.4% in May 2010 to 4.8% in May 2011), in Lithuania – by 4.5 percentage points and Rumania – by 4.1 percentage points, thus becoming the countries with the highest inflation rate in European Union.

Figure 4.17

Harmonised Index of Consumer Prices
(December 2009 = 100)

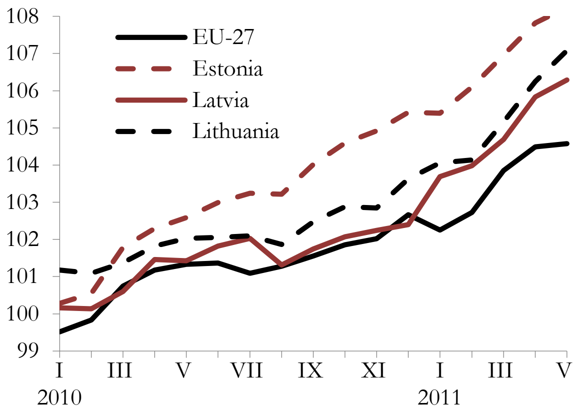


Figure 4.18

Harmonised Consumer Price Index in Groups and Subgroups
(December 2009 = 100)

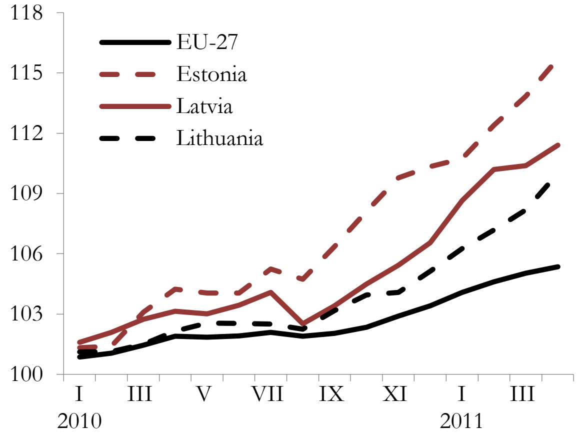
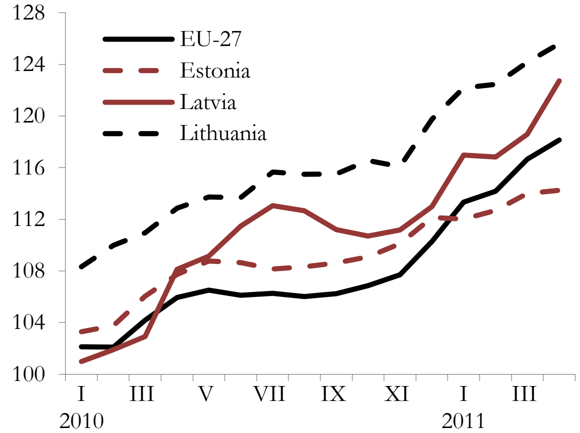
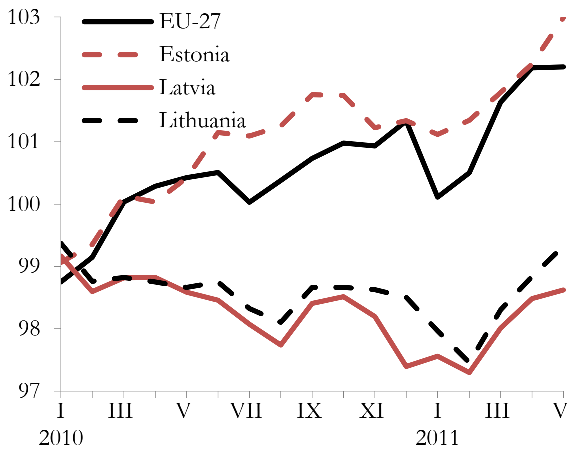
Food products (including alcohol and tobacco)	**Energy**
	

Figure 4.18 continued

Total price index excluding energy and food products
(December 2009=100)



In 2011 in the Baltic States consumer prices in the group of food products and energy continued to increase.

The rise in food prices in the EU also in the first five months of 2011 was mainly determined by the increasing demand for food in the developing countries.

The highest rise in prices among the Baltic States in the food product group in May 2011 was observed in Estonia – by 11.2%, while in Latvia the prices increased by 9.1% and in Lithuania – by 8.6%.

In May 2011 in comparison to May 2010, the energy price level most rapidly increased in Latvia – by 13% and Lithuania – by 11.3%, but in Estonia half of the amount – by 5%.

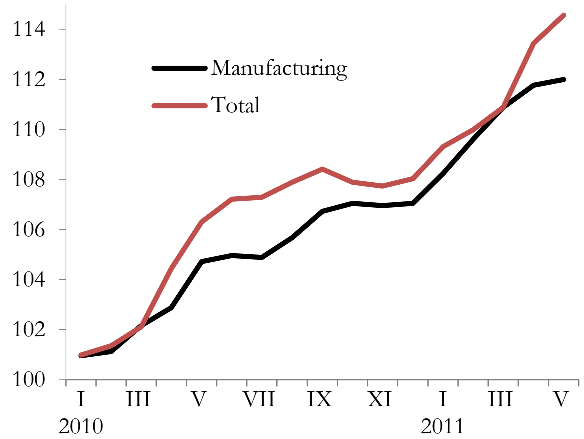
4.2.2. Producer and Foreign Trade Prices

After the decrease of prices in 2009, the **producer prices** started to grow again in 2010. In general, prices continued rising also in 2010, although the price rising rate became more moderate in the last months of the year. Prices rose for both products sold in domestic market which was affected by stabilizing domestic demand and exported products which mainly relied on the rise in prices in the world markets for the main export goods of Latvia, including wood and timber products, metal articles, and food.

In May 2011, the producer prices were by 7.8% higher than in May 2010, including manufacturing – by 7%. Prices for products sold in the domestic market rose by 9.5%, but for exported products – by 5.3%. Most rapid price increase is observed in electric energy, gas supply, heat supply and air-conditioning – by 10.3%, in production of food products – by 11.2% and metal production – by 14.2%.

Figure 4.19

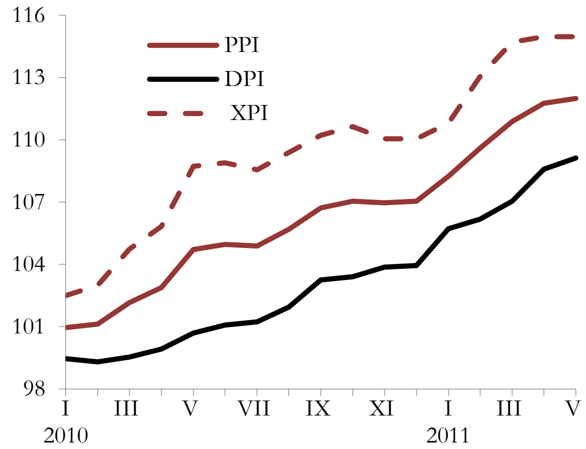
Producer Price Changes
(December 2009 = 100)



The average producer prices in the European Union continued rising in the first four months of 2011. Rise in price level mainly relied on rise in prices for energy resources which, in its turn, caused increase in costs of intermediate consumption. Rather significant rise in producer prices arises along with the increase in demand. It has particular impact on prices of food and agricultural products and other raw material, as well as metal prices.

Figure 4.20

Dynamics of Producer Price Changes in Manufacturing
(December 2009 = 100)



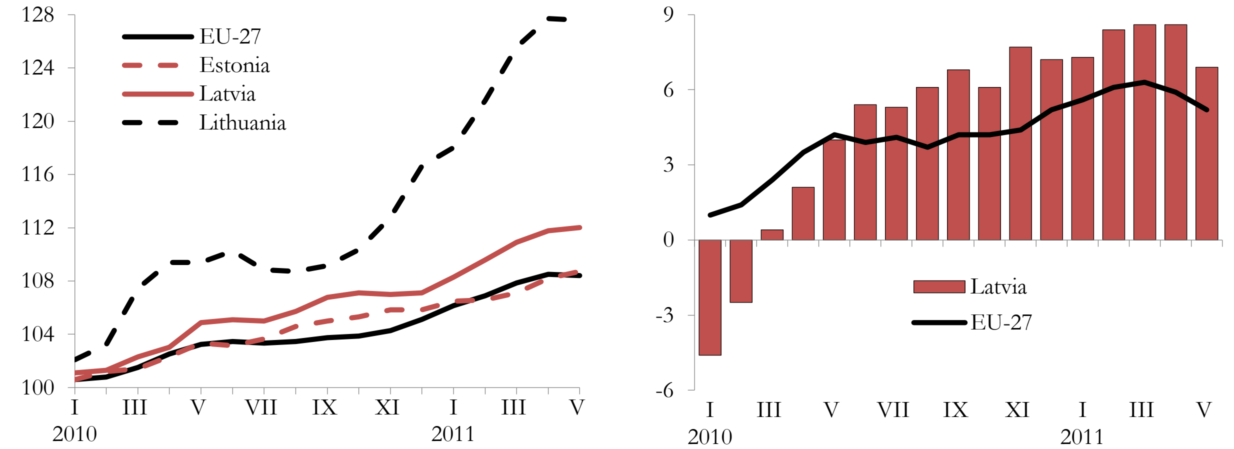
PPI – producer price index;
DPI – producer price index for products sold in the domestic market;
XPI – producer price index for exported products

If comparing the Baltic States, the most rapid increase of the producer price index in the four months of 2011 was observed in Lithuania, the most moderate – in Estonia.

Figure 4.21

Producer Price Index by Months in Manufacturing

December 2009 = 100	**Changes in comparison with the corresponding period of the previous year,%**

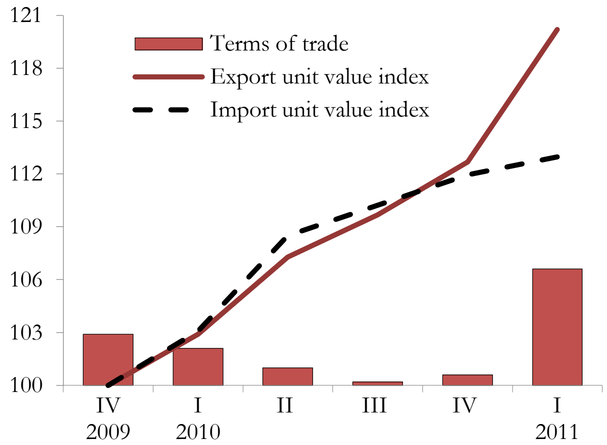


At the beginning of 2011 in comparison with the beginning of the previous year, the trade conditions of Latvia considerably improved as import prices in 2011 grew almost half slower than those of export. In the 1st quarter of 2011, the unit value for exported goods increased by 16.8% and that of imported goods – by 9.6%, if compared to the corresponding period in 2010.

Figure 4.22

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)



The average export unit value level in the 1st quarter of 2011 was mainly raised by the increase of unit value for metals and metal articles, food products, as well as wood and timber products, if compared to the 4th quarter of 2010. In its turn, the increase of unit value for mineral products, metal and metal articles, as well as chemical industry and related industry products had the most significant impact on the average unit value level.

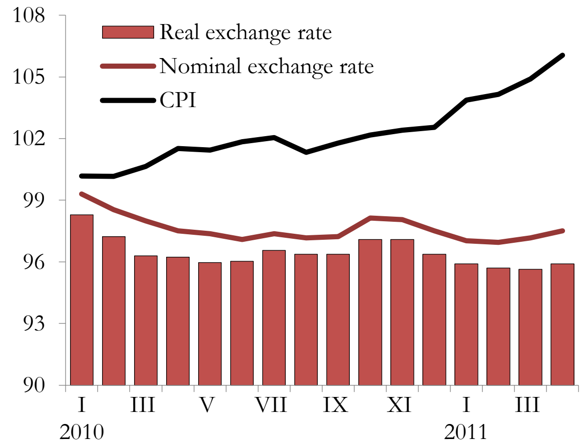
As competiveness of Latvian entrepreneurs improved, the real effective exchange rate of the Latvian lat continued decreasing in 2010 and at the beginning of 2011. Despite the slight increase at the end of 2010 and in April 2011, generally it is in a low level.

Previously, the decrease of the real effective exchange rate of the lat has been determined by the decrease of consumer prices, but at the moment, decrease of the real effective exchange rate of the lat is determined by the low nominal effective exchange rate of the lat (see also Chapter 4.4.1).

Figure 4.23

Effective Exchange Rate of the Lat*

(December 2009 = 100)



* Effective exchange rate of the lat has been calculated in proportion 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

Due to the global financial crisis, Latvia experienced substantial adjustment to the balance of current account payments, which began in the second half of 2007, when the inflow of foreign investments rapidly decreased. As a result, the current account balance moved from the lowest level in the history (in the 3rd quarter of 2007 the deficit was 24.8% of GDP) reaching the highest level in history (in the 4th quarter of 2009 – surplus 10.7% of GDP).

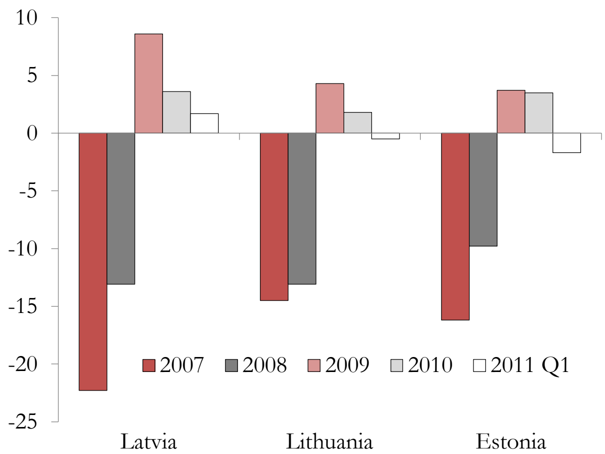
In general, the surplus of current account was 3.6% of GDP in 2010 (in the 1st quarter – 8.6%, in the 2nd quarter – 5.8%, in the 3rd quarter – 1.1%, and in the 4th quarter – -0.3%). The quarterly dynamics of current account in 2010 shows another change in direction, i.e. decrease of positive balance and approaching the state of deficit which was typical in Latvia for several years. In the 1st quarter of 2011, the positive balance of current account increased to 1.7% of GDP.

Similarly to Latvia, substantial adjustments to the balance of payments of the current account are taking place also in our neighbouring countries.

In Estonia, the current account surplus in 2009 reached 3.7% of GDP compared to the 9.8% deficit in 2008. However, in Lithuania the positive balance of the current account was 4.3% of GDP in 2009 (deficit in 2008 – 13.1% of GDP). In 2010, the current account surplus in Estonia and Lithuania was correspondingly 3.5% and 1.8%. Yet, in the 1st quarter of 2011, the current account balance was already negative in both countries.

Figure 4.24

Current Account Balance in the Baltic States
(% of GDP)



Source: *Eurostat*

Changes in the current account of Latvia in 2010 are mainly related to changes in income balance sheet items and less to changes in foreign trade balance sheet items.

Foreign trade deficit of Latvia in 2010 was 6.4% of GDP – by 0.7 percentage points lower than in 2009. It was due to the faster increase of goods export than of goods import (in 2010, the goods export in actual prices increased by 28.6% and import – by 20.4%). In 2010, the negative trade balance was three times lower than in 2007. However, it should be noted that along with increasing economic activities, the dynamics of import is becoming faster and further improvement of foreign trade balance will be based on improving competitiveness of producers in foreign markets. In the 1st quarter of 2011, the foreign trade deficit reached 7% of GDP, thus being slightly higher than a year ago.

Contrary to the balance of goods, adjustment of the balance of services is moderate. Substantial adjustment to balance of services took place in 2009 (surplus reached 6% of GDP exceeding the level of 2008 by 2 percentage points). It was related to the rapid decline in service import volumes in the 1st quarter of 2009. Since the 2nd quarter of 2009, the dynamics of both import and export has been stable. In 2010, the balance of services reached the level of 6.2% of GDP, but in the 1st quarter of 2011 – 6.1% of GDP. The balance of services almost totally covers the negative trade balance of goods.

Figure 4.25

Current Account Deficit, Investments, and Savings
(% of GDP)

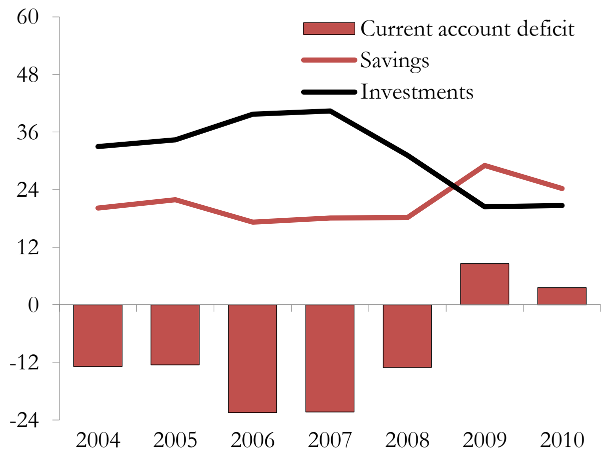


Table 4.6

Balance of Payments of Latvia
(% of GDP)

	2007	2008	2009	2010	2010 I-III	2011 I-III
A. Current account	**-22.3**	**-13.1**	**8.6**	**3.6**	**8.6**	**1.7**
Trade balance	-23.9	-17.7	-7.1	-6.4	-6.7	-7.0
Export	28.5	28.3	28.3	37.4	33.8	44.0
Import	-52.4	-46.0	-35.5	-43.9	-40.6	-51.0
Balance of services	3.5	4.0	6.0	6.2	6.4	6.1
Net revenues	-3.2	-1.6	6.3	0.2	5.0	-0.5
Current transfers, net	1.3	2.2	3.4	3.6	4.0	3.1
B. Capital account	**1.9**	**1.5**	**2.4**	**1.9**	**3.4**	**0.1**
C. Financial account*	**24.6**	**11.4**	**-7.0**	**-1.3**	**3.1**	**-8.7**
Direct investments	6.8	3.0	0.6	1.4	-3.6	5.4
Abroad	-1.3	-0.7	0.2	-0.1	-1.1	-0.6
In Latvia	8.1	3.7	0.4	1.5	-2.5	6.0
Portfolio investments**	-1.6	0.8	2.3	-1.7	-0.7	-5.3
Assets	-1.0	1.8	3.2	0.5	2.0	-4.2
Liabilities	-0.5	-1.0	-0.9	-2.2	-2.7	-1.1
Other investments	19.3	7.6	-9.8	-1.0	7.5	-8.9
Assets	-21.7	-1.4	-4.0	-4.1	11.1	8.2
Liabilities	40.1	8.9	-5.8	3.1	-3.5	-17.1
D. Net errors and omissions	**-0.8**	**-1.8**	**0.8**	**-0.2**	**0.7**	**-0.1**
E. Reserve assets	**-3.4**	**2.0**	**-5.0**	**-4.0**	**-15.8**	**7.0**

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

Significant changes are observed also in the income balance of the current account, which has been positive for seven successive quarters since the 4th quarter of 2008. The income balance surplus in the 2nd quarter of 2009 reached 9.1% of GDP. The income balance shrank in the next periods and was negative in the 3rd and 4th quarter of 2010 (respectively 0.7% and 3.6% of GDP). The decrease of the positive income balance in the 1st half of 2010 was based on decrease in losses of non-resident enterprises, as well as a significant increase in the amount of paid dividends, particularly in the 2nd quarter (almost 5 times if compared to the 1st quarter). Yet, the formation of negative income balance surplus in the 2nd half of 2010 was based on the increase of non-resident investment income including reinvested profits. Overall in 2010 and in the 1st quarter of 2011, the income balance was almost balanced.

Due to the impact of the global financial crisis, when the capital inflow ran short, there was a significant decrease of the domestic demand, which resulted in substantial adjustments of the economy.

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. The investment level increased from 33% to 40.4%, but the level of savings decreased from 20.2% to 18.1%, compared to 2004, ensuring less than a half of domestic investment financing.

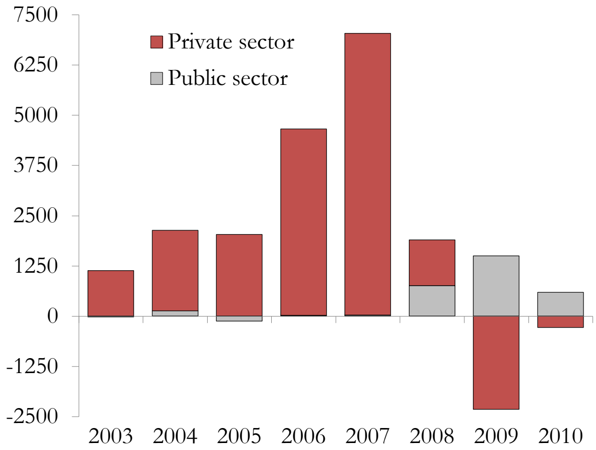
As the conditions in the global financial markets deteriorated, the situation changed drastically. A high debt burden, decrease of economic activities and income, as well as uncertainty about the future development fostered economy of households. Along with the increase in the level of savings, the investments are decreasing rapidly. In 2009, investments share in GDP was 20.4%. However, the level of national savings in 2009 was 30% of GDP. The level of savings exceeded the level of investments also in 2010, though this difference has reduced mainly because of the decreasing level of savings.

4.3.2. Financial Flows

Liberalization of financial flows ensures the inflow of foreign capital in Latvia. There are no limitations with regard to convertibility of the national currency in Latvia. Foreign companies may freely withdraw their investments and profits after paying taxes. Likewise, all residents of Latvia are free to use financial services of foreign companies. Furthermore, there are no restrictions for operations with securities.

Figure 4.26

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 has increased almost 3.5 times. The unfavourable conditions in global financial markets weakened the intensity of foreign investment flow. Volumes of private capital inflow rapidly decreased in 2008 (almost 7 times lower than in 2007), but since the 4th quarter of 2008, outflow of private foreign capital was observed, which intensified in 2009. Outflow of private foreign capital in 2009 was almost 2 times higher than the inflow in 2008.

In the first half of 2010, the capital outflow continued although to a smaller extent than a year ago, however, in the 3rd quarter of 2010, for the first time since the end of 2008, capital inflow into the private sector was observed. It was significantly influenced by the increase of reinvested profits thus indicating that the results of operations of non-resident enterprises are improving.

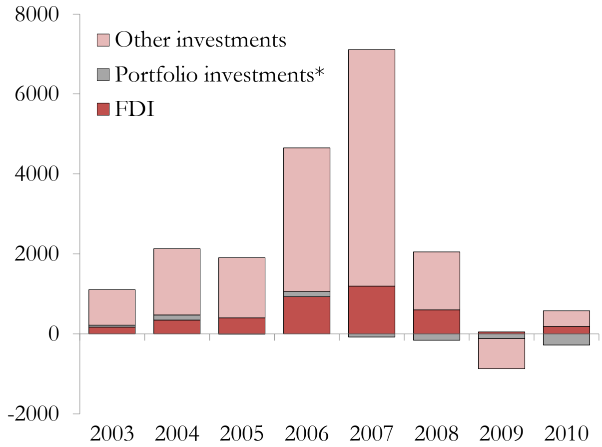
In 2010, there was deficit in the financial account of the balance of payments, though the negative influence on the state of financial account caused by the outflow of private capital was reduced by long-term public sector loans.

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

During the period of 2005-2007, the foreign direct investments (FDI) 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 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. But in 2010, the FDI flows exceeded the indicator of previous year almost four times and constituted 6% of GDP. Fluctuations of the incoming FDI flows to a great extent are related to investments in fixed capital of foreign enterprises. In 2011, inflow of FDI in the economy of Latvia continues increasing. The volume of direct investments in the 1st quarter of 2011 was equal the volume of 2010.

Figure 4.27

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

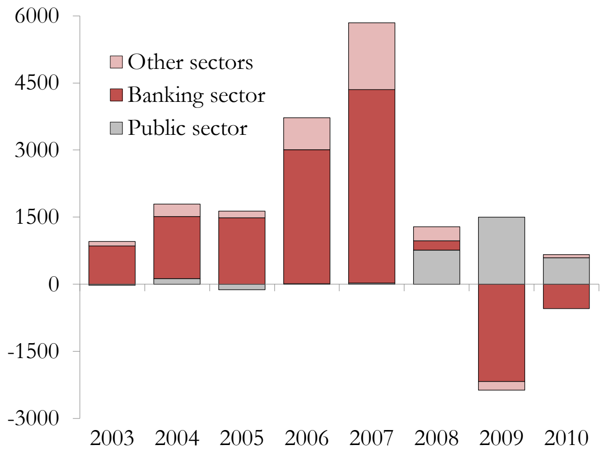


* portfolio investment and derivative financial instruments

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 in the 1st quarter of 2011, the balance of portfolio investments was negative, which was mainly due to repayment of long-term liabilities of the banking sector.

Figure 4.28

Incoming Foreign Investment Flows by Sectors*
(million LVL)



* excluding foreign direct investments

Until 2008, a large part of the total foreign investments was formed of other investments, i.e. financial transactions that are not included in the direct and portfolio investments. These are trade loans, loans and borrowings, cash and deposits, etc. Decrease of short-term flows was observed in 2008, but in 2009, flows of other investments were negative (-9.8% of GDP), mainly on the account of rapid decrease of foreign liabilities of the banking sector. However, in 2010, the negative balance of other investments was only 1% of GDP, determined by the decrease of government long-term loans and debt commitments.

Overall, the foreign capital flows were negative in 2010 and in the 1st quarter of 2011.

The debt of Latvia to the rest of the world in 2010 was 165.2% of GDP, including government debt – 33.4% of GDP. Since the end of 2009 external government debt increased by almost 7.5 percentage points.

4.3.3. Foreign Direct Investment

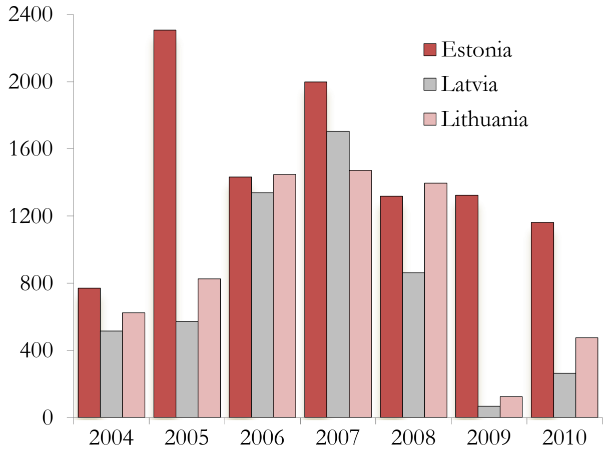
Due to the impact of the global financial crisis, foreign capital flows in the economy of Latvia have significantly decreased. However, the FDI flows in comparison with other financial flows were more stable.

Currently, the intensity of FDI flows in Latvia, like in almost all countries of the world, is considerably weaker than before the crisis. It is explained with the considerable losses suffered by entrepreneurs during the period of rapid recession, which weakened the investment capacity, as well as reduced the tendency to invest.

Decrease of FDI inflow is observed also in our neighbour countries. 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 Lithuania and Latvia they were correspondingly by 80% and 94% lower than a year ago. However, in 2010, flows of incoming FDI in Estonia constituted 88% of the flows in 2009, while in Latvia and Lithuania they increased nearly 4 times.

Figure 4.29

Inflow of FDI in the Baltic States
(million EUR)



Since 2008, the activities of Latvian investors abroad have decreased as well. Compared to 2007, foreign direct investments of Latvian entrepreneurs reduced almost twice, but in 2009 they were negative. The activities of Latvian investors are increasing in 2010.

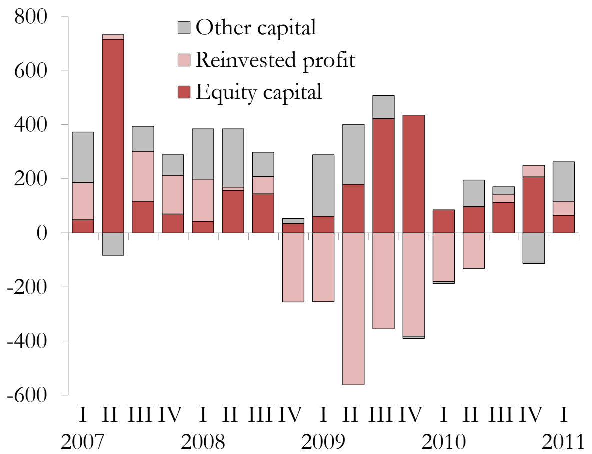
The structure of the incoming FDI shows that since the 4th quarter of 2008, direct investment enterprises are operating with losses. In 2009, they reached LVL 1094.5 million (EUR 1542 million). Losses of the direct foreign investment enterprises were fully compensated by investments in equity capital and other capital, therefore the incoming FDI flows were positive in 2009 (LVL 47.5 million). In the 1st quarter of 2010, the investments in equity capital were slightly lower than the losses of the direct investments of enterprises, thus resulting in still negative incoming FDI flows. Due to the improving economic situation, losses of foreign investors reduced and an increase of reinvested profit has been observed since the 3rd quarter of 2010. Overall, the incoming FDI flows were positive in 2010 and in the 1st quarter of 2011.

According to the international investment balance of Latvia, the FDI stock in the economy of Latvia reached LVL 6167.3 million at the end of the 1st quarter of 2011 which is by 5% more than a year ago. The share of FDI in the structure of foreign capital stock constituted 25 percent.

The global financial crisis has had no impact on the geopolitical structure of foreign capital stock of Latvia. Mainly these are investments of the EU countries. At the end of March 2011, the FDI of the EU countries constituted 80% of all FDI stock, one third of them are investments of the new EU Member States, and almost half of them are investments of the euro zone countries.

Figure 4.30

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

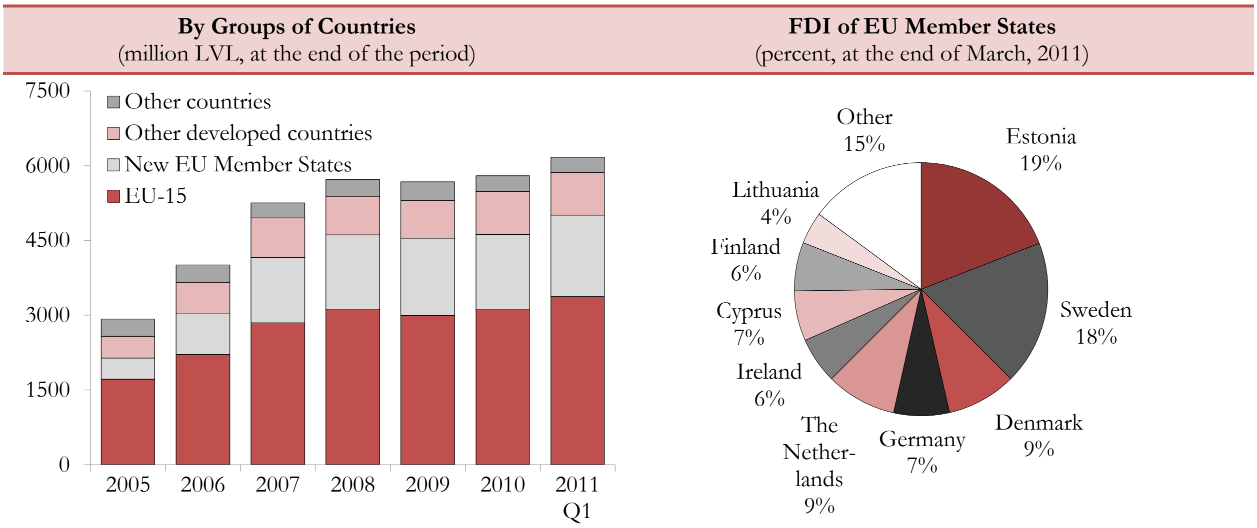


The biggest investor countries in the economy of Latvia are Sweden and Estonia. The FDI stock by these two countries at the end of March 2011 formed almost one third of the total FDI stock. They were mainly directed towards the financial intermediation sector. Though since the end of 2008, the FDI stock of the abovementioned countries in the financial intermediation sector has decreased by 14.5%, they still constitute over a half of the FDI stock in the sector.

Large investments have been made also by entrepreneurs from Denmark, Germany, and the Netherlands with investment volumes at the end of March 2011 constituting 25% of the FDI stock in the national economy of Latvia. It should be noted that annual investments of German entrepreneurs have been rather small since 2004, therefore their share in the total FDI stock is decreasing. At the end of 2004, they constituted 15.3% but at the end of the 1st quarter of 2011 – only 7.1% of the FDI stock. The FDI of Germany focuses on the energy sector (36.5%) and real estate operations (22%). It should also be noted that the German investments in the energy sector have decreased by more than a half since the end of 2005. In the 4th quarter of 2010, also the German investments in the financial intermediation sector decreased almost 8 times. At the end of 2010, they constitute only 3.4 of the FDI stock of Germany (in the 3rd quarter of 2010 – 21.5%).

Figure 4.31

FDI Stock



Until 2008, the growth rates of the FDI in service sectors were almost one and a half times faster than in manufacturing sectors, and the share of service sectors in the FDI stock formed 80% at the end of 2008. However, in 2009 and 2010, the foreign direct investment increased faster in sectors of goods manufacturing (respectively by 6.6% and 10.6%), while the level of the FDI stock in services sectors remained unchanged in 2009, but in 2010 it reduced by 7.4%.

After accession of Latvia to the EU, foreign investors have made significant investments in the financial intermediation sector, the share whereof in the FDI stock increased from 24% at the end of 2004 to 40% at the end of 2008. At the end of March 2011, the level of the FDI stock in this sector was 23%. It should be noted that the decrease of domestic demand had a negative impact on investment in trade and communication sectors, the FDI stock in the abovementioned sectors at the end of March 2011 was respectively by 11.3% and 7.4% lower than at the end of 2008. The decrease of the FDI in these sectors was partially compensated by investments in the real estate sector (by 30.6%), therefore the overall level of the FDI stock in the service sectors has not changed since the end of 2008.

Table 4.7

FDI Stock by Sectors

(end of the period, million LVL)

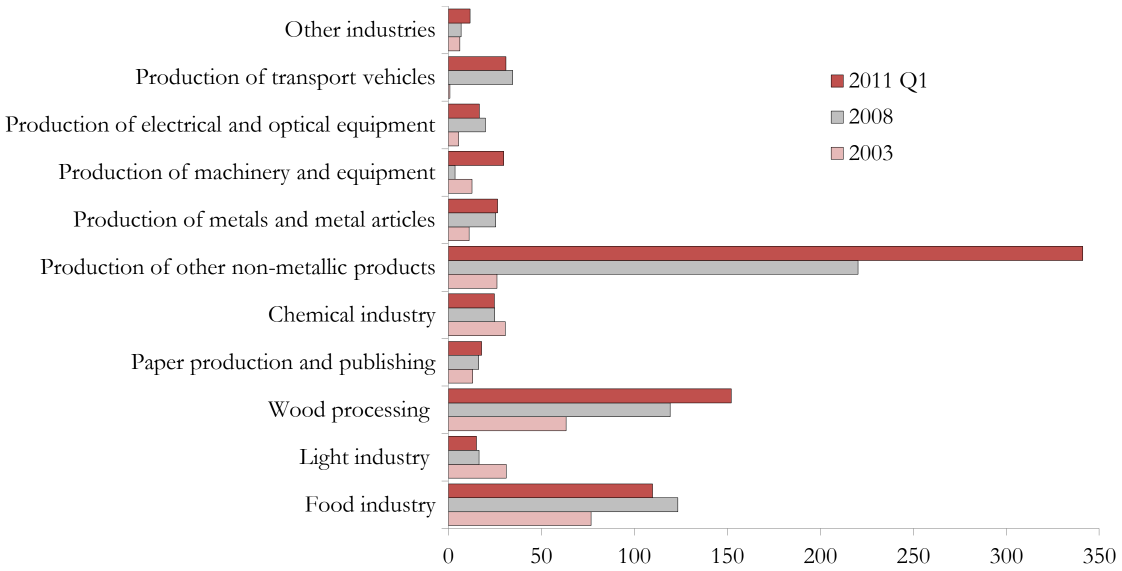
	2004	2005	2006	2007	2008	2009	2010	2011 Q1
Primary sectors	49.8	59.5	71.6	113.1	145.2	167.5	207.9	191.2
Manufacturing	276.1	376.0	395.8	516.8	611.0	654.5	725.0	776.5
Energy	164.7	327.6	348.1	270.7	204.9	190.5	216.0	288.9
Construction	36.5	49.7	67.6	85.5	107.1	126.6	109.4	102.4
Trade	395.7	437.8	562.3	676.4	862.0	856.5	737.4	753.1
Transport and communications	333.3	336.4	347.0	392.5	466.3	428.1	424.7	431.9
Financial intermediation	375.9	625.4	964.6	1486.2	1647.3	1645.1	1326.8	1411.0
Other services	439.2	529.0	795.3	1223.5	1251.3	1371.3	1492.1	1593.5

From the end of 2008 to the end of March 2011, a particularly rapid increase of the FDI stock in goods production was observed in the energy sector and manufacturing – respectively by 27% and 41%. The increase of the FDI stock in the manufacturing to a great extent was influenced by substantial investments in production of construction materials (increase by 54.9%) and wood processing (increase by 27.5%). The share of sectors mentioned above in the FDI stock constituted 63.5% in manufacturing at the end of the 1st quarter of 2011 (at the end of 2008 – 55.6%).

Figure 4.32

FDI Stock in Manufacturing

(end of the period, million LVL)



Overall, upon evaluating the FDI structure in the 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 it is loss of competitiveness in foreign markets. The volume of the FDI stock in the light industry in 2010 was by 7.3% lower than in 2008. Similar tendencies are observed in several EU Member States. Yet, the decrease of the FDI stock in 2009 and in the 1st quarter of 2010 was mainly based on the decreasing demand in domestic market. It should be noted that the FDI in this sector has been gradually increasing since the 3rd quarter of 2010. At the end of March 2011, the FDI stock in food industry increased by 12.3% and constituted 18.6% of the FDI stock in manufacturing in comparison with the end of 2010 (at the end of 2010 – 13.5%). The FDI have reduced also in production of vehicles (by 10% in comparison with the end of 2008), as well as in production of electric and optical equipment (by 17%).

It should be noted that overall, interest of foreign investors about the manufacturing sector has not decreased, but it has even increased in some manufacturing sub-sectors. Foreign investments in production of machinery and equipment have been growing significantly. The share of sector mentioned above in the structure of the FDI stock in manufacturing is increasing and it constituted 3.8% at the end of March 2011 (at the end of 2008 – 0.6%). Changes of the FDI stock in other manufacturing sub-sectors are insignificant.

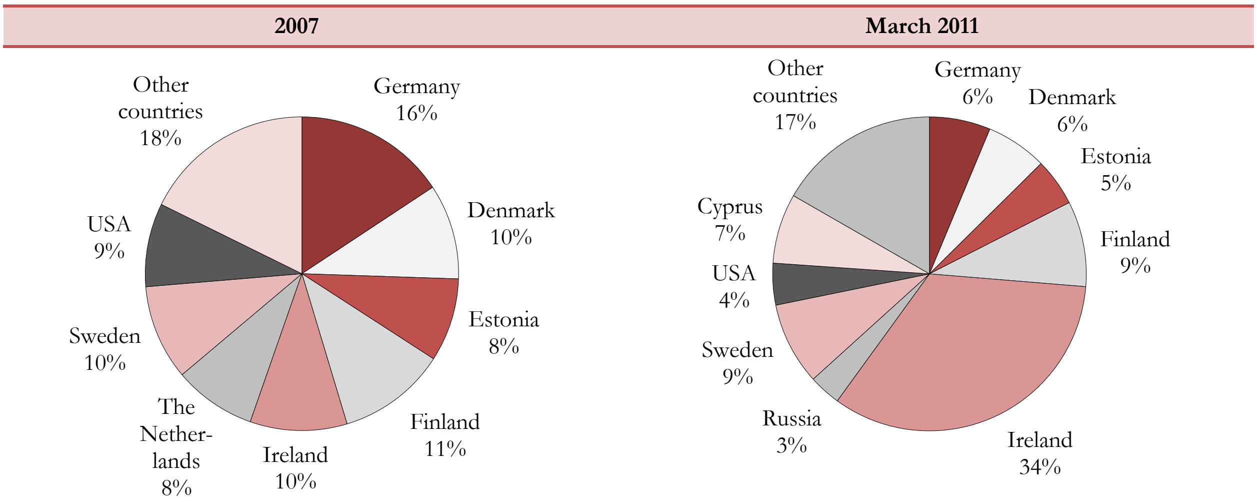
Upon evaluating the changes of FDI stock in the structure of manufacturing, it can be concluded that the share in high and medium-high technologies sectors constituted almost 12% at the end of March 2011 (at the end of 2008 – 11.3%).

Largest investments in manufacturing have been made by investors from Denmark, Finland, Germany, Sweden, Ireland, Estonia, the Netherlands, and the USA. The investments of the abovementioned countries constituted 70% of the FDI stock in the 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 significantly changed. At the end of March 2011, the capital of Ireland was dominating in the structure of the FDI stock constituting more than a third of the FDI stock in the manufacturing which was greatly influenced by the rapid increase of investments of this country. It has increased almost three times since the end of 2008. The volume of the FDI stocks of other largest investor countries has decreased, for example, that of Germany and Denmark – respectively by 18.1% and 3.9%, as well as of the USA – by 21%. At the same time, investment stock of Russian entrepreneurs in the manufacturing at the end of March 2010 was by 11% larger than in 2008 and constituted 3.3% of the FDI stock in the manufacturing.

Figure 4.33

Structure of the FDI Stock in Latvian Manufacturing by Countries

(at the end of the period, percent)



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

IDAL continues developing its range and supply of services on the basis of FDI market needs and ensuring a link between 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 IDAL experts in the process of project implementation.

Overall, it should be noted that interest about Latvia as a possible investment destination is increasing as the world recovers from the global economic and financial crisis. In 2010, the number of requests for information serviced by IDAL reached 158 which is by 20% more in comparison with the indicators of 2009 (132 requests). As the interest of possible investors is increasing in general, after the initial interest about the investment environment in Latvia, the indicator of the number of requests for projects in the framework of which the investors seriously consider Latvia as a place of project implementation has increased by 6% constituting 45% (for comparison – in 2009, this indicators was 39%). In 2010, IDAL dealt with 79 such investment projects including 58 new projects and 21 projects launched in previous periods.

In 2010, 10 enterprises have made a decision to implement projects in Latvia through the support of IDAL both in the service sector (administrative services, USA; personnel rent services, Lithuania) and manufacturing (gas filling, logistics and distribution station, (AGA/Linde Gas, Germany); metal processing (Brabantia, the Netherlands); metal processing (Dallas S.A, Greece); metal processing (Norway); metal processing (Germany); metal processing, (Aluminum Company of Baltic, Italy (in 2011 the project developer was changed from initial Sopena Group, Spain, to private persons from Italy)); metal processing (Redius, Russia); pre-processing of agricultural products (Green Mushroom Farm, Germany)). As the projects will be implemented, investments in amount of EUR 33.49 million are expected, thus creating 518 new jobs.

By evaluating the interest of investors in the 1st quarter of 2011 and dealing with investment requests and projects, IDAL points out that particular interest is observed in the sector of shared service centres/business process outsourcing centres (30%), similarly the sectors of renewable energy resources or the green technologies and metal processing and electronics have a significant share in the project portfolio (20% each). Interest can be observed also in the transport and logistics sector and interest is also increasing in the life sciences sector. The interest in these sectors is expected to remain. However, upon evaluating particularly those investment projects with which IDAL is currently dealing, it can be concluded that green technologies and metal processing/electronics are the most widely represented sectors (respectively 40% and 39%).

Unfortunately, a lot of foreign investment projects are lost due to still unsolved problematic issues, for instance, lack of industrial plots and infrastructure, deficiencies in territorial planning, as well as due to lack of qualified labour force.

For solving these problematic issues, an important programme of infrastructure development is planned to be launched and implemented in the period from 2014 to 2020. In order to solve issues regarding sectoral needs for qualified labour force, a reform of the higher educational system is currently worked on, as well as the role of employers in professional education programmes is fostered and increased by establishing professional education competence centres.

In order for Latvia to be competitive among other European countries, state support instruments and investment stimuli for attraction of foreign investment are necessary, for example, as in other countries competing with Latvia in investment attraction – state financial support for investment projects important to the national economy, grants for creation of new workplaces, infrastructure support, tax relief. Some improvements can be already observed in this area – new investment stimuli for attracting foreign investments are being developed, for example, as of January 1, 2011, entrepreneurs are offered company income tax relief for large investment projects, as well as financial support is sought for investment projects important to the national economy, and grants for creation of new workplaces to be available in the second half of 2011/in 2012.

In order to improve progress of local and foreign investment projects important to Latvia, IDAL continues implementing investment attraction according to the *Polaris* methodology which envisage 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 private sector, universities, and scientific institutions in this process.

When analysing the growth of sectors at European level and Latvian competitiveness in comparison with the Baltic States, Poland, and the Czech Republic, IDAL has currently identified seven sectors with the best potential for Latvia to attract foreign investments (wood processing, metal processing and engineering, transport and logistics, green technologies, health care, life sciences (pharmacy and biotechnologies), and information technologies). Therefore, in order to implement *Polaris* qualitatively, IDAL will cooperate with representatives of the private sector to identify precisely the niches which need investments, as well as will collaborate with scientific institutions to prepare well-developed investment project offers with the highest possible value added.

4.4. Financial and Capital Markets

4.4.1. Monetary Policy and Exchange Rate

Like in the case of majority of world's central banks, the main goal of monetary policy also of the Bank of Latvia is to maintain price stability in the state. 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.

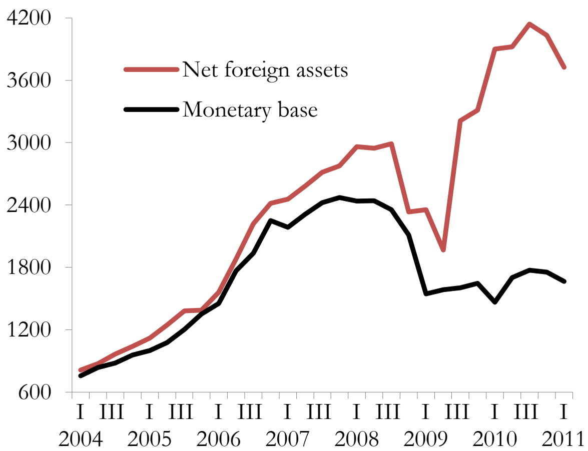
Since February 12, 1994, the Bank of Latvia has been implementing fixed national currency exchange rate policy by pegging the exchange rate of the lats (LVL) to the SDR[1] currency basket (1 SDR = 0.7997 LVL). As of January 1, 2005, the peg of the lats to the SDR was replaced with the peg to the euro (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 (EMU)[2]. On March 16, 2010, the Cabinet of Ministers upon accepting amendments to *Latvia's National Euro Changeover Plan* decided that January 1, 2014 is the target date for introducing the euro in Latvia.

On May 2, 2005, Latvia joined the ERM II with the already existing exchange rate of the lats against euro. Within the framework of the ERM II standard fluctuations of the exchange rate in the amount of +/-15% around the central or peg rate are allowed. However, Latvia commits unilaterally to keep the exchange rate fluctuation margin within +/-1%, retaining the former range of fluctuation band of the lats, which was habitual to the financial market since 1994, when the lats was pegged to the SDR and was kept when the lats was re-pegged to the euro on January 1, 2005.

Figure 4.34

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

(million LVL, at the end of the period)



[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 introducing the euro.

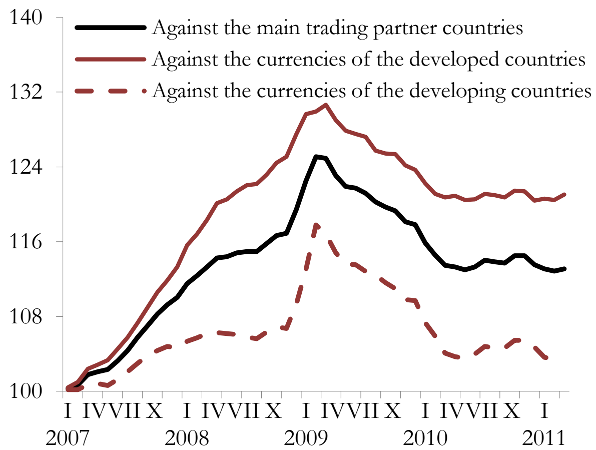
The Bank of Latvia operates like the so-called currency board, freely buying and selling foreign currencies. The Bank of Latvia has managed to gain credibility without using the formal currency board system and to get experience at the same time using a wide range of market-oriented monetary instruments fully compatible with the monetary policy instruments available to the European Central Bank.

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 223.5% at the end of the 1st quarter of 2011 (266.2% at the end of the 1st quarter of 2010 and 152.4% at the end of the 1st quarter of 2009).

Figure 4.35

Index of the Real Effective Exchange Rate of the Lats*

(by months)



* Calculated using the consumer price index. December 2006 is the base of the real effective exchange rate index (2006 = 100).

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, mainly in debt securities issued by the governments of the USA, Euro zone countries, United Kingdom, and Japan, as well as by their agencies and international organizations. Foreign reserves of the Bank of Latvia (including gold reserves, foreign convertible currency, and SDR) at the end of April 2011 amounted to USD 7693.5 million (at the end of April 2010 – USD 7190.7 million, at the end of April 2009 – USD 4023.8 million).

The Bank of Latvia calculates the real effective exchange rate of the lats[1] against the currencies of 13 main trading partner countries of Latvia[2]. It shows the relative export competitiveness of Latvia in the global markets.

Due to the comparatively high inflation during the years of rapid growth, the real exchange rate of the lats increased against the currencies of the developed and developing countries. An especially rapid increase of the exchange rate of the lats occurred during the 2nd half of 2008 and at the beginning of 2009, which mainly was related to devaluation of national currencies of the trading partner countries of Latvia. Since March 2009, the real effective exchange rate of the lats gradually decreased due to the decrease of the price level and wages, as well as due to optimizing other production costs. However, since April 2010, the real effective exchange rate showed a moderate tendency to decrease, but since June, when inflation resumed, the real effective exchange rate of the lats was increasing, and this tendency continued also at the beginning of 2011.

4.4.2. Market Structure and Development

At the end of the 1st quarter of 2011, 21 **banks** operated and 10 branches of foreign banks were registered in Latvia. 11 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.

The global financial market crashes have also affected the Latvian banking system, resulting in worsening basic indicators of Latvian banks. In order to follow the liquidity level and risks of banks, monitoring of banks was intensified. In order to prevent insolvency of the second largest bank AS "Parex banka", the state took over the majority of its shares (see Box 4.1).

In the 1st quarter of 2011, all operational indices of the banks of Latvia complied with the regulatory requirements. In the 1st quarter of 2011, the banking sector liquidity ratio was 65.1% (the minimum normative requirement is 30%), which has increased in comparison with the corresponding period of 2010.

Bank profit indices also prove the improving situation. 7 Latvian banks and 1 foreign bank branch operated with profits in the 1st quarter of 2010, however, 14 Latvian banks and 4 foreign bank branches operated with profits (total LVL 53.6 million) in the 1st quarter of 2011. During this period, income of the banking sector exceeded expenditures, and it is mainly explained with the fact that the necessity for reserves for unsecured credits has been reduced. Since the beginning of 2011, two Latvian

[1] The real exchange rate of the lats includes changes of the nominal exchange rate of the lats against the currency of the trading partner countries of Latvia, as well as consumer price changes in Latvia compared with consumer price changes in the trading partner country. The real exchange rate is calculated by dividing the nominal exchange rate index with the ratio of foreign and domestic price indices.

[2] Denmark, Finland, France, Germany , Great Britain, Italy, the Netherlands, Sweden, and the USA are included in the group of developed countries, while Estonia, Lithuania, Poland, and Russia are included in the group of developing countries.

banks have increased initial capital in the total amount of LVL 998.2 million, but in 2010, overall 14 Latvian banks have increased capital in the amount of LVL 324.4 million.

Box 4.1

Restructuration of AS "Parex banka"

In order to help the second largest bank in terms of assets (its assets constituted 13.8% of the total assets of Latvian banking sector) to avoid financial problems created by the global financial crisis, in November 2008, the state, with intermediation of the VAS "Mortgage and Land Bank of Latvia", took over the block of shares of AS "Parex banka" (51% of shares).

As a result of restructuring the bank, the bank "Citadele" commenced its operations on August 1, 2010, being a newly-established credit institution established within the framework of the restructuring plan for AS "Parex banka", and its founder is VAS "Privatizācijas aģentūra". However, AS "Parex banka" continues its operation as a solution bank with the aim to maximally recover state investments. After division of AS "Parex banka", VAS "Privatizācijas aģentūra" owns 82% of AS "Parex banka" shares and 75% of the bank "Citadele" shares. The second largest shareholder is the European Reconstruction and Development Bank, which holds 25% of shares and one share with the voting rights of the bank "Citadele" shares and a holder of 15% of AS "Parex banka" shares.

On May 17, 2011, the government approved sale strategies of AS "Citadele" and AS "Parex banka" envisaging mutually unrelated sale process applying the best solution to each bank. AS "Citadele" bank will be sold at an auction, by organizing prior selection of bidders in two stages. However a combined sale strategy will be applied to AS "Parex banka" envisaging not to sell the bank in total at the moment but to carry out activities to improve or maintain asset value.

At the end of the 1st quarter of 2011, the average capital adequacy ratio was 15.2% (the minimum requirement stipulated by law is 8%). But the return on assets (ROA)[1] of the banking sector was 0.6% and the return of equity (ROE)[2] was 7.2%, which has significantly increased in comparison with the corresponding period of 2010 (in the 1st quarter of 2010 – ROA was -2.5% and ROE was – 29.8%).

At the end of the 1st quarter of 2011, 12 **insurance companies**, 3 of which offered life insurance and 9 – non-life insurance, as well as 10 branches of foreign insurance companies operated in Latvia.

At the end of the 1st quarter of 2011, the amount of gross premiums signed by insurance companies has increased by 34.3% and constituted LVL 65.7 million in comparison with the corresponding period of 2010, however, the amount of paid gross compensations has increased by 6.1% and constituted LVL 33.4 million.

The situation in the global financial markets significantly affects the Latvian **securities market** – in 2008 and 2009, the securities market faced low demand and amount of sold shares. The share price index also decreased significantly.

2010 can be considered as a year of considerable growth. In 2010, the value of the Baltic stock exchange index Baltic Benchmark increased by 69.8%, but the share index of Latvian stock exchange NASDAQ OMX Riga increased by 41.1% and was the fourth most rapidly growing state index in Europe and the tenth most rapidly growing state index in the world.

The situation has also been improving in 2011 – at the end of May 2011, OMX Baltic Benchmark value reached 523.22 points, which is by 27.78% more than in the corresponding period of 2010, but NASDAQ OMX Riga index value reached 418.36 points, which is by 23.7% more than in the corresponding period of 2010.

The fact that Latvia successfully emitted 10-year Eurobonds in the amount of USD 500 million with the interest rate set at 5.25% a year, which is lower than in the previous emission of Eurobonds in March 2008, when the interest rate was 5.5% a year, also proves the financial stabilisation. The total amount of pledges sevenfold exceeded the supply and reached USD 3.6 billion. The emission carried out can be considered as a benchmark emission by returning Latvia to international markets after the last Eurobond emission in March 2008. This Eurobond emission was carried out by implementing the approved medium-term borrowing strategy and enforcing agreement concluded by the government of Latvia, the Bank of Latvia, and the Financial and Capital Market Commission with the international borrowing programme partners envisaging the return of Latvia to international financial markets, as well as envisaging no further use of resources from programme funding.

4.4.3. Assets, Deposits, and Credits

At the end of the 1st quarter of 2011, **bank assets** of Latvia were LVL 21.2 billion, which is by LVL 0.3 billion less than in the corresponding period of the previous year. Bank credits constituted the largest part of bank assets (65.5%).

Along with the first signs of national economy growth, the amount of cash in circulation has slightly been increasing since the beginning of 2010. At the end of the 1st quarter of 2011, LVL 795.6 million of cash was in circulation, which is by 18.9% more than in the corresponding period of 2010. It is mainly influenced by the increase in balance of **deposits** attracted by banks that began at the end of the 4th quarter of 2009 and continues also in 2011.

At the beginning of 2011, changes of the deposit currency structure continued. At the end of the 1st quarter of 2011, the amount of residents' deposits in lats increased by 10.3% comparing to the corresponding period of 2010, and it constituted

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

44.6% of all residents' deposits. The greatest part of residents' deposits (49.3%) is still in EUR, however, the amount of these deposits is decreasing.

Table 4.8

Monetary Indicators of the Latvian Banking System

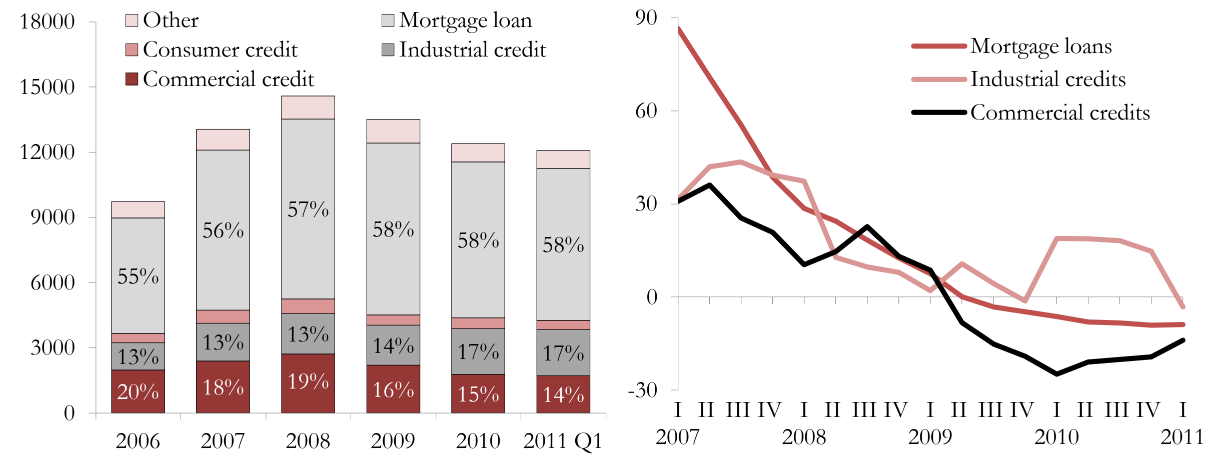
	2007	2008	2009	2010	2011 Q1
at the end of the period, million LVL					
Net foreign assets	-4482.8	-5914.6	-3022.0	-1219.8	-1075.4
Net domestic assets	10 654.0	11 846.1	8842.3	7609.8	7413.7
Domestic credits	13 018.2	14 279.7	12 204.3	11 215.1	11 063.1
to government (net)	-87.4	-370.0	-1474.6	-1430.8	-1264.8
to companies and individuals	13 105.6	14 649.7	13 678.9	12 645.9	12 327.9
Other assets (net)	-2364.2	-2433.6	-3362.0	-3605.3	-3649.4
Broad money M2X	6171.3	5931.4	5820.3	6390.0	6338.2
Cash in circulation (without vault cash balance)	900.0	866.1	667.3	807.4	795.6
Deposits of individuals and companies including:	5271.3	5065.3	5153.0	5582.7	5542.5
deposits at short notice	2864.9	2308.0	2206.2	2782.1	2703.0
time deposits	2406.4	2757.3	2946.8	2800.6	2839.5
changes in comparison with the corresponding period of the previous year, %					
Domestic credits including:	31.8	9.7	-14.5	-8.1	-4.6
to companies and individuals	34.0	11.8	-6.6	-7.6	-7.9
Broad money M2X	12.6	-3.9	-1.9	9.8	6.0
Cash in circulation (without vault cash balance)	-7.1	-3.8	-23.0	21.0	18.9
Deposits of individuals and companies	16.9	-3.9	1.7	1.1	4.3
GDP (in current prices)	**32.3**	**9.5**	**-19.2**	**-2.7**	**7.6**

The balance of bank **credits** granted to domestic entrepreneurs, individuals, and the government still continues decreasing. The balance of credits granted to entrepreneurs at the end of the 1st quarter of 2011 in comparison with the corresponding period of 2010, decreased by 9%, while the credits granted to households – by 6.6%. Since the beginning of 2009, a particularly rapid decrease has been observed with respect to the bank credits to the government.

Figure 4.36

Amount and Structure of Credits Granted to Domestic Enterprises and Individuals
(end of the period, million LVL)

Credits Granted to Resident Financial Institutions, Non-financial Companies, and Households
(increase in comparison with the respective quarter of the previous year, %)



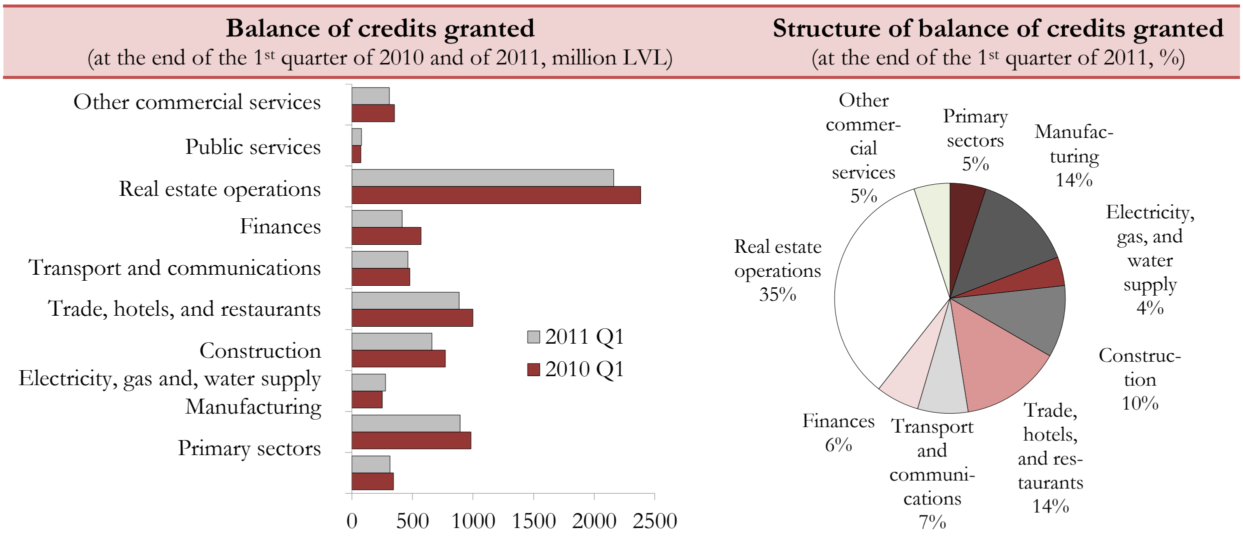
In the 1st quarter of 2011, just like before, mortgages in the structure of credits granted to domestic enterprises and individuals are dominating with a share of 58% in the total credit structure. However, the share of commercial and industrial credits in total was only 32%, which in comparison with the beginning of the year, has slightly increased.

The amount of the granted **mortgage loans** grew very rapidly over the preceding years (by 39% in 2007 and by 13% in 2008). In 2009, granting mortgages practically stopped, and this tendency continued also in 2010 and at the beginning of 2011. A similar situation is observed also in the field of consumer credits.

The balance of **commercial and industrial credits** has been decreasing since November 2008 and continued declining also in 2009. At the beginning of 2010, they slightly increased followed by a decrease in the next quarters, and at the end of the 1st quarter of 2011, the balance of granted credits lagged behind the result of the corresponding period of the previous year by 8.3%.

Figure 4.37

Credits to Residents by Sectors of National Economy



At the end of the 1st quarter of 2011, overall **in the national economy** non-banks had granted credits in the amount of LVL 6456.6 million which is by 8.5% less than at the end of the 1st quarter of 2010. The most rapid decline of credit balance appears in the financial sector. The balance of credits granted increased only in public services and electric energy, gas, and water supply sector. The largest credit balances are still in the sector of real estate operations (34% of the total credits granted to the sectors of national economy). A relatively high share of credits granted is also in manufacturing, trade, hotel, and restaurant, as well as in the construction sectors.

8.2% of all credits granted to the residents are credits in lats. The majority of credits (89.1%) are granted in EUR possibly due to a much lower interest rates for credits granted in EUR.

Although **the amount of credits with overdue payments** slightly shrank at the end of 2010, the amount of such credits continued increasing in the 1st quarter of 2011 and reached 26.7% of the total banks' credit portfolio (at the end of 2008, the credits with overdue payments constituted 15% in the total credit portfolio, in 2009 – 25.5% and at the end of the 2nd quarter of 2010 already 28.6% of the total banks' credit portfolio being the highest indicator).

In 2011, the banks continued to cooperate with the clients facing difficulties to repay the credits. At the end of the 1st quarter of 2011, restructured loans and loans in work-out process constituted 35.6% of the total credit portfolio. The share of restructured loans in the total banks' credit portfolio increased even more, from 19.9% at the end of 2010 to 20.1% or LVL 2.8 billion at the end of the 1st quarter of 2011. The largest part of restructured loans was loans to enterprises (mainly to microenterprises and small enterprises) and households.

The share of loans in work-out process continued increasing at the beginning of 2011, and reached 15.5% or LVL 2.1 billion of total banks' credit portfolio at the end of the 1st quarter of 2011. Credits to enterprises and households also constitute the largest part of the loans currently being in work-out process.

At the end of the 2nd quarter of 2009, the weighted average **interest rate** on short-term credits granted in lats to enterprises and individuals rapidly increased by 24.4% due to the consequences of the global financial crisis, uncertainties about state budget, as well as rumours of possible devaluation of lats.

Since the end of 2009, the weighted average interest rate on short-term credits granted in lats to enterprises and individuals has reduced, and at the end of the 1st quarter of 2011, it was 6.4%, which means that the situation has stabilized. Considering that LVL is pegged to EUR, the stabilization of the situation is proved also by the convergence of LVL exchange rate to the EUR exchange rate.

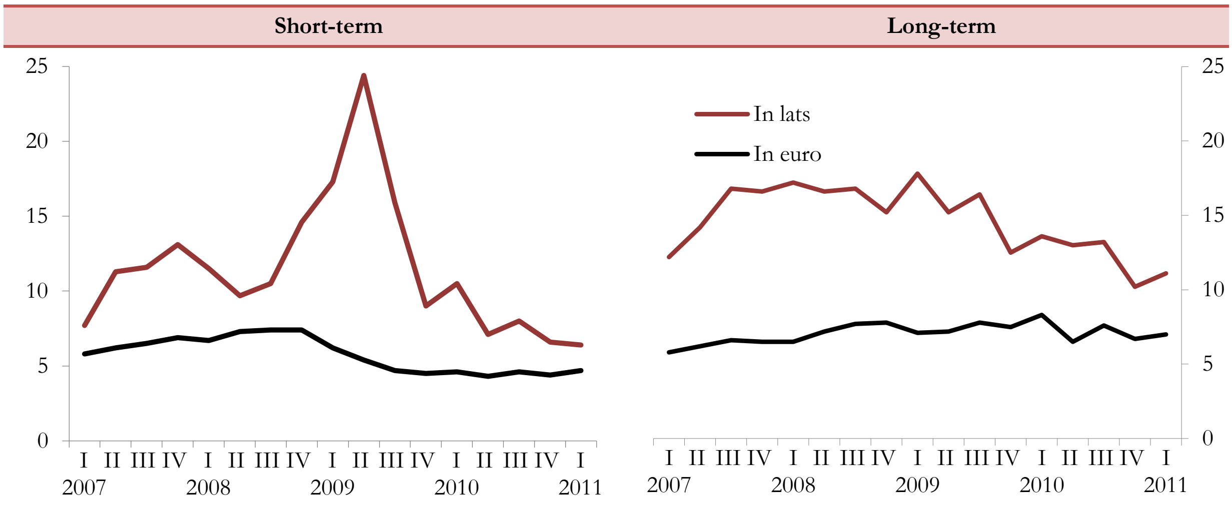
Over the year, more moderate fluctuations were observed in the weighted average interest rates on long-term credits granted in lats, which decreased from 17.8% at the end of the 1st quarter of 2009 to 11.1% at the end of the 1st quarter of 2011.

The interest rates on credits granted in EUR were as usual lower and their fluctuations less explicit. At the end of the 1st quarter of 2011, the weighted average interest rate on short-term credits granted in EUR was 4.7%, but on long-term credits – 7%.

Figure 4.38

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

(percent)



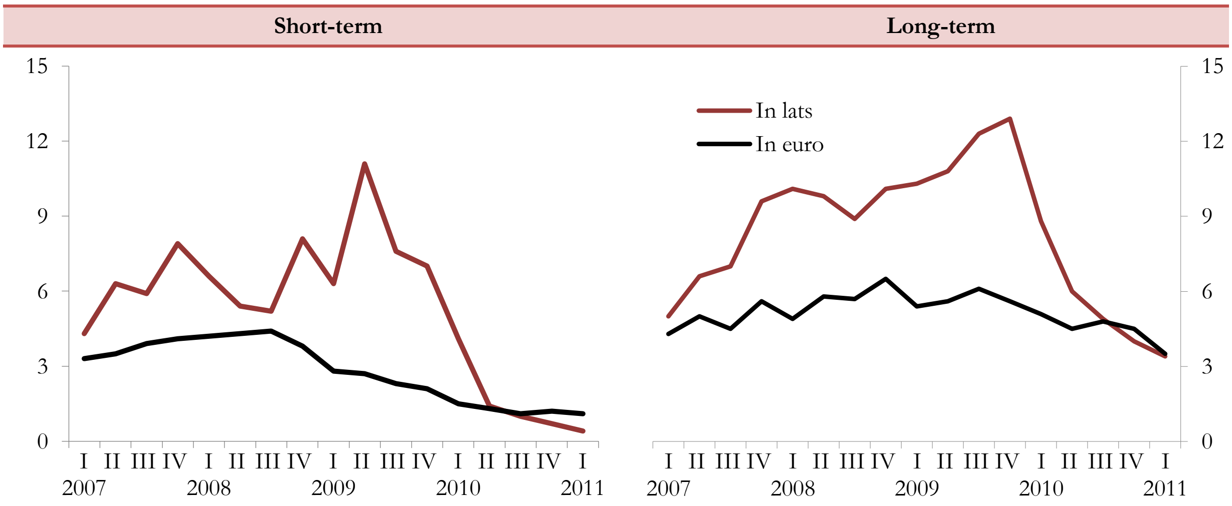
In the mid-2009, the weighted average interest rate for long-term deposits attracted in lats in credit institutions increased, reaching 12.9% at the end of 2009. Since the beginning of 2010, the weighted average interest rate for long-term deposits attracted in LVL in credit institutions gradually decreased to 3.4% at the end of the 1st quarter of 2011 being an even lower indicator than long-term deposits attracted in EUR in credit institutions.

The interest rates for short-term deposits attracted in LVL in credit institutions showed the most rapid growth in the 2nd quarter of 2009 thus reaching 11.1%, and later gradually decreasing until falling to 0.4% at the end of the 1st quarter of 2011, being an even lower result than short-term deposits attracted in EUR in credit institutions.

Figure 4.39

Weighted Average Interest Rates for Deposits Attracted in Credit Institutions, Quarterly Profile

(percent)



5. Labour Market

5.1. Employment and Unemployment

Due to the economic crisis, situation in the labour market significantly deteriorated at the end of 2008 and in 2009 – the number of the employed decreased, and the unemployment increased. The lowest point was reached in the 1st quarter of 2010 when the employment rate shrank to 57.7% (population aged 15-64 years), but the unemployment rate (population aged 15-74)[1] increased to 20.5%.

Table 5.1

Key Indicators of Employment and Unemployment

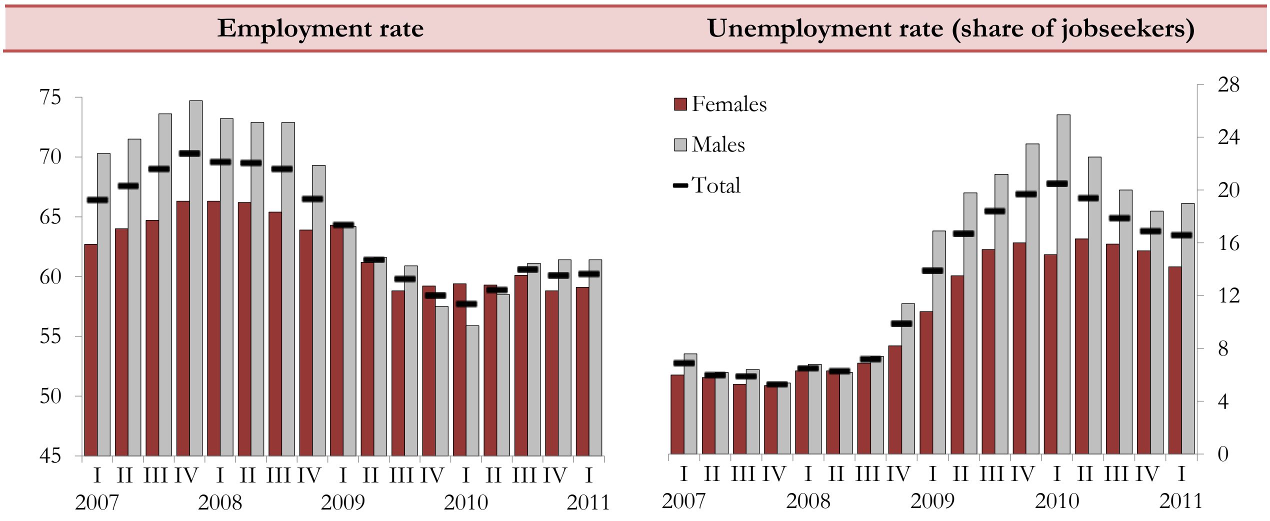
Indicators	2005	2006	2007	2008	2009	2010
Number of employed persons (aged 15-74, thousand)	1035.9	1087.6	1119.0	1124.0	986.8	940.9
Economic activity rate (aged 15-64, %)	69.5	71.3	72.9	74.5	73.9	73.2
Employment rate (aged 15-64, %)	63.4	66.3	68.4	68.6	61.1	59.3
Unemployment rate (share of job-seekers aged 15-74, %)	8.7	6.8	6.0	7.5	16.9	18.7
Number of job-seekers (unemployed) (aged 15-74, thousand)	99.1	79.9	72.1	91.8	200.6	216.3
Registered unemployed persons (end of the period, thousand)	78.5	68.9	52.3	76.4	179.2	162.5

Along with resumed economic activities, the situation in the labour market has been slowly improving since the spring 2010. However, as the improvement resumed from a very low point, the average indicators of the labour market in 2010 are worse than in 2009.

The number of employed in 2010 has reduced by 4.6% or by 45.8 thousand people. The employment rate has also slightly declined; in 2010 it was 59.3% in comparison with 61.1% a year before, but the unemployment rate was by 1.8 percentage points higher. At the end of 2010, Latvia had the third highest unemployment rate in the EU.

Figure 5.1

Employment and Unemployment in Latvia
(percent)



[1] The employment rate refers to the age group 15-64 years but the number of employed and unemployment indicators (except for the registered unemployment) – for the age group 15-74 years.

Economic recession reduced also the number of economically active population. Although the rate of economic activity in 2010 still remained high, it lagged behind the indicator of the previous year by 0.7 percentage points and was by 1.3 percentage points lower than in 2008. Lost hopes to find a job are one of the main reasons for the decrease in the number of economically active population.

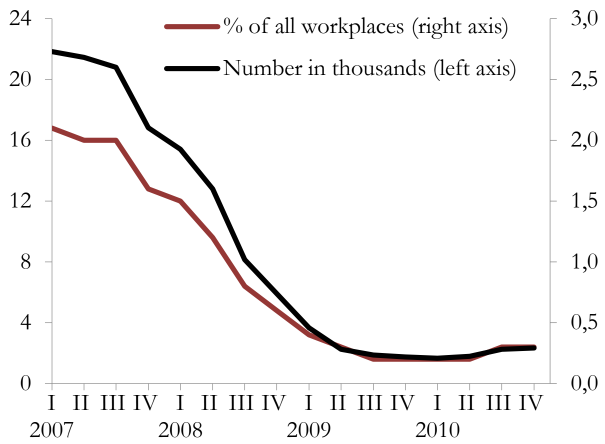
Overall, the negative impact of crisis on the labour market has a longer lasting nature than the recovery of economic activities. The situation in the labour market is likely to improve very gradually, and no rapid increase in the number of employed is expected as the growth will be ensured also by the increase of productivity.

The unemployment caused by the crisis has affected men much more than women. However, since the 2nd quarter of 2010, the male unemployment rate rapidly decreased – from 25.7% in the 1st quarter to 18.4% at the end of the year. In its turn, the female unemployment rate slightly increased in this period – from 15.1% to 15.4%. At the end of 2010, the male employment rate once again exceeded the female employment rate – in the 4th quarter of 2010 the male employment rate was 61.4%, but that of females – 58.8%.

The number of vacancies, which is one of the indicators reflecting changes in labour demand, began decreasing since the second half of 2007. After the rapid decrease in 2008, the number of vacancies stabilized, remaining at a rather low level. When the economic situation improved in 2010, the number of vacancies slightly increased and in the 4th quarter of 2010 there were 2.3 thousand vacancies (at the end of 2007 there were 16.8 thousand vacancies).

Figure 5.2

Vacancies



In 2010, in comparison with 2009, the structure of the employed population slightly changed (see Table 5.2).

The number of employed in 2010 was by 45.8 thousand lower than in 2009. The decrease affected almost all sectors. In 2010, the largest decrease in the number of employed compared with the previous year was in the public service sector (by 14.8 thousand people), trade and hotel sector (by 11.2 thousand people), as well as construction sector (by 10 thousand people).

Table 5.2

Employed by Economic Sectors*

(aged 15-74)

	Structure (%)		Changes (%)		
	2009	**2010**	**2009/2008**	**2010/2009**	**2010/2008**
Total including:	**100**	**100**	**-12.2**	**-4.6**	**-16.3**
Primary sectors	9.4	9.8	0.4	-0.5	0.0
Manufacturing	13.6	14.3	-21.8	0.3	-21.6
Electricity, gas, and water supply	1.7	1.9	-21.2	6.5	-16.1
Construction	7.7	7.0	-39.7	-13.2	-47.6
Trade, hotels, restaurants	19.6	19.3	-11.0	-5.8	-16.1
Transport and communications	9.9	9.9	-7.7	-4.9	-12.2
Other commercial services	15.9	16.1	-1.6	-3.8	-5.3
Public Services	22.3	21.8	-5.1	-6.7	-11.5

* According to Statistical Classification of Economic Activities NACE 1.1 rev.

In this period, a slight increase in the number of employed was observed in the sectors of electric energy, gas, and water supply and in the manufacturing, where the number of the employed has increased respectively by 1.1 thousand people or 6.5% and by 0.3 thousand people or 0.3%.

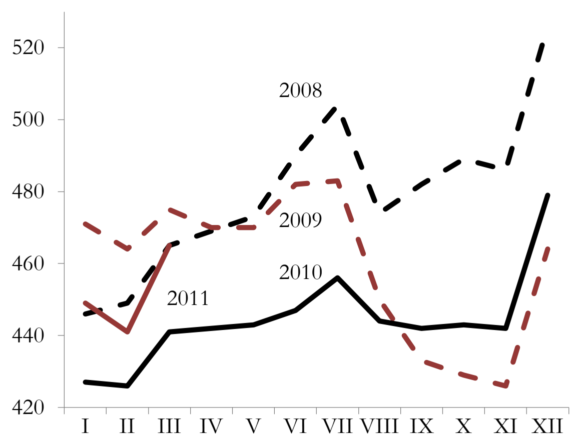
5.2. Labour Costs and Productivity

During the economic recession, significant adjustments took place in the labour market resulting in a reduced number of employed and wages. Decreasing economic activities in 2008 first led to a reducing number of employed; wages on the other hand remained at a rather high level. In 2009, along with the reduced employment, adjustment of wages was observed, as well. When the economic situation stabilized, changes in wages and employment were moderate.

In 2010, situation started to improve gradually. Since September 2010, the average gross monthly wage of the employed was already higher than in the corresponding period of 2009. Also in 2011, the dynamics of wages remains positive.

Figure 5.3

Average Gross Monthly Wage of Employed
(in lats)



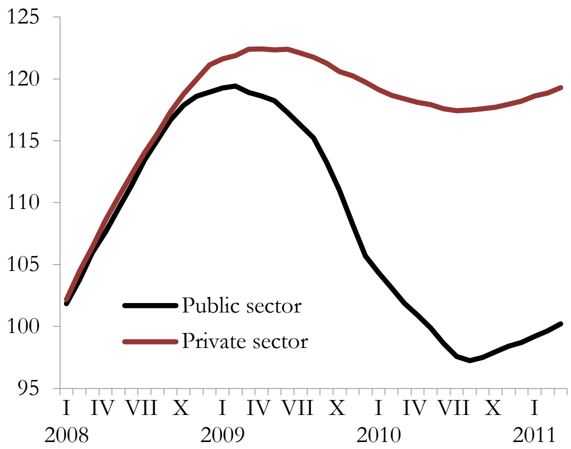
The average gross monthly wage of employed in 2010 was LVL 445, i.e., by 3.5% lower than in the previous year, yet by nearly 12% higher than on average in 2007. But in the 1st quarter of 2011, the gross monthly wage of the employed exceeded the level of the corresponding period in the previous year by almost 5%. Considering the intensity of economic recession, such adjustment of wages is rather minor.

The adjustment process of wages was differed considerably from sector to sector. Decrease in the gross monthly wage during the crisis was mainly based on wage cuts in the public sector determined by the necessity to limit public budget expenditures. Wages in the public sector in 2010 was on average by 6.8% lower than a year before. However wage cuts in the private sector were not so significant – by 1.4% which proves that entrepreneurs preferred reducing the number of employees in order to cut their costs. The average gross monthly wage of the employed in the manufacturing in 2010 remained at the level of the previous year (in 2009 it reduced by 2%).

In 2010, compared to 2008, the average gross monthly wage of the public sector employees reduced overall by nearly 17%, and on average it was at the level of 2007. Wages in private sector in the same period was reduced only by 2.4% and the average gross monthly wage in 2010 exceeded the level of 2007 by 18%.

Figure 5.4

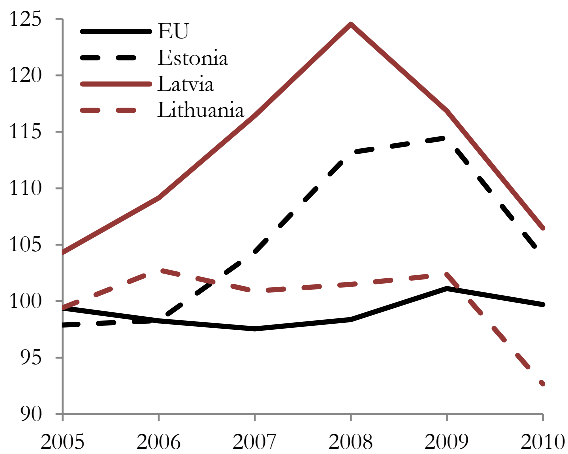
Average Gross Monthly Wage of Employed in Public and Private Sectors
(December 2007 = 100, 12-month moving mean)



In the 1st quarter of 2011, comparing to the corresponding period of the previous year, wages in both public and private sector were respectively by 6.4% and 3.6% higher.

Figure 5.5

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



Source: *Eurostat*

Since 2009, the production unit labour costs (ULC)[1] have been significantly reduced. The ULC is one of the indicators characterising competitiveness

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

(the country in general and individual sectors). The dynamics of this indicator shows that the competitiveness of Latvia among the EU Member States has increased.

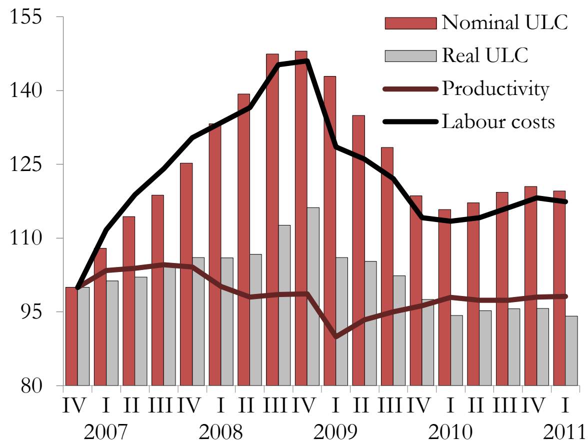
In 2009 compared with the previous year, the real ULC in the EU countries has increased on average by 2.8%. Our neighbouring countries also showed positive dynamics of this indicator. The real ULC in Estonia and Lithuania increased respectively by 1.2% and 0.9%. However in Latvia it decreased by 6.2%. The real ULC in 2010 decreased in all three Baltic States in comparison with the previous year.

Unlike 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 is related to the cyclical factors or crisis consequences.

Figure 5.6

Changes of Labour Costs in Latvia

(4th quarter of 2006=100)



Source: *Eurostat*

The real ULC still continued to grow in 2008, but not as rapidly. The decrease of demand in domestic and foreign markets had a negative impact on the situation in the commodity markets. In 2008 compared to the previous year, the GDP decreased by 4.2%, but no relevant adjustments in the labour markets took place at the same time, and it was the main reason for growth of the real ULC. The real production unit labour costs in 2008 were almost by 7% higher than in the previous year.

The significant adjustments in the labour market in 2009 affected the dynamics of both productivity and labour costs. Compared to 2008, productivity has decreased by 5.5% as GDP decreased faster than the number of employed. But 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%.

Dynamics of the ULC in 2010 and the 1st quarter of 2011 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. Yet, considering the low competitiveness of Latvia in the common EU labour market, the changes already were rather moderate. Therefore, the decrease in the unit labour costs, as well as the increase in productivity was to a great extent based on changes in the number of employed. In 2010, compared to the previous year, the real ULC was by 8.9% lower, but in the 1st quarter of 2011 this indicator was by just 0.2% lower than a year before.

Dynamics of unit labour costs and productivity in 2010 and at the beginning of 2011 shows that the rapid adjustment period is over and opportunities to improve competitiveness based on labour cost cuts have been exhausted.

The increase in competitiveness of Latvia no longer can be based on this factor, moreover taking into account that it will not be possible to keep low wages under circumstances of free labour movement.

5.3. Labour Market Forecasts

Labour market forecasts for the period until 2016 have been developed in compliance with the economic development scenarios (see Chapter 3.3.).

Along with stabilization of the situation in the national economy, since the 2nd quarter of 2010, positive changes have been observed also in the labour market.

The situation in the labour market will continue improving in 2011. As previously forecasted, the number of employed aged 15-74 years slightly decreased in the 1st quarter of 2011, however, along with new seasonal jobs, it is expected to rise again starting from the 2nd quarter. Overall, the number of employed in 2011 is expected to be by 2.2% higher than the 2010 average, but still will be below the level of 2009.

In 2011, the employment rate (aged 15-74 years) might constitute on average 54.8%, which will be by 1.7 percentage points higher than in 2010. But in 2012, the employment rate is expected to increase up to 55.8%. The employment will continue increasing also in the coming years, and in 2016, the employment rate will be close to 63 percent.

In general in the coming years, the employment rate will be more moderate than the growth as the output will be based mainly on the growth of productivity.

The unemployment rate will continue decreasing in line with the increase of employment in the coming years. The unemployment rate in 2011 is expected to decrease by about 3 percentage points and will constitute 15.7% in comparison with 2010. In 2012, the unemployment rate will decrease to at least 14.3%.

Unemployment will continue decreasing also in the upcoming years however a high labour force surplus will remain in the national economy even until 2014. The situation will change as of 2015, when processes in the labour market will be mainly determined by the declining labour force supply due to negative demographic tendencies. The unemployment rate in 2015 could be 9%, but in 2016 – approximately 7-8%.

In 2010, more rapid growth was observed in primary sectors, manufacturing, as well as in the sector of electric energy, gas, and water supply. Yet, the growth of sectors in general was based on the increase in productivity; therefore positive effect on employment was rather small.

The situation will slightly change this year, taking into consideration low labour costs, the growth in general will be based equally on productivity and employment; and as a result, also the labour market will experience positive changes.

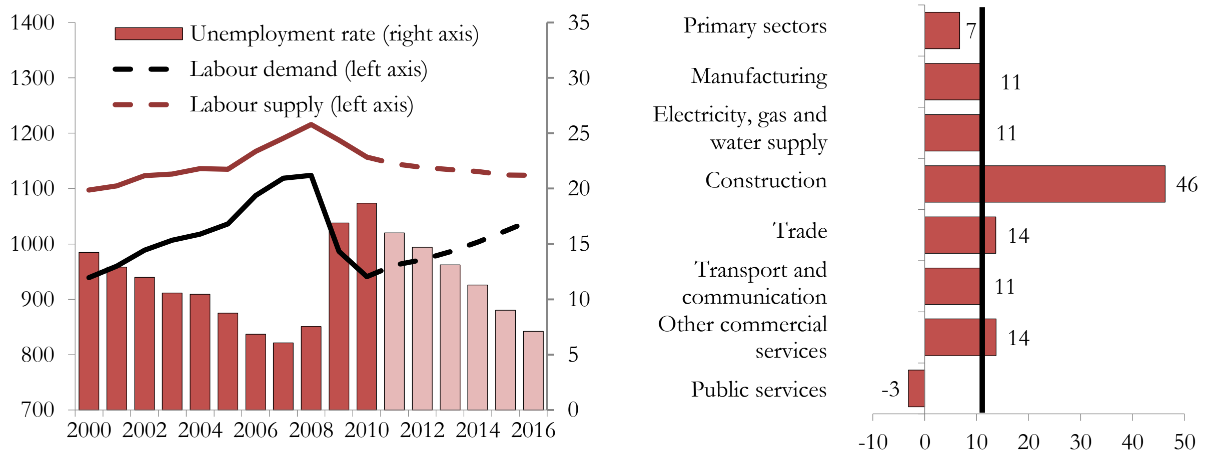
Although rather rapid growth is expected in the manufacturing also in 2012, overall it will still be based on the increase in productivity; therefore the increase in employment is likely to be insignificant in this sector. Similar tendencies will remain up to 2016.

The most rapid medium-term increase in labour demand is expected in the construction sector. Considering the significant surplus of construction specialists in the labour market, the growth of the sector in medium-term will mainly depend on attraction of extra labour resources. However, despite the above mentioned considerations, in 2016, the number of employed in the construction sector will still be lower than in 2008 (by about 23% lower).

Figure 5.7

Medium-term Labour Market Development Tendencies*

Forecasts of labour force demand and supply* (aged 15-74 years, thousand persons)	**Changes in the number of employed population in 2016, compared to 2010 by sectors** (percent)



* the actual annual data are reflected until 2010

Unlike other sectors, the employment will continue decreasing up to 2016 in the public service sector, which will mainly depend on structural reforms of the public sector and negative demographic tendencies (low birth rate and ageing population). Overall, the number of persons employed in the public services sector in 2016 will by 3% lower than on average in 2010. The most rapid decrease of labour force demand in the public sector is expected in the education sector. It will be based on the low birth rate of the 90's resulting in a reduced number of pupils.

The current economic development tendencies show, that the economic recovery in Latvia and in the world is taking place faster than it was initially expected. Despite the fact, that there will be substantial labour surplus in the medium-term in Latvia, in a longer period, new challenges are expected, radically changing the situation in the labour market. It is expected that the number of the working age population (aged 15-74) will decrease in Latvia by more than 8% until 2020 compared to the level of 2010. At the same time, the demographic load may increase by 19%. Thus, the key long-term challenges contrary to the medium-term will be mainly related to the ageing population and its consequences.

5.4. Employment Policy

The employment policy has an important role in the EU strategic development documents. The development vision of both *EU 2020 Strategy* and the *Integrated Guidelines* emphasizes the dimension of employment. At the EU level, an aim has been set forth to achieve that by 2020 the employment level for population aged 20-64 years must reach 75%.

At the national level each Member State prepares the national reform programmes reflecting activity directions and measures to be carried out for the implementation of the *EU 2020 Strategy,* The national reform programme of Latvia for the implementation of the *EU 2020 Strategy* was approved by the Cabinet of Ministers on April 26, 2011 (see Section 6.1).

The quantitative objective set by Latvia in the context of implementing the *EU 2020 Strategy* is to reach an employment rate of 73% by 2020 in the age group of 20-64. For reaching the objective, policy directions are planned on both labour supply part and labour demand part.

Policy directions for improving the labour supply:

- reducing structural unemployment, including economic activation of the labour;
- improving the legal framework of legal labour relations and of labour protection and application thereof;
- promoting self-employment and entrepreneurship;
- structural changes in vocational education;
- modernization of higher education.

Policy directions for improving the labour demand:

- structural reforms in goods and service markets;
- improving business environment.

At the national level, the State Employment Agency (SEA) is the implementer of 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 changing labour market needs determine the necessity for a regular revision and improvement of these measures.

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

- professional training, retraining, and promotion of qualification;
- measures for specific person groups;
- measures to improve competitiveness;
- work practice with a grant (in 2010 and 2011 this measure completely replaces the measure *Paid Temporary Work*);
- measures for business or self-employment start-ups;
- complex support measures.

During the years of economic growth, the demand for active employment measures had decreased, however, in 2009 due to the significant rise in unemployment, it increased considerably. Also in 2010, the demand remained at a high level. 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 the 1st quarter of 2011 – 53.4 thousand unemployed (one unemployed person may participate in several activities).

The majority of the unemployed are involved in the measures to improve competitiveness (including informal education); in 2010, the number of such unemployed persons was 187.7 thousand. The rest of the measures in this period were implemented to the following extent: 8.2 thousand unemployed participated in professional training, retraining, and promotion of qualification; 1.1 thousand unemployed have started training with an employer; 2.1 thousand unemployed were involved in measures for specific person groups 52.8 thousand unemployed – in the measure *Work Practice with a Grant*, and 16.9 thousand unemployed – in the complex support measures.

Along with the active measures, the SEA implements **preventive unemployment reduction measures**:

- career consultations;
- training programmes for the employed who are subject to the risk of unemployment;
- training programmes for involvement of adults in lifelong learning.

The career consultations help clients to increase awareness about their professional direction. 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, but in the 1st quarter of 2011, 20.1 thousand were serviced, 16.5 thousand of them unemployed and job seekers.

The changing situation in the labour market has caused the following modifications in the implemented active employment measures and preventive unemployment reduction measures.

Taking into consideration the socio-economic situation and in order to reduce the social impact of the crisis, in 2009 implementation of short-term activities by rising co-funding of the EU funds was launched. These measures were continued also in 2010. Among them, the measure *Work Practice with a Grant* is planned to be implemented by the end of 2011, but the measure *Training Programmes for the Employed Subjected to the Risk of Unemployment* was implemented by the end of 2010.

The measure *Work Practice with a Grant* was launched in September 2009. It is a crisis employment measure for the unemployed, who no longer receive the unemployment benefit, providing the unemployed with a monthly grant in the amount of LVL 100 for the work of public benefit. As of July 1, 2011, the amount of the grant is reduced to LVL 80. A work supervisor, inventory, as well as coverage of transportation costs are ensured to the unemployed. In 2009, 19.3 thousand unemployed were involved in the measure *Work Practice with a Grant* with the funding of LVL 8 million. In 2010, the number of the involved unemployed was 52.8 thousand, using LVL 27.2 million during this period. In the 1st quarter of 2011, 11.5 thousand unemployed were involved.

The short-term measure *Training Programmes for Employed Subjected to the Risk of Unemployment* provides support to the potential unemployed. It offers training opportunities for employees in enterprises, which have suspended work temporarily due to the economic crisis, providing these persons also with grants. This measure uses a coupon-system giving the person an opportunity to choose the education programme and educational establishment. The measure was commenced in September 2009 and until the end of the year, 3253 persons at the risk of unemployment started the training (the funding used during this period was LVL 0.7 million). Within the framework of the measure, 2634 persons started the training in 2010, a total of 5795 persons were involved this year (the funding used in this period was LVL 3.4 million). The measure will not be implemented after 2010.

In 2010, in order to gradually shift the focus from operative, short-term measures reducing the social impact of the crisis to traditional employment policy measures the implementation of the following measures has been launched:

- education programmes for involvement of adults in lifelong learning;
- mastering the first and second level professional higher education programmes.

The measure *Training Programmes for Involvement of Adults in Lifelong Learning* launched in the 3rd quarter of 2010 is taking over the tasks of the measure *Training Programmes for the Employed Subjected to the Risk of Unemployment*, for example, with respect to the administration of the coupon system. The aim is to promote availability of lifelong learning, by giving an opportunity for people of target groups to increase and improve knowledge and skills necessary for work. 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. Unlike the measure *Training Programmes for the Employed Subjected to the Risk of Unemployment*, the persons involved in the new measure will no longer receive a grant, and they will be obliged to co-finance the set amount of the value of a training coupon (certain groups of persons are exempt from co-financing) in order for them to consider their decisions on education more properly. In 2010, 9895 coupons were issued, and 5155 persons started the training (the used funding – LVL 0.9 million). The number of coupons issued in the 1st quarter of 2011 is 1178; 3554 persons started the training.

In 2010, within the framework of professional training, retraining, and promotion of qualification of the unemployed, a new training measure *Mastering the First and Second Level Professional Higher Education Programmes* was launched. The target group of the measure includes the unemployed with incomplete higher education willing to complete the commenced education with the training coupon method. A total of 690 unemployed began participation in the measure in 2010. Administration issues, high expenses incompliant with the current limited budget called for re-evaluation of usefulness of the measure implementation. Therefore, it was decided not to continue the measure in the upcoming years, and no new participants are involved now.

Due to the reduced budget, implementation of several measures was terminated in 2009, and they have not been resumed also in 2010. Among them are two youth employment-promoting measures: *Employment Measure during Summer Holidays for Persons Acquiring Education in Establishments of General Education, Special Education, or Professional Education* and *Youth Summer Employment Project for Youth of Latvian Origin Living Abroad*. The aim of the first measure was to foster pupils' employment during the summer and give them an opportunity to gain work experience, but the aim of the second one – to give the Latvian youth living abroad an opportunity to get acquainted with the working and living conditions in Latvia, thus promoting possible returning to their ethnic native country. Similarly, the measure *Promoting Regional Mobility of Persons Employed by Enterprises* for elimination of regional differences in the labour market is no longer implemented.

Due to the increasing economic globalization, rapid development of technology, and negative demographic processes, increasingly more attention in the European employment strategy is being paid to the issues of **labour market flexibility and employment security or flexicurity**. These issues are becoming more important in the conditions of economic crisis.

Flexicurity comprises 4 fields of activity, which must promote labour market flexibility and employment security by mutual cooperation. It is necessary to achieve that labour legislation and agreements are sufficiently flexible and correspond to the interests of both the employer and the employee. If necessary, active labour market policies must efficiently facilitate the transfer from one workplace to another or from the status of an unemployed to the employed. The lifelong learning systems should be improved enabling an employee to be employed during the entire period of the ability to work. At the same time, a modern social security system must be established, which would provide adequate assistance to residents in case of unemployment, as well as would facilitate mobility and faster return to the labour market.

The social dialogue is important in the implementation of flexicurity principles. 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 is the aspect of **safety at work** that ensures 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) if comparing to 2007.

In 2010, improvement of the legal framework in the field of labour protection was continued. The simplified procedure of accident investigation came into force on January 1, allowing employers easier investigation and registration of accidents at work. Simultaneously, a list for the commercial business types, for which the employer must involve a competent institution for labour protection issues, has been updated.

Yet, on April 28, 2010, amendments to the *Labour Protection Law* came into force, thus improving the legal framework of the labour protection. As of October 1, a new procedure for training in labour protection issues has been specified.

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 labour protection policy planning, increasing capacity and efficiency of national control and supervision mechanism, introducing the "preventive culture" into the society and enterprises, ensuring economic impetus and state support to the employers.

Latvia has a relatively high rate of **undeclared employment** in certain sectors, and these issues have become more aggravated due to the economic recession, thus increasing unfair competitiveness and reducing the social security of employees.

In order to use the available resources effectively and in a coordinated manner, while bearing in mind the limited budget conditions, an *Action Plan for Reducing Unemployment for 2010-2013* was elaborated. In April 2010, the Cabinet of Ministers approved the action plan prepared by the Ministry of Welfare. The measures are implemented in the following key directions: effectivization of the undeclared employment control mechanism; reduction of unfair competition; revision of the penalties policy with respect to undeclared employment; informing and educating the society about the negative consequences of undeclared employment.

In August 2010, the Cabinet of Ministers approved the *Action Plan for Combating the Shadow Economy and Ensuring Fair Competition for 2010-2013* prepared by the Ministry of Finance. The aim set in this plan is to reduce the shadow economy and ensure fair competition. The key directions of activity are tax policy, reduction of the administrative burden, support to the honest entrepreneurs, and promotion of transition to legal economy, improving capacity of controlling institutions, elaboration of the laws and regulations, penalties policy, work with society, and elimination of shadow economy in risk sectors. Implementation of the measures included in the plan will also promote reduction of the undeclared employment.

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 implementation of the *EU 2020 Strategy*.

Latvia has decided to foster continuous improvement and development of public knowledge, skills, and competences providing the lifelong learning available so that 15% of the population (aged 25-64 years) would be continuously involved in educational process in 2020. In 2009, the share of the abovementioned persons was 5.3%, yet, it is expected to reach 12.5% in 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, thus fostering transition to learning outcome-based education offer;
- 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.

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. The *Europe 2020* strategy replaces the *Lisbon Strategy* approved by the European Council in March 2000 (see Box 6.1).

Box 6.1

European Commission's communication *Europe 2020: A Strategy for Smart, Sustainable and Inclusive Growth*

Europe 2020 strategy is developed taking into consideration long-term challenges – globalization, limited availability of resources and the process of population ageing. According to the European Commission, Europe needs a strategy that will help to overcome crisis and transform EU into smart, sustainable and inclusive economy, which ensures high employment level, productivity and social cohesion. *Europe 2020* strategy offers a vision on how to develop a 21st century social market economy in Europe.

The European Commission's communication defines ***three priorities of the Europe 2020 strategy:***
– *Smart growth*: developing an economy based on knowledge and innovation;
– *Sustainable growth*: promoting a more resource efficient, greener and more competitive economy;
– *Inclusive growth*: fostering a high-employment economy ensuring social and territorial cohesion.

The European Commission offers **five headline EU-level targets** to be achieved by 2020:
– 75% of population aged 20-64 years should be employed;
– 3% of GDP should be invested in research and development (R&D);
– to reduce greenhouse gas emissions by 20% compared to 1990 (including the increase of CO_2 emissions reduction by 30%, if the conditions are right), increase the share of renewable energy resources in gross energy consumption to 20% and increase energy efficiency by 20%;
– the share of early school leavers should be under 10% and at least 40% of the younger generation (aged 30-34 years) should have a tertiary degree;
– 20 million less people should be at risk of poverty.

According to the European Commission, the abovementioned targets are interrelated. In order to achieve them, the European Commission suggests translating them at the national level, taking into account the country-specific situation of each EU Member State. The European Commission acknowledges that reaching headline targets of the *Europe 2020* strategy needs implementation of a range of measures at national, EU and international level. For this purpose, the European Commission's communication offers to implement **seven flagship initiatives**:
– *Innovation Union* – published on October 6, 2010: envisages improving the framework conditions and access to finance for research and innovation to ensure that innovative ideas can be turned into products and services, thus promoting growth and employment;
– *Youth on the move* – published on September 15, 2010: envisages to enhance the performance of education systems and to facilitate the entry of young people in the labour market;
– *A digital agenda for Europe* – published on August 26, 2010: envisages improving Internet speed and enjoying the benefits of a digital single market for households and firms;
– *Resource efficient Europe* – published on January 26, 2011: envisages helping to decouple economic growth from the use of resources, ensure the shift towards a low carbon economy, increase the use of renewable energy resources, modernize transport sector, and promote energy efficiency;
– *An industrial policy for globalization era* – published on October 28, 2010: envisages improving the business environment, notably for SMEs, and supporting the development of a strong, sustainable and competitive industrial base;
– *An agenda for new skills and jobs* – published on November 23, 2010: envisages modernizing labour market and empowering people by developing their skills throughout the lifecycle with a view to increase labour participation and better match labour supply and demand, including through labour mobility;
– *European platform against poverty* – published on December 16, 2010: envisages ensuring social and territorial cohesion so that the benefits of growth and employment are widely spread and people at risk of poverty and social exclusion are enabled to live in dignity and take an active part in society.

The European Commission in its communication indicates that economic, social and territorial cohesion will remain the integral part of the *Europe 2020* strategy, thus ensuring that all resources are mobilized and focused on the pursuit of the strategy's priorities. Thereby the European Commission emphasizes that the cohesion policy and structural funds, while important in their own right, are the key instruments to achieve the priorities of smart, sustainable and inclusive growth in the EU Member States and regions.

On June 17, 2010, the European Council formally approved the *Europe 2020* strategy and its key components: EU-level headline targets for 2020, the *Integrated Guidelines* (see Box 6.2) 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 and Convergence Programmes* (developed and implemented for fulfilling requirements of the Stability and Growth Pact).

Box 6.2

Integrated Guidelines

According to the *Treaty on the Functioning of the EU* (TFEU), the European Commission presents proposals regarding *EU Broad Economic Policy Guidelines* (Article 121 of the *TFEU*) and *Employment Policy Guidelines* (Article 148 of the *TFEU*), which comprise the *Integrated Guidelines*. The proposal of the European Commission is being discussed by different EU Council formations, where a discussion between the EU Member States and the European Commission takes place. The European Council prepares an opinion and agrees on the proposal of the European Commission. When the *Integrated Guidelines* are approved by the EU Council, the EU Member States should develop their national reform programmes, which present the national level policy for implementation of the *Integrated Guidelines*. In other words, the *Integrated Guidelines* can be considered as a set of tasks based on which the EU Member States prepare their national reform programmes for the implementation of the *Europe 2020* strategy. The European Commission carries out annual assessment and issues recommendations to each EU Member State. The Article 121.4 of the *TFEU* envisages that in case the economic policy of a particular EU Member State does not comply with the *Broad Economic Policy Guidelines* (which constitute a part of the *Integrated Guidelines*) and the EU Member State fails to fulfil the Council's recommendations, the European Commission may address a policy warning to the EU Member State, by pointing out that the respective EU Member State does not fulfil obligations stipulated in the *TFEU* making this decision publicly available.

10 *Integrated Guidelines* approved by the EU Council:

Broad Economic Policy Guidelines

Guideline 1	Ensuring the quality and sustainability of public finances
Guideline 2	Addressing macroeconomic imbalances
Guideline 3	Reducing imbalances within the euro area
Guideline 4	Optimizing support for R&D and innovation, strengthening the knowledge triangle (i.e., education, research and innovation) and unleashing the potential of the digital economy
Guideline 5	Improving resource efficiency and reducing greenhouse gases
Guideline 6	Improving the business and consumer environment, and modernizing and developing the industrial base in order to ensure the full functioning of the internal market

Employment Policy Guidelines

Guideline 7	Fostering female and male participation in the labour market, reducing structural unemployment and promoting job quality
Guideline 8	Developing a skilled workforce responding to labour market needs and fostering lifelong learning
Guideline 9	Improving the performance of education and training systems at all levels and increasing participation in tertiary education
Guideline 10	Promoting social inclusion and combating poverty

Figure 6.1

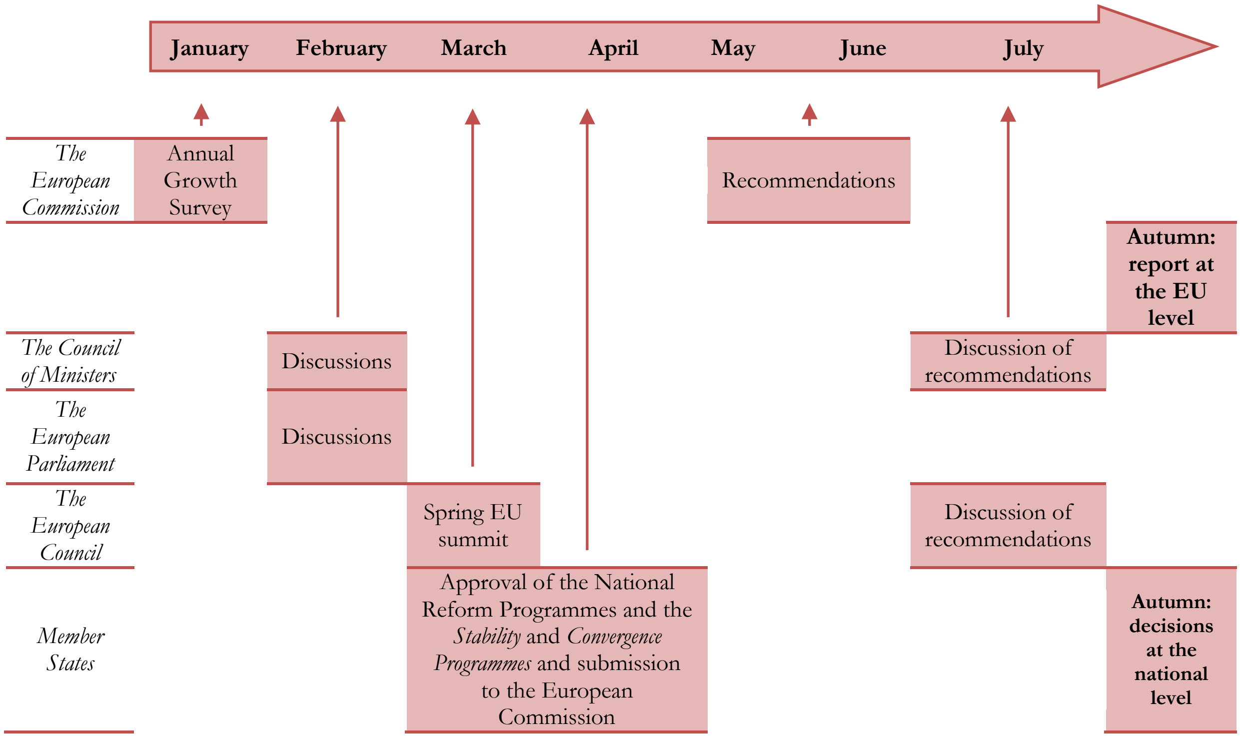
Surveillance mechanism of the National Reform Programmes and the *Stability* and *Convergence Programmes* of the EU Member States

It should be noted that the governance and surveillance mechanism for implementation of the *Europe 2020* strategy has been strengthened in comparison with the *Lisbon Strategy* (see Figure 6.1). The idea of such strengthened surveillance mechanism is the following: the surveillance consists of two pillars – 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).

On September 29, 2010, the European Commission has proposed a package of legislation (comprises 5 draft regulations and 1 draft directive) regarding the new EU economic governance mechanism to strengthen coordination and surveillance of economic policy at the EU level within the framework of the European Semester. The idea of the European Semester is reflected in the Figure 6.2.

Figure 6.2

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



The European Semester will be held annually with the aim to evaluate the economic situation in the EU as a whole and in the EU Member States, as well as to provide recommendations for the EU Member States on implementing and strengthening their economic policy. It should be noted that the *Europe 2020* strategy is closely related to the economic policy and priorities of structural policy of the EU Member States, as according to the *TFEU*, the EU Member States should take into consideration the strategic development documents, for example, strategies, guidelines, policy, recommendations, etc., approved by the EU.

By approving the *Euro Plus Pact*, the European Council on March 24-25, 2011 made the coordination of the EU economic policy even more intense. 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 for the next 12 months in their National Reform Programmes and *Stability* and *Convergence programmes* (see Box 6.3).

Box 6.3

<u>Euro Plus Pact</u>

The *Euro Plus Pact* is **aimed at** strengthening the pillar of the Economic and Monetary Union and 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 prevented.

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, yet 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.

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 in 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. According to the *Treaty on the Functioning of the EU,* both of them are components of the EU-level instrument for economic policy coordination and surveillance (in the framework of the so-called European Semester). Multilateral surveillance of both programmes is being carried out at the EU level, based on which the European Commission is entitled to give a policy warning, if the economic policy of any particular EU Member State is not in line with the EU *Integrated Guidelines* and targets set at the EU level. The National Reform Programmes are linked also to the EU budget as a part of the measures is co-financed from the EU budget. The EU funds financing plays an important role in implementing measures of the NRP of Latvia.

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 targets of Latvia for 2020 in the context of the *Europe 2020* strategy and main measures for 2011-2013 to achieve them.

The NRP of Latvia is based on the *Integrated Guidelines* and requirements of the European Commission regarding preparation of the NRPs of the EU Member States, taking into account national priorities and objectives of Latvia set in other Latvian policy planning documents, such as the Sustainable Development Strategy of Latvia – *Latvia 2030*, as well as the *Strategic Development Plan of Latvia for 2010-2013*. The NRP of Latvia is closely related to the *Convergence Programme of Latvia for 2011-2014,* which was developed together with the NRP of Latvia.

The aim of Latvia is to foster growth and employment, thus ensuring medium-term growth rate of GDP in the amount of 4-5%, 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 pre-conditions for successful achievement of targets of Latvia for 2020 in the context of the *Europe 2020* strategy.

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 with a view of favouring productive investment.

The NRP of Latvia sets the following frontloading measures:

– improvement of active labour market policy measures by gradual transition from crisis-related measures to traditional active labour market policy measures;
– elimination of administrative barriers;
– modernization of higher education;
– speeding up the absorption of the EU funds.

As already mentioned, the NRP of Latvia reflects the targets of Latvia for 2020 in the context of the *Europe 2020* strategy (targets of Latvia) – see Table 6.1.

The targets of Latvia have been set taking into account the medium-term development scenario of the national economy of Latvia, as well as the targets of the Sustainable Development Strategy of Latvia – *Latvia 2030*.

According to the targets of Latvia, it is planned to reach a 73% employment level by 2020, to increase investments in research and development (R&D) to 1.5% of GDP, to increase the share of persons having obtained tertiary education to 34-36%, to reduce the share of school drop-outs to 13.4%, to reduce the share of people at risk of poverty to 21%, to increase the share of renewable energy sources in gross energy consumption to 40%, etc.

On June 7, 2011, the European Commission published the assessment of the national reform programmes and *Stability* and *Convergence programmes* of the EU Member States providing also recommendations to the EU Member States.

It should be noted that the assessments and recommendations of the European Commission differ among the EU Member States as the economic situation differs from country to country. So, for example, those EU Member States that receive the international assistance from the European Commission and the IMF are recommended to continue implementing measures envisaged in these assistance programmes. The EU Member States with high budget deficits are recommended to carry out fiscal consolidation and harmonize wage dynamics and productivity. The EU Member States without significant budget deficit issues and those having budget surplus are recommended to implement measures aimed at promoting growth in the medium term and long term.

Table 6.1

National Targets of Latvia for 2020 in the Context of the *Europe 2020* Strategy

	EU-27		Latvia		
	Fact	Targets	Fact	Targets	
	2009	2020	2009	2020	*Latvia 2030*
Employment rate (age group of 20-64 years), %	69.1	> 75.0	67.1	**73.0**	Increase labour participation and to use maximally all human capital resources available in Latvia, including older people
Expenditures on research and development (R&D) (% of GDP)	1.9 (2008)	3.0	0.46	**1.5**	> 3
Tertiary education (share of population aged 30-34 having completed tertiary education)	32.3	40.0	30.1	**34.0 ... 36.0**	>90 per 1000 inhabitants aged 20-29 years
Share of early school leavers (age group of 18-24 years, %)	14.4	< 10.0	13.9	**13.4**	Share of population aged 20-24 having completed at least upper secondary education >90
Persons at risk of poverty after social transfers (%)[1]	17.0 (2008)	20 million less people should be at risk of poverty[2]	26.0[3] (2008)	**21.0 (121 000 less people should be at risk of poverty or exclusion)**[4]	Persons at risk of poverty after social transfers <16
Energy efficiency (gross inland energy consumption, Mtoe)	1799.29 (2008)	To increase energy efficiency by 20%	4.6	**To gain energy savings of 0.668 Mtoe in consumption of primary energy resources or 0.48% that is the total contribution of Latvia in achievement of the EU common energy efficiency target**	<150[5]
Share of renewable energy sources in gross final energy consumption (%)	10.3 (2008)	To increase the share of renewable energy sources in gross final energy consumption to 20%	29.9 (2008)	**To increase the share of renewable energy sources in gross final energy consumption to 40%**	>50
Greenhouse gas (GHG) emissions (% compared to 1990 level)	88.7 (2008)	To reduce GHG emissions by 20% compared to 1990	44.4 (2008) 11.9 Mt (2008)	**To limit GHG emissions in sectors outside the ETS[6] so that the increase does not exceed 17% compared to 2005** **To limit the overall GHG emissions so that in 2020 they do not exceed 12.19 Mt CO_2 equivalent**	–

[1] Persons with an equivalised disposable income below the risk-of-poverty threshold, which is set at 60% of the national median equivalised disposable income (after social transfers).
[2] Expressed using three indicators – number of people who are either at-risk-of-poverty and/or materially deprived and/or living in jobless households.
[3] Indicator includes at-risk-of-poverty rate and/or jobless households.
[4] Expressed using two indicators – at-risk-of-poverty rate and/or jobless households.
[5] Energy intensity of the economy is reflected here (gross inland energy consumption against GDP (kg oil equivalent per 1000 EUR of GDP)) according to the *Eurostat* methodology.
[6] Sectors not covered by the EU Emission Trading System (EU ETS), for example, transport, small-sized industry and energy sector, agriculture.

As regards the assessment of the European Commission concerning the NRP of Latvia and the *Convergence Programme of Latvia for 2011-2014*, the European Commission recognizes the medium-term macroeconomic scenario of Latvia as plausible. The European Commission emphasizes that the planned fiscal effort for 2011-2012 is in line with the required adjustment. Reduction of budget deficit over the medium term, as foreseen by the programme, would help reduce the risks to the sustainability of public finances.

Taking into account the abovementioned, the European Commission recommends Latvia to implement the measures as laid down in the *Council Decision 2009/290/EC*, as amended by *Council Decision 2009/592/EC,* and further specified in the Memorandum of Understanding of January 20, 2009 and its subsequent supplements, in particular the last supplement of June 2011.

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

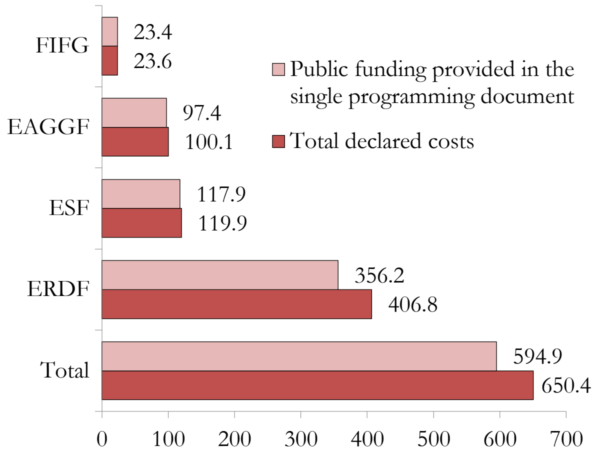
Latvia was one of the first EU Member States to submit all closing documents for the EU Structural Funds programming period 2004-2006 to the EC by June 30, 2010 (three months prior to the term), to receive the final payment of the programme. The amount of the final payment is potentially up to 5% of the Structural Funds allocation, which in the case of Latvia is LVL 22 million. Considering the former practice of the EC with respect to making final payments, the final payment may be expected not sooner than in 2012 when the EC will have examined the closing documentation of the programme and verified eligibility of the declared costs.

The overall costs in the amount of LVL 650.4 million have been declared to the EC (109% of the total public funding envisaged in the planning documents), among them funding from Structural Funds – LVL 462.4 million or 105% of the total Structural Funds allocation envisaged in the planning documents. Surplus in the amount of LVL 55.5 million (incl. share of Structural Funds – LVL 21.8 million) relies on the national decision of Latvia to invest larger state co-financing and undertake over-commitment, thus providing a reserve for those cases if Latvia itself or the EC finds ineligible costs and if financial correction is to be applied within the programme closing process. In such case, the reserve may be used by replacing the ineligible costs with declared reserve eligible costs.

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

Figure 6.3

Total declared costs of the EU Structural Funds for the programming period 2004-2006, million lats, till March 31, 2011



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

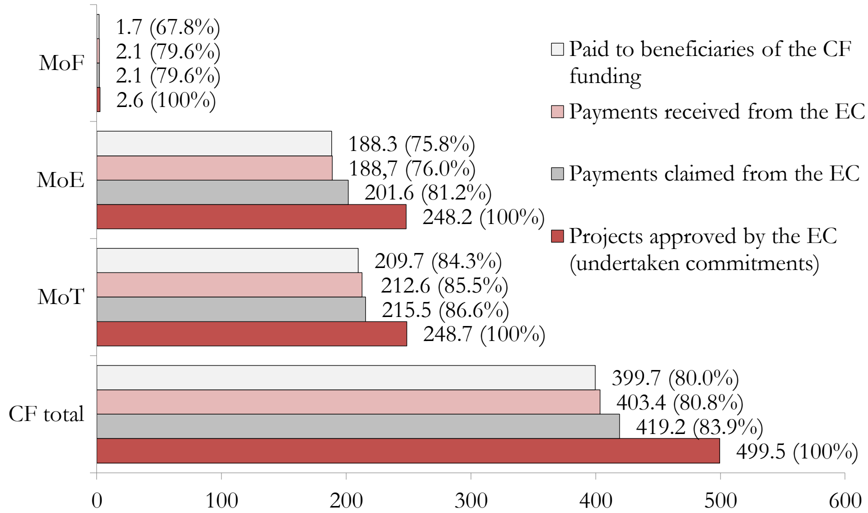
Implementation of the CF projects for programming period 2004-2006 is carried out until December 31, 2010. Together 46 large-scale projects for the total funding of the Cohesion Fund in the amount of LVL 499.5 million were approved. Furthermore, 34 out of 46 approved projects were implemented in the environment sector, 24 – transport sector and 2 projects were implemented as technical support projects by the Ministry of Finance for administrative capacity-building of the implementation system. Works of 45 projects were completed and one project was terminated, as well as all eligible costs in the framework of the projects in the amount of LVL 361.1 million in the environment sector, LVL 428.2 million in transport sector, and LVL 2.4 million in the technical support project of the Ministry of Finance were made as of December 31, 2010.

As of December 31, 2010, the CF funding beneficiaries had received LVL 399.7 million or 80% of the CF funding. LVL 419.2 million or 83.9% of the CF funding has been declared in the European Commission. LVL 403.4 million or 80.8% 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 December 31, 2010

(million LVL, % of undertaken commitments)



Programming period 2007-2013

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

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

NSFD, which is the basis for distribution 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. However, 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 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 550 million or LVL 387 million;
– 2. OP *Entrepreneurship and Innovations* (ERDF) – EUR 769 million or LVL 540 million;
– 3. OP *Infrastructure and Services* (ERDF+CF) – EUR 3.21 billion or LVL 2.25 billion.

Table 6.2

EU fund financial progress in the programming period 2007-2013 till April 30, 2011

Fund	Funding of the EU funds	Concluded contracts		Paid to the funding beneficiaries		Received EC's repayments (incl. advances)	
	million LVL	million LVL	%	million LVL	%	million LVL	%
ESF	387.0	356.1	92.0	165.2	42.7	193.2	49.9
ERDF	1714.8	1191.5	69.5	508.8	29.7	384.9	22.5
CF	1082.1	825.8	76.3	332.7	30.7	255.9	23.6
Total	**3184.0**	**2373.5**	**74.5**	**1006.8**	**31.6**	**834.1**	**26.2**

As of April 30, 2011, projects for the amount of more than a half (or 74.5%) of all financing of the EU funds available for Latvia within the given programming period had been approved, and contracts for a total of LVL 3 377.2 million had been concluded. As of April 30, 2011, the funding beneficiaries had received LVL 1 432.6 million.

Box 6.4

Activities under the responsibility of the Ministry of Economics

A total of LVL 558.9 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 47.1 million;
2. OP *Entrepreneurship and Innovations* – LVL 370.4 million;
3. OP *Infrastructures and Services* –LVL 141.4 million.

Contracts concluded until May 31, 2011 within the framework of activities under the responsibility of the Ministry of Economics:

– Within activity *Support to Training of the Employed for Promotion of Competitiveness of Entrepreneurs – Support to Training Organized in Partnerships*, 29 contracts have been concluded for the total contractual sum of LVL 16.9 million.
– Within activity *Support to Individually Organised Trainings for Entrepreneurs*, 88 contracts have been concluded for the total contractual sum of LVL 2.3 million.
– Within activity *Attraction of Highly Qualified Employees*, 3 contracts have been concluded for the total contractual sum of LVL 106.2 thousand.
– Within activity *Competence Centres* 6 contracts have been concluded for the total contractual sum of LVL 37.4 million
– Within activity *Technology Transfer Contact Points*, 8 contracts have been concluded for the total contractual sum of LVL 1.9 million.
– Within activity *Development of New Products and Technologies*, 100 contracts have been concluded for the total contractual sum of LVL 7.2 million.
– Within activity *Introduction of New Products and Technologies into Production*, 40 contracts have been concluded for the total contractual sum of LVL 7.9 million.
– Within activity *Development of New Products and Technologies – Support to Strengthening Industrial Property*, 13 contracts have been concluded for the total contractual sum of LVL 174.7 thousand.
- Within activity *High Value Added Investments*, 29 contracts have been concluded for the total contractual sum of LVL 64.9 million.
– Within activity *Access to International Trade Markets – External Marketing*, 572 contracts have been concluded for the total contractual sum of LVL 4.1 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 3 million.
– Within activity *Measures to Encourage Innovations and Business Start-ups*, 1 contract has been concluded for the total contractual sum of LVL 2 million.
– Within activity *Business Incubators,* 1 contract has been concluded for the total contractual sum of LVL 20.1 million.
– Within activity *Co-financing to the Investments in Micro, Small and Medium-sized Enterprises Operating in the Specially Assisted Areas*, 177 contracts have been concluded for the total contractual sum of LVL 13.6 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 7.7 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 4.3 million (ERDF).
– Within activity *Improvement of Heat Insulation of Multi-apartment Residential Buildings*, 172 contracts have been concluded for the total contractual sum of LVL 9.2 million (ERDF).
– Within activity *Improvement of Heat Insulation of Social Residential Buildings*, 60 contracts have been concluded for the total contractual sum of LVL 4.7 million (ERDF).
– Within activity *Measures for Raising Efficiency of Central Heat Supply Systems,* 17 contracts have been concluded for the total contractual sum of LVL 11.5 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).

Activity *Measures to encourage innovations and business start-ups*

The aim of the activity is to inform and encourage as large part of society as possible to start up a business, improve business image in the public viewpoint, as well as increase public understanding of the role of innovations in promoting competitiveness, inform the public about activities regarding innovations and potential thereof, thus encouraging as large part of the society and entrepreneurs as possible to focus on development and use of innovative solutions.

The beneficiary of the funding within the framework of the activity is the Investment and Development Agency of Latvia, which implements the following measures:

– *measures for building capacity of educational staff to motivate the youth:*
  - practical training measures on business start-ups at elementary, secondary, and high school level;
  - increasing understanding of educators about business possibilities thus promoting not only theoretical but also practical training process;
  - support to implementation of students' educational business programme;
  - ensuring training and mentoring programmes for business start-ups;
  - organizing debate competitions of pupils and students regarding business issues;
– *measures to identify and propagate good practice of business start-ups and innovation development in order to ensure adoption of good practice in the entrepreneurship:*
  - organizing competitions in relation to business plans;
  - measures to identify and propagate the good practice;

Box 6.4 continued

– *innovation and business marketing activities:*
  - preparing and issuing informative and advertising materials;
  - preparing of broadcast series on measures ongoing in the framework of the activity;
  - video, audio, visual advertising.

Activity *Business Incubators*

In order to promote establishment and development of micro, small and medium-sized enterprises, the Investment and Development Agency of Latvia is implementing the project *Development of Business Incubators in Latvia,* co-financed by the European Regional Development Fund. A business incubator is a combination of infrastructure and personnel aimed at aiding new and small businesses to develop through supporting them in their early stage of development with infrastructural, day-to-day consultations, and services concerning business development fundamentals.

The aim of the project is to promote establishment and promotion of new, viable and competitive enterprises in regions of Latvia by providing them with the environment and consultancy services necessary for business development.

Currently the Investment and Development Agency of Latvia has concluded 9 contracts on business incubation services in the regions of Latvia, and 1 contract on business incubation services to creative industry enterprises in Riga.

In the framework of activities listed below the enterprises will be allocated the funding as an investment equity capital (in case of a venture capital investment programme), loan (in case of a loan programme), and guarantee (in case of a guarantee programme) instead of a grant, thus the funding will be gradually repaid to the funds (loan fund, guarantee fund, holding fund) and will be accessible for repeated support to the enterprises. This way, the afore-mentioned financial instruments will operate as long-term support instruments.

Activity *Support to Self-employment and business start-ups*

The programme envisages combined support to business start-ups and newly established companies, i.e., consultations, training, and financial loans and grants for starting own business.

Support may be granted to working-age persons, including unemployed persons who have expressed willingness to start commercial activity or self-employment, as well as to newly established companies. For the purpose of this programme, newly established companies are companies that have lawfully registered their activity not earlier than 3 years before applying for the support in the framework of the programme.

In the framework of the programme, persons willing to start an economic activity or having started it within the last year, can receive full support in: (1) consultations with respect to the preparation and implementation of a business plan; (2) training; (3) financial support – loans up to LVL 54 thousand; a grant for starting economic activity (up to LVL 3.6 thousand, but not exceeding 35% of the loan amount); grant for repaying the loan up to LVL 2 thousand (but not exceeding 20% of the loan amount).

In the framework of the programme, persons who have started their economic activity more than a year ago, but not more than three years ago before filing the applications for aid, as well as persons carrying out or having carried out economic activity within the last year but willing to apply for support to start an economic activity in another field, including manufacturing of a new product on a condition that a new enterprise must be registered for the implementation of the business plan, will receive consultations, training, a loan and a grant for the repayment of the loan (up to LVL 2 thousand, but not exceeding 10% of the loan amount).

The total funding available for loans is LVL 16.5 million. Programme financing for grants, training, and consultations in the business plan preparation stage is LVL 6.57 million.

By May 1, 2011, 1679 agreements had been signed on the participation in the programme, and 366 business plans had been approved for granting loans for the total amount of LVL 3818 thousand.

Holding Fund

On July 16, 2008, a contract between the government of the Republic of Latvia and the European Investment Fund (EIF) was concluded on introduction of the Holding Fund of the European Union structural funds. Financing for the Holding Fund is allocated from the SF resources earmarked for the programming period of 2007-2013 in the framework of the SF activity 2.2.1.1 *Holding Fund for the Investment in Guarantee, High-Risk Loans, and Venture Capital Funds and Other Financial Instruments*.

Within activity *Holding Fund for the Investment in Guarantee, High-Risk Loans, and Venture Capital Funds and Other Financial Instruments*, the following financial instruments are implemented:

(1) venture capital – On January 22, 2010, the EIF and *BaltCap Management Latvia* concluded a contract on foundation of a venture capital fund. In addition to EUR 20 million invested by EIF, *BaltCap Management Latvia* invested co-funding of private investors in the fund for the amount of EUR 10 million. By May 1 of this year, *BaltCap Management Latvia* has made 2 venture capital investments in amount of EUR 1.75 million;

(2) seed and start-up capital – On June 16, 2010, the EIF and *Imprimatur Capital Baltics* concluded a contract on foundation of the seed and start-up capital fund. In total, the planned funding available for seed and start-up capital investments constitutes EUR 20.4 million. By May 1 of this year *Imprimatur Capital Baltics* has made 5 seed capital investments in the amount of EUR 500 thousand and on May 20 of this year signed an agreement on start-up capital investments of EUR 400 thousand;

(3) high-risk loans – On March 26, 2010, the EIF concluded a contract with *JSC Swedbank* and *JSC SEB Banka.* In total, the funding available for SMEs is LVL 73 million. By May 1 of this year, 4 loan agreements for the amount of EUR 2.3 million have been concluded.

Activity *Guarantees for Development of Enterprise Competitiveness*

Since April 20, 2009, when a contract with SIA "Latvian Guarantee Agency" was concluded, 490 guarantee agreements for the total amount of LVL 71.03 million, and 63 export guarantee agreements for the total amount of EUR 3.55 million have been concluded by May 1, 2011.

Box 6.4 continued

Export Credit Guarantees

As from June 1, 2009, the guarantees of export activities risks are issued to the enterprises by the Latvian Guarantee Agency for the term of two years. The guarantor will guarantee compensation in case of a non-payment by a foreign debtor and in cases of their insolvency. The guarantee will cover up to 90% of the export activity value but not exceeding the equivalent of EUR 1 million per one deal in Latvian lats at the exchange rate of the Bank of Latvia on the day of assigning the guarantee.

The guarantees are issued for activities to the third countries, and from July 1, 2010 until December 31, 2010, export credit guarantees were issued also for the activities with the EU Member States and particular member states of Organisation for Economic Co-operation and Development – Australia, Canada, Iceland, Japan, New Zealand, Norway, Switzerland, and the United States of America. The guarantees for business activities to the EU Member States and Australia, Canada, Iceland, Japan, New Zealand, Norway, Switzerland, and the USA were issued to an enterprise or cooperative partnership of agriculture services, which has received a written guarantee refusal from a private enterprise of the insurance market sector and with which an agreement was concluded before December 31, 2010, and in the framework of which goods or services will be supplied by June 30, 2011. Furthermore, 5 such export guarantees in the amount of LVL 341 thousand were issued in the period from July 1, 2010, to December 31, 2010.

The following criterion is defined as the main for issuing guarantees of export activities to the third countries: the state of origin of the product to be exported shall be Latvia, meaning that an essential processing or treatment operation has taken place in Latvia, and as a result a new product has been produced.

The formulated conditions for issuing the export credit guarantee do not exclude any of the economy sectors – it means that the support is available to enterprises of all the sectors, including wood-processing, milk processing companies, as well as enterprises of services sectors, for instance transport, logistics, etc.

Activity *Loans for Development of Enterprise Competitiveness*

In the framework of this programme, funding is available to small, medium, and large enterprises, which have economically justified further operation plans, but are lacking financing of credit institutions due to increased risks.

Enterprises can receive a separate loan of liquid assets or an investment loan, or both of the loans. The total amount of a loan for improvement of enterprise competitiveness may not exceed LVL 7.5 million for one enterprise.

Two types of loans are available:

(1) for investments – up to LVL 5 million (min. – LVL 200 thousand, not applicable if the funding is necessary for implementation of the EU SF projects), loan term – up to 10 years. The purchased fixed assets must be new, except in cases when the loan beneficiary is a small or medium-sized enterprise, and cases when this enterprise is taking over the assets of another enterprise. The beneficiary of the loan will invest at least 25% from the total project costs in implementation of the projects using own resources or external funding not connected with any type of commercial activity aid;

(2) for liquid assets – up to LVL 2.5 million (min. – LVL 100 thousand, not applicable if the funding is necessary for implementation of the EU SF projects), loan term – up to 5 years.

The total amount of earmarked loan fund is LVL 210 million comprised of: the ERDF and state budgetary financing – LVL 43.3 million; Mortgage and Land bank of Latvia funding – LVL 15.2 million; the Northern Investment Bank funding – LVL 150 million.

By April 1, 2011, 361 loans have been granted for the total amount of LVL 148.6 million, including share of the ERDF programme – 53 loans have been approved for LVL 60.6 million, 38 loans out of them have been granted for the amount of LVL 38.4 million.

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

Till March 31, 2011, in the framework of the operational programme "*Human Resources and Employment"*, the most significant progress in the field of approved projects and concluded agreements was observed in the field of employment, namely within the priority *Human Resources and Employment,* where contracts have been concluded for LVL 395.94 million (92%), within the priority *Promotion of Employment and Health at Work*, where contracts have been concluded for LVL 159 million (99.2%), within the priority *Education and Skills,* where contracts have been concluded for the amount of LVL 98.6 million (96%), within the priority *Higher Education and Science*, where contracts have been concluded for LVL 81.8 million (89.6%) of the public financing available to priorities. Contracts on financing from the EU funds in the amount of LVL 30.6 million 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 16.7 million have been concluded. In terms of payments made, the most significant progress has been achieved in the priority *Human Resources and Employment* – LVL 191 million (45.8%), but in the priorities *Promotion of Employment and Health at Work* – LVL 105 million (65.2%), *Higher Education and Science* – LVL 42 million (45.8%), *Education and Skills* – LVL 30 million (29.5%), *Promotion of Social Inclusion* – LVL 11 million (25.6%), and *Administrative Capacity Building* – LVL 5 million (23.3%).

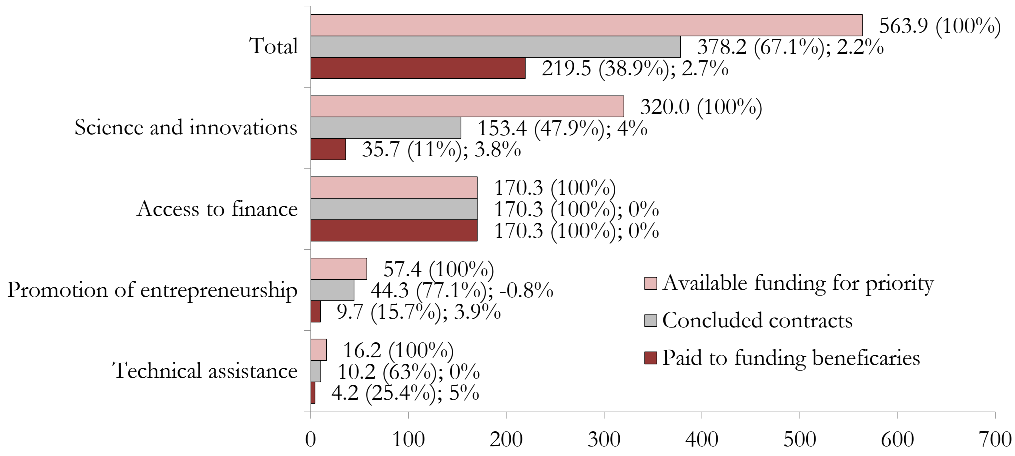
Till March 31, 2011, implementation of projects has been launched in the framework of the operational programme *Entrepreneurship and Innovations*, with an aim to promote development of internationally competitive science, strengthen capacity of science and research potential, and update science infrastructure, thus facilitate knowledge transfer to the national economy and strengthen knowledge-based entrepreneurship. Implementation of several science and innovation support measures and activities thereof continued, directed towards promotion of technology transfer and innovation commercialization to ensure cooperation between research and business sectors for development of new, competitive, and market-demanded products and technologies or services. Access to finance, ensured in the framework of the financing instruments of the EU funds, still plays a significant role in the economic recovery process.

Information regarding fund absorption in the operational programme *Entrepreneurship and Innovations* is reflected in Figure 6.5.

Figure 6.5

Absorption of EU funds in the operational programme *Entrepreneurship and Innovations* till March 31, 2011;

(million LVL, (% of available public financing); % changes in comparison with the September 30, 2010)



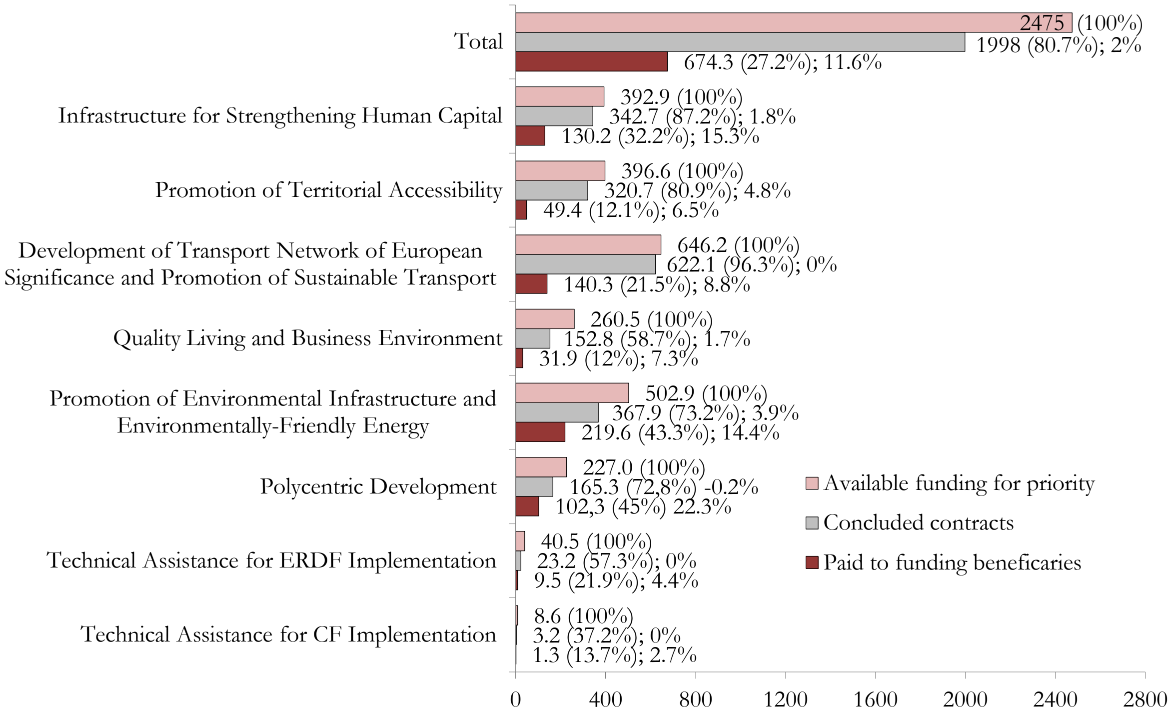
Taking into consideration the seasonal impact on infrastructure projects the most significant progress within implementation of the operational programme *Infrastructure and Services* is expected in the 2nd and 3rd quarter of 2011. The main factors delaying project implementation are procurement issues (complaints, procurements completed without any results, problems occurred within procurement procedure), rise in prices based on tendencies in the motor road construction market and water management sector, problems related to execution of construction works.

Information regarding fund absorption in the operational programme *Infrastructure and Services* is reflected in Figure 6.6.

Figure 6.6

Absorption of EU fund financing in the operational programme *Infrastructure and Services till March 31, 2010*

(million LVL, (% of available public financing); % changes in comparison with September 30, 2010



Box 6.5

Amendments to the operational programmes and additions thereto in the 1st quarter of 2011

Operational programme *Human Resources and Employment* and an addition thereto:

On March 1, 2010, the Cabinet of Ministers approved amendments to the addition of the operational programme *Human Resources and Employment* by the Decree No. 76 envisaging the following:

a) to transfer the remaining financing in the amount of LVL 151.4 thousand from the sub-activity *Practical Application of the Legislation on Labour Relations and Work Safety in Sectors and Enterprises* to *Capacity Strengthening of Labour Market Institutions*, thus making it possible for the State Labour Inspection to continue improving professional qualification of its personnel, particularly the inspectors.

b) specify the supported activities and the target groups to be implemented in the framework of the sub-activity *Complex Support Measures to Integrate People in the Society and Labour Market* envisaging to involve the youth at social exclusion risk, especially long-term unemployed, in such support measures that could promote their long-term integration into the labour market and thus eliminating the risk of reducing economic potential and of faster public ageing by applying specific wage subsidy mechanism to support the most disadvantaged unemployed youth.

Operational programme *Entrepreneurship and Innovations* and an addition thereto:

On February 1, 2011, the Cabinet of Ministers approved amendments to the addition of the operational programme *Entrepreneurship and Innovations* envisaging the following:

a) to specify the aim of the sub-activity *Development of Science Infrastructure* sorting the aims to be achieved within the first and second selection stages. Also, the range of funding beneficiaries has been specified on the basis of the agreement with the EC on extending the range of funding beneficiaries, defining that project applicants of the second selection stage may be scientific institutions registered in the Register of Scientific Institutions of Latvia and enterprises registered in the Republic of Latvia.

b) to make corrections to the financial plan of the measure 2.1.2 *Innovations*, reallocating the ERDF funding in the amount of LVL 204.2 thousand from the sub-activity *Contact Points of Transfer of Technologies*, funding in the amount of LVL 202.3 thousand from sub-activity *Development of New Products and Technologies*, and funding in the amount of LVL 646.8 thousand from sub-activity *Development of New Products and Technologies - Aid for Incorporation of Industrial Property Rights* to the sub-activity *Competence Centres*. The total funding to be reallocated amounts to LVL 1.1 million.

Operational programme *Infrastructure and Services* and addition thereof:

No amendments were made to the operational programme *Infrastructure and Services* in the 1st quarter of 2011.

6.2.2. Foreign Trade Policy

As of 2011, the medium-term strategy of the EU trade policy *Trade, Growth and World Affairs* approved in December 2010, is being implemented envisaging expansion of export markets of third countries keeping their openness, as well as fostering spreading of fair trade conditions all over the world.

It should be noted that the EU External Action Service started its operations on January 1, 2011, through which the EU hopes to ensure closer coordination of external measures and support implementation of the common EU trade policy tasks.

According to the medium-term tasks set within the framework of the common EU trade policy, the work is going to be continued on development and expansion of a multilateral trading system and bilateral trade conditions with third countries, as well as on implementation of new initiatives, among them, regarding enhancing market availability of government orders, improvement of the export control system, and defining measures for the support of small and medium-sized enterprises.

Multilateral relations

In November 2011, it will be ten years since launching the World Trade Organization's (WTO) Doha Development Agenda (DDA) negotiations aimed at significantly reducing the global trade restrictions.

Taking into consideration agreements on further work reached at the end of 2010, the WTO Member states actively discussed all issues on DDA negotiations in the first half of 2011. However, the positional differences of interests among the WTO Member states, especially those regarding elimination of industrial goods trade barriers among developed and developing countries prevent the DDA from being completed by the end of this year.

Therefore possibilities to continue further negotiation process are currently being evaluated. The majority of the WTO member states support the proposal of the WTO Director-General Mr. P. Lamy on the so called approach of different speed – first of all, to agree on rather simple issues that are nevertheless important to the poor countries and then to agree gradually on other elements, including the disputable issues. Depending on this evaluation, the decision on the DDA in general or some subjects of negotiations might be made during the WTO 8th Ministerial Conference in December 2011.

Currently, there are 30 candidate countries[1] **in the WTO accession process**. Among the key countries of Latvia's foreign trade, work on the accession process of the Customs Union of Russia, Kazakhstan, and Belarus, as well as Azerbaijan, Tajikistan, and Serbia has become active last year. In mid-2011, out of these countries, Russia was the closest to accession to the WTO, taking into account the strong political

[1] Afghanistan, Algeria, Andorra, Azerbaijan, Bahamas, Belarus, Bhutan, Bosnia and Herzegovina, Comoros, Equatorial Guinea, Ethiopia, Iran, Iraq, Kazakhstan, Lao People's Democratic Republic, Lebanese Republic, Libyan Arab Jamahiriya, Montenegro, Republic of Liberia, Russian Federation, Samoa, Sao Tome and Principe, Serbia, Seychelles, Sudan, Syrian Arab Republic, Tajikistan, Uzbekistan, Vanuatu, Yemen

support of the EU and USA and Russia's pledge to integrate into the multilateral trading system as soon as possible.

Having regard to the abovementioned, intense work on updating the WTO multilateral obligations of Russia is going on in 2011, taking into consideration the Customs Union with Belarus and Kazakhstan established in 2010, as well as on solving specific problematic issues, including those regarding regulation of sanitary and phytosanitary measures.

Kazakhstan continues negotiations on conformity of its laws and regulations to the WTO standards, which are planned to be activated after concluding bilateral market access negotiations with the EU and USA. But the accession negotiations of Belarus are still in the early stage. In its turn, Ukraine, since 2008, still delays accession of Montenegro to the WTO.

Bilateral relationships within the framework of the EU Common Trade Policy

At the moment, a number of **EU non-preferential agreements** are in force, including Partnership and Cooperation Agreements (PCA) with Armenia, Azerbaijan, China, Georgia, Moldova, Russia, Ukraine, and others. These agreements cover a general cooperation framework on the basis of multilateral trade system norms, without stipulating more profound economic integration of the contracting parties. Among the key countries of Latvia's foreign trade, it is important to note the EU-Russia negotiations on a new PCA, which were continued in the first half of 2011. In the framework of these negotiations, among other matters, the parties discussed provisions of the trade and investment section.

At the same time, the EU has concluded a number of **preferential agreements** comprising mutually favourable trade conditions. By now, such agreements have been concluded with the Balkan countries[1], the European Economic Area countries[2], and Switzerland, as well as Chile, South Africa, South Korea[3], and Mexico.

The EU-Central American[4] FTA was initialed on March 27, 2011, but on April 13 – the EU-Andean Community[5] free trade agreement (FTA). Currently, the content of these agreements is getting technically prepared for signing.

A range of negotiations on the EU preferential trade agreements with third countries is currently in process, among them, FTA negotiations with two countries of the Association of South-East Asia[6] – Singapore and Malaysia, the countries of the Southern Common Market[7] (*Mercosur*), India, Canada, the Gulf Cooperation Council countries[8] (GCC), Ukraine and Mediterranean countries[9], as well as negotiations on economic partnership agreements (EPA) with the majority of African, Caribbean and Pacific (ACP) Group of States. Similarly, in the near future negotiations on preferential trade agreements with Armenia, Georgia, and Moldova are planned to be launched, but after accession of the respective countries to the WTO – also with Azerbaijan, Russia, Kazakhstan, and Belarus.

It is important to note that during the EU-Japan summit held in Brussels on May 28, 2011, the parties reached a political agreement on starting to work on the EU-Japan FTA process preparation, including what concerns the impact assessment of possible FTA in the EU and its Member States, as well as defining potential priorities of the negotiations.

In addition, the bilateral economic relationships between the EU and its most important global partners – China, Japan, and US – are promoted within the framework of frequent regulatory dialogues.

Promotion of accessibility to the third country markets

In order to ensure efficient access of exporters from the EU, including Latvia, to the markets of the third countries, relevant instruments for ensuring market accessibility are being applied for identifying, eliminating, and/or preventing barriers. In the first half of 2011, the work on strengthening the Market Access Partnership was continued. As a result, 13 Working Groups [10] and 33 Market Access Teams[11] were working on solving particular issues for EU enterprises related to trade barriers in the third countries, as well as matters of various sectors and regions.

Taking into account the EU Common Trade Policy Strategy *Trade, Growth and World Affairs*, the European Council of March 24-25, 2011, approved the first annual *Trade and Investment Barriers Report*.

Since launching the supervision of world country trade policy instruments in 2009, the most trade restrictions have been or are planned to be imposed not only in such markets important to Latvian export

[1] Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Serbia, and Turkey

[2] Iceland, Liechtenstein, and Norway

[3] Temporarily in force as of July 1, 2011 (until completion of ratification procedures)

[4] Costa Rica, Guatemala, Honduras, Nicaragua, Salvador, and Panama after its involvement in the Central American economic integration process

[5] Bolivia, Columbia, Ecuador, Peru

[6] Brunei, Burma, Cambodia, Indonesia, Laos, Malaysia, the Philippines, Singapore, Thailand, and Vietnam

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

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

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

[10] Established Working Groups in the sector of the EU market access – SPS/Animal products; SPS/Vegetable products; Vaccines/Japan; Medical devices/India, China, Korea, Taiwan, Brazil, and Turkey; Electronics and information and communication technologies/Turkey and China; Tyres; Automotive; Postal services; Distribution services; Textiles; Wine and spirits; Leather; Chemistry sector

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

as Russia, Ukraine, Belarus, and Kazakhstan, but also in the markets of the strategically important trade partner countries of the EU – Argentina, Brazil, Canada, China, India, Japan, and USA. The trade restrictions are mainly imposed on the trade of products, raw materials, and services of agricultural, steel, automotive, textile, and electronic industry, and generally the restrictions are manifested in a form of raised import duties, import licensing, public procurement procedures, investment restrictions, non-transparent certification procedures, supporting measures for domestic exporters, measures for domestic market protection, as well as compensations and anti-dumping measures.

Improvement of the EU Market Access database *(http://madb.europa.eu)* was continued at the beginning of 2011.

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

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) have been established, ensuring supervision of validity of agreements and analysis opportunities for further cooperation improvement.

In the first half of 2011, two IGC meetings have been held – with Azerbaijan and Russia. Business forums of Latvian and Azerbaijani entrepreneurs, Latvian and Armenian entrepreneurs, and Latvian and Russian entrepreneurs have been organized, as well.

The IGC meetings and business forums planned to be held this year will be with Ukraine (in Kiev, June 29-30), Belarus (in Latvia, autumn of this year), Kazakhstan (in Astana, autumn of this year), and China (in Beijing, the second half of the year).

Although Latvia and Russia have concluded an agreement on economic cooperation, active cooperation also with the regions of the Russian Federation is being carried out. Similarly, as an agreement on economic cooperation with the government of Vologda Oblast was concluded on April 9, 2008, on September 16, 2010, an agreement with the administration of Pskov Oblast was signed. Currently, negotiations are held with the governments of Kirov, Ivanovo, and Yaroslavl Oblast, as well as with the government of the Republic of Bashkortostan with regard to conclusion of an agreement in the field of economic cooperation.

Sectoral issues of the EU foreign trade

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, besides, the EU is the second largest steel producer in the world after China.

The sector all over the world has recovered more rapidly than expected. In 2010, the EU steel production reached 172.9 million tons, which is by 24.6% more than a year before, thus ensuring a new world record of steel production. Such increase in EU output in 2010 mainly was due to the increasing demand in export markets of growing economies. Also in the EU sectors, which employ steel, except construction and shipbuilding, active operations are observed. At the beginning of 2011, the positive tendencies in manufacturing sectors and investments in machine work sectors contributed to the demand for steel, especially steel sheets. According to the *Eurofer* forecasts, the steel consumption in 2011-2012 might increase by 4-5%.

In 2010, the EU steel import constituted 27 million tons, which is by 30% more than in 2009. The main source of the EU steel product import in 2010 was Russia, Ukraine, China, and Turkey.

The EU currently applies quantitative restrictions on import of particular steel products from Russia and Kazakhstan. In October 2007, the EU and Russia concluded an agreement on steel trade for 2007 and 2008, as well as agreed on annual extension thereof for the years 2009 and 2010, envisaging an annual increase of 2.5% in quotas. Thus, in 2011, the quotas for Russia were defined in the amount of 3.27 million tons. As regards to Kazakhstan, autonomous measures are currently being applied, and in 2011 import quota is defined in the amount of 0.2 million tons. After accession of Russia and Kazakhstan to the WTO, the EU steel agreements with these countries will automatically become invalid.

Additionally, for the purpose of the steel flow monitoring system, the EU applies the prior surveillance system for the import of particular steel products from all third countries.

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 2011 regarding textiles and clothing are related to development of proper regulations regarding development of intellectual property protection provisions and 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. Thus, the restrictions of the EU textile goods import imposed on China were cancelled as of

January 1, 2009, but since May 5, 2010, the double-control monitoring system (licensing) without quantitative restrictions applied to the import of certain textile goods originating from Uzbekistan has been cancelled, as well. Thereby the EU is currently applying quantitative restrictions only to the import of textile goods from Belarus and North Korea. It must be noted that these countries are not WTO member states, besides they are recognized as violators of human rights and democratic principles.

Trade Defence Instruments

Trade defence instruments of the European Union

In the EU, as well as in the majority of the other world's countries, which import goods and raw materials from other countries, a system of trade defence instruments (TDI) is functioning – anti-dumping, anti-subsidy, and domestic market defence measures.

During the first half of 2011, 98 anti-dumping and 7 anti-subsidy measures were applied in the EU with regard to various products of other countries. More than a half of the afore-mentioned measures were applied to China, India, Indonesia, Russia, Taiwan, Thailand, and Ukraine. No defence measure is in force in the EU at the moment.

In Latvia, the affected producers, importers, traders and consumers of goods are involved in the TDI procedures. From the perspective of interests of Latvian producers, the most significant measures performed during this half-year are the following:

- an anti-dumping inspection with respect to import of fibreglass and fibreglass mesh fabric from the People's Republic of China. In these cases, Latvia is against unfair trading practice of Chinese producers, supporting perspective and development-oriented growth of Latvian fibreglass products producers and their competitiveness in both domestic and export markets;
- an anti-dumping inspection with respect to import of coated paper from the People's Republic of China. Considering the fact that application of a duty will lead to an increase in the price for final products (polygraphy costs) produced using the abovementioned goods, Latvia is against the application of the duty.

Trade defence instruments applied by third countries

The same way as EU applies trade defence measures, also other third countries may apply any of the defence mechanisms either against all exporters of the respective EU product (e.g., domestic market protection measures) or against exporters of the specific product of a particular EU Member State (e.g., anti-dumping measures).

The economic interests of Latvia are most considerably affected by the anti-dumping measures introduced by the USA in 2001 with respect to import of steel bars from the EU. In accordance with repeated reports of the WTO Disputes Settlement Institutions, the anti-dumping duty calculation method used by the USA has been recognized as unjustified and non-compliant with the WTO's norms, and must be revised in the near future.

6.2.3. Internal Market of the European Union

The internal market of the European Union – a cornerstone of European integration – is recognised as one of the most significant and successful EU projects. The EU internal market currently comprises 30 countries (including European Economic Area countries – Norway, Iceland, and Liechtenstein) with approximately 500 million consumers, and it encompasses a territory without internal borders where free movement of goods, persons, services, and capital is ensured. After long and serious work within the framework of the EU, a uniform formation of set of rules has been achieved for operators of economic activity, border control has been cancelled, more competitive business environment is established, 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 for residents, an opportunity to introduce single currency has been established, 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 sufficiently high results regarding the transposition efficiency of the directives have been achieved. Latvia has repeated the best result so far with a deficit of directive transposition of 0.4% and has been ranked the 4th among 27 Member States, thus ensuring the Lisbon aim of 2009 to transpose 99% of the directive requirements or to allow the directive transposition deficit of 1%. This summer, the European Commission will provide latest information on the process of directive transposition in Latvia.

In Latvia, the process of implementing the principles of free movement of goods and services and the rights to do business are 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. TRIS database is a free-of-charge service and is accessible on the portal *www.europa.eu*. The majority of the notified draft technical regulations are available in all EU languages.

In 2010, Latvia has submitted 12 draft technical regulations to the European Commission, but in 6 cases the European Commission objected to the draft technical regulations. The European Commission suspended the progress of draft technical regulations for 12 months in one of these cases.

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 movement 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, 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 different products received from merchants of 22 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, provisions of the laws and regulations are regularly analysed, and proposals on necessary amendments (cancellation of permits in particular fields of services, introduction of open-ended permits instead of existing fixed term permits, replacement of requests for permits with requests for registration, revision of the number of documents to be submitted for receiving the permit, simplification of procedures for re-certification of persons, implementation of electronic procedures in document exchange among state institutions and merchants) are prepared in order to simplify service rendering in Latvia. 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*.

In order to facilitate starting and performing a business activity, the existing administrative barriers and procedures are continuously reviewed, accordingly eliminating and simplifying the requirements for the issue of permits (licences, certificates, certifications, and other documents), as well as creating an opportunity to settle the required procedures electronically. The fixed term permits in certain spheres (licensing of professional education programmes, distribution of plant protection products, and training of tractor machinery drivers) are replaced by open-ended term licences. Simplification of permit prolongation procedures and review of the list and number of the documents to be submitted for permit receiving are continuing.

In order to improve administrative cooperation abilities between public administration authorities of the European Community, since November 2007, the ***Internal Market Information System*** (IMI) has been established and is available in Latvia. The system ensures secure and fast data exchange among the responsible institutions of the European Union

Member States, allows effective communication despite the barriers created by differences of languages and administrative structures. The Member State authorities have an opportunity to verify authenticity of company documents submitted by persons and enterprises issued in another Member State or solve other problems by communicating with the institutions of the country of origin using IMI, which means that there is no need for the entrepreneur to go back to the country of origin and submit additional references, certify them at a notary, etc. In addition, responsible authorities ensuring IMI system's *Alert mechanism* complete activity are identified and registered in the IMI system. IMI system *Alert mechanism* is created in order to ensure effective supervision and protection of the service receiver by informing the Member States about activities of services that can cause harm to a person's health, safety, or environment. In the IMI system, 52 responsible institutions of Latvia accounting for information exchange of one or several fields are registered: 7 – in the sphere of professional qualification, 36 – in the sphere of services, 3 – in the sphere of professional qualification and services, 3 – in the sphere of employee secondment, 2 – in the sphere of employee secondment and services. National coordinator of the IMI system and the coordinator of IMI system *Alert mechanism* is the Ministry of Economics. From January to May of this year, 8 requests for information were registered in Latvia in the IMI system.

From January of 2010 to May of 2011, 17 cases have been submitted to the **SOLVIT Coordination centre of Latvia**. 12 of the submitted cases are settled, 3 are closed as unsettled, but 2 cases were rejected as they failed to comply with the conditions for SOLVIT case solution. The number of complaints about residence permits for the family members of Latvian citizens, as well as about benefits in other Member States has significantly increased within the 2009 and 2010. Also in 2011, SOLVIT continues the information campaign started in the previous year by informing the society on the activity of SOLVIT in various seminars, as well as through mass media. The task of the SOLVIT network is to find a quick and practical solution to EU internal market problems caused by activity of public institutions using incorrect application of the laws and regulations of the European Community. SOLVIT solves problems of residents and entrepreneurs alike, besides this service is free of charge.

6.3. Sector Development Policies

6.3.1. Energy Policy

The main approaches to the energy policy (see also Chapter 6.9) 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 sphere of energy both within the medium-term and long-term period.

At the moment, taking into consideration that economic development of Latvia is experiencing significant changes and deviations from forecasts used in developing the *Energy Development Guidelines for 2007-2016*, as well as to ensure security of energy supply of Latvia and efficient long-term operation of the energy market, broader use of smart technologies, acceptable price for energy users in future, and to foster investment-favourable environment for entrepreneurship in the energy sector, as well as to utilize efficiently the European Union financial aid for innovative solutions in the energy sector, a long-term planning document of energy sector development – *Energy Strategy 2030* is being developed in addition to the medium-term planning document of energy sector development – *Energy Development Guidelines for 2007-2016*. The *Energy Development Guidelines* are going to be defined based on the aims and tasks set in the *Energy Development Strategy*. The aim of the *Energy Strategy 2030* is to ensure safe, environmentally friendly energy supply at reasonable price. The strategy will be developed taking into account the currently effective documents in the field of energy market, renewable energy, and energy efficiency in order to jointly develop a single body of policy documents in the energy sector.

In **electricity supply**, more than 90% of electric energy generated in Latvia is generated by AS "Latvenergo", which also ensures electric energy import and supply to the consumers. Currently, 34 traders have received licences for electric energy trade. However, only 2 traders are operating actively in the electric energy market – AS "Latvenergo" and SIA "Enefit". Since September 1, 2005, the operator's functions of electric energy transmission system are performed by AS "Augstsprieguma tīkls". Since July 1, 2007, the operator's functions of electric energy distribution system are performed by AS "Sadales tīkls". Both joint-stock companies are AS "Latvenergo" subsidiary companies.

A well-operating internal 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 European Union *Third Internal 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 merchants loose motivation to make proper investments in networks. Separation of ownership at the transmission level is considered as the most efficient way to foster non-discriminating investments in infrastructure, fair access to the network for new participants, and transparency in the market.

By implementing separation of the transmission system operator ownership, the transmission system (networks) remains a part of the vertically integrated company AS "Latvenergo", but activities related to fulfilling the functions of a transmission system operator (transmission service rendering, operative management of transmission system and connected generating units thereof, 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 AS "Latvenergo". As a result, the owner of AS "Latvenergo" subsidiary company's transmission system assets – AS "Latvijas elektriskie tīkli" – began to operate on April 1, 2011, but AS "Augstsprieguma tīkls" will be separated from AS "Latvenergo" in August 2011.

The electric energy market of Latvia is developed in the context of the Baltic, Nordic, and European electric energy market.

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. Considering that integration of the Baltic electric energy market is emphasized as important to integrate the Baltic region physically and to carry out construction of new interconnections to improve electricity supply safety of the Baltic States and develop cross-border trade, as well as reach competitive prices, the *BEMIP* action plan envisages that countries carry out necessary measures so that electric energy exchange could start operation in 2011 in the Baltic States, including Latvia. The common Baltic day-ahead electric energy trade on the trading platform Nord Pool Spot, electric energy trade within the framework of each present-day, as well as market principle-based management of network jam and overload management organized by AS Nord Pool Spot and organization of indirect auctions have to be implemented within time period from 2011 to 2013.

Due to free and open market operation, the energy supply safety is no longer based on subsistence with capacities amounting to 100% but is now based on diversified and reliable energy supply routes and sources. Latvia as the EU Member State must ensure national fulfilment of the common requirements set in the EU legislation in the energy sector (see Box 6.6). In the field of electricity supply, it means that the electric energy sector in Latvia is operating in accordance with the European Union directive on the promotion of the use of renewable energy resources for electric energy production, common rules of the electric energy market, cogeneration based on a useful heat demand, promotion, electricity supply safety, and investments in infrastructure.

Currently, AS "Latvijas Gāze" is the only enterprise operating in the Latvian **natural gas market**, and it has exclusive rights to carry out transmission, distribution, storage, and sale of natural gas in compliance with the licences issued by the Public Utilities Commission.

The Latvian gas supply system is not connected to the EU common gas supply system, and Latvia has only one gas supplier – AS "Gazprom". Gas supply business environment in the region and 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.

Currently, the *Directive 2003/55/EC* of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing *Directive 98/30/EC* are transposed into the *Energy Law*.

As the first long-term agreement between Russian JSC "Gazprom" and AS "Latvijas Gāze" on natural gas supply until 2015 was concluded only on July 18, 2003, and the first natural gas supply pursuant to this agreement was initiated on April 5, 2004, Latvia is recognized as emerging market from April 5, 2004 to April 4, 2014, according to Article 2(31) of the *Directive 2003/55/EC*.

According to the *Law on Procedure for Entering into Force of Separate Sections of the Energy Law*, derogation from requirements stipulated in the *Directive 2003/55* regarding permission to construct or use natural gas facilities and to carry out the procedure of natural gas supply and issue, designation of system operators, tasks of system operators, rules undertaken by transmission system operators for balancing the gas transmission system, unbundling transmission system operators, designation of distribution system operators, responsibility of distribution system operator for balancing the gas distribution system, unbundling distribution system operators, separate accounts for natural gas transmission, distribution, liquefied natural gas and storage in internal accounts, third person access to transmission and distribution system and liquefied natural gas objects, market openness and measures to ensure supplies for eligible consumers using direct line is applied in Latvia until April 4, 2014.

Box 6.6

Harmonisation of normative acts with the EU directives

The key fields in harmonisation of normative acts with the EU legislation are oil and oil product reserves, security of supply and energy efficiency, as well as introduction of market principles in the energy sector:

– establishing **oil product reserves.** In order for Latvia to fulfil the provisions of the EU normative acts, it is necessary to ensure that the normative acts of Latvia comply with the Council *Directive 2006/67/EC* of 24 July 2006, imposing an obligation on Member States to maintain incorporated requirements *(Directive 2006/67/EC*) of crude oil and/or petroleum products mandatory stocks, and with the requirements incorporated in the Council *Directive 2009/119/EC* of 14 September 2009, imposing an obligation on Member States to maintain mandatory stocks of crude oil and/or petroleum products (*Directive 2009/119/EC*).

– the Decree of the Cabinet of Ministers of March 29, 2010, *Concept on the Creation of State Oil Product Reserves* assigned the Ministry of Economics to draft legislation to ensure that the Ministry of Economics could start performing functions of the Central reserves maintenance structure from September 1, 2010. By implementing the concept, amendments have been made to the *Energy Law*, *Law on Taxes and Fees,* and other laws and regulations, as well as open tenders have been announced for *Security Reserve Service Rendering for Creation of State Oil Product (Fuel) Reserves in the Amount of 25% in the Territory of Latvia* and *Security Reserve Service Rendering for Creation of State (the Republic of Latvia) Oil Product (Fuel) Reserves in the Amount of 75% in the Territory of the European Union Member States (Kingdom of Denmark, Republic of Estonia, Republic of Lithuania, Republic of Finland, and Republic of Latvia).* The Ministry of Economics has announced the results of the open tenders – the merchants who are granted the general right to conclude agreements and contracts were announced.

– **electrical power sector.** The legal framework for the electric energy market consists of the *Energy Law* and *Electricity Market Law,* and regulations of the Cabinet of Ministers issued in line with this law.

– On August 15, 2009, the regulations of the Cabinet of Ministers of August 11, 2009, *Regulations Regarding Permits for Increasing Electricity Production Capacities or the Introduction of New Production Equipment* came into force. On May 20, 2011, the Amendments of the Cabinet of Ministers of May 17, 2011, *Amendments to the Regulations of the Cabinet of Ministers of March 16, 2010, No. 262 "Regulations Regarding the Production of Electricity Using Renewable Energy Resources and the Procedures for the Determination of the Price"* stipulating that from May 26, 2011 to January 1, 2013, the Ministry of Economics would not organize tenders for the acquisition of the rights to sell electric energy produced from biomass, biogas, solar or wind power plants within the framework of mandatory procurement, and a producer would not be allowed to qualify for sale of electric energy within the framework of mandatory procurement and acquisition of rights to receive a guaranteed fee for installed electric capacity. According to these Regulations of the Cabinet of Ministers, a tender for the rights to sell electric energy produced from renewable energy resources within the framework of mandatory procurement was organized in October 2010, by passing 18 decisions regarding biogas power plants setting the annual electric energy purchase volume of up to 134 308.488 MWh, 6 decisions regarding biomass power plants setting the annual electric energy purchase volume of up to 98 007.882 MWh, 4 decisions regarding wind power plants with capacity exceeding 0.25 MW setting the annual electric energy purchase volume of up to 63 665.241 MWh, and 7 decisions on wind power plants with capacity below 0.25 MW setting the annual electric energy purchase volume of up to 3800 MWh for granting the rights to sell electric energy produced from renewable energy resources in a form of mandatory procurable electric energy volume. In 2010, 15 decisions regarding hydroelectric power plants with capacity of up to 5 MW were also made, setting the annual electric energy purchase volume of up to 13 188.3 MWh. Overall in 2010, decisions granting the rights to sell electric energy produced from renewable energy resources in a form of mandatory procurable electric energy volume were passed to 50 power plants with the total installed electric energy production capacity of 84.38 MW setting the annual electric energy purchase volume of up to 312 969.911 MWh.

– As for production of electric energy by cogeneration, the *Regulations of the Cabinet of Ministers of March 10, 2009 On Electricity Production and Price Determination upon Production of Electricity in Cogeneration* are applicable. These regulations determine the criteria of cogeneration stations qualification so that they could obtain the rights to sell electric energy produced within the framework of mandatory procurement or to receive a guaranteed fee about the electric capacity installed in a cogeneration station whereby also the decision of the European Commission (December 21, 2006) defining harmonized efficiency reference values for separate production of electric energy and heat is enforced by applying the *Directive 2004/8/EC* of the European Parliament and of the Council on the promotion of cogeneration based on a useful heat demand in the internal energy market and amending *Directive 92/42/EC.* On September 23, 2010, the Amendments of the Cabinet of Ministers *Amendments to the Regulations of the Cabinet of Ministers of March 10, 2009, No. 221 "Regulations Regarding Electricity Production and Price Determination Upon Production of Electricity in Cogeneration*" came into force, determining that as of November 1, 2010 the possibility is no longer envisaged to apply for qualification for sale of electric energy within the framework of mandatory procurements or for receiving a guaranteed fee for electric capacity installed in cogeneration power stations using fossil energy resources or peat. According to these Regulations, 97 decisions regarding granting the rights to sell electric energy produced in cogeneration station within the framework of mandatory procurements have been passed to power plants with the total installed electric capacity if 930 377 MW and the total electric energy volume of 3 154 028.07 MWh, including use of natural gas as fuel – 74 decisions (904 936 MW/ 2 974 090.15 MWh), biogas – 10 decisions (10.48 MW/ 82 859.12 MWh), biomass – 12 decisions (14 721 MW/ 96 075.8 MWh), liquefied gas – 1 decision (0.24 MW/ 1003 MWh), as well as 1 decision granting the rights to receive a guaranteed fee for electric capacity installed in a cogeneration power station in the amount of 23 MW has been passed in 2010.

Box 6.6 continued

- On July 13, 2009, the requirement of the Directive of the European Parliament and of the Council *Directive 2009/72/EC* concerning common rules for the internal market in electricity and repealing *Directive 2003/54/EC* (*Directive 2009/72/EC*) was adopted aimed at further unbundling of electric energy trade and production from activities related to electric energy transmission system. The aim of norms included in the draft law *Amendments to the Electricity Market Law* is to create legal environment so that from March 3, 2012, a transmission system operator would be established in Latvia according to the *Directive/72/EC.* The draft law contains norms stipulating requirements for independence of a transmission system owner, electric energy system owner to be owner of an electric energy transmission system, legal status, supervision thereof, and relationship with the transmission system operator. Simultaneously, the draft law establishes the procedure and provisions, based on an evaluation of which a regulator certifies a transmission system operator. The draft law contains a range of amendments specifying or defining new obligations for the regulator – to approve and supervise the multi-annual network development plan of transmission system operator, supervise the relationship between a transmission system operator and electric energy system owner, to be a dispute settlement institution between the transmission system operator and electric energy system owner, supervise utilization of fees for overload management received by the transmission system operator.
- **gas sector.** Legal framework of the gas sector consists of the *Energy Law* and regulations of the Cabinet of Ministers issued in line with this law. The *Directive 2009/73/EC* of the European Parliament and of the Council concerning common rules for the internal market in natural gas and repealing *Directive 2003/55/EC* (*Directive 2009/73/EC*) was adopted on July 13, 2009; Article 49(1) of the Directive stipulates that those articles of this directive regarding requirements for permission for the construction or use of natural gas facilities and carry out procedure of natural gas supply and issue, separation of transmission systems and transmission system operators, market openness and measures to supply for eligible consumers using a direct line shall not be applied to Estonia, Latvia, and/or Finland until any of these Member States is directly connected to the interconnected system of any Member State other than Estonia, Latvia, Lithuania and Finland. Taking into consideration that the legal situation and actual circumstances, if comparing *Directive 2009/73/EC* with *Directive 2003/55/EC* have not changed, as well as the fact that Latvia features traits of an emerging natural gas market, Latvia has suspended implementation of the respective articles of *Directive 2009/73/EC* until April 4, 2014.

The *Directive 2009/28/EC* of the European Parliament and of the Council of 23 April 2009 *on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC* and *2003/30/EC* imposing specific obligations on the Member States in the **field of renewable resources** had to be transposed into laws and regulations of Latvia by December 5, 2010. According to the *Directive 2009/28/EC*, the general objective of Latvia is to increase the share of energy produced from renewable energy resources (RER) in the total gross final consumption of energy from 32.6% in 2005 to 40% in 2020. The Ministry of Economics, which is responsible for the Latvian energy policy, has developed a draft law on *Renewable Energy Resources Law* and has launched preparation of the necessary draft regulations of the Cabinet of Ministers and amendments to the laws and regulations for the purpose of implementing the requirements of the *Directive 2009/28/EC.*

In accordance with the provisions of the *Directive 2003/30/EC* of the European Parliament and of the Council of 8 May 2003 *on the promotion of the use of biofuels or other renewable fuels for transport* and requirements established in the *Biofuel Law* (adopted on July 15, 2005), by December 31, 2010, the share of biofuel in Latvia must be at least 5.8% of the total amount of fuel used in transport.

In order to promote consumption of biofuel in Latvia and according to the provisions of the *Biofuel Law*, ensure that its consumption by December 31, 2010 is in the amount of at least 5.8% of the total amount of fuel intended for transport available in national economy, obligatory 5% biofuel admixture to fossil fuel[1] has been introduced as of October 1, 2009. 2009.

In accordance with the delegation set out in Article 18 of the *Law on The Energy Performance of Buildings*, overtaking requirements of *Directive 2002/91/EC* of the European Parliament and of the Council of 31 March 2004 on the energy performance of buildings, *Regulations On Requirements of Energy Efficiency to the Centralised Heat Supply Systems Existent in the Possession of a Licensed Energy Supply Merchant and the Procedures for the Inspection of the Conformity Thereof* were adopted by the Cabinet of Ministers on October 20, 2009 stipulating energy efficiency requirements for centralised heat supply systems in possession of licensed energy supply merchants and inspection procedure of their conformity.

Investments in the energy sector

Although each EU Member State is responsible for its energy supply security by taking into account the energy market and infrastructure integration of the EU Member States, the individual solutions of each state are insufficient. At the moment, it cannot be talked about a single European energy market because it is considerably fragmented. Also, the Baltic States are among the isolated regions in the European internal energy market.

Increase in energy supply security in the Baltic States is also a priority of the European Union. Effective interconnection of the Baltic Sea region states was defined as one of the six priority infrastructure projects in the *Second Strategic Energy Review* adopted by the European Commission in

[1] Requirement for obligatory 5% biofuel admixture do not apply to Class 0, 1, 2, 3, and 4 diesel fuel used in arctic and severe winter weather conditions.

November 2008. *The Baltic Energy Market Interconnection Plan* (BEMIP) was elaborated for the implementation of the previously mentioned project.

Currently, several projects included in the BEMIP are being implemented ensuring successful integration of electric energy markets of the Nordic and Baltic States.

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 within the framework of *European Energy Programme for Recovery* made 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, which foresees development of power-lines and interconnections in the Baltic States. Within the framework of NordBalt project, it is planned to construct the Lithuania-Sweden interconnection and strengthen the transmission system in the western part of Latvia – the *Kurzeme Circle*. The European Commission plans to invest EUR 131 million in the construction of the Lithuania-Sweden interconnection, however EUR 44 million is granted for improvement of network infrastructure within the framework of the project *Kurzeme Circle*. The total expenses of the project *Kurzeme Circle* amount to EUR 88 million, deadline – 2014.

The work within the project *Kurzeme Circle* will be carried out in two stages. In the first stage, it is planned to construct a 330 kV cable by joining Riga CHP-1 with the substation "Imanta", and to reconstruct a 110 kV cable "Mīlgrāvis-Bolderāja". Reconstruction of a 110 kV line and construction of a new 330 kV overhead line in the section Grobiņa-Ventspils are planned within the second stage.

There are no delays in implementation of the projects. The works envisaged by the projects were started by AS "Latvenergo" and AS "Augstsprieguma tīkls" already in 2009 in compliance with the strict co-financing schedules determined by the European Commission.

In order to increase natural gas supply security at the regional level, Latvia is focusing on implementation of a project on two-way gas flow between Latvia and Lithuania, as well as on investigation of possibilities to enlarge the Inčukalns underground gas storage.

Within the framework of *European Energy Programme for Recovery*, the European Commission has decided to financially support the project elaborated by AS "Latvijas Gāze" and Lithuanian gas company AB "Lietuvos Dujos" for two-way gas flow between Latvia and Lithuania. AS "Latvijas Gāze" will receive EUR 10 million, i.e., a half of the funding necessary for implementing the joint project's part in Latvia.

Within the framework of the project, it is planned to reconstruct 15 gas wells in Inčukalns underground gas storage, construct a new gas transmission line over the Daugava River, create a new piston chamber in Latvia, as well as to modernise the gas compressor station in Panevėžys and a part of Lithuanian gas-pipe system. The transmission line over the Daugava River and a new piston chamber must be constructed before the end of 2010, but reconstruction of 15 drill holes in Inčukalns underground gas storage should be performed before the end of 2011.

In order to increase efficiency of heat energy production, to reduce losses of heat energy in transmission and distribution systems, and to foster replacing fossil fuel with renewable fuel, several projects are implemented within the framework of the Cohesion Fund. Within the first stage of project application selection (from April 14 until May 26, 2009), 11 project applications were approved for CF funding in the amount of LVL 6.7 million in Activity 3.5.2.1 *Measures Regarding The Increase of Efficiency of Centralised Heat. Supply Systems* of supplement to the Operational Programme *Infrastructure and Services*.

In the second round of the selection of project applications (from October 25 until December 1, 2010) the available funding amounts to LVL 35.6 million.

In order to significantly increase production of electric energy and heat energy from renewable energy resources, diversify primary energy resource supply, and increase subsistence of electric energy, 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. Within the first stage of project application selection (from April 14 until August 31, 2009), 10 project applications were approved for CF funding in the amount of LVL 21.4 million.

According to the Decree of the Cabinet of Ministers of August 24, 2010, *Amendments to the Appendix of the Operational Programme "Infrastructure and Services",* the additional funding for the Activity 3.5.2.2 was redistributed, thus the total available funding within the Activity 3.5.2.2 amounts to LVL 34.4 million. It is planned to organize the second round of project application selection.

6.3.2. Construction and Housing Policy

The aim of the **construction policy** is to promote development of sustainable and competitive construction sector.

The Ministry of Economics has developed new **draft of *Construction Law***. It is aimed at creating modern and up-to-date legal regulatory framework for the construction process. The new draft of *Construction Law* will significantly simplify the construction process and promote its transparency, as well as facilitate development of the construction market and entire national economy wherewith. The Draft Law contains the following principles to be observed within the construction process:

- principle of architectonic quality – when designing buildings, the qualitative aspect of architecture is implemented highlighting the individual identity of natural or urban landscape and is easily integrated in the cultural environment, thus enriching it and creating qualitative living-space, as well as observing and preserving the existing cultural heritage;
- principle of openness – construction process is open, and the society is informed about the planned construction and the decisions made in relation to it;
- principle of sustainable construction – the construction process creates the qualitative living environment, *inter alia* providing energy resources necessary for the building and as for the people of present and further generations promoting usage and adjustment of existing buildings and effective usage of natural resources;
- principle of accessible environment – in the construction process, such environment is created that is suitable for people to get around conveniently and use the buildings according to their function.

Box 6.7

Data characterising the construction sector

In the 4th quarter of 2010, the construction production volume (in current prices) was LVL 2289 million, in the first quarter – LVL 107.1 million. In the 4th quarter of 2010, the construction production volumes in accordance with balanced data of working days in comparable prices have decreased by 9.6% if compared to the corresponding quarter of the previous year.

In the 4th quarter of 2010, the Building and Construction Authorities have issued 332 construction permits for single dwelling-unit construction, capital repairs, reconstruction and renovation, which is 82% of all construction permits issued in the 4th quarter of 2009. In the 1st quarter of 2011, there were issued 279 construction permits for the same construction works, which constitutes 107.7% if compared to those issued in the 1st quarter of 2010. The number of issued construction permits in 2010 has increased in the field of office construction.

Changes in volumes of construction works performed by construction organizations in the 4th quarter of 2010 compared to the corresponding period of the previous year constitute – 1.7% (-44.1% in the 1st quarter of 2010, – 31.9% in the 2nd quarter, and -4.5% in the 3rd quarter).

In the first quarter of 2011, the volume of construction works (in current prices) performed by Latvian builders abroad was LVL 14.8 million, which is by LVL 6.3 million more than in the 1st quarter of 2010. However, in the 1st quarter of 2011, foreign builders in Latvia have performed construction works in the amount of LVL 2.8 million, which is by LVL 2.5 million more than in the 1st quarter of 2010.

In the 4th quarter of 2010, the construction costs on average increased by 1.5% if compared to the 4th quarter of 2009. The wages of workers increased by 7.8% and prices for construction materials by 0.8%. In its turn, the costs for machinery and machines maintenance and use decreased by 2.1%.

In the 1st quarter of 2011, the construction costs on average increased by 0.7% if compared to the 1st quarter of 2010. Costs for machinery and machines maintenance and use increased by 4.1%, but prices for construction materials – by 0.5%. The wages of workers decreased by 3.1%

Recently, the following significant changes in normative acts regulating construction have been made:

- on November 9, 2010, the Cabinet of Ministers approved the Latvian Construction Standard LBN 007-10 Harmlessness Requirements for Structures which regulates restriction of use of lead and other harmful substances in construction materials. Foreign producers of building materials made use of the non-existing restrictions in Latvia thus endangering Latvian consumers and distorting the building material market of Latvia;
- Latvian Construction Standard LBN 201-07 *Fire Safety of Buildings* has been restructured, thus making it easier to use for construction designers. It updates requirements regarding materials and methods for insulating building facades;
- amendments have been made to the Latvian Construction Standard LBN 002-01 *Thermotechnics of Building Envelopes*, stipulating that the design solutions for plastered facades of external walls co-financed by the European Union, state, or local municipality shall be developed in accordance with the European technical approvals issued on the basis of the Guidelines for European technical approval of External thermal insulation composite systems ETAG 004.

A range of CoM regulations have been developed or amendments thereof that have been already adopted, for example, *General Construction Regulations*, *Regulations Regarding the Amount of the State Fee and Procedures for the Payment for Registration Activities in the Construction Merchant Register*, *Regulation on the Latvian Construction Standard LBN 007-10 "Harmlessness Requirements for Structures"*, etc.

Currently in the **housing policy** a lot of attention is paid to improve energy efficiency of multi-apartment residential buildings.

Serial multi-apartment residential buildings built in the pre-war period and Soviet period mainly are in bad technical condition and have poor heat insulation leading to an increase in payments for heat energy. The state broadly supports improvements of heat insulation in multi-apartment residential buildings (see Box 6.8).

Box 6.8

Measures for improving heat insulation of multi-apartment residential buildings

By now in the activity *Improvement of Heat Insulation of Multi-Apartment Residential Buildings* of the Operational programme *Infrastructure and Services*, which has been implemented since 2009, support for renovation was provided only for those multi-apartment buildings that have been commissioned after 1944.

Taking into consideration the rather great interest of apartment owners living in multi-apartment residential buildings built in the pre-war period, the Ministry of Economics proposed and the European Commission approved granting of co-financing of the European Regional Development Fund (ERDF) to renovation of such buildings, as well. Thus, support will be provided to the apartment owners of all multi-apartment residential buildings the construction of which has been launched before 1993 and if the buildings have been commissioned before 2002 (except buildings included in the list of state protected cultural heritage monuments).

Similarly, the European Commission agreed to revoke the formerly established total amount of minimum 20 quality criteria points to be submitted for the multi-apartment residential building to be allowed to apply for the ERDF support. This will offer an opportunity to apply for the support the multi-apartment residential buildings with small amount of apartments located within territories of higher development indexes. At the same time, in order to ensure efficient investments, that is, so that investments could pay off no later than in 20 years, there was a plan to introduce a condition that the saved heat energy (megawatt hour/per year) achieved as a result of the building renovation in proportion to the ERDF financing given in the project application must be higher than or equal to 2.

Also, the apartment owners of the multi-apartment residential buildings whose building was located together with other buildings on the same land lot were not allowed to be supported by the ERDF. From now on, the apartment owners of multi-apartment residential buildings located on the same land lot are allowed to apply for support as joint owners of a real property renovating all multi-apartment residential buildings belonging to the real property.

Those owners of multi-apartment residential buildings, who have concluded agreements with the Investment and Development Agency of Latvia on renovation of the buildings, will be offered an opportunity to receive an advance payment not exceeding 20% of the requested financing in addition to the interim and final payment.

The number of documents to be submitted together with the application for the renovation of a multi-apartment residential building has been reduced, as well. The technical inspection opinion, contract of authorization, and local estimate of construction costs are no longer required to be added to the application; as well as in some cases for the implementation of the renovation measures a building inspection report can be submitted instead of a building energy audit report.

In order to improve the quality of construction works carried out within the framework of both project applications and projects, a mandatory requirement has been set for the project applicants regarding the professional civil liability insurance of the project designer, insurance of the construction warranty period or a bank's warranty of the construction warranty period, as well as supervision of construction works.

According to *the Law on Apartment Property* which was enforced on January 1, 2011, the owners of apartments may decide on renovation of the building in several ways – in a general meeting, by inquiring the owners or by mutual agreement if all owners of apartments vote for renovation of the building.

The abovementioned improvements and advantages of the activity *Improvement of Heat Insulation of Multi-Apartment Residential Buildings* are implemented by the Regulations of the Cabinet of Ministers of April 5, 2011, *On the ninth stage of the project application selection of the Activity 3.4.4.1 "Improvement of Heat Insulation of Multi-Apartment Residential Buildings" of the supplement to the Operational Programme "Infrastructure and Services"*.

The number of submitted projects proves growing interest of population in improving heat insulation of multi-apartment buildings. In 2009 (from May to December), 117 projects were submitted, in 2010 – 170, but in 2011 (from January to May 30) – already 175 projects. Within the framework of the activity, 172 contracts for renovation of multi-apartment residential buildings have been concluded, the amount of the attracted ERDF co-financing is LVL 9.2 million and renovation of 35 buildings has been completed out of all buildings, thus disbursing ERDF co-financing in the amount of LVL 1.3 million to the owners of apartments.

In the first half of the 2011, 30 seminars have been organized within the framework of the informative campaign *Live Warmer* in cooperation with the Investment and Development Agency of Latvia, the Latvian Association of Local and Regional Governments, Riga Technical University, and regional structural funds information centres, informing managers of multi-apartment buildings and owners of apartments about the possibilities to attract ERDF co-financing and about qualitative renovation of buildings.

Law on Administration of Residential Houses which came into force on January 1, 2010, establishes the professional qualification of the manager required for management of residential buildings. No state or municipal institution controls whether the manager responsible for the building has acquired the education stipulated by the law. Decision-making on conclusion of the agreement with particular manager is left up to the owner of residential building (as well as to the owners of apartments) who must verify the professional qualification of the manager by himself/herself. Yet, in practice, due to insufficient knowledge, it is difficult, especially for owners of apartments, to verify whether the education of the manager conforms to the requirements set in the law. When deciding on imposing sanctions on a person for avoiding maintenance of residential building, local municipality is required to find the guilty person – either the owner or the manager. Currently, local municipalities do not have information about those managers operating in the field of management of residential buildings within their administrative territory therefore the owner of the residential building or all owners of the apartments have to be present whenever preparing a protocol.

In order to develop a register that would provide comprehensive information about managers of residential buildings to the owners of residential buildings, as well as the state and municipal institutions, Regulations of the Cabinet of Ministers *On Keeping and Updating the Register of Residential Building Managers* were adopted on May 3, 2011. The Register of Residential Building Managers is expected to be launched on January 1, 2012, and it will contain information about the managers operating or willing to operate in the residential building management market including information about residential buildings currently administered by a particular manager, as well as qualification of the manager and his/her personnel.

A new law for regulating legal relations of rent of residential premises is planned to be developed to improve the legal regulation for housing, and it will replace the effective *Law on Residential Tenancy* of 1993. The main tasks of the new law are to balance relations between the tenant and the landlord to create conditions for rental market development. The procedure for setting rent, settlement of rental disputes, as well as competence of the rental board is planned to be improved. In addition to this law, amendments to the *Law on Administration of Residential Houses* and *Law on Residential Property* are expected to be developed to specify rights and obligations of public utilities providers and recipients.

Currently, regulations on the minimum requirements of energy efficiency for residential buildings are being developed and one of the tasks of these regulations is to set the maximum acceptable level of energy consumption in a residential building, and if it is exceeded the owner of apartment must reduce it.

The *Social Housing Conception* is planned to be forwarded for consideration in the Cabinet of Ministers to improve the legal regulation of the social housing sectors, yet, once this conception is adopted, a new law on social residential buildings is to be developed.

6.3.3. Tourism Policy

The tourism policy in Latvia is formed to promote development of local and international tourism, thus ensuring efficient use and protection of tourism resources. The main goal of the state tourism policy is to promote growth of the tourism sector turnover and its share in the economy, as well as to increase the export capability of tourism services in the medium term by 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. An active integration of the new image into all activities to promote awareness of Latvia as a tourism destination is continuing in 2011.

Box 6.9

Tourism development indicators

According to the data of the United Nations World Tourism Organization, the world tourism in general has recovered from the crisis of 2008-2009 faster than expected, and in 2010 the growth of the tourism sector in the world was 6.7%, but the average growth in Europe was 3%. According to the data of this organization, the results of the Baltic States in 2010 were the following: Lithuania +8%, Estonia +12%; Latvia +15%. Among the tendencies having negative impact on development of the European tourism are slow recovery rate of economy, huge unemployment, financial crisis in several euro zone countries, and budget stabilization measures directed towards cutting down the expenses in several countries.

The tourism sector is also a significant source of export income providing a considerable contribution to the national gross domestic product. According to CSB, tourism satellite account calculations, the share of incoming tourism consumption in goods and services export in 2008 was 11.5%, while in 2004 it was 8.9 percent.

In 2010, the number of border crossings by foreign tourists in Latvia reached 5.04 million, which is by 6.6% more than in 2009 (4.73 million). Like in the previous years, the average duration of visits of tourists in Latvia was 1.2 days, which is slightly less if compared to 2009 (1.3 days). It should be admitted that also the average expenses of one tourist per day have faced a slight decrease – in 2010 it was respectively LVL 54. Despite the increase in the number of the entrants, the total expenses of foreign tourists in Latvia have decreased to LVL 333.9 million. Downturn of expenses in the amount of 3% in comparison with 2009 (LVL 344.1 million) is observed.

In 2010, 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 34.3 million.

According to data provided by the CSB, at the end of 2010, there were 628 tourism campsites in Latvia, which is by 69 more than at the end of 2009. At the same time, also the number of persons served in hotels and other tourist campsites in 2010 has increased by 17.7%.

The vision of national tourism development – Latvia in target markets is known as an attractive tourism destination for individual tourists ensuring truly welcoming hospitality and appropriate, qualitative, innovative, sustainable, and authentic tourism products having high value added created by a human being using knowledge and professionalism for the needs of target segments.

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 percentage growth in export of the total tourism services.

In order to ensure constant involvement of sectoral social partners in implementation of the tourism policy, the Latvian Tourism Advisory Council and the Advisory Council of the Latvian Tourism Development Agency (LTDA) composed of authorized representatives from the Ministry of Foreign Affairs, Riga City Council, professional and regional tourism associations, as well as from the advertising sector continue to work in 2011.

In order to ensure efficient implementation of the *European* ***Council Directive of 13 June, 1990 on package travel, package holidays, and package tours***, in 2010 the Ministry of Economics has developed the *Database of Tourism Agents and Tourism Operators* (TATO) (*http://tato.em.go.lv*), thus informing both consumers and other interested people about the activity of enterprises acting in the sector, as well as preventing fraudulent situations in the sector. In total, 354 enterprises were registered in the database by March 1, 2011, 23 of them were registered as tourism operators, 82 – as tourism agents and operators, but 249 – as tourism agents. Information included in the database is publicly available for anyone interested, and the Ministry of Economics encourages Latvian tourists to verify the conformity of service providers to the requirements of the laws and regulations, particularly ensuring security guarantees of money paid by the tourists.

Implementation of measures supporting Latvian resorts has been set as one of the main tasks in 2011. The Ministry of Economics in cooperation with the Jūrmala City Council, the Ministry of Environmental Protection and Regional Development, the Curortology Association of Latvia, and resort rehabilitation centre "Jaunķemeri" have developed draft law *Amendments to the Tourism Law*. Development thereof is the first step towards elaboration of legal regulation of resorts aimed at creating appropriate framework for fostering development of the resort sector. The draft law contains editorial adjustments to the existing *Tourism Law* and envisages authorizing the Cabinet of Ministers to pass regulations prescribing procedure for granting or annulling the resort status of a municipal administrative territory or of a part of it.

Also, the work on development of the European Union Funds programme for reconstruction of resort treatment institutions has been commenced. The aim of the programme is to increase competitiveness of health tourism products, promote an increase in the number of foreign patients, thus reducing the problems caused by seasonality.

The Latvian Tourism Development Agency (LTDA) which is subordinated to the Ministry of Economics and ensures implementation of Latvian tourism policy has set the following tasks for 2011:

– fostering international competitiveness of Latvia as tourism destination;
– organizing measures promoting cooperation among the Baltic States to foster local tourism and promote the Baltics as a single tourism destination.

The annual state budget funding for 2011-2013 that is envisaged for promoting tourism development is earmarked as state co-funding for implementation of the Sub-activity 2.3.1.1.2 *Access to International Trade Markets – Strengthening International Competitiveness of Industry Sectors* of the Activity 2.3.1.1 *Access to International Trade Markets* of the supplement to the Operational Programme *Entrepreneurship and Innovations* of the European Regional Development Fund (ERDF). Within the framework of the Sub-activity, the following activities are supported:

– organizing national stands in 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 2011, the total amount of funding (state budget funding and the ERDF co-funding) for tourism marketing is LVL 878 992.

Box 6.10

Activities of the Latvian Tourism Development Agency in the first half of 2011

By implementing the *Tourism Marketing Strategy of Latvia for 2010-2015* and Action Plan for 2011, the LTDA:

- in cooperation with the Latvian tourism sector organized participation of Latvia in international tourism exhibitions in foreign tourism markets (in Russia, Finland, and Germany);
- organized work seminars and publicity measures to promote the Latvian tourism offer intended for tourism professionals and mass media representatives in Russia, Germany, Sweden, and Finland;
- organized foreign journalists' visits in Latvia, in which representatives of mass media from Russia, Lithuania, Estonia, and the Great Britain were participating, as well as published the Latvian tourism offer in newspapers in Estonia and Sweden;
- continued updating and improving Latvia's tourism portal *www.latvia.travel* according to the visual and content concept of the new tourism image of Latvia, as well as ensured development of the portal content and translation thereof in 4 languages – Latvian, English, Russian, and German;
- in cooperation with Lithuanian and Estonian national tourism organizations launched a campaign promoting the Baltic tourism objects *Great Baltic Travel 2011*, including 10 objects from Latvia and organizing wide publicity campaigns;
- issued 5 types of new informative materials and brochures on health and medical tourism, tourism offer near Riga, business tourism, as well as the map of Latvia and brochure of the tourism image;
- issued the monthly newsletter of Latvian tourism *www.greetingsfromlatvia.lv* in Latvian, English, Russian, and German, distributing it to foreign tourism professionals and journalists in 17 countries, to a total of over 6000 addressees;
- maintained tourist help-line telephone 1188 *(Tourist Hotline*), to provide necessary information and help in emergency situations to foreign tourists 24 hours a day;
- launched introduction of the quality system of Latvia's tourism services *Q-Latvia*;
- organized 3 training measures for Latvian tourism entrepreneurs on creating and developing tourism products according to the target market requirements in the regions of Latvia;
- ensured regular cooperation and representation in local and international tourism sector events, conferences, and sectoral discussions, as well as in the European Travel Commission and the Baltic Joint Marketing Council.

International cooperation in the field of tourism

In 2011, Latvia continues developing and strengthening 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.

In order to ensure further international integration of the Latvian tourism sector, representation of state interests, and adoption of better practice, in the first half of 2011, the Ministry of Economics has continued the work with such institutions as the United Nations World Tourism Organization, Tourism Advisory Committee and Sustainable Tourism Working Group of the European Commission.

The Latvian Tourism Development Agency (LTDA) already the fifth year organizes a tender of the project EDEN *(European Destinations of Excellence*) of the European Commission. In 2011, the theme of the EDEN project is *Renovation of Architectural Monuments into Tourism Objects*. In total, 12 applications have been submitted for the tender this year. Līgatne paper mill village was recognized as the most excellent European tourism destination in Latvia in 2011. The project *Līgatne paper mill village – the witness of workers' historical lifestyle* was submitted by the Līgatne Regional Council.

As the winner of the tender, Līgatne is going to be promoted in local and foreign mass media and a video about it is to be made and shown at the closing event of the EDEN project during the European Tourism Forum. Līgatne is to be allowed to use the brand of the EDEN project for promoting recognisability of the place.

6.4. Improvement of Business Environment

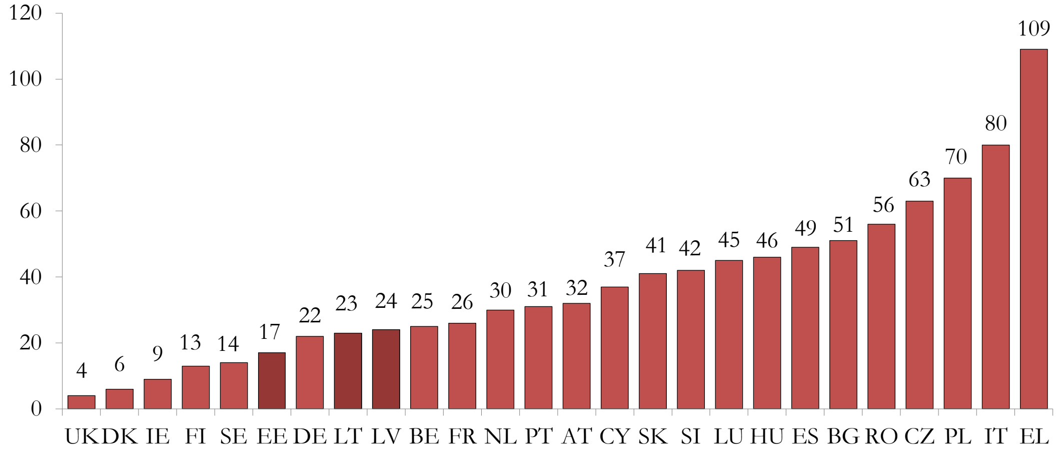
The research *Doing Business* (DB) performed by the World Bank, as well as the *Study of Administrative Procedure Impact Upon Business Environment* are the most popular measures for evaluating business environment, with the aid of which the opinion of entrepreneurs about the factors preventing their activity is determined, and a list of tasks that need to be fulfilled within the framework of the annual *Action Plan to Improve the Business Environment* is prepared.

Latvia ranked 24th on the DB 2011 index, which is 3 positions higher than in the *Doing Business* report of 2010, Estonia ranked 17th, but Lithuania – 23rd. Latvia ranked among those countries (85% of all countries covered in the DB research), where reforms carried out during the last 5 years have facilitated entrepreneurship, meanwhile Estonia and Lithuania have been placed in the group where it has become more difficult to carry out business activities.

Figure 6.7

Rank of Latvia and other EU Member States in the World Bank's research *Doing Business* in 2011

(business environment in general)



According to the *Strategic Development Plan of Latvia for 2010-2013* the objective of Latvia is to reach the 19th position in the DB index in 2013. In order to achieve the objective, it is necessary to carry out more rapid reforms and make decisions oriented towards long-term development of national economy, especially in fields where the rank of Latvia is below the 50th position.

Table 6.3

Rank of Latvia in the World Bank's research *Doing Business* in 2010 and 2011

Indicators	2010	2011	Changes
Starting a Business	51	53	-2
Dealing with Construction Permits	77	79	-2
Getting Credit	6	6	0
Registering Property	61	57	+4
Protecting Investors	57	59	-2
Paying Taxes	56	59	-3
Trading Across Borders	16	16	0
Enforcing Contracts	14	14	0
Closing a Business	89	80	+9
Overall business rank	**27**	**24**	**+3**

The objective of the *Action Plan to Improve the Business Environment* for 2011 is "simple and qualitative services in entrepreneurship: more e-services", and it includes measures to be carried out that affect indicators of Latvia in the research *Doing Business*. The Plan for 2011 includes 31 measures to be carried out; and the following are the most important.

In order to simplify starting a business, electronic registration system of enterprises is to be introduced and issue of paper registration certificates of enterprises and submission of copies thereof to various institutions is to be cancelled, as well as official electronic publication is to be introduced, thus reducing costs related to the official publications by at least 25%. These measures will enter into force on May 1, 2012.

Having evaluated **the micro-enterprise support** in 2010, by implementing the provisions set in the *Concept of Micro-enterprise Support Measures* (approved by the Cabinet of Ministers on October 30, 2009), it can be concluded that the necessary preconditions for the economically active part of population to start a business have been created. For instance, according to the data of *Lursoft*, from May 1, 2010 until May 1, 2011, amendments to the *Commercial Law* have encouraged registration of 15 240 new limited liability companies, 9508 (62.38%) of which are limited liability companies with reduced fixed capital. However, implementation of the *Law on Micro-enterprise Tax* from September 1, 2010 until May 5, 2011, has encouraged registration of 11 110 micro-enterprise tax payers, and about 50% of them are newly established enterprises.

The main task in the field of **construction** is to adopt the new *Draft Construction Law*, which will ensure significant reduction in procedures for harmonization of construction and required time. On May 3, 2011, the *Draft Construction Law* was submitted to the Saeima. The *General Construction Regulations* approved on the meeting of the CoM on May 24, 2011, sets shorter deadlines for harmonization of construction required for the planning and architectural process, obtaining acceptance of technical regulations and construction design, as well as it sets the minimum deadlines for obtaining the construction permit.

In the field of real property it is planned to implement the one-stop shop principle in registration of property data and corroboration of the title. It is envisaged that data of the National Real Estate Cadastre Information System and of the Sate Unified Computerized Land Register are to be updated by mutual obtaining of data without involving the owner of the real property.

It should be noted that the *Law on Local Municipalities* which entered into force on October 1, 2010, prescribes a more precise pre-emption rights procedure and deadlines for exercising these rights by local governments including a condition that a statement on refusal to exercise the right shall be issued within 5 business days, thus having positive impact on the evaluation of Latvia in the field of real property in the ranking of the DB 2012.

In the field of protecting investors, amendments to the *Commercial Law* will be prepared by September 1, 2011, in order to introduce a regulation on the rights of holding companies and ensure transparency of transactions performed by related enterprises, especially regarding transactions involving the conflict of interests. A draft information report *On Employing an Inspection by an External Auditor to ensure that a Transaction Involving the Conflict of Interests Concluded by a Quoted Joint Stock Company Enters Into Force* has been developed envisaging to set the exact regulation so that quoted joint stock companies could verify the transparency of a transaction involving the conflict of interest in due time. The draft information report mentioned above has been submitted for approval to the Cabinet of Ministers on May 23, 2011.

In the field of closing a business, improvements rely on the new *Insolvency Law* which entered into force on November 1, 2010. It is much boarder and equally favourable to all merchants irrespective of their legal status. The duration of insolvency process is expected to be reduced from 3 years to approximately 1 year. Also, the costs of the process are expected to constitute a half of the current amount. According to the information of Insolvency Administration, only 244 insolvency processes of legal entities have been initiated by May 11, 2011, that is 9.6% if compared to 2010.

In the field of promoting e-services, a section for entrepreneurs is planned to be developed on the portal www.latvija.lv in 2011. It will contain guidance maps for the *Doing Business* topics thus providing easy understandable information about the required administrative formalities at the respective business stage in one place irrespective of the institution responsible for rendering the service.

6.5. 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 6.11

The number of small and medium-sized enterprises in Latvia

There were 71.4 thousand economically active individual merchants and commercial companies in Latvia in 2009 (excluding farms, and fish farms and self-employed persons, who perform economic activity), 99.5% of which belonged to the category of SMEs. The distribution of economically active SMEs in Latvia is the following: micro-enterprises – 82.5%, small enterprises – 14.1%, medium-sized enterprises – 2.9%, large enterprises – 0.5%.

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 8 years from 17 in 2001 to 32 in 2009.

However, it is equally important to emphasize the number of performers of individual work (self-employed persons) in 2009 – 45.3 thousand (20 per 1000 inhabitants), as well as the number of farms and fish farms in 2009 – 11.9 thousand (5 per 1000 inhabitants). Taking into account the fact that there is no single methodological practice among the EU Member States for calculating such indicator characterizing the economic activity as the number of enterprises per 1000 inhabitants, it is difficult to perform 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 2009 in Latvia there were 57 performers of economic activity per 1000 inhabitants.

According to the statistics of "Lursoft" and the Register of Enterprises, in the year 2010, 13 421 subjects were registered in the Register of Enterprises and Commercial Register, and 8035 subjects of the Register of Enterprises and Commercial Register were liquidated. Within 5 months of 2011, 8261 subjects of the Register of Enterprises and Commercial Register were registered, but 1665 – liquidated.

Aid to SMEs in Latvia is regulated by the *Law on Control of Aid for Commercial Activity*, which came into force on January 1, 2003.

On June 28, 2007, the Cabinet of Ministers approved the *Programme on Promotion of Entrepreneurship Competitiveness and Innovation for 2007-2013*.

Box 6.12

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.

The programme envisages implementing the policy that is based on the best practice examples of developed countries, and it is implemented in accordance with the activity directions (see Box 6.13) outlined in the *European Charter for Small Enterpris*es and other EU documents, at the same time taking into account specific problems of SME development in Latvia.

Box 6.13

Activities of the EU for promoting entrepreneurship of SMEs

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 implement the aims set out in the *Act,* in 2009, the European Commission commenced an extensive campaign *European SME Week*, providing the current and future entrepreneurs with information about activities for adjustment of entrepreneurship of the European Union, Member States, regional and municipal institutions improving and popularizing entrepreneurship, as well as awarding entrepreneurs for contribution to prosperity of Europe, establishment of work places, innovations, and competitiveness.

Officially, *European SME Week 2010* took place from May 25 to June 1, when a range of conferences, seminars, trainings, discussion forums, and award ceremonies were organized in 37 European countries. In order to ensure experience exchange and new knowledge for further business development for the current and future enterprises, conferences, matchmakings, regional and thematic seminars were organized in the framework of the *European SME Week 2010 in Latvia* on such topics as service rendering in the EU Member States (*Services Directive*), legal issues of export (export contracts), public procurement in the European Union, introduction of a customer management system in an enterprise, etc. Discussions were held on available support for business start-up and expansion, practical advices for the implementation of business ideas were provided, as well as the initiator of *European SME Week 2010* idea in Latvia – "Madara Cosmetics" Ltd – was honoured during these events. In total, more than 15 informative events for entrepreneurs were organized in Latvia, engaging over 3000 entrepreneurs.

European SME Week 2011 will be organized from October 3 to October 9, 2011, in cooperation with the Polish presidency, but in the Member States, including Latvia, activities of the SME week related to entrepreneurship will be organized in September and October, paying particular attention to insolvency and "second chance" issues.

On October 30, 2009, the Cabinet of Ministers approved the ***Concept of Micro-enterprise Support Measures*** with the 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.

Currently, the Concept is being successfully implemented, and amendments to the relevant laws and regulations have been made.

In order to foster establishment and development of micro, small, and medium-sized enterprises, IDAL implements the project ***Development of Business Incubators in Latvia*** co-financed by the European Regional Development Fund. A business incubator is a combination of infrastructure and personnel aimed at aiding new and small enterprises to develop supporting them in their early stage of development with infrastructure, day-to-day consultations, and services concerning basic business development issues.

Box 6.14

Implementation of *the Concept of Micro-enterprise Support Measures*

The most important measures carried out during 2010 to reduce costs required to start a business: reduction of the state duty by 50% for registration in the Register of Enterprises, provision of an opportunity to found an enterprise with reduced fixed capital, entering into force of the *Law on Micro-enterprise Tax*, an option to impose a patent fee to persons performing economic activity, and provision of an accounting programme free of charge to micro-enterprises.

In May 2010, when the amendments to the Commercial Law entered into force, costs required to start a business were significantly reduced, envisaging that a limited liability company may be founded with reduced fixed capital (from LVL 1). At the same time, upon registering such Ltd the following was stipulated:

– the state duty is LVL 15, the charge for the announcement – LVL 12.60;
– no state duty must be paid for registration of changes in fixed capital and announcements related to increase in fixed capital.

According to the statistical data of "Lursoft", 15 240 new limited liability companies were registered in the Register of Enterprises from May 1, 2010 until May 1, 2011, and 9508 (62.4%) of them are limited liability companies with reduced fixed capital. Since January 1, 2010, a physical entity performing economic activity in specific professions or fields may choose to pay a patent fee, which is an optional provision. The patent fee is a final tax payment consisting of personal income tax and state social insurance contributions for the economic activity of a physical entity in a specific profession. Patent fees are applied to over 60 professions (mainly for craft services), and monthly payment is set specifically for each group, the amount thereof ranges from LVL 30 to LVL 70 per one calendar month. Respective social guarantees are ensured to all payers of the patent fee. From January 1, 2010, until the end of May 2011, 1883 applications of patent fees have been submitted to the SRS.

As from September 1, 2010, individual merchants, individual proprietorships, farms and fish farms, and individual persons registered in the State Revenue Service as persons performing economic activities, as well as limited liability companies can obtain the status of a payer of micro-enterprise tax if they meet the following criteria:

– participants are physical entities;
– the turnover does not exceed LVL 70 thousand per calendar year;
– the number of employees does not exceed 5.

The tax rate applied to micro-enterprises is 9% of the turnover or income from economic activity. The micro-enterprise tax comprises state social insurance contributions, personal income tax, and entrepreneurship risk state duty for employees of the micro-enterprise, as well as the corporate income tax or the personal income tax of the owner of the micro-enterprise for the income part of the economic activity of the micro-enterprise.

11 110 micro-enterprise tax payers (50% of them – newly established merchants) were registered in the State Revenue Service from September 1, 2010 until May 2011.

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

At the end of the 1st quarter of 2011, 313 micro, small, and medium-sized enterprises providing (maintaining) 1142 work places receive services at ten business incubators. Results of the business incubators achieved at the end of the 1st quarter of 2011 show that the expected indices of the project *Development of Business Incubators in Latvia* (on average, annually 166 micro, small, and medium-sized enterprises and the number of created (maintained) work places – 259, have been incubated) will be achieved.

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.

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, plays a substantial role in implementation of support instruments.

In 2011, the Mortgage Bank continues the implementation of both the existing and new development programmes, in the framework of which support is provided for specific groups of merchants and inhabitants as instructed by the government:

– *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 Small and Medium-Sized Enterprises of Latvia*;

- *SME Growth Loan Programme;*
- *Programme of Agricultural Liquid Assets;*
- *Agricultural Investment Loan Programme*;
- *Agricultural Credit Fund Loans*.

Box 6.15

Transformation of the Mortgage Bank into a Development Bank

In December 2009, the Cabinet of Ministers accepted the concept *Transformation of the State Joint Stock Company "The Mortgage and Land Bank of Latvia" into Development Bank*. The aim of the concept was to select the optimal options for transformation of the Mortgage Bank into a development bank, by reducing the number of transactions of a commercial bank and focusing the work of the bank on directions currently crucial to the national economy**.** The 1st model of the concept was supported providing foundation 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.

The Mortgage Bank will phase out the volume of the commercial loan portfolio, and implement the remaining unpaid commercial loan portfolio or transfer it for servicing to another financial institution according to the situation of that particular moment at the end of 2013. It is provided that in the process of transformation, the Mortgage Bank annually will implement new support programmes in the amount of LVL 70 million according to the priorities defined by the government in such fields as financing of SMEs and business activity start-ups, promotion of micro-enterprises and self-employment, financing of innovative, technologically intensive, and high value added projects, funding for production of goods and rendering of services that are competitive in the international market, implementation of energy efficiency measures, development of agriculture and rural areas, particularly focusing on fostering self-employment and engaging in commercial activity the specific socially sensitive population groups (for example, the disabled, unemployed, new families, national minorities).

In April 2011, the Cabinet of Ministers made a decision on the transformation process of the Mortgage Bank by approving the transformation plan containing proposals on separation of bank's commercial assets prepared by a financial consultant involved by the Ministry of Finance. The commercial assets are the commercial loan portfolio, subsidiary companies that currently are operating as separate legal units, and real properties that are not necessary for carrying out the bank's functions. The Cabinet of Ministers will make the final decision on the model of separation of the commercial assets and implementation thereof by the end of 2011.

Currently, the most significant support programme 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. Support within the programme is provided to small, medium-sized, and large enterprises registered in Latvia, which have economically justifiable further activity plans, but cannot receive funding from credit institutions due to the increased risks. Within the framework of the programme, loans for investment (up to LVL 5 million) and liquid assets loans (up to LVL 2.5 million) are being granted, with the maximum loan amount for one enterprise not exceeding LVL 7.5 million. The loans are mainly envisaged for implementing projects of enterprises operating in the processing industry and for enterprises attracting funding of the EU Structural Funds grant programmes. 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 May 2011, 365 loans have been granted in the amount of LVL 150.4 million, among which loans in the amount of LVL 98.4 million have already been issued. 55 loans in the amount of LVL 62.2 million[2] were granted from the part of the programme funded by the ERDF. The fields receiving most funding are timber processing, power industry, production of pharmaceutical products, and food production.

The programme ***Support for Self-employment and Business Start-ups*** co-funded by the ESF and approved by the Cabinet of Ministers in March 2009, offers complex support to business start-ups and newly established enterprises, i.e., consultations, trainings, and funding in a form of loans (up to LVL 54 thousand) and grants[3] for starting an economic activity. Support may be granted to persons of the working age, including unemployed persons, as well as to the newly established enterprises, who have expressed their wish to start commercial activity or self-employment. For the purposes of this programme, newly established enterprises are such enterprises, which have registered their activity lawfully not earlier than 3 years before applying for the support under the programme, as well as entrepreneurs having experience in business activities who plan to produce a completely new product or provide a new service if they found 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% from 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's and the state budget – LVL 14 million, and co-financing of the Mortgage Bank of LVL 9 million. In the framework of the total funding of the programme, LVL 16.5 million is envisaged for loans, while LVL 6 million – for grants, trainings, and consultations. It is planned that during implementation

[1] Currently, the total amount of programme resources amounts to LVL 140.2 million. Programme funding comprises resources of 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 May 24, 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).

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 the launch of the programme until the end of May 2011, cooperation agreements with 1679 entrepreneurs have been concluded, 771 clients have submitted business plans, including 410 start-up projects that have already been supported for the total loan amount of LVL 5.2 million. In cases of 210 projects, also grants for the total amount of LVL 1.5 million have been awarded. 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 on such modules as basics of business activity (for organizations of a small business), management basics, legal regulation of entrepreneurship, finance management of the enterprise, accounting and taxes of economic activity, and basics of marketing. So far, 870 programme participants have been trained.

In December 2008, the Cabinet of Ministers approved the *Micro-crediting Programme for Latvian Small and Medium-Sized Enterprises*. The programme is aimed at introducing a mechanism of micro-crediting for small and medium-sized enterprises and self-employed persons, as well as at promoting access to micro-credits for start-up or development of a business activity. The micro-credits up to LVL 3 thousand are intended for implementation of business projects – for investments and liquid assets – for enterprises with up to 10 employees, as well as for self-employed persons. The total budget of the programme is LVL 565 thousand, including a contribution from the Ministry of Finance in the amount of LVL 452 thousand and financing from the Mortgage Bank in the amount of LVL 113 thousand. Since February 2009, when the implementation of the programme was launched, until the end of May 2011, the Mortgage Bank has granted 356 loans for the total amount of LVL 966 thousand, of which loans in the amount of LVL 933 thousand have already been issued. Thus, implementation of the programme is completed. However, taking into account the demand of the entrepreneurs for micro-credits, the Bank continues micro-crediting by using resources of loans that have already been repaid.

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 aim of the programme is to improve the access to funding of those, who perform economic activity and are registered in Latvia, thus fostering economic development. It is envisaged that within the framework of the programme, until December 2013, loans for liquid assets and investments in the amount of LVL 140 million will be available for promoting development of micro, small, and medium-sized enterprises and agricultural service cooperatives. The total loan amount per one performer of economic activity may not exceed LVL 300 thousand; the maximum loan amount for liquid assets is LVL 200 thousand. According to the conditions of the programme, the total amount of the loan within this programme for one micro-entrepreneur operating in service industry may not exceed LVL 30 thousand. By the end of May 2011, within the framework of the programme, 261 loans in the amount of LVL 13.2 million have been granted, including the loans in amount of LVL 10.9 million that have already been issued.

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 Rural Development Fund may be attracted for these loans. Over the course of the year, the programme has been rather popular among farmers: 340 loans in the amount of LVL 11.1 million have been granted, including loans issued in the amount of LVL 10.3 million.

The Regulations of the Cabinet of Ministers *Procedure for Administration and Control of the State and European Union Support to Agriculture, Rural and Fisheries Development by Establishing the Credit Fund* were approved in July 2010, envisaging the issue of loans for financing the projects[2] approved by the Rural Support Service. Loans for a period up to 15 years are planned to be allocated for investments in agricultural enterprises – for construction, purchasing stationary devices and equipment thereof, purchasing construction materials, and preparing technical projects. So far, the Mortgage Bank has approved 7 projects for LVL 2.5 million, the amount of granted loans – LVL 1.8 million.

By expanding the range of loan programmes envisaged for agricultural development, since the beginning of 2011, the Mortgage Bank has resumed granting loans from the ***Agricultural Long-term Investment Crediting Programme***, initially

[1] In the Riga region, training is provided by companies "Riga College of Accounting and Finance" and "Biznesa komplekss"; in the regions of Vidzeme and Latgale – association of SIA "Mācību un konsultāciju centrs ABC" and SIA "Mensarius"; in the regions of Kurzeme and Zemgale – SIA "Stockholm School of Economics in Riga".

[2] Measures of Rural Support Service: Modernization of Farms, Creating Value Added to Agricultural Products, Support to Establishment and Development of Enterprises (Including Diversification of Activities not Related to Agriculture), Promotion of Tourism Activities, Investments in Aquaculture Enterprises, Processing of Fishing and Aquaculture Products)

approved in 2001. Within the framework of this programme, investment loans are available for up to LVL 200 thousand, and farmers may apply for the loans, if producing of agricultural products constitutes at least 60% of the total income. 25 loans in the amount of LVL 1.9 million have been granted by the end of May 2011, within the framework of the programme.

The Mortgage Bank is planning also further development and implementation of new support programmes. For instance, in compliance with the Informative Report *On Undistributed Funding of Latvian and Swiss Cooperation Programme* considered in the Cabinet of Ministers in March 2010, the Mortgage Bank in cooperation with the Ministry of Finance and involved sectoral ministries prepared a summary of the ***Micro-crediting Programme*** project, which in November 2010 was harmonized with the Swiss party, which is willing to co-finance the implementation of the programme for the amount of CHF 7.48 million. It is envisaged that within the framework of the programme, micro-enterprises will be able to receive micro-credits in the amount of up to LVL 10 thousand for a loan term not exceeding 5 years. At the moment, the documents of the programme are prepared, and the Swiss party is about to approve it. The micro-crediting programme is expected to be launched in August 2011 and will be effective for the next four years.

SIA "Latvian Guarantee Agency" (LGA) is a state-owned capital company with the aim to promote access to funding for enterprises registered in Latvia. LGA offers two guarantee programmes for improvement of competitiveness:

– Loan Guarantees, with the aim to help enterprises to attract credit resources in cases when their collateral is insufficient to receive credit resources;
– Export Loan Guarantees, with the aim to support exporters covering political and commercial risks related to export transactions.

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.

The ERDF funding available within the framework of the activity is LVL 60 million.

In October 2010, the Cabinet of Ministers approved the *Regulations Regarding Guarantees for Improving Competitiveness of Merchants and of Conforming Agricultural Service Cooperative Societies,* stipulating that the LGA issues guarantees for the following financial services: loans for investments; liquid asset loans; financial leasing; local factoring. The guarantees cover up to 80% of the principal amount of the financial service but not exceeding EUR 1.5 million for one enterprise. The maximum term for guarantees attracted to investment loans or financial leasing is ten years; the maximum term for liquid assets loans and local factoring is three years.

Guarantees issued within the framework of the Activity 2.2.1.3 *Guarantees for Improvement of Enterprise Competitiveness for the Loan Guarantee Programme* since launching the activity until April 30, 2011*:*

– number of applications – 1104 applications from 303 enterprises;
– amount applied for – LVL 182 million;
– number of issued guarantees – 490 guarantees to 162 enterprises;
– amount of issued guarantees – LVL 71 million;
– amount of guaranteed credits – LVL 140 million.

In May 2009, the Cabinet of Ministers adopted regulations ***On Short-term Export Credit*** establishing coverage and beneficiaries of short-term export credit guarantees, as well as the procedure for granting guarantees and the procedure under which the guarantor covers the loss. The LGA export credit guarantee covers up to 90% of the amount of deferred payment but not exceeding EUR 1 million or an equivalent in another currency. The deadline of the deferred payment cannot exceed 2 years.

Guarantees issued within the framework of the Activity 2.2.1.3 *Guarantees for the Improvement of Enterprise Competitiveness for the Export Loan Guarantee Programme* since launching the activity until April 30, 2011:

– number of applications – 120 applications from 36 enterprises;
– number of issued guarantees – 63 guarantees to 16 enterprises;
– amount of issued guarantees – LVL 3.55 million.

In order to foster mutual cooperation between industry and sector-related enterprises that is directed towards increasing the volume of export, the Ministry of Economics continues implementing the **Cluster Development Programme**, within the framework of which 7 cluster projects (IT, electronics, chemistry and pharmacy, metal processing, light industry, logistics and related sectors, as well as space technology development) are supported in 2011. The state budget funding for implementation of these projects in 2011 constitutes LVL 0.17 million. As of 2012, the EU Structural Funds funding in the amount of LVL 2 million is planned to be attracted for expanding the existing cluster programmes and fostering new ones.

Development of **industrial design** plays an increasingly important role in raising competitiveness of industry by offering the industrial enterprises the privilege to position the manufactured production as original and new, at the same time increasing the value added to the end-product along with the demand and international competitiveness.

In 2011, the Investment and Development Agency of Latvia continued organizing the activity *Design Bus (Dizaina autobuss)*, which offers Latvian designers an opportunity to establish direct contacts with industrial enterprises for developing cooperation projects. Within the framework of the project, 11 designers visited 3 Latvian food manufacturing enterprises in the first half of 2011.

In order to support small and medium-sized enterprises of Latvia selected in accordance with the procedure of a tender for development of export product design, in March 2011, the Investment and Development Agency of Latvia announced a tender of applications for the knowledge transfer project *Provision of product design development service to manufacturing enterprises*. Within the framework of the activity, five projects of enterprises are being supported.

To provide information about the current activities in the design field of Latvia and world, the industrial design portal *www.designlatvia.lv* is maintained also in 2011. The portal is developed as a platform for cooperation between industrial enterprises and designers where both have an opportunity to share their successful cooperation experience, as well as search for and address each other for implementation of cooperation projects.

6.6. Innovation and New Technologies

In the research *Innovation Union Scoreboard 2010* published in 2011, Latvia ranked 27th out of 27 countries (Estonia – 14th, Lithuania – 25th). Although the innovation index of Latvia is the lowest among the 27 Member States of the European Union, it should be emphasized that the average increase in indicators included in the innovation index over the last five years in Latvia is 2.71% which is higher than the average increase of the 27 Member States – 0.85%.

The research evaluates a wide range of indicators in eight areas important to innovation development – human resources, openness, excellence, and attractiveness of research environment, finance and support, enterprise investments, cooperation among enterprises and entrepreneurship, intellectual property, innovation activity, and economical effects. Upon analyzing the indicators included in the research, it can be concluded that Latvia shows comparatively better indicators in the area of human resources, as well as improvements in the area of intellectual property can be observed. Lower are the indicators in the area of research environment, innovative enterprises, as well as in cooperation between enterprises and scientists.

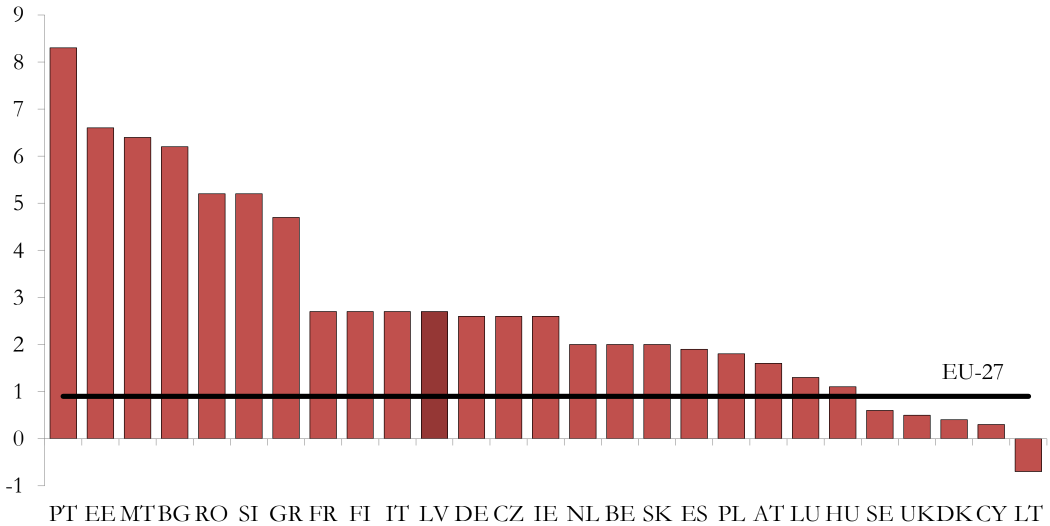
According to the data of the Eurostat, within the time period from 2006 to 2008, on average 24.3% of enterprises in Latvia were innovative, while in the EU countries the same indicator constituted 52%.

The share of high technology products in the total export is comparatively low: in 2010 it was 10.9%, in 2009 – 10.7%, but the share of medium high technology products in the total export in 2010 constituted 14.5% (in 2009 – 12.5%).

Figure 6.8

Changes in innovation index

(2006-2010)



Source: European Commission, Innovation Union Scoreboard 2010

The share of investments in research and development (R&D) in Latvia was 0.45% of GDP in 2009, which is the lowest amount of state and private sector investments in R&D in the EU (for comparison EU-27 – 2.01% of the GDP). In 2010, the state and private sector investments in R&D continued decreasing. The National Reform Programme of Latvia for implementation of *EU 2020* strategy sets a new objective to increase the investments of Latvia in R&D – 1% of the GDP in 2015, and 1.5% of the GDP in 2020 (see Section 6.1.2). For achievement of the objective the following main policy directions have been set:

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

For development of the scientific activity potential, the Ministry of Education and Science in 2011 continues implementing several measures aimed at increasing the number of the employed in science and research, establishing competitive scientific institutions with advanced material supply by consolidating state scientific institutions and strengthening their infrastructure. The core activities are implementation of 5 state research programmes in the priority scientific directions and launching development of 9 research centres of national significance within the framework of the EU Structural Funds activity *Development of Science Infrastructure*.

In order to foster cooperation between enterprises and scientists, in 2011 the Ministry of Economics in cooperation with the Investment and Development Agency of Latvia continues implementing one of the most important support activities **Competence centres**. At the beginning of 2011, the Investment and Development Agency of Latvia has concluded agreements on granting support to six competence centres. The total public support to the 6 approved projects by 2015 is LVL 37.4 million, and it will attract additional co-funding of private sectors in the amount of at least LVL 22 million.

Within the framework of the competence centres, enterprises in cooperation with the scientists are going to develop new technologies and products in sectors important to Latvia (pharmacy and chemical industry, information and communication technologies, forestry, manufacturing of electric and optical equipment, environmental, bioenergetics, and biotechnological sector, transport and engineering industry). A total of 72 enterprises and 17 scientific institutions are going to be involved in the competence centres.

In order to promote technology transfer, the Investment and Development Agency of Latvia continues to support provision of the activity of eight **Technology transfer contact points** at higher education institutions (University of Latvia, Riga Technical University, Riga Stradins University, Latvia University of Agriculture, Ventspils University College, Rezekne Higher Education Institution, Daugavpils University, and Art Academy of Latvia). The task of the technology transfer contact points is to provide a practical link between research and industry sectors, to actively get involved in recognizing results of commercial researches, as well as to ensure services of industrial property protection.

As a result of activity of the eight Technology transfer contact points, in 2010 commercialization offers of 67 research projects were prepared, 36 patent applications (5 of them are international patent applications) were submitted, as well as 51 agreements on cooperation of enterprises and researchers were concluded on carrying out commissioned researches, providing scientific services, and sale of industrial property or the right to use thereof.

In order to build the innovation capacity of enterprises, the Investment and Development Agency of Latvia in 2011 continues supporting projects approved within the framework of the EU Structural Funds programme *Development of New Products and Technologies* and *Support for Introduction of New Products and Technologies into Production*. In both programmes, 145 projects for the total public funding in the amount of LVL 15.2 million are already implemented or being implemented. The second stage of project selection in the programme *Support to Introduction of New Products and Technologies into Production* took part from November 15, 2010, to February 1, 2011, during which 182 project applications for LVL 58 million were received. The funding available for the second stage of the project selection is LVL 34 million.

In 2011, the 29 projects approved within the framework of the activity ***High Value Added Investments*** are continued to be supported for total public funding in the amount of LVL 65 million. Within this programme, the support is granted for development of large scale production plants – for purchasing equipment, construction of buildings, and creation of new workplaces. In 2010, the public funding in the amount of LVL 20.7 million was paid for ongoing construction of production plants. Construction of production plants is expected to be completed by 2013.

In order to inform the public and build understanding, the Investment and Development Agency of Latvia continues to implement the activity ***Measures to Enhance Motivation for Innovations and Business Start-ups***. In the first half of 2011, amendments to the provisions of the programme were made, thus ensuring opportunity to provide deeper expert consultations and support services to authors of the most perspective business ideas for its development. At the same time, several informative and training measures are going to be implemented in 2011, for example, the *Idea Cup 2011*, series of seminars *Innovative Business Start-ups*, mentoring programme for new entrepreneurs, a training course *Become an Entrepreneur in 5 days* were organized.

Within the framework of the transnational cooperation project of the Baltic Sea Region JOSEFIN, the Investment and Development Agency of Latvia provides consultation services to small enterprises for developing innovation projects. The aim of the consultations is to prepare an innovation project for attracting funding. Implementers of the projects approved within the framework of the tender can receive consultations in four topical directions (development of a business plan and market survey, funding attraction and project financial matters, protection of intellectual property, marketing). In the first half of 2011, 6 enterprises have received consultations; however in the second half of 2011, it is expected to provide individual consultations to at least another 15 enterprises.

6.7. 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), 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.

Box 6.16

Usage of computers and Internet in Latvia

According to the data of CSB survey *Computer and Internet Usage in Households,* 63% of all households (households with at least one person in the age group of 16-74 years) had computers and 60% of households had Internet connection in 2010. The best situation with accessibility to computers and internet was for households in the Riga region (computers – 67%, Internet – 65%) and in the Pieriga region (computers – 67%, Internet – 62%), while in other regions, the situation was not as good – in the Zemgale region (computers – 62%, Internet – 58%), Vidzeme region (computers – 60%, Internet – 56%), Kurzeme region (computers – 59%, Internet – 57%), and Latgale region (computers – 56%, Internet – 52%). 63% of inhabitants in the age group of 16-74 years used a computer and Internet on a regular basis (at least once a week). 53% of all households had broadband Internet connection.

At the beginning of 2010, 95% of all companies having 10 and more employees had computers, 91% of such companies had Internet connection, and 49% of enterprises had their own website. In 2009, 80% of companies having 10 and more employees used Internet for cooperation with the public and local government institutions. In 2010, 31% of all employees of companies used a computer on a regular basis, while computers connected to the Internet had been used regularly by 28% of employees.

At the beginning of the academic year 2009/2010, the number of computers per 100 full-time students at higher education institutions and colleges was 15. At the beginning of the academic year 2010/2011, 11.6 computers were available per 100 pupils in professional education institutions, but in general education schools – 9.9 computers. At the beginning of the academic year 2009/2010, out of the total number of all education institutions, all higher education institutions and colleges and general education schools, and 90% of professional education institutions had an Internet connection.

According to the CSB data, in 2009 the share of ICT sector in the GDP constituted 3.3%. In 2009, 2636 companies operated in the ICT sector in Latvia, employing 16 765 persons, the companies' turnover reached LVL 1.3 billion, staff costs – LVL 178 million. The value added to the ICT production reached LVL 15 million, provision of the ICT services – LVL 344 million. The foreign trade balance of the ICT was negative: LVL 57.4 million, because import with LVL 259.3 million exceeded export with LVL 201.9 million. It should be noted that in 2009 comparing to 2008, the ICT production import reduced by 41.7%, while export remained almost unchanged.

The *Europe's Digital Competitiveness Report* published in 2010 analyses development of information society over the recent years. It points out that Latvia has improved its indicators in several fields and is close to the average EU level. The most rapid progress has been observed in spread of broadband Internet, except in rural areas and enterprises where in 2009 no progress at all was observed comparing to 2008. The number of Internet users (61% of the total population) even slightly exceeds the average EU level (60%), but Internet usage fields are very different. The number of those Internet users who read news on the Internet, use Internet banking, publish information on the Internet, study online has rapidly increased, while the use of e-commerce is considerably below the average EU level. The rapid, yet still insufficiently fast development of e-government is noted. Participation of Latvia in the European digital library project *Europeana*, where Latvia is represented by the National Library of Latvia has received positive remarks.

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[1] ICT sector is defined in accordance with the OECD definition which specifies inclusion of the following economic activities (NACE 2nd rev.): ICT manufacturing (manufacture of electronic components; manufacture of electronic boards; manufacture of computers and peripheral equipment; manufacture of communication equipment; manufacture of household electronic devices; manufacture of magnetic and optical media), ICT wholesale (wholesale of computers, computer peripheral equipment and software; wholesale of electronic equipment. telecommunications equipment and its components), and rendering ICT services (software publishing; telecommunications; computer programming, consulting and other related activities; data processing, hosting, and other related activities, web portals; repairs of computers, computer peripheral equipment and communication equipment).

Along with Latvia's accession to the EU, the European Union initiatives related to development of the information society have become binding for Latvia.

A new aim has been set in the European Commission's communication *A Digital Agenda for Europe* adopted on August 26, 2010 – according to the *EU 2020 Strategy* to gain economic and social benefit from the digital single market based on fast and particularly fast Internet. *A Digital Agenda for Europe* includes 101 legislative initiatives and a number of EU, regional, and Member States' measures of horizontal level in seven areas in three dimensions of the *EU 2020 Strategy* development: social, environmental, and global dimension (see Box 6.17).

Box 6.17

<u>European Union initiatives in developing the information society</u>

The European Commission approved the communication *A Digital Agenda for Europe* on August 26, 2010, and announced it as one of the seven flagship initiatives of the *EU 2020*. The aim of this program is to gain economic and social benefit from a digital single market based on fast and particularly fast Internet. The following priority actions are outlined in the programme: establishment of a digital single market, bigger interoperability, improvement of Internet security and users' confidence, faster access to the Internet, more investment in research and development, broadening digital competence skills and inclusion, application of information and communication technologies in order to solve problems important for the society, for example, climate change and ageing of the society, as well as international support is important. It is essential to simplify electronic payments and invoices and opportunities to use telemedicine services fast, and introduce energy efficient lighting. The communication contains an action plan in seven fields of the Digital Agenda, at the same time pointing out that the Digital Agenda is a document prepared in the current situation, and that it will develop along with the experience and rapid changes in technology and society. Taking into account the abovementioned, the measures included in the communication are planned to be initiated mainly from 2010 to 2015.

The EU has launched several initiatives to make the high-speed broadband communications accessible for households, expand the range of e-commerce services for enterprises, and make state services available online. High quality telecommunication services are very important for efficiency and competitiveness of all manufacturing sectors and services. Three priorities are set for this purpose:

– to ensure availability of low-price, world-class communication infrastructure and various services for enterprises and citizens;
– every citizen must acquire skills necessary to live and work in the information society;
– lifelong learning possibility must be an important part of the European social model.

In order to evaluate the first results of the *Digital Agenda for Europe* achieved for period from May 2010 to May 2011, the European Commission has prepared the first progress report (*Digital Agenda Scoreboard*). It analyses the progress of 101 policy measures and achievement of 13 objectives. Overall, the implementation of the project is successful. Only 6 measures of all policy measures have been delayed, but another 14 measures are subject to the risk of delay, majority of them are measures in the field of data protection. Good progress in the EU in general has been achieved regarding an increase in the number of regular Internet users, use of e-government, purchasing via Internet, as well as the number of broadband connections and use of energy efficient LED lighting has been significantly increased. However, insufficient progress has been observed in spread of cross-border e-commerce, sale of SME's production over the Internet, spread of high-speed broadband Internet, reduction of mobile communication roaming prices, as well as state investments in R&D have not been increased.

Annexes to the progress report evaluate progress of each member state. Latvia has achieved progress in ensuring several types of access to the Internet (increased number of fixed broadband lines and 3G coverage ensured in all Latvia), Internet users have improved their skills, and the number of e-government services has increased. However, lagging behind the EU level has been observed in the spread of broadband Internet, especially in rural areas, and indicators of e-commerce spread and extent, as well as mobile phones are rarely used for Internet access.

In order to support Latvia in development of information society, Riga was approved to be the location of the Body of European Regulators for Electronic Communications (BEREC) office seat by voting of the European Transport, Telecommunications and Energy Council of Ministers on May 31, 2010, in Brussels. An office seat agreement on establishment of BEREC Office in Riga was concluded on February 24, 2011. The agreement has to be approved by the Saeima. The Saeima approved it in a second reading on June 9, 2011.

Development of information society in Latvia is regulated by the *Information Society Development Guidelines for 2006-2013* approved by the Decree of the Cabinet of Ministers on 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", State 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.

Development of information society and e-government is analysed in informative reports. The most important is the informative report *On the Opportunities of Use of Microsoft Infrastructure Software and Optimization of Information Technologies Infrastructure in the Ministries and their Subordinate Institutions* reviewed by the Cabinet of Ministers on April 6, 2010. By the end of 2010, the ministries have submitted informative reports on opportunities of IT infrastructure optimization in the ministries and their subordinate institutions, but the Ministry of Finance additionally submitted also an informative report on the *Centralization of Financial Accounting in Sector Ministries and their Subordinate Institutions, as well as in Other Central State Institutions, and Proposals for Opportunities of Optimization of*

Information Technologies Necessary for Accounting of Institutions Base on Principle of Single Data Centre.

Funding from the European Union Structural Funds, as well as state and local government budget is used for development of electronic government and information society. The total available ERDF funding constituted LVL 96.6 million.

The list of priority projects was updated by the Decree of the Cabinet of Ministers of March 15, 2010, *On the Priority Projects' List for the Development of Electronic Government and Information Society* (see Box 6.18).

Box 6.18

Priority projects for development of electronic government and information society

According to the Decree of the Cabinet of Ministers of March 15, 2010, *On the Priority Project List for the Development of Electronic Government and Information Society*, a list of priority projects of ministries, institutions under their jurisdiction and supervision on the development of electronic government and information society for the planning period of 2007-2013 of the European Union funds was approved. The list contains 65 projects with the total eligible costs in the amount of LVL 98.9 million, of which 44 projects are approved.

The largest financing (almost LVL 2 million and more) has been granted to such projects as the 2nd stage of development and introduction of Joint State Archives Information System (LVL 3.5 million), development of Biometric Data Processing System (LVL 3.5 million), the 2nd stage of development of the Portal *www.skolas.lv* (LVL 3.1 million), development of the Information System of the Register of Enterprises (LVL 2.7 million), the 2nd stage of development of Digital Library (LVL 2.7 million), development of Client-Guided Service System for the Ministry of Agriculture and its subordinate institutions (LVL 2.5 million), development of Information System on Construction (LVL 2.5 million), the 1st stage of the development of Information System of Electronic Health Card and Integrity Platform (LVL 2.5 million), development of Geospatial Information System of the State Land Service geospatial data (LVL 2.3 million), E-services and development of its infrastructure (LVL 2.3 million), the 2nd stage for the development of the Unified Environment Information System (LVL 2.3 million), development of Electronic Attendance Booking (*e-booking*), the 1st stage for the Electronization of Health Care Job Flow (*e-referrals*), development of Society Health Portal, ensuring information security and protection of personal data (LVL 2 million), development of the Joint Geospatial Information Portal and linking of the sectoral GIS with the portal (LVL 2 million), the 2nd stage for updating the general catalogue of the National Museum Holdings (LVL 2 million), introduction of Joint municipal information system service centre software, data migration to new platform, ensuring compatibility with the State information systems management integrator (LVL 2 million), development of e-catalogue functionality of the Electronic purchase system (LVL 2 million), development of Integration environment for the public government document management system (LVL 2 million).

Information summarized in the informative report *On Absorption of Funding for the Sub-activity 3.2.2.1.1 "Development of Information Systems and Electronic Services" of the Addition of the Operational Programme "Infrastructure and Services" in 2010* shows that 44 projects for the total amount of LVL 62 million have been approved, 39 agreements on implementation of projects for the total amount of LVL 58 million have been concluded, and 2 projects for the total amount of LVL 1.4 million have been cancelled by September 30, 2010.

The list of priority projects is expected to be improved in 2011, and the third stage of project application selection is to be announced as there is balance of funding in the amount of LVL 2.9 million formed as a result of procurement procedures until December 31, 2010.

Electronic services

According to the *Eurostat* data, Latvia had introduced 93% of 20 basic electronic services (average in the EU – 84%) in 2010. The Internet portal *www.latvija.lv* is developed as a single access point for the services of the state and local governments in Latvia. In total, information about almost 1600 services is available in the public services catalogue. Since June 2010, it is possible to register a new enterprise in the Register of Enterprises electronically.

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*).

On January 12, 2010, the Cabinet of Ministers supported the *Concept on Electronic Identification Cards* envisaging introduction of electronic identification cards. The card will be a person's identification and travel document in the EU, as well as the means for a person's electronic identification and authentication for electronic services, and also a carrier for creating (using) an e-signature. The Office of Citizenship and Migration Affairs plans to launch card issuing in the second half of 2011. In order to ensure that the electronic identification card could be used just as a passport in the whole EU territory, a Draft of the *Personal Identification Documents Law* has been submitted to the Saeima on June 16, 2011.

On December 28, 2010, the Cabinet of Ministers approved the *Regulations Regarding Centralized Electronic Procurements* which envisage that starting from February 1, 2011, state institutions are obliged to make procurements in the centralized e-procurement system or e-catalogue office equipment, computers, paper, software, and specified medical products, for which the contractual price in 12 months for the respective goods or services group is LVL 100 or more.

According to the data of the State Regional Development Agency, the total sum of general agreements on procurement in 2010 reached LVL 6.8 million (in 2009 – LVL 4.4 million), the number of goods in e-catalogue reached 40 thousand. The largest part was formed of procurements of computer technologies, printing equipment, and medicaments.

Broadband Internet

According to the *Eurostat* data, the number of broadband Internet access lines in Latvia in 2010 reached 18.8 (EU average – 25.6) 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 about the speed published on measurement website *speedtest.net* of the Internet research company "Ookla Net Metrics" at end of June 2011, Latvia with the download speed 23.5 Mbit/s takes the 6th place and with the upload speed 14.4 Mbit/s – the 4th place among 172 world countries. Such results are reached due to investments of the largest Latvian telecommunication enterprises in development of the optical network.

It is planned to improve the broadband Internet infrastructure by attracting ERDF financing from the Operational Programme *Infrastructure and Services*, thus ensuring the use of the Internet with the download speed of at least 2 Mbit/s in the whole territory of Latvia.

Combating computer piracy

According to the data of the international software copyright protection organisation "Business Software Alliance", the level of computer piracy in Latvia remained at 56% in 2010 (the level has not changed since 2006), while the losses to Latvian economy caused by piracy have reached almost LVL 15 million.

The level of computer piracy will be reduced by the possibilities to use free-of-charge and open code software. Already 25.4% of all enterprises used such software in 2010.

E-commerce

According to the CSB data, 39% of all Internet users in 2009 had purchased and ordered goods or services on the Internet for individual purposes at least once in a life. But 72% of Internet users had used Internet banking in the last three months (EU average – 52%).

In 2009, 17.1% of all enterprises had purchased but 6.9% of all enterprises had sold goods or services on the Internet or other computer networks. The goods and services purchased by enterprises on the Internet and other computer networks constituted 3.9% of the total purchases in 2009, however, the turnover of the sold goods and services amounted to 6.5% of the total net turnover (EU average – 14%).

6.8. 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, so that consumers could choose various good 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 legal 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 serious breaches of the *Competition Law* – prohibited agreements and dominant position abuse.

The *Competition Law* defines several issues, where agreement between market participants is prohibited, because its purpose or consequences hinder, restrict, or distort the competition, including direct or indirect agreement on a price or provisions of formation thereof. The Competition Council identified a breach of this particular norm in the activities of the 22 commercial banks (see Box 6.19).

The *Competition Law* stipulates that the market participants are prohibited to agree on action or inaction that inconveniences a potential market participant to enter a particular market. The CC identified a violation of this norm of the law between the RIMI group companies and the lessor of shopping centre space (see Box 6.20).

The CC carries out merger control of market participants, if the total turnover of the merging participants in the preceding financial year has been at least LVL 25 million or if their total market share in the particular market exceeds 40%. The *Competition Law* stipulates that before the merger, these market participants have to submit a notification about the planned operation to the Competition Council. The Competition Council with its decision is entitled to prohibit a merger, as a result of which a dominant position is created or strengthened, or which may significantly reduce the competition in any particular market. If the planned merger has no significant impact on the competition, the Competition Council adopts a decision permitting the merger. In order to prevent negative consequences regarding the competition in market, the Competition Council may permit the merger, upon determining binding provisions for the merger participants.

Box 6.19

The CC imposes fines to 22 commercial banks for a prohibited agreement

On March 3, 2011, the Competition Council made a decision identifying a breach and imposed a fine for a prohibited agreement between 22 commercial banks. The prohibited agreement is related to commission paid by banks for card payments, as well as for ATM services. The agreement was in force from December 1, 2002, to January 7, 2011, however the duration of participation of banks in that agreement differed.

In order to ensure card payments, a card payment system exists in Latvia the costs of which are mainly covered by the payments of those traders who accept payment cards at their outlets. During the inspection, the CC found out that the volume of payments made by the traders has been directly dependent on the volume of interbank payments. Therefore, the volume of the interbank payments in 2009 reached 75% of the payment applied to traders in case of debit cards and 100% in case of credit cards. Thus, the agreement between banks on single interbank payment without setting this payment according to the expenses of the particular bank distorted the competition and failed to make all banks invest effort to attract new customers-traders by applying lower commission payments.

The CC concluded that the interbank payment set by Latvian banks, and accordingly the payment applied to traders was economically unreasonable and failed to conform to the changes in the market conditions and decrease in bank expenses. In order to prevent the damaging influence of the bank agreement on the competition, the payment was expected to drop as the volume of card payments increased along with income of the banks. However, during the whole period of the agreement, which exceeded eight years, the payment remained unchanged, thus making it impossible for the traders to gain the benefit of this scale. Yet, if there were no agreement between all banks or certain bilateral agreements, the banks should apply the interbank payment conditions for VISA and MasterCard applied by the international payment card organizations that overall were not higher besides, in specific time periods they were considerably below those set by the Latvian banks.

Therefore, the agreement resulted in distortion of the competition that could ensure applying lower commission for cash withdrawal or viewing the account balance on other bank's ATM to consumers. Such condition was especially important at the beginning of the agreement (from 2002) when clearing transactions were less popular and there was a lower number of bilateral agreements between banks that today allows receiving the particular services at a lower price or even free of charge.

Fines calculated in percentage of the annual turnover of the previous financial year in the particular market are imposed on the banks involved in the breach. The total fine imposed on the banks constitutes LVL 5.5 million.

Active consolidation of enterprises was observed in 2007 and 2008. In 2006, the CC made 28 decisions on mergers of enterprises, and in 2007 and 2008 – 82 and 57 respectively. Mergers of market participants took place mainly in such fields as fuel trade, retail of consumer goods at supermarkets, and medical product trade. Year 2009 brought significant changes, only 12 decisions on merger of enterprises were made and 9 decisions in 2010. The rapid decrease was influenced by amendments made to the *Competition Law* on the initiative of the Competition Council in 2008 allowing refusing examination of insignificant mergers and simplifying the procedure of the examination. The decrease in merger transactions was partially affected by the overall economic situation in the country.

Box 6.20

The CC has found a prohibited agreement between RIMI group and owners of shopping centre space

The Competition Council made a decision identifying a prohibited agreement among RIMI group companies SIA "RIMI Latvia", SIA "Supernetto", and SIA "Plesko Real Estate" and the lessor of the shopping centre space SIA "Marno J". The agreement envisaged a prohibition to rent space to other enterprises without consent of RIMI group companies and limiting possibilities of competitive specialized food shops to operate in these shopping centres.

Within the framework of the case, the CC found that the agreements concluded between RIMI group and SIA "Marno J" entitles the RIMI group to decide on renting other areas of the particular shopping centre, thus these agreements are restrictive not only to potential lessees but also unreasonably restricts the rights of the lessor to independently operate its business.

So, without consent of the RIMI group, the lessor of the shopping centre space SIA "Marno J" has refused to lease space to SIA "Daudznozaru kompānija "Daugava"". According to the information available to the CC, enterprises AS "Talsu gaļa" and AS "Putnu fabrika "Ķekava"" have also faced difficulties to lease space at shopping centres, because no consent was granted by the daily consumer product supermarket.

Denying the specialized food shops to operate at the shopping centres hinders their development. At the same time, the producers become increasingly dependent on retail supermarkets because the possibility for them to develop an efficient, sufficiently large, and easily accessible alternative distribution channel by establishing their own chain of specialized shops is denied.

The companies are imposed a fine for a total of LVL 163 thousand, as well as a legal obligation to eliminate the identified breach by removing the restrictive clauses from the agreements with SIA "Marno J", as well as other owners of the shopping centre spaces with whom they have concluded agreements containing restrictions of similar content and nature.

A fine in the amount of LVL 152 thousand is imposed on SIA "RIMI Latvia", SIA "SUPERNETTO" – in the amount of LVL 1 590, but the fine imposed on the property management agent enterprise SIA "Plesko Real Estate" – in the amount of LVL 9 890. Since the retail supermarket benefited th from the restricted competition and the lessor was forced to accept the restrictive conditions to conclude the agreement or not worsen the conditions of the agreement with RIMI group companies, no fine was imposed on SIA "Marno J".

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 analyzing comprehensive information on competition situation in different 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.

Box 6.21

Results of market supervision implemented by CC in the field of medical product distribution

Within the framework of market supervision of the **medical product distribution,** the Competence Council analysed the process of price formation.

During the supervision the CC evaluated only those laws and regulations and conditions that might have impact in competition among market participants and prices for medical products. For the purpose of market supervision case, the CC obtained information from state administrative institutions like the State Agency of Medicines, the Centre of Health Economics, etc., and market participants. Latvian producers of medical products and representatives of foreign producers as well as wholesalers of medical products and pharmacy enterprises were polled. The Competition Council received information from 27 producers, 13 wholesalers, 7 pharmacy enterprises and other persons.

In the final report, the CC draws attention to existing issues as well as possibilities of targeted use of competition among market participants and legal regulation to ensure lower prices and wider choice to consumers.

The CC has found that the full use of possibility to set a lower price for medical products was restricted by the system for setting mark-ups approved by the Cabinet of Ministers and possibility for producers of medical products to struggle for the choice of doctors instead of patients in case of analogue medicine as well as administrative barriers imposed by the state regarding registration of the medical products, opening and organization of pharmacies, parallel import of medical products and distribution of generic medicine, as well as failure of responsible institutions to ensure consideration of all allowances applied to wholesalers of medical products and pharmacies when calculating the final price for medical products.

The CC specifies that it is necessary:

– to promote price competition among producers of medical products thus excluding the possibility for the producer to struggle for the favour of the doctor issuing the prescription (allowing doctors to name only active substances of the medical product instead of giving the name of a specific medical product in the prescription) and making it possible for a patient to get information about the possible low-price equivalent prescription and non-prescription medical products in pharmacies. At the same time, the CC reminds that currently the consumer is entitled to get information about all medical products based on the same active substance and considered as analogue in pharmacies – so that the patient has the option to choose an analogue low-price medical product even if the doctor has prescribed particular medical product;
– to change the system for setting mark-ups of prices for medical products, thus not permitting the benefit of wholesalers and pharmacies from selling expensive medical products;
– to eliminate existing administrative barriers, which currently restrict possibilities to import a new medical product, by differentiating registration costs in favour of low-price or less profitable medical products;
– to evaluate further possibility to organize purchase and registration of medical products at the level of the Baltic States, thus preventing the rise in price caused by the small market volumes;
– to revoke restrictions imposed on the parallel import of medical products, as well as restriction on distribution of generic medicine which currently supports producers of expensive original medical products instead of entering and sale of the low-price generic medicine in the market;
– in order to ensure that the consumer gets the discount offered by the producers and wholesalers, to forbid those currently existing discounts that cannot be or are not included in the consignment bills of particular medical products and therefore are not included in the final price calculation;
– to set different calculations of maximum acceptable mark-ups for those enterprises that are both wholesalers of medical products and own pharmacies to prevent the current situation when price for medical products includes expenses not incurred to these enterprises (for example, expenses of marketing activities);
– to promote a situation where pharmacies purchase medical products directly from the producers – thus promoting decrease in both price for medical products and turnover and correspondingly the market share of wholesalers;
– to remove partially restrictions regarding opening of new pharmacies to promote price competition among pharmacies and make them consider lower price mark-ups.

The CC has informed the Ministry of Heath about the conclusions made. An agreement has been reached between the head of the CC and the Minister of Health on further participation on the CC in amending the regulation of pharmaceutical market.

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*. The CC recognizes the necessity to ensure legal environment for development of entrepreneurship, which is difficult due to the economic recession, as well as is aware of the necessity to timely detect distortion of competition in the sectors affecting a wide range of consumers. Therefore, market supervision activities are carried out in 2010 and 2011, allowing to obtain and analyse information about the competition situation in markets important to consumers, as well as to find solutions for improvements thereof. As a result of specific controls, cases have been initiated regarding breaches of competition rights. During the abovementioned period, the CC has completed market supervision in such sectors as sale of sugar, surveying, geodesy and land utilization, sale of fruits and vegetables, distribution of medical products, grain purchasing, production and wholesale of flour and its products, sale of fuel, retail trade of milk and bread in supermarkets and others.

Among the controls affecting a wide range of consumers is market supervision of medical product distribution (see Box 6.21).

Market participants and other interested persons can get acquainted with 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/ecn_brief*) and the European Commission home page.

According to the *Council Regulation (EC) No 1/2003* of 16 December 2002 *on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty*, the European Commission and the competition authorities of the member states in close cooperation apply the Community competition rules**.** Besides exchange of information and other activities within the framework of the cooperation the Competition Council, the European Commission and other competition authorities of the member states by court permission are entitled to joint inspection (inspection of premises of enterprises and employees thereof, means of transport and other properties), envisaged by Articles 20, 21, and 22 of the *Council Regulation (EC) No 1/2003,* as well as the Section 34-34 of the *Competition Law*. In 2011, the Competition Council in cooperation with a competition authority of another member state has carried out 2 inspections.

6.9. Regulation of Public Utilities

The Public Utilities Commission is a multi-sector regulator performing 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 with profitability according to the economic situation. The Commission adopts its decisions independently and 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 interests of users, and fostering development of public utility providers, setting tariff calculation methodologies and approving tariffs in accordance with the laws of each sector, issuing licenses and registering electronic communications and mailing service entrepreneurs, promoting competition in the regulated sectors, carrying out extrajudicial settlement of disputes, and supervising compliance of the provided services with license or general authorisation conditions and set quality requirements.

In accordance with amendments to the *Law on Regulators of Public Utilities* adopted on June 11, 2009, regarding establishment of a single regulator, 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.

Situation and policies of the regulated sectors

Electricity (see also Chapters 3.2.3 and 6.3.2)

The dominant role in power supply is played by the AS "Latvenergo" generating more than 90% of power produced in Latvia and ensuring power supply, as well as delivery to users, who have not chosen another supplier. As from September 1, 2005, all functions of electricity transmission system operator are fully carried out by AS "Augstsprieguma tīkls" fully owned by AS "Latvenergo", but as from July 1, 2007, the functions of a distribution system operator are carried out by the AS "Sadales tīkls" fully owned by the AS "Latvenergo".

Electricity is also generated by 140 small hydropower stations, 30 wind power stations and 69 cogeneration power stations. About 30 other enterprises have received licences to distribute or sell electricity.

Latvian electricity market is fully for 100% opened to competition from July 1, 2007, and since the second half of 2008, when the largest electricity users buy electric power at an agreed price, several electricity users have changed their power supplier.

On July 13, 2009, the European Parliament approved a body of laws aimed at developing single European energy market thus promoting higher competition and also wider choice, energy efficiency and power supply safety. It establishes new requirements for network operator decoupling and ensuring necessary investments, independence of member states' regulators, as well as provides establishment of cooperation organization for energy regulators at the European scale. Draft amendments to the *Electricity Market Law* and the *Energy Law* as well as *Draft Law on Renewable Energy* have been developed in relation to implementation of the abovementioned body of laws. The said draft laws envisage unbundling transmission system operators, creating conditions for energy exchange, simplifying entrepreneur licensing, as well as setting single, clear and long-term predictable regulation for promotion of use and production of electricity from renewable energy resources.

Several amendments are expected to be made to the *Law on Regulators of Public Utilities*, thus implementing the principles regarding independent status and capacity of regulating institution and entitling the Commission to regulate independent system operator and owner of the transmission system set in the *Directive 2009/72/EC* of July 13, 2009.

Regarding to the conditions of the *Directive 2009/72/EC* of July 13, 2009, Latvia has chosen to implement the model 2 for unbundling electricity transmission system operator which envisages setting up an independent system operator. As of April 1, 2011, AS "Latvijas elektriskie tīkli" fully owned by AS "Latvenergo" began its operation having in possession a transmission network, i.e. 330 kV and 110 kV power lines and substations/distribution points. AS "Latvijas elektriskie tīkli" is going to lease out transmission assets, as well as manage and service all the 330 kV and 110 kV power lines within the territory of Latvia, provide operation, maintenance and repairs of equipment installed at 330 kV and 110 kV substations and distribution points, parametric testing, measuring and conformity assessment, dielectric testing of power safety devices, perform reconstructions and new construction works of transmission network ordered by AS "Augstsprieguma tīkls" and in accordance with the requirements of AS "Augstsprieguma tīkls".

On January 12, 2011, the Commission approved the tariffs for electricity distribution services of AS "Sadales tīkls" which entered into force on April 1, 2011. The average rise in the tariffs of AS "Sadales tīkls" is 20.8%. The rise in tariffs is composed of electricity losses and expenses related to ensuring the technological process in the distribution system and increasing tariffs for electricity transmission system services of the transmission system operator as of January 1, 2011, as well as the rise in the lease payment of distribution system assets related to revaluation of distribution system assets.

On January 27, 2011, AS "Latvenergo" submitted to the Commission a draft project of electricity trade differential tariffs for related users. AS "Latvenergo" submitted the draft tariffs in accordance with the procedure specified in the law envisaging that the public electricity trader AS "Latvenergo" sets tariffs by itself, and the draft of tariffs was submitted to the regulator for evaluation whether they are calculated in accordance with the methods. The Commission carefully evaluated the draft tariffs and concluded that it complies with the methods and is economically justified therefore there is no reason to reject it. The new tariffs entered into force as of April 1, 2011, the average rise in tariffs for end-consumers is 21%. AS "Latvenergo" has developed and as from April 1 of this year has been implementing also a new tariff structure for households – the start tariff and base tariff. The start tariff which is equal to previous tariff is applied to the user's consumption from 0 to 1200 kWh in a 12-month period but the base tariff is applied starting with 1201 kWh.

Gas supply

Supply of natural gas in Latvia is ensured by a vertically-integrated enterprise AS "Latvijas Gāze".

In July and August 2010, the excise duty was applied to natural gas used as fuel or petrol. In accordance with amendments to the *Law on Excise Duties* approved on August 25, 2010, application of the excise duty to natural gas was abolished for the period from September 1, 2010 until July 1, 2011. According to the amendments to the *Law on Excise Duties* adopted on April 14, 2011 the excise tax rate for natural gas used as fuel was reduced from LVL 15.6 to LVL 12 per 1000 m^3. On April 14, 2011, amendments to the *Law on Value Added Tax* were also adopted envisaging application of the standard tax rate of 22% to natural gas supply as of July 1, 2011.

Heating energy supply

In accordance with amendments of June 11, 2009 to the *Law on Regulators of Public Utilities*, the Commission took over the regulatory functions in heat supply from local government regulators or local government councils (boards) by November 1, 2009.

On April 14, 2010, the Commission adopted new *Methodology for Calculating Tariff of Heating Supply Services* (Council Decision No 1/7), which specifies many regulating issues. Comparing the new methods approved by the Commission with the previous effective Regulations of the Cabinet of Ministers of June 26, 2001, No 281 *Methodology for Calculating Public Utilities Tariffs in Sectors Regulated by Local Governments*, the main positive traits are the following:

– explicitly defined not to include debtor debts in the tariffs. This means that payers will not pay for those who fail to pay;
– capital investments/contributions are included in the draft tariffs on the basis of actual data about investments. This means that users pay for actually implemented projects instead of paying for theoretical investment plans of the heat supply enterprises;
– set maximum profit limit, as well as set differentiation of maximum profit limit depending on efficiency of the heat supply enterprise. As a result, the heat supply enterprise is encouraged to invest only in cost-efficient projects thus excluding discussions on the amount of the profit margin.

The amendments adopted on October 27, 2009 to the Regulations on Types of Regulated Public Utilities of the Cabinet of Ministers entered into force on

March 19, 2011, and according to them the following are to be regulated in the heat energy supply:

- production of heating energy in equipment with the total installed thermal capacity higher than one megawatt, if the amount of supplied heat to users exceeds 5000 megawatt hours per year;
- heating energy transmission and distribution if the total amount of transferred and distributed heating energy exceeds 5000 megawatt hours per year;
- heating energy trade to users if the total amount of heating energy trade exceeds 5000 megawatt hours per year.

Since entering into force of these regulations of the CoM the Commission is entitled to evaluate and approve end tariffs for almost all regulated enterprises providing heating energy supply services to end users. Previously, for a great part of the vertically-integrated enterprises that provide heating energy supply services the Commission was entitled to approve only the tariff for heating energy production.

88 heat supply enterprises are providing public utilities in the heat supply sector.

Electronic communication and postal services

396 enterprises were registered and actively operated in the sector of electronic communication on May 20, 2011. In the postal sector, the state AS "Latvijas Pasts" provides general postal services, while 55 service providers operate actively in the sector of express mail.

On November 25, 2009, the European Parliament and Council approved a body of laws aimed at promoting higher competition and improving internal market of electronic communication services, thus strengthening the mechanism of the European Community regarding regulating operators with significant influence on markets. The Commission participated in development of the draft law *Amendments to the Electronic Communications Law* aimed at improving legal regulation in the electronic communications sector, as well as making editorial clarifications of provisions and explanations laid down in the *Electronic Communications Law*. The draft law clarifies and improves terms used in the *Electronic Communications Law*, improves competence and rights of the Commission including cooperation with the Body of European Regulators for Electronic Communications (BEREC), specifies obligations of electronic communications enterprises, complements information and provisions to be included in the agreement of electronic communications services, specified procedure for defining the electronic communications service market and analysing the market, includes procedure for harmonizing in the European Commission, sets shorter periods for implementing the service of keeping number, improves monitoring of electronic communications service quality, complements the general service liabilities and includes new rules of personal data protection.

In the first half of 2011, the Commission has been developing amendments to the laws and regulations of the sector related to changes in the legal regulation of the European electronic communications sector, thus exercising the authorities set in the draft law *Amendments to the Electronic Communications Law*.

Railway

In the railway sector, VAS "Latvijas Dzelzceļš" ensures maintenance of the public railway infrastructure. Domestic passenger transportation is carried out by AS "Pasažieru vilciens" and SIA "Gulbenes – Alūksnes bānītis". In the sector of cargo transportation, there are also several operators, such as SIA "LDz Cargo", AS "Baltijas ekspresis", and AS "Baltijas tranzīta serviss". SIA "LDz Cargo" carries out also international passenger transportation.

On September 23, 2010, the amendments to the *Railway Law* entered into force, according to which the Commission no longer sets the fee for using the public railway infrastructure, but considers complaints on conformity of the fee for using the public railway infrastructure to the methodology, as well as complaints on the application of an increased fee for using the public railway infrastructure and allowances thereof. During the first half of the 2011, the Commission has been developing the *Procedure for Applying the Fee for Using the Public Railway Infrastructure* and the *Procedure for Payments of the Fee for Using the Public Railway Infrastructure*.

Water supply and sewerage, waste management and disposal

In accordance with amendments of June 11, 2009, to the *Law on Regulators of Public Utilities*, the Commission took over the regulatory functions in the sectors of heat supply, municipal waste management and water management from local government regulators or local government councils (boards) by November 1, 2009. A total of around 160 enterprises have been licensed in the water administration sector and 15 enterprises – in the waste disposal sector.

On October 28, 2010, the new *Waste Management Law* was adopted, which no longer envisages regulation of the municipal waste management services (except for disposal in dumps and landfill sites) in accordance with the *Law on Regulators of Public Utilities*. Therefore, the Commission performs regulatory functions only regarding municipal waste disposal in landfill sites and dumps.

On March 9, 2011, the Commission approved the new *Methodology for Calculating the Tariff of Municipal Waste Management Services*. Since adoption of the methodology, draft tariffs of one enterprise for waste management services have been submitted to and are now being considered by the Commission.

6.10. 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;
– support instruments;
– contractual security.

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*.

In 2011, Latvian exporters are offered a wide range of **direct export support services** – consultations about issues related to export, including foreign markets and specific trade requirements, were provided, seminars on export skills and informative seminars on foreign markets, as well as trade missions and individual business visits at potential cooperation partners abroad were organized. Work on identification and progress of export and investment projects is being carried out as well.

In 2011, the available state support has been expanded with funding of the EU Structural Funds. The Activity 2.3.1.1 *Access to international trade markets – External Marketing* is being implemented within the framework of the Measure *Support Activities for Entrepreneurship* of Operational Programme of the EU Structural Funds for 2008-2013 *Entrepreneurship and Innovations*. Within its framework merchants are offered extensive **support for implementation of external marketing measures** – participation in exhibitions, matchmakings, trade missions, organizing seminars and conferences.

The IDAL arranges **national stands** of Latvian enterprises in 11 international branch exhibitions abroad.

In order to improve competitiveness of Latvian merchants in export markets, **export credit guarantees** (see also Section 6.5) are granted for transactions with the deferred payment term not exceeding 2 years. Access to export credit guarantees allow enterprises to increase their total export volume (especially to countries with high risk degree), broaden export markets (CIS region, rapidly growing economies, etc.), as well as consolidate in the existing markets. 63 export credit guarantees had been issued by April 30, 2011, to 16 merchants for total amount of LVL 3.55 million. All enterprises with whom a contract has been concluded, represent the manufacturing (for example, production of communications equipment, production of household electric appliances, production of veneer plates and wood panels; production of soaps, detergents, and abstergents; production of foodstuffs).

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. The work of the representations is focused on accurate support according to the needs of companies. 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. In 2011, four new Foreign Economic Representative Offices of Latvia are planned to be opened in priority foreign markets for the entrepreneurs. Services of the Foreign Economic Representative Offices of Latvia and the IDAL are provided to the merchants according to the **one-stop shop** principle: when looking for business partners abroad, entrepreneurs can access a stable, fast, and capable support system: the merchant – the Investment and Development Agency of Latvia (IDAL) – the Representative Office.

In order to compete successfully in the market of investment attraction and to improve the progress of domestic and foreign investment projects which are important for the country, the Investment and Development Agency of Latvia has launched **implementation of the investment attraction methods *Polaris*,** which envisages unified and coordinated activity from ministries, municipalities, infrastructure companies, and public institutions for implementation of strategically important domestic and foreign investment projects, as well as involvement of the private sector, universities, and research institutions.

Harmonized interagency cooperation for successful implementation of investment projects is provided by the ***Coordination Council for Large and Strategically Important Investment Projects****, which was established in 2010, is managed by the Prime Minister,* and is composed of the Ministers for Economics, Traffic, Finance, Foreign Affairs, Environment, Agriculture, Regional Development and Local Government, Education and Science, as well as of external representatives and other experts from state and municipal institutions, infrastructure enterprises, and non-governmental organizations.

6.11. Consumer Rights Protection and Market Surveillance

The consumer rights protection system in Latvia is in a constant process of becoming stronger and developed in order to ensure efficient market surveillance and consumer rights protection.

Improvement of the Legal Framework

In order to introduce the norms of the *Directive 2008/122/EC* of the European Parliament and of the Council of 14 January 2009 on the protection of consumers in respect of certain aspects of timeshare, long-term holiday product, resale and exchange contracts into the laws and regulations of Latvia, the Cabinet of Ministers approved the *Regulations regarding contract on long-term rights to use holiday houses, long-term contract on holiday services, contract on long-term rights to use holiday houses or holiday services resale, and exchange contract of long-term rights to use holiday houses* on February 22, 2011. The regulations stipulate requirements and provide forms for different contracts related to obtaining long-term rights to use holiday houses – i.e., contracts concluded by a consumer (tourist) for a period exceeding one year on regular use of a holiday house (for example, the consumer undertakes to use one particular holiday house every year within the time period from July 1-31). Uniform provisions for conclusion of such contracts have been introduced in all EU Member States with an aim to increase consumer rights protection and ensure clear and understandable provisions for conclusion of such contracts in any EU Member State. At the same time, in all the EU Member States identical information to be provided to a consumer prior to conclusion of the contract, uniform requirements for advertising, information to be included in the contract, right of withdrawal, as well as uniform requirements to be applied to specific contracts were established.

On February 15, 2011, the Cabinet of Ministers approved the *Regulations on the Safety of Toys* containing norms arising from the *Directive 2009/48/EC* of the European Parliament and of the Council of 18 June 2009 on the safety of toys. The framework included in the regulations is aimed at increasing safety and health of consumers, especially children, by ensuring that only safe toys are offered in the market. The regulations also envisage improving and making the framework of safety requirements for toys more transparent by providing clear, separated obligations for producers, their authorized representatives, importers, and distributors, as well as at the improving market surveillance mechanism thus promoting cooperation among merchants, market surveillance institutions, and conformity assessment institutions.

To ensure more efficient consumer rights protection in the field of non-bank crediting, the Saeima at the end of 2010 approved amendments to the *Law on Taxes and Fees* and *Consumer Rights Protection Law*, thus providing a legal framework for the development of a non-bank creditor licensing system. In order to establish a more specified procedure for issuing, reregistering, terminating, and annulling a special permit (licence) to a capital company for rendering consumer crediting services and for paying a state fee for issuing and reregistering the special permit (licence), *Regulations regarding procedure for issuing, reregistering, terminating, and annulling a special permit (licence) for rendering consumer crediting services and paying a state fee for issuing and reregistering the special permit (licence), as well as requirements for capital company regarding obtaining the special permit (licence)* was approved by the Cabinet of Ministers on March 29, 2011.

On May 9, 2011, the Committee of the Cabinet of Ministers supported the *Draft Concept to Improve Procedure for Settlement of Consumer Disputes and Complaint Consideration*. The concept is developed taking into account the existing issues in settlement of individual consumer disputes with producer of goods, vendor, or service provider and consideration of consumer complaints, the increasing number of consumer complaints, as well as taking into account the decrease of state budget for consumer rights supervision. The duty of Latvia is to provide the consumers with an alternative opportunity to settle out-of-court disputes, and such duty arises also out of obligations of Latvia as a Member State of the European Union. The main issues identified in this field are long and inefficient proceedings, issues related to expert opinions (quality and impartiality, examination costs), civil disputes are solved within the framework of administrative process, besides, the current system fails to foster negotiations between parties, but the parties wait for an administrative decision of an institution, as well as normative acts do not establish clear scope of competence of the Consumer Rights Protection Centre (CRPC), etc. In order to ensure efficient settlement of consumer disputes and complaints consideration, the Committee of the Cabinet of Ministers supported implementation of a version of the draft concept envisaging establishment of a Committee for Consumer Complaint Consideration in addition to consumer consulting and assistance which makes a decision after considering an individual consumer dispute. It is envisaged that the committee is going to be a collegial decision-making authority which involves representatives of consumer non-governmental organizations and entrepreneur associations having a right to vote in the decision-making process. Drawing from the experience of other countries, such alternative dispute settlement mechanism works well, and it has a high satisfaction level (such out-of court consumer dispute settlement model exists, for example, in Finland, Denmark, and Estonia). Implementation of the concept is expected to be launched in 2013.

In order to ensure fair practice in out-of-court debt recovery process, development of the *Draft Law* *on Debt Collection* is launched. The draft law envisages dealing with the most important issues faced by consumers in out-of-court debt collection process, i.e., an excessive charge for a debt collection service (for example, cost estimation for recovering a debt of LVL 30 amounts to LVL 3), use of aggressive out-of-court debt collection methods such as threats, visiting at work, visiting consumer at home late at night, failure to provide complete and true information on the amount of the debt to be collected and components constituting the debt, etc.

During the first half of 2011, discussions continued about the *Proposal for a Directive of the European Parliament and of the Council on consumer rights*, published by the European Commission on October 30, 2008. The proposal was prepared after a revision of consumer *acquis,* which was commenced in 2004. Originally, it was planned that the draft directive integrating four valid directives in the field of consumer rights protection, will regulate the aspects of consumers' contractual rights with respect to contracts on purchase of goods and service rendering concerning purchases in shops, distance marketing agreements and agreements concluded outside of company premises. The draft directive envisaged establishment of single definitions, uniform requirements concerning information to be provided to the consumer prior to the conclusion of a contract, the information to be included in the contract, the rights to withdraw, as well as the regulation of sellers' liability for goods incompliant with the agreement, and to envisage a new regulation on unfair agreement provisions. However, since there were severe contradictions between the opinions of the Member States regarding the definition of a maximum harmonization principle in the draft directive, according to which the Member States would be prohibited to introduce new or stricter requirements for consumer rights protection regarding issues harmonized in the draft directive, as well as the European Parliament objected to it, the draft was substantially changed by deleting the chapter on seller's liability for goods which do not comply with agreement provisions and the chapter on unfair contract provisions, thus establishing regulations mainly for distance agreements and agreements concluded outside of company premises. Discussions about the draft directive in the Council of Ministers and the European Parliament will be continued also in the second half of 2011.

Supervision of Consumer Rights

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, whose operation is aimed at ensuring protection of consumer rights and interests. In order to ensure implementation of the institution's functions, the CRPC implements activities for 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 consumer 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.

In the 1st quarter of 2011, the CRPC, within the framework of its operation, has rendered 9573 consultations to consumers and legal entities. When requesting a consultation, consumers most often have been interested in issues related to their rights if they have purchased a product or received a service that fails to comply with contract provisions, as well as regarding failure to observe the principle of legal equality of the contracting parties.

In the 1st quarter of 2011, the CRPC has received 647 **consumer complaints and applications**. In comparison with the corresponding period of 2010, a decrease of 13% is observed in the number of submitted complaints. Most often consumers have filed complaints concerning services incompliant with contract provisions, purchased goods incompliant with contract provisions, and regarding failure to observe the principle of legal equality of the contracting parties. Out of all received complaints, the majority has been about footwear, electric goods, and mobile phones. In the field of services, the majority of complaints have been about aviation, electronic communications, rent, and public utilities services. The recession of national economy has had a significant impact exactly on the financial capacity of consumers; issues regarding consumer crediting are still topical. Also in 2011, the majority of complaints about failure to observe the principle of legal equality have been received regarding contracts on consumer crediting and action of creditors. The dynamics of filed complaint content have not significantly changed over the past few years.

CRPC **for supervision of consumer rights** in 2011 has set such priority areas as protection of collective interests of consumers, supervision of consumer crediting contracts, supervision of electronic communication service contracts, supervision of security guarantees issued by complex tourism service providers to consumers, as well as considering amendments to the legal framework, launch licensing of creditors non-compliant with the status of a credit institution.

In the field of protection of collective interests of consumers and contract supervision, implementation of the project *Supervision of Contract Provisions and Commercial practice / Advertisement in the Field of Electronic Services* was launched at the beginning of 2011, and within the framework of the project, contract provisions of 10 largest electronic service providers are currently being evaluated and/or draft contracts are being harmonized, as well as commercial practice is being evaluated in the field of electronic communication services (Internet, television, telephony, mobile communication and other services). Within the framework of the field mentioned above, implementation of the project *Supervision of Contract Provisions and Security Guaranty of Money Paid by a Client in the Field of Complex Tourism Services* is launched by inspections at places, where tourism services are rendered.

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 support of the European Commission. In the context of cross-border, consumers most often have turned to the ECC Latvia about issues related to air services that constitute about 35% of the total number of received complaints and rendered consultations, as well as questions about goods or services purchased remotely (ordering over Internet or choosing from a catalogue).

In 2011, the CRPC in the field of **market surveillance** has identified such priority directions as safety of toys and children products, safety level of playgrounds, safety and conformity to the set provisions for vehicles, electric goods, personal protective equipments, conformity of transportable pressure equipment and construction products to the set requirements, surveillance of dangerous equipment at the place of its use (control of ropeways (lifts) intended for skiers).

The following surveillance projects have been launched and implemented in the 1st quarter of 2011:

– *market surveillance of transportable pressure equipment*;
– *market surveillance of LED (light emitting diodes) modules and products*;
– *market surveillance of toys – children's books and board games*;
– *surveillance of children's products;*
– *surveillance of ropeways (ski lifts) intended for skiers.*

The surveillance project of ropeways (ski lifts) intended for skiers implemented by the CRPC, as well as the CRPC activities regarding market surveillance of toys – children's books and board games have received wide public response and interest of entrepreneurs regarding their liability.

In the field of **state metrological supervision,** the CRPC has carried out inspections for evaluating conformity of measurement equipments to the normative requirements at the place of use in the 1st quarter of 2011. 1017 measurement equipments (including non-automatic scales at trading enterprises, fuel filling equipment) were subjected to metrological monitoring in 100 manufacturing, trading, and service rendering enterprises. So far the control measures of pre-packed goods included in the CRPC action plan have been implemented by carrying out control of pre-packed goods content amount and conformity of labeling intended for distribution at manufacturing and wholesale enterprises, including such priority groups of goods as juices and other non-alcoholic beverages.

6.12. Quality Assurance

6.12.1. Quality Structural Policy

The main task in the field of quality assurance is to promote adequate application and observance of requirements of the 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 system in Latvia is regulated by the *Law on Conformity Assessment*, *the Standardization Law*, and *the Law on Uniformity of Measurements*, as well as by related regulations of the Cabinet of Ministers deriving from the above laws.

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 accordance with the needs of the Latvian national economy, in order to protect the consumers and environment from low-quality products and services and to promote growth 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 protect the society from inaccurately performed measurements;
– encouraging introduction of environmental quality management and other voluntary quality

systems in enterprises in order to ensure manufacturing of high-quality production, service rendering, and competitiveness of Latvian merchants in international markets;
- promotion of effective 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.

6.12.2. Accreditation, Standardization, Metrology

Since July 1, 2009, 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 SIA "Standardization, Accreditation, and Metrology Centre" as the national standardization organization in compliance with the *Standardization Law* manages and coordinates activities of Latvian merchants and organizations in the field of standardization.

The main functions of LVS are to set up a fund of Latvian standards and to issue Latvian standards in cooperation with international and European organizations of standardization.

Since 2004, LVS is a full-fledged member of the European Committee for Standardization (CEN) and of the European Committee for Electrotechnical Standardization (CENELEC). LVS is also a corresponding member of the International Organization for Standardization (ISO) and an associate member of the International Electrotechnical Commission (IEC).

In accordance with the approved plans, the priority directions of the activity by LVS in 2011 is distribution of standardization information, updating and maintaining the totality of Latvian standards, improvement of the electronic sales system of standards, and cooperation with international, European, and national standardization organizations.

Until May 1, 2011, 33 920 standardization documents have been registered in the LVS, including 28 382 European standards adapted to the status of a Latvian standard. In 4 months of 2011, 50 standardization technical committees and 4 working groups coordinated by the LVS have adapted 465 European standards, and 7 mandatory applicable standards have been translated into Latvian. Standardization information services have been provided to 1274 legal and physical persons

Continuing the improvement of the electronic sales system of standards, more than 40.5% 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 Status and Cancelled Latvian Standards* in fields that interest 540 regular clients.

The LVS participates in development cooperation projects coordinated by the Ministry of Economics.

Within the framework of the Economic Cooperation Programme between Latvia and Ukraine which envisages continuing cooperation in the field of standardization, a bilateral agreement for 2011-2012 between the State Service of Ukraine for Technical Regulations and the Standardization Bureau (LVS) of SIA "Standardization, Accreditation, and Metrology Centre" defining and implementing the priority directions and forms of the cooperation has been prepared for signing.

SIA "Standardization, Accreditation, and Metrology Centre" has signed a cooperation agreement with the International Organization for Standardization (ISO) on holding a conference *Social Responsibility* in Riga, Latvia. The conference is intended to getting acquainted with and implementing the ISO 26000:2010 *Guidance on Social Responsibility*.

The LVS continues development of the technical infrastructure to provide easy access to the standardization information for merchants. The LVS actively participates in informative seminars to explain and raise awareness of standardization process, standards, and their impact on entrepreneurship. An informative brochure has been prepared for entrepreneurs about the benefits from applying standards and their relation to legislation.

A cooperation agreement on exchange of information has been concluded with the official newspaper *Latvijas Vēstnesis*. 21 regulations of the Cabinet of Ministers containing direct or indirect references to the standards and 6 lists of standards to be applied have been entered into the section "Standards in legislation" of the LVS website.

A place for viewing the Latvian standards has been established at the library of Riga Technical University for the benefit of students. One copy of the e-volume *Library Standards* has been delivered to the Faculty of Social Sciences of the University of Latvia.

Pursuant to the approved plans for the future activity of LVS, the priority directions of LVS activity in 2011 are the following:

- supplementation and update of the fund of Latvian standards;

- improving of the LVS's information technologies for better client service quality and information development;
- improving the system of electronic sales of standards;
- cooperation with entrepreneur associations and certification institutions in distributing information and organizing seminars and training;
- cooperation with international, European, and national standardization organizations.

Accreditation

The Latvian National Accreditation Bureau (LNAB), which is a structural unit of SIA "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.

According to the *Law on Conformity Assessment*, the main functions of LNAB are:

- to evaluate, accredit, and supervise the testing and calibration laboratories and certification and inspection institutions for conformity to the requirements prescribed in the laws and regulations and Latvian national, EU, or international standards;
- to organize examinations of skills and coordinate inter-laboratory comparative testing in compliance with the international requirements;
- to represent Latvia in international accreditation organizations;
- to maintain and update the informative base of accredited institutions.

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. At the moment, the status of accreditation is maintained for 211 accredited institutions. New accreditation has been awarded to laboratories in the field of veterinary medicine and medicine. The conformity of one institution is maintained in compliance with the *Principles of Good Laboratory Practice*. LNAB continues to provide accreditation services in Ukraine, where one institution for personnel certification has been accredited.

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, 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. Additionally, cooperation with the accreditation institution of Georgia has been launched by assisting in fulfillment 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. Also training seminars for conformity evaluation institutions are organized.

Metrology

Since July 1, 2009, the Metrology Bureau of SIA "Standardization, Accreditation and Metrology Centre" (LATMB) is the national metrology institution of Latvia and its aim of activity is to ensure and develop credibility and traceability of measurements in the country. The Metrology Bureau fulfils assignments in the field of metrology stipulated in the *Law on Uniformity of Measurements*.

The National measurement standards are calibrated and standard maintaining procedures of the standards are fulfilled according to the LATMB schedule in the national metrology institutes of the European Union (NMI). Calibration of the standard load of 500 kg mass was carried out in the Czech NMI. Having calibrated the standard load, the LATMB carried out post-calibration works, stability and drift control of the calibration results and updating of uncertainty budget. Preparation works for calibration of the standard load of 10 kg mass in Danish NMI has been launched. Stability analysis and drift assessment of national electric measurements and length standards were carried out over a period of the calibration. 5 reliability validation procedures for calibration results have been fulfilled in the field of CMC (Calibration and Measurement Capabilities).

In the first half of 2011, the conformity of measurement equipment types was evaluated, and 9 of them were certified, as well as conformity of measurement equipment types was re-evaluated, and certification was prolonged for 8 types. The list of the approved measurement equipment types is regularly updated on the LATMB website. The list of the standards to be applied to technical and metrological requirements for vehicle speed control systems has been developed and prepared for publishing.

11 consultations on regulated metrology issues have been provided, among them 3 to foreign enterprises. German enterprise *BARTEC Benke GmbH* received explanations regarding implementation of requirements in Latvia set in the *Directive 2004/22/EC*.

The annual quality management system report of the LATMB has been prepared and submitted for evaluating to the Technical Committee for Quality

(TC-Q) of the European Association of National Metrology Institutes (EURAMET). All 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 2011, the LATMB continues cooperation with the EURAMET, as well as the International Organization of Legal Metrology (OIML) and the European Cooperation in Legal Metrology (WELMEC). The LATMB has analyzed the materials and proposals on new terms and definitions considered therein of the EURAMET conference of April, 2011, on the International Mutual Recognition Arrangement (CIPM MRA). The LATMB personnel have became acquainted with the activity of the WELMEC 27th Commission, decisions made in the meeting of May, 2011, and with the supplements to the documents discussed during the meeting.

Cooperation with metrology institutions of Lithuania – the national metrology institution (NMI) VMT and the Institute of Metrology of Kaunas University of Technology – has been expanded. Issues of regulated metrology in fields of approval of measurement equipment types, applying harmonized standards, and development of measurement equipment testing programmes were discussed during the business visits.

Cooperation with Latvian metrology institutions still continues. 59 reference standards, as well as 3 mass comparators of SIA "National Metrology Bureau of Latvia" have been calibrated.

6.13. 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 Latvian national economy development and to narrow the activity performed by the state and local governments as entrepreneurs.

As the goal of mass privatization in Latvia is 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 6.22).

Box 6.22

Law on the Completion of Privatization of State and Local Government Property and Use of Privatization Certificates

The *Law on the Completion of Privatization* prescribes:

- the deadline, 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 to perform public administration functions or commercial activity of the state or local government;
- that the Cabinet of Ministers or a local government could adopt decisions regarding the bringing a state or local government property to privatization by December 30, 2010;
- 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 conclusion of the land redemption contract has to be submitted to the State Land Service (September 1, 2008), as well as for the application for decision with respect to the allocation of the property for payment has to be submitted (August 31, 2010) and that the land purchase agreement has to be concluded by December 30, 2010;
- 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 persons could submit an application for granting of privatization certificates 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 establish publicly available registers of privatization proposals and land property buy-outs.

Privatization of state property and land

Privatization of state property or land is carried out and privatization proposals are summed up by the state joint stock company Latvian 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 land that has not been built on 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 Latvian 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 April 1, 2011, 628 proposals for privatization of real estate, 57 proposals for privatization of state capital shares and 4338 proposals for privatization or privatization continuation of land have been registered in the Register of Privatization Proposals of the Latvian 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 according to the competence were transferred to the Latvian Privatization Agency. 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 October 1, 2010, the privatization provisions in the statutory procedure have been approved for 2471 state property objects (excluding land). 94 companies were transformed to public joint stock companies, thus releasing 439.14 million shares into public circulation. During this period, the income obtained from privatization of the state property objects (excluding land and selling of shares and alienation of capital shares emerged as a result of capitalization of debts) amounted to LVL 1.662 billion, of which LVL 396.538 million was in cash and LVL 1.266 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 187.41 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 Latvian Privatization Agency carries out privatization of state-owned land since 1997. By April 1, 2011, 4979 state land lots were privatized (purchase agreements signed). The total sales price for the privatized state land constitutes LVL 198.85 million, of which LVL 95.84 million was in cash and LVL 103.01 million in property compensation certificates. On April 1, 2011, income from privatization of these land lots amounted to LVL 182.40 million, of which LVL 86.4 million was in cash and LVL 96 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 council of the municipality (city). 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, district).

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 June 1, 2011, the Ministry of Economics has reviewed and accepted for information 3285 privatization projects for the total estimated price of LVL 158.8 million (*inter alia* payments in certificates for the nominal value of LVL 58.1 million).

From January 1, 1997 until April 1, 2011, the Ministry of Economics has reviewed and accepted privatization provisions in respect to 1671 building land lots and local government land lots that have not been built on (separate announcements of privatization of building land lots as from September 1, 2005) with 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 Article 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 land that has not been built on to the Ministry of Economics is voluntary and is not imposed by the law.

According to Article 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 land that has not been built on, 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 houses

Privatization of residential houses 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 – the

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 Privatisation of State and Local Government Residential Houses*.

By June 1, 2011, 571 residential buildings with 1154 non-privatized state apartment properties and 467 non-privatized parts of residential buildings managed by apartment owners with 1062 non-privatized state apartment properties have been handed over to the possession of the Latvian Privatization Agency.

The privatization process of the state residential houses – by June 1, 2011, decisions on bringing 5105 residential houses to the privatization have been made. The Board of the Latvian Privatization Agency has to make a decision on bringing to privatization another 99 state residential houses being in possession of the Agency. By June 1, 2011, privatization announcements have been sent to 50 116 state apartment tenants. 44 246 state apartments have been privatized by June 1, 2011, and 18 apartments have been privatized in 2011.

The privatization process of local government residential houses – data on the privatization process of local government residential houses 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.

By June 1, 2011, 3861 state residential houses were transferred to the **possession of apartment owners**.

12 state residential houses have been transferred to the possession of apartment owners in 2011.

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 are being carried out with regard to the rural and urban land reform being implemented in the country.

In cities, allocation of land for the use to residential building owners or orchard users, who have received the land for setting up an orchard with building rights, has been completed. The urban land commissions have reviewed opinions concerning the rights to acquire ownership of land for payment and have completed their entry in the Urban Land Redemption Register. By 2010, the decision-making process regarding land property allocation for payment was completed. Regarding urban lands, decision-making is still in progress concerning termination of rights to use land and conclusion of land rent agreements with persons, who had submitted a land boundary plan or confirmation of pre-payment for entry in the *Cadastre information system* by September 1, 2008, but had not submitted the registered land boundary plan along with an application for the decision on allocating land property for payments by August 31, 2009, or had not concluded a land redemption (purchase) agreement with the state joint stock company "Latvijas Hipotēku un zemes banka" (Mortgage and Land Bank of Latvia) by December 30, 2010.

Amendments to the Law on Completion of State and Local Government Property Privatization and Use of Privatization Certificates came into force on June 1, 2011, envisaging that those redeemers of rural and urban lands who have not managed to conclude a land redemption (purchase) agreement with the Mortgage and Land Bank of Latvia will be able to do that until December 30, 2011.

Before the abovementioned amendments, the *Law on Completion of Privatization* stipulated that those owners of residential buildings and orchard users in towns who had submitted a land boundary plan with an application for decision making regarding allocation of land property for payment and had received the decision by August 31, 2009, had to conclude the land redemption (purchase) agreement with the Mortgage and Land Bank of Latvia by December 30, 2010. In accordance with the Regulations of the Cabinet of Ministers of August 25, 2008, *Procedure on the Conclusion of Land Redemption (Purchase) Agreement* the Mortgage and Land Bank of Latvia by December 30, 2009, has concluded 72 969 agreements.

Currently, the abovementioned amendments to the *Law on Completion of Privatization* envisage that those owners of residential buildings and orchard users in towns, who had submitted a land boundary plan with an application for decision making regarding allocation of land property for payment and had received the decision by August 31, 2009, can conclude a land redemption (purchase) agreement with the Mortgage and Land Bank of Latvia until December 30, 2011.

According to the amendments to the *Law on Completion of Privatization*, city land commissions as of June 1, 2011 will resume the decision-making process regarding allocation of land for payments to the users of urban land – to owners of residential buildings and orchard users, who had submitted a confirmation of pre-payment by September 1, 2008, and had carried out the cadastral survey by August 31, 2009, but had not submitted an application and relevant documents for the decision for allocating land property for payments or had received a refusal on redeeming (purchasing) the land.

Allocation of land for use has been completed in rural areas, however, the decision-making process is still in progress regarding the termination of rights to use land and conclusion of land rent agreements with persons, who had made pre-payment by September 1, 2008, but had not submitted a land boundary plan for the entry in the *Cadastre information system* and application for allocation of land property for a payment for use to the respective regional office of the State Land Service by August 31, 2010, or had not concluded land redemption (purchase) agreement with the Mortgage and Land Bank of Latvia by December 30, 2010.

By December 30, 2010, about 6530 persons have failed to pay for the land and to conclude an agreement with the Mortgage and Land Bank of Latvia on 9860 land units requested for redemption in the rural areas, however, almost 670 persons having made the pre-payment have failed to submit the application for a decision on allocation of the cadastral-surveyed land to the State Land Service.

According to the amendments to the *Law on Completion of Privatization,* persons may submit the application for allocation of land in rural areas for payment to the State Land Service from June 1, 2011, until August 31, 2011, on a condition that privatization certificates have been transferred by September 1, 2008, and a land boundary plan of the requested land has been submitted for the entry in the *Cadastre information system* by August 31, 2010. Therefore, allocation of land in rural areas for payment, as well as conclusion of redemption (purchase) agreements with the Mortgage and Land Bank of Latvia will be resumed as of June 1, 2011.

All the land purchasers, who have received the decision of allocation of land for use by the day of entering into force of the amendments to the *Law on Completion of Privatization*, will be entitled to conclude the redemption agreement with the Mortgage and Land Bank of Latvia until December 30, 2011.

In case a land redemption (purchase) agreement with the Mortgage and Land Bank of Latvia is not concluded before the extended deadline set in the *Law on Completion of Privatization* – until December 30, 2011, both urban and rural land purchaser loses the opportunity to redeem the land at its cadastral value, as well as loses the pre-payment already made with privatization certificates before the cadastral survey.

With the abovementioned amendments the term was prolonged until March 31, 2012, by which the Mortgage and Land Bank of Latvia will provide the State Land Service and corresponding city municipalities with the information on the concluded land redemption (purchase) agreements.

The Article 16(1) of the *Law On Completion of Land Reform in Rural Areas* envisaged that the former land owners or their heirs, as well as former land owners who before July 21, 1940 had started to redeem real estate from the General Agriculture Bank or State Land Bank left in Latvia by German emigrants or their heirs whose ownership rights to the land have not been restored or the compensation certificates have not been granted, would have an opportunity to claim for 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.

On December 20, 2008, the Regulation of the Cabinet of Ministers *Procedure on Reviewing Requests Submitted to the Central Land Commission* came into force. It envisages the procedure of restoring land ownership rights to land allocated for completion of the land reform to the former land owners or their heirs.

Before starting the process of restoring land ownership rights, the State Land Service (SLS) in cooperation with the local governments examine 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 performance of the mentioned 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.

14% of all claimers for land allocated for completion of land reform are constituted by 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%.

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 who is 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.

In 2010, the process to restore ownership rights to the first priority claimers was commenced. 56 claimers selected land units at their local government and regional level, and the SLS local government and regional level commissions for completion of the land reform prepared the required documents for them and submitted to the CLC for making a decision on ownership restoration.

Due to the amendments to the laws and regulations, the first priority claimers since July 1, 2010 obtained the rights to select inheritable land anywhere in Latvia. Therefore, since August 2010, the state level commission for completion of the land reform established by the SLS has examined claims of the 90 first priority claimers, preparing the required documents and submitting them to the CLC for making a decision on ownership restoration. 90 claimers in total have selected 509 land units across Latvia, while 4 claimers refused selection of the land units. The largest number of land units was selected in Rīga district – 56, Jelgava district – 49, and Liepāja district – 48. The smallest number of land units was selected in Preiļi district – only 1 land unit.

If the number of persons in the priority group exceeds the number of available land units, the State Land Service commission for completion of the land reform organizes an auction in accordance with the Regulations of the Cabinet of Ministers of December 20, 2008, *Procedure for Reviewing Requirements Submitted to the Central Land Commission*.

As the number of persons expressing the wish to acquire a land in the territory of former Rīga district exceeded the number of available land units, the state level commission for completion of the land reform organized an auction of land units.

After the auction, the SLS commission for completion of the land reform sends the auction minutes and land boundary scheme signed by the claimer to the CLC for preparing a statement and sending it to the claimers for continuing the processing of ownership rights.

The largest number of claimers was in the territory of Rīga district – approximately 10 claimers per 1 land unit, but 17 claimers have applied for 1 particular land unit in Carnikava municipality. There were 2 to 3 claimers on average per one selected land unit in the rest of the territory of Latvia.

The examination of proposals of all first priority claimers in the local government and regional level, as well as in the state level commissions for completion of the land reform is completed in January 2011.

As of April 2011, the preparation of lists of land units allocated for completion of the land reform and forwarding these lists to the second and third priority claimers for selecting the respective land units has been launched at the local government or regional level. In case there is not sufficient area for compensating the inheritable land at regional level for claimers, they will be offered an opportunity to select land units at the state level anywhere in Latvia. According to the *Law on Completion of Land Reform in Rural Areas*, the CLC must complete the restoration of ownership rights by December 30, 2012.

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 Privatisation Certificates*. By April 1, 2011, the total amount of 104.4 million privatization certificates have been issued to 2.45 million people for the time they have lived in Latvia, including 794.7 thousand privatization certificates granted to 41.4 thousand politically repressed persons. 8.01 million property compensation certificates have been issued to 117.2 thousand former owners or their heirs, including 691.7 thousand certificates for property alienated for the state needs at the privatized specialized state agricultural enterprises, 4896.4 thousand for land in rural areas, 969.3 thousand for house ownership, 814.4 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.

No property compensation certificates have been issued to former owners or their heirs in the 1st quarter of 2011.

As from December 1, 2007, in accordance with the Article 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 6.4

Use of Privatization Certificates

(until April 1, 2011)

Type of property	Amount	Number of privatization certificates (million)	including property compensation certificates (thousand)
Residential buildings	446 thousand apartment privatization units	38.0	589.8
Enterprises and other properties	no exact data	7.3	109.6
Capital shares (stocks)	no exact data	44.5	954.0
including:			
in public offering	128.7 million shares	37.1	820.0
Land	316.8 thousand land lots	17.1	5149.2
Total:		**106.8**	**6802.6**
% of total certificates issued		94.9%	84.9%

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 April 1, 2011. Compensations in the total amount of LVL 17.5 million have been paid to 8411 persons, thus cancelling 0.6 million property compensation certificates.

Cash compensations in the total amount of LVL 4.7 million were paid to 26.2 thousand politically repressed persons by April 1, 2011, thus cancelling privatization certificates. According to the provisions set in the Article 27 of the *Law on Completion of Privatization,* 3.2 thousand persons have lost their rights to cancel 15 thousand certificates.

By April 1, 2011, 106.8 million privatization certificates or 94.9% of the total number of issued certificates have been used for privatization of state and local government property (see Table 6.7). From April 1, 2008 until April 1, 2011, instead of 348.8 thousand property compensation certificates 453.3 thousand privatization certificates have been used.

On April 1, 2011, 2.2 million privatization certificates or 1.9% of the total number of granted certificates, including 0.13 million property compensation certificates were stored on the accounts of 386 thousand natural persons.

On April 1, 2011, 0.97 million privatization certificates or 0.9% of the total number of granted certificates, including 0.006 million property compensation certificates were stored on the accounts of legal entities.

In April 2011, holders of privatization certificates could use services of 12 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 in the 1st quarter of 2011, varied from 8.6 thousand privatization certificates in February to 20.4 thousand privatization certificates in March and from 0.16 thousand property compensation certificates in February to 1.1 thousand property compensation certificates in April.

6.14. National Economy Council

The National Economy Council of the Ministry of Economics (NEC) is an advisory institution established by its 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 accordance 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 Bylaw No 1-11-3* of April 7, 2010.

In order to represent the interests of sectors professionally, as well as to improve cooperation between the Ministry of Economics and other state institutions, the NEC invites Sectoral Associations, representing entrepreneurs of the respective sector and their interests, as well as independent experts – economists, representatives of education and science.

The objective of the NEC activity is to promote development and implementation of policy of favorable business environment in Latvia, as well as 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 preventing entrepreneurship and to perform all necessary activities to eliminate them, to participate in developing of the laws and regulations and policy programming documents that promote commercial activity, and to promote innovations and external trade.

The 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. The NEC prepares proposals and adopts recommending decisions on these issues. The NEC carries out a dialogue between the entrepreneurs and the Ministry of Economics, as well as other state institutions and public organizations.

The decisions adopted by the NEC are of recommending nature.

Box 6.23

The NEC personnel and work organization

Based on the decision of the Managing Committee, the NEC personnel is approved by the Minister for Economics.

The NEC Managing Committee is a consulting and coordinating institution that takes part in settlement of business policy related issues and is responsible for assessment and approval of issues of the agenda of the NEC meetings and action plan of the NEC, as well as for ensuring and improving efficiency of the NEC activity.

The personnel of the Managing Committee are approved by the Minister for Economics. The Managing Committee is composed of five representatives of the NEC founders at the same time being the NEC members:

- representative from the Ministry of Economics;
- representative from the Free Trade Union Confederation of Latvia;
- representative from the Employers' Confederation of Latvia;
- representative from the Latvian Association of Local and Regional Governments;
- representative from the Latvian Chamber of Commerce and Industry.

The NEC consists of 26 NEC experts designated by the NEC Managing Committee, among them the Minister for Economics, the NEC Chairman, and representatives from Latvian entrepreneur organizations, public institutions, and other organizations.

A representative from the Foreign Investors Council in Latvia participates in the NEC meetings as an observer.

Decisions on changes or additions to the composition of the NEC are made by the NEC founders in the meetings of the NEC Managing Committee.

The NEC is managed by the Chairman elected by the members of the NEC Managing Committee from among its members in a rotation sequence for a term of office of one year.

The NEC meetings are held on average once 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 the NEC meetings, recommending decisions of the NEC are made by the NEC Managing Committee.

The NEC cooperates with the Cabinet of Ministers, ministries, and other state institutions to achieve inclusion of the proposals suggested by the NEC necessary for improving the business environment into the laws and regulations prepared by the responsible institutions.

On May 21, 2009, the NEC, the Ministry of Economics, and the Ministry of Finance signed a cooperation memorandum on *Growth, Competitiveness, and Employment*. The cooperation memorandum is aimed at cooperation and harmonized action of the NEC, the Ministry of Economics, and the Ministry of Finance to promote economic growth, employment, and competitiveness of Latvia.

In order to represent professionally the interests of economic sectors in an effective dialogue with the Ministry of Economics, the NEC, and other business organizations and state institutions, the Ministry of Economics has set up a model for cooperation with the national economy sectors.

Box 6.24

The NEC on priorities of economic policy

The NEC believes that in order to maintain stable macro-economic environment and promote competition in Latvia a balanced budget must be formed; 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 risk sectors where violations of the competition rights are possible, by limiting administrative and other barriers to the competition.

The 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.

Also the normative acts must be assessed, already during their drafting process, in order to identify and prevent possible violations of the competition rights, technical barriers to trade, and discriminating conditions within the sector of free movement of goods and services and business rights. The state support and procurement monitoring must be improved thus achieving 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 facilitating co-operation of education, research, and national economy sectors by ensuring transfer of knowledge and technologies must be elaborated and implemented.

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.

The NEC reviews proposals for the improving legislation submitted by the institutions-associations representing the entrepreneurs. Sectoral Associations evaluate draft legislation and give opinions on them. The Ministry of Economics informs the drafters of the laws and regulations about proposals for improving of legislation submitted to the NEC.

At the moment, 14 Sectoral Associations are represented in the 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, foodstuff, publishing.

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 on improvement of economic development and business environment adopted within the framework of the declaration by the government, and that Sectoral Associations will assess and give an opinion on draft legislation elaborated by the ministries.

In the first half of 2011, 5 National Economy Council meetings have been held, in which the following main issues have been considered:

- establishment of a single EU patent system;
- proposals included in the *Action Plan to Improve the Business Environment* for 2011;
- implementing activities of the *Action Plan of Combating Shadow Economy and Ensuring Fair Competition*;
- establishing development financial institution;
- *the National Reform Programme of Latvia*;
- *the National Reform Programme of Latvia*. Section 2.5 *Improvement of Business Environment;*
- *Guidelines on Cohesion Policy for Programming Period 2014-2020*;
- Public management of enterprises;
- *Informative Report on Medium-term Forecasts of Labour Demand and Supply*.

7. Recommendations

Economic growth in Latvia has resumed. Improvement of the economic situation mainly depends on the increase in export volumes and growth of tradable sectors that partially allow compensating the still weak domestic demand and developing domestic market-oriented service sectors.

Although the economic disproportions, which developed in the years of rapid growth, have been reduced during the crisis, nevertheless, due to the remaining budget imbalance of public and private sectors (households and enterprises), the so called process of balance sheet effect still continues, int. al., debt restructurization.

The risk to injure economy due to the external shocks is still preserved. It is connected to deep integration of Latvia into global financial markets, which still haven't recovered their stability.

A risk to the financial stability of the public sector is deterioration of the demographic situation, as according to forecasts, the number of Latvian working age population will continue decreasing.

In order to stabilize the financial position of private and public sector, it is necessary to increase economic competitiveness which is an important pre-condition for ensuring sustainable economic growth.

Taking into account the abovementioned, in our opinion, the immediate tasks of the economic policy are as follows:

- **for securing macroeconomic stability:**
  - to ensure strict fiscal discipline according to the determined budget deficit reduction schedule in the *Latvia's Economic Stabilisation and Growth Revival Programme*;
  - to implement activities in order to reduce inflation, so that Latvia could join the euro area on January 1, 2014;
  - to reduce shadow economy by creating favourable conditions for transition to official economy and by supporting honest entrepreneurs; to continue transforming SRS into an institution that supports entrepreneurs;
  - to ensure development of sustainable countercyclical fiscal policy, by strengthening national legal framework and medium-term budget planning, as well as by stipulating clear conditions for defining fiscal objectives;
  - to ensure sustainability of public finance, including raise of the retirement age;

- **for improving business environment and ensuring competitiveness :**
  - 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 decreased;
  - to promote development of e-government and e-services. The establishment of the state mega-system ("the list of registers") must be completed, functionality of the e-signature must be expanded, and the usage of electronic procurements must be facilitated;
  - to ensure introduction of the one-stop agency principle in respect to availability of the state and local government services;
  - to invent completely functioning electronic registration of enterprises and thus to reduce the time for registration process
  - to implement new regulation for the construction process, envisaging reduced number of state and municipal institutions involved in the harmonization of construction designs and reduced maximum period of harmonization. To implement a construction information system;
  - to invent one-stop shop agency principle for real estate data registration, by providing data Exchange between State Real Estate Cadastre Information System and State Unified Computerized Land Register;
  - to improve mutual coordination of indicators and terms to be entered in state registers and other information systems in order to prevent repeated request of information from respondents, thus decreasing the administrative burden in entrepreneurship;
  - to turn against the most serious breaches of Competition Law - prohibited agreements and abuse of dominant position. According to above mentioned violations, particularly to the identification of cartels, it is important to take direct preventive action; thus situation analysis and controls of activities implemented in the markets, where the increased risk of breach of the prohibition of agreements exist, must be set as a priority;

- **for improving protection and supervision of consumer rights:**
  - to introduce a licensing system of non-bank lenders ensuring stricter supervision for them;
  - to strengthen consumer protection in the field of financial services by introducing recommendations laid down in the World Bank's *Research on Consumer Protection and Financial Possibilities in Latvia*;
  - to develop conceptually new regulations for arranging the sphere of out-of-court debt recovery;

- **for promoting investment, business start-ups, and access to finances:**
  - to promote access to finances for enterprises, by implementing new financial instruments state support programmes of venture capital and mezzanine instruments to support the merchants capital base;
  - to pay more attention to the allocation of financing for the development of entrepreneurship at an early stage (measures for the access to the pre-seed and seed capital, opportunities to receive loans with preferential terms);
  - to address foreign enterprises more actively and to inform them about advantages of Latvia to attract export-oriented foreign direct investments to Latvia;
  - by evaluating foreign experience, enlarge development of state support instruments in the promotion of private investments;
  - to promote unified and coordinated action between ministries, local governments, infrastructure enterprises, and public institutions with regard to implementation of strategically important investment projects by involving the private sector, universities, and scientific institutions in this process as well;
  - to promote information exchange between Latvian companies looking for strategic investors, and foreign companies;

- **for developing knowledge-intensive economy:**
  - to support entrepreneurship with high value added;
  - to facilitate cooperation between the scientists and entrepreneurs by supporting competence centres in order to promote cooperation between 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;
  - more actively support 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 the use of the EU funds:**
  - to reduce the time necessary for administrative procedures, by simplifying the procedure for developing and approving the conditions of activities implementation;
  - to direct the EU funds to viable projects, taking into account priority sectors approved by the government;

- **for promoting export:**
  - to continue ensuring access to export credit guarantees in order to increase access to the markets with a higher risk degree and to promote export 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 ensuring to Latvian entrepreneurs a range of state export support services broadly and easily accessible abroad;
  - to ensure representation of Latvian foreign economic interests in the framework of a multilateral trading system and negotiations with the third countries in order to improve contractual conditions of international trade, thus fostering openness of third-country markets and exportability of Latvian entrepreneurs;
  - to continue tackling the protective measures by eliminating trade barriers faced by Latvian entrepreneurs in export markets;
  - to consistently implement protection of the interests of Latvia in matters of the EU internal market, to promote deeper integration thereof, elimination of barriers and obstacles to cross-border economic activities, thus facilitating export of Latvian goods and services to the EU;

- **for establishing flexible labour market:**
  - to solve structural problems of the labour market by supporting the efforts to obtain suitable and higher qualification in accordance with the requirements of the labour market and improving internal mobility of the labour force;
  - the adult lifelong learning system must take into account the currently existing nonconformities in profession groups, i.e., majority of population is employed in a profession which is not related to their acquired education;
  - to pay particular attention to the youth who are neither involved in any training nor are employed by returning them to the education system to acquire qualification and practice;
  - to encourage active participation of employers in improvement of education quality – establishing practice places, participating in development and improvement of education

programmes, as well as development and implementation of active labour market policy measures;
- to develop interdisciplinary education/study programmes, particularly promoting development of business abilities;
- to develop 1st level professional higher education (colleges) – reduced training period, saved state and private funding;
- to review the regulation of legal labour relations by expanding the flexibility among employer and employee; ;
- to promote conformity of training to the requirements of labour market – consider opportunity to improve (change) the existing planning system of labour training by reviewing former methodology of short-term labour market forecasting and procedure for defining training directions in order to take into consideration labour market forecasts, as well as medium-term and long-term development objectives of national economy;

– **for improving energy efficiency:**
- to develop the minimum energy efficiency requirements for residential buildings;
- to develop constant support system for heat insulation of multi-apartment houses, at the same time to diversify available support instruments for appropriate activities;
- to set requirements regarding construction of low energy consumption buildings;
- to reduce heat energy losses in centralized heat supply by reconstructing the existing heat sources and heat networks, and by setting energy efficiency requirements for centralized heat supply systems;
- to promote production of energy in high-efficiency cogeneration stations by developing new heat supply infrastructure;
- to develop unified public transportation rout network (ban of grants for parallel routs, coordinated schedules, improved rout planning system), replace passenger traffic (electric trains and diesel-engine trains) rolling stock to more effective.

– **for ensuring efficient, safe, and sustainable energy supply:**
- in order to create stable environment for long-term investments to promote long-term production, use and export of local renewable energy; to adopt the *Law on Renewable Energy*
- to promote broader use of renewable energy resources in the sectors of electric energy, heat supply and transport by using co-financing of the EU Structural Funds and other support mechanisms;
- to develop the base-load power station projects by choosing the types of energy resources, which will ensure resource supply guarantees and sustainability, as well as increase the state subsistence of energy;
- to develop energy infrastructure projects by implementing the *Baltic Energy Market Interconnection Plan* within the framework of the EU Baltic Sea Region Strategy.
- to find opportunities to diversify energy sources by developing regional liquefied natural gas terminal;

– **for managing residential buildings:**
- to deal with issues of collecting debts of payments for heat energy and building management by speeding up legal proceedings to specify the rights and obligations of public utilities providers and recipients;
- to create favourable conditions for development of the residential rental market.

A consistently implemented structural policy will promote revival of 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.