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 annual ***Report on the Economic Development of Latvia***, which evaluates the economic situation and policy of Latvia, as well as forecasts economic development perspectives.

We are pleased to conclude that the economic growth of Latvia resumed in 2010, which was mainly based on the increase of export volumes. Export volumes of goods even exceed the pre-crisis level. Not only the increase of external demand is important for export improvement, but also the increase of competiveness of Latvian producers is important which is recovered on the account of both decrease of costs and rise in productivity.

Growth is observed in all sectors of goods production. Growth of our key export sector – manufacturing – should be noted particularly. The volumes of production in 2010 significantly increased in sectors of wood processing, production of electric and optical equipment, as well as production of transport vehicles. Positive tendencies are observed also in sectors of metal and metal articles production, as well as in the machine building industry.

The situation in the domestic market is gradually stabilizing and the situation in the labour market is improving – unemployment is gradually decreasing and the number of employed persons is increasing.

The recovery of national economy proves that the consistent and targeted policy of the Latvian government and the Ministry of Economics directed towards promotion of exports and rising competiveness of entrepreneurship has been the right step and it brings clear and tangible results.

Exports will be the main driving force of economy also in 2011. On the basis of analysis of the macro-economic situation, labour demand and labour supply, the experts of the Ministry of Economics forecast GDP growth in the amount of 3.5%, increase of goods and services export by over 6%, rise in the investment volume by 7%, increase of the number of employed by 2-3% in 2011.

The government will continue consistently to implement the programme for economic stabilisation of Latvia, which has helped to prevent insolvency of the country. The programme envisages maintaining stability of the national currency – the lats, gradually reducing budget deficit and fulfilling other requirements so that Latvia could enter the euro zone in 2014.

The government has set three main tasks for the next few years – promoting competiveness, developing production or state re-industrialisation and solving energy supply and energy safety issues.

To raise competiveness 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 the economy. The priority of production development must be based on the currently competitive sectors – wood industry, food processing, metal processing, chemical industry and pharmacy, as well as production of electric appliances. Currently, these sectors of economy constitute about 80% of manufacturing.

In 2010, state and EU fund support for business start-ups and development, personnel education, export promotion, improvement of tourism infrastructure, improvement of centralized heat supply system efficiency and renovation of social and multi-apartment residential buildings has been allocated in the amount of LVL 38.8 million. By attracting the 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, i.e. promotion of knowledge and technology transfer into production to ensure production of higher value added products and establishment of new innovative enterprises.

Important work has been done by developing favourable environment for micro-enterprises and by encouraging people, who have ideas to start business, thus reducing the unemployment. An enterprise can be founded by investing only LVL 1 in its equity 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 barriers.

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. Likewise, we will continue the work in progress to improve business environment by eliminating bureaucratic barriers, thus making the business environment of Latvia more attractive to foreign investors, by introducing electronic government and electronic communications, as well as by expanding export representation and by promoting interest strengthening in the markets important for Latvia.

Latvia holds the 24th position among 183 countries examined in the World Bank *Doing Business 2011* index, thus moving up by 3 positions in the overall assessment compared to the previous year. The Ministry of Economics is developing 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 organizations.

The most important activity for the energy sector in 2011 is to continue the launched development projects aimed at energy independence and security of energy supply of Latvia, as well as integration of energy markets of the Baltic States into the EU single 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 on the main economic and social indicators, development of sectors of the national economy and foreign economic environment, the economic policy of the government for promoting growth and employment, the key instruments for implementing the policy, including utilisation of the EU structural funds.

At the end of the Report, the authors provide recommendations regarding improvement of the economic policy.

The Cabinet of Ministers has not assessed all the issues addressed in the Report; hence, several conclusions about the economic development of the country and proposals for further action reflect only the opinion of experts of the Ministry of Economics.

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

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

December 2010

Artis Kampars
Minister of Economics

Contents

ABBREVIATIONS

Abbreviations

CC	Competition Council
CF	Cohesion Fund
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
CIT	Corporate Income Tax
CLC	Central Land Commission
CM	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 good, including value, and transport and insurance costs to the border of exporting country
FTA	Free Trade Agreement
GDP	Gross Domestic Product
HPP	Hydro-Power Plant
ICT	Information and Communication Technologies
IDAL	Investment and Development Agency of Latvia
IMI	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
NPS	Nuclear Power Station
NSFD	National Strategic Framework Document
OP	Operational Programme
PIT	Personal Income Tax
PJ	Petajoule
SEA	State Employment Agency
SF	European Union Structural Funds
SJSC	State Joint Stock Company
SLS	State Land Service
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
TEC	Thermal Power Station
TPI	Trade Protection Instruments
TWh	Terawatt per hour
USA	United States of America
VAT	Value Added Tax
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-27 countries	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

After a rapid growth for several years with an average annual increase of the GDP at the rate of 11% in 2005-2007, in 2008 **recession started in the economy of Latvia as a result of the global financial crisis**. In 2008-2009, the GDP decreased by 21.4%. The most critical period for the real sector of the economy was the 1st half of 2009, when economic activities decreased very rapidly and unemployment increased. The economic downturn continued also in the 2nd half of 2009, however, it was considerably slower than in the previous quarters, and a slight increase of exports and in manufacturing output had been already observed.

Since the beginning of 2010, the economic recession in Latvia has stopped and the growth has resumed. In three quarters of 2010, the GDP volume has increased. Growth has been more rapid than previously expected. In the 3rd quarter of 2010, the GDP has increased by 0.9% in comparison to the 2nd quarter of 2010 (according to the seasonally adjusted data, in the 1st and 2nd quarters the growth was 1% and 1.2% respectively). In the 3rd quarter of 2010, the GDP exceeded the level of the 3rd quarter of 2009 by 2.9%.

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

Table 1.1

Latvia: Key Economic Development Indicators

	2007	2008	2009	2010e	2011f
(changes in comparison with the previous year, %)					
Gross domestic product	10.0	-4.2	-18.0	0.0	3.5
Private consumption	14.8	-5.2	-24.1	0.8	3.7
Public consumption	3.7	1.5	-9.2	7.7	-0.6
Gross fixed capital formation	7.5	-13.6	-37.3	-19.2	7.0
Exports	10.0	2.0	-14.1	9.3	6.2
Imports	14.7	-11.2	-33.5	10.2	6.3
Consumer prices	10.1	15.4	3.5	-1.1	3.5
(% of GDP, unless indicated otherwise)					
General government budget fiscal balance	-0.3	-4.1	-10.2	-8.5	-5.4
General government debt	9.0	19.7	36.7	42.0	46.0
Exports-imports balance	-20.0	-13.6	-1.5	-1.6	-1.9
Changes in the number of employed population (aged 15-74 years)	2.9	0.5	-12.2	-4.4	2.5
Unemployment rate (share of job-seekers in the number of economically active persons aged 15-74 years, %)	6.0	7.5	16.9	19.0	17.0

e – estimation; f – forecast

Export volumes of goods in current prices within eleven months of 2010 exceeded the volumes in the corresponding period of 2009 by 28.8%. Export volumes of goods have already exceed the pre-crisis level. It is important to note that not only the growth of external demand is crucial for expanding export possibilities, but also the increase of Latvian producers' competitiveness, which is achieved owing to cuts in labour costs and to an increase in productivity.

The growth in three quarters of 2010 was observed in all sectors of production of goods. Since December 2009, production volumes of manufacturing have increased by 1.7% on average monthly. Within eleven months of 2010, significant increase in production volumes was observed in such sectors as wood-processing, paper industry and printing and publishing industry, production of electrical and optical equipment, as well as production of transport vehicles. Positive tendencies are observed also in production of metals and metal articles, machine building industry. Meanwhile, the growth rate is slower in food industry, which is closely related to domestic consumption and in production of non-metallic mineral products, which is affected by the situation in the construction sector.

Private consumption is gradually stabilising, as indicated by the increase in retail trade turnover. The retail trade turnover has grown by 10% in the period from December 2009 until November 2010 (according to the seasonally adjusted data). Moreover, since

August 2010 the retail volumes have already exceeded the level of the corresponding months of 2009.

In the 3rd quarter of 2010 compared to the 2nd quarter the amount of public consumption or public services has slightly increased (according to the seasonally adjusted data), however, it is still below the level of the corresponding quarter of 2009 (by 2.4%). Dynamics of public consumption are closely related to the implementation of budget consolidation measures.

Investment processes to a great extent are determined by the access to financial resources, still relatively low production capacity, cautious crediting policy of the banks, as well as decline in state investment volumes. Although in the 3rd quarter of 2010 compared to the previous quarter the gross fixed capital formation has increased by 6.3% (according to the seasonally adjusted data), such increase only partially compensated the decrease in investments experienced in the first quarters, and in the 3rd quarter of 2010 they remained at the level of the 3rd quarter of 2009.

In 2010 the GDP will be close to the level of the previous year or even slightly above it. **Meanwhile,** the Ministry of Economics forecasts that **the overall growth in 2011 will be positive** and the GDP might exceed the level of 2010 by 3.5%.

Due to the crisis, the consumer prices decreased gradually. Prices for goods were first to respond to the decrease of domestic demand and started falling in the 2nd half of 2008, while prices for services began to drop in March 2009. From April 2009, when the decline in prices began, until December 2009, the prices decreased on average by 0.5% per month. As a result, in December 2009, the 12-month inflation was negative, i.e., a 1.2% deflation was observed.

In 2010, the decline in consumer prices had stopped. Although private consumption was at a very low level, it did not continue decreasing anymore. Thus, it was not to be considered as a factor influencing the decrease of prices. Also on behalf of the supply, the pressure on the decrease of prices is not observed anymore, although it was characteristic at the beginning of the crisis, when the decrease of prices was affected by the large amount of production stocks and the willingness of entrepreneurs to get rid of them as soon as possible.

The price increase (by 2.5%) in 2010 was mainly affected by the global rise in prices for food and energy, which is likely to continue also in 2011, thus causing subordinate impact also on prices of manufactured final products. The price increase could be partially reduced by budget consolidation measures launched by several countries in order to reduce expenditures to balance the financial condition of the state.

Budget consolidation measures will influence also the overall price level in Latvia. Their influence will be dual. At the beginning of the year, prices will increase due to the raised value added tax and excise tax. Due to this, the prices might rise by 1-1.2%. However, the reduction of budget expenditures will slightly slow down the private consumption, thus reducing the possibilities to increase prices for goods and mainly services.

In 2011, the situation in the labour market will not provide for such increase in wages that could constitute a factor stimulating inflation. The Ministry of Economics forecasts that **the overall rise in prices in 2011 might reach 2.5-2.8%** (12-months inflation).

The situation in the Latvian financial system has started stabilising. Increase in deposits is observed since the end of the 4th quarter of 2009. At the end of the 3rd quarter of 2010, the amount of deposits compared to the same period of 2009, increased by 11.5 percent.

In 2010, the balance of loans granted to residents continued to decrease. At the end of the 3rd quarter of 2009, the overall balance of loans granted to resident financial institutions, non-financial corporations and households was LVL 13.9 billion. At the end of the 3rd quarter of 2010, it was LVL 12.8 billion, which is by 7.8% less than a year ago.

The share of loans with overdue payments in the total credit portfolio is still growing. If at the end of the 3rd quarter of 2009 there were 25.2% of loans with overdue payments in the total credit portfolio, then at the end of the 3rd quarter of 2010 they reached 28.5 percent.

Weighted-average interest rate of short-term loans in the lats was 8% in the 3rd quarter of 2010, which is a considerable decrease in comparison to the 2nd and 3rd quarter of 2009. Less marked fluctuations were observed in weighted-average interest rate of long-term loans in LVL, which reached the maximum increase at the beginning of 2009, but in 2010 fell to 13.2%. With stabilization of the economic situation, the interest rates of the lats have come closer to the interest rates of the euro.

The deterioration of the economic situation has significantly affected the fiscal condition of Latvia. The general government budget deficit in Latvia in 2008 was LVL 672 million or 4.1% of GDP, whereas in 2009 it increased to LVL 1334 million or 10.2% of GDP. According to provisional data, in 2010 the general government budget deficit in Latvia did not exceed the expected 8.5% of GDP (it complies with the commitment of Latvia upon conclusion of the Memorandum of Understanding with the EU and signing the Letter of Intent with the IMF).

Significant budget consolidation measures have been carried out in Latvia, by implementing cumulative fiscal adjustment in 2009-2010 in the amount of 10.5% of GDP (over 9.5% taking into account the necessity to repay the withheld pensions), int. al., by reducing 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 number of public agencies is reduced by 50%, and savings in the area of support functions are carried out by centralising these functions.

The objective of the Latvian fiscal policy for 2011 is to hold the deficit within 6% of GDP, but in 2012 the deficit should be below 3% of GDP according to the ESA 95 methodology. It will help Latvia to recover confidence in international financial markets, prevent further increase of the government debt and promote fulfilment of the Maastricht criteria, so that Latvia could introduce the EU single currency – the euro – on January 1, 2014.

In order to follow the fiscal objectives, the government upon planning the draft budget for 2011 accepted fiscal consolidation measures in the amount of LVL 292 million – LVL 88.8 million in expenditures, LVL 158.1 million in revenues and LVL 44.9 keeping a fixed contribution rate in the funded pension scheme. In order to ensure economic growth recovery in Latvia, the state budget provides LVL 1.167 billion for absorption of EU funds and other foreign financial assistance. The total expected revenues of the general consolidated budget in 2011 are LVL 5.1 billion, expenditures – LVL 5.7 billion, and deficit according to the ESA 95 methodology – 5.4% of GDP.

The economic downturn has significantly worsened the situation in the labour market. During 2009, the number of employed in age group 15-74 years has decreased by 137.4 thousand or 12.2%, but the unemployment rate has increased by 9.4 percentage points. According to the data of the State Employment Agency, there were 179.2 thousand unemployed people at the end of 2009, which comprised 16% of the country's economically active population.

Since the 2nd quarter of 2010, the situation in the labour market has been slowly improving. The number of employed and economically active population is increasing, as well as unemployment is gradually decreasing. In the 3rd quarter of 2010 compared to the previous quarter the number of employed population aged 15-74 has increased by 2.6% and was 960.4 thousand, which is by 43.7 thousand more than in the 1st quarter of 2010. Also in the 3rd quarter of 2010 compared to the previous quarter the number of economically active population has increased by 0.8%. Due to the increase in employment, the unemployment rate is decreasing as well. According to the Labour Force Survey data, the unemployment rate in the 3rd quarter of 2010 was 18%, which is by 2.4 percentage points lower than at the beginning of 2010. Since March 2010, the registered unemployment rate has been gradually decreasing and by the end of November it was 14.3%. 161.8 thousand job-seekers were registered, which is by 32.4 thousand less than in March 2010. In December, due to seasonal factors, the number of registered unemployed persons slightly increased, but registered unemployment rate remained 14.3% of the economically active population.

In 2011 situation in the labour market will continue to improve gradually. According to the estimation of the Ministry of Economics, in 2011 the number of employed persons will increase by 2-3% compared to 2010. Due to the increase of employment, the unemployment will decrease. Unemployment rate in 2011 will be within 16-17%.

The further development of the economy will depend to a great extent on the ability of global economy to revive growth, as well as on efficiency of the economic recovery policy implemented by Latvia. The global economy recovers faster than expected. However, future perspectives should be evaluated carefully. The key political priority in global economy is still related to recovery of the financial sector, also taking into account the subordinate impact caused by the downturn of the real sector. The further development of the EU can be negatively affected by financial issues in the government sector of several countries and by the need to reduce the excessive budget deficit to ensure sustainable finances of the countries.

2. DEVELOPMENT OF THE WORLD ECONOMY[1]

So far the overall recovery of global economy is slightly faster than previously forecasted. However, the growth rate is gradually falling. The majority of developed countries and some developing countries will be forced to implement significant economic adjustments. Recovery of these countries is slow and accompanied by high unemployment rate which causes significant social problems. Yet, in those developed and developing countries that managed to avoid the financial crush, more rapid growth is observed.

Table 2.1

GDP Growth

(percentage in comparison with the previous year)

	2008	2009	2010f	2011f
World, *inter alia:*	**2.8**	**-0.6**	**4.8**	**4.2**
USA	0.0	-2.6	2.6	2.3
Japan	-1.2	-5.2	2.8	1.5
EU, *inter alia:*	0.8	-4.1	1.7	1.7
Eurozone countries	0.5	-4.1	1.7	1.5
CIS	5.3	-6.5	4.3	4.6
China	9.6	9.1	10.5	9.6

Source: "The World Economic Outlook October 2010", International Monetary Fund; f – forecast

In the first half of 2010, the recovery of global economy was based on increase in stocks and investments, thus promoting development of manufacturing and global trade. The low consumer confidence, as well as the decrease in household welfare level limits the increase of consumption in developed countries.

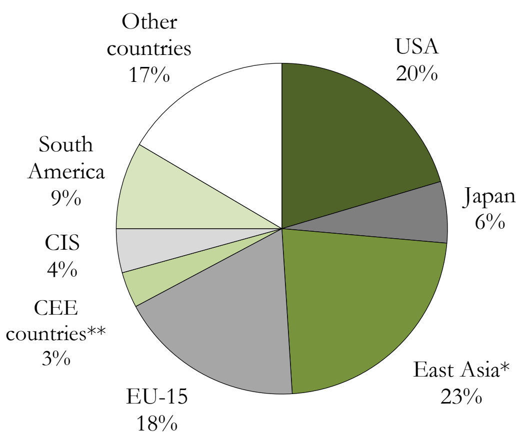
Overall, the global growth is forecasted to increase by 4.8% in 2010 and by 4.2% in 2011, which corresponds to the previous forecasts. As usual, growth will be more rapid in the less developed and developing countries (by 7.1% and 6.4% in 2010 and 2011 respectively), while the growth in economies of developed countries will be more moderate (by 2.7% and 2.2% in 2010 and 2011 respectively). The low capacity load level and high unemployment will still determine the low inflation rate, except for some rapidly growing economies.

In the first half of 2010, the growth of economies in developed countries was 3.5 %, which, considering the deep global recession, is a comparatively low indicator.

Figure 2.1

Breakdown of the World's GDP by Groups of Countries in 2009

(structure, GDP by purchasing power units)



Source: "The World Economic Outlook October 2010", International Monetary Fund.

* China, 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 the **USA** in 2010 is recovering due to strong stimuli to macroeconomic policy and to financial stability measures. Yet, the growth rate is slightly reducing. The growth of the USA economy in the 2nd quarter of 2010 was 1.7%, compared to the growth of 3.7% in the 1st quarter. Besides, similar tendencies are forecasted also in the upcoming quarters.

Such slow growth is partially related to weak private consumption, because the net value of household assets has rapidly reduced and a high unemployment rate still remains. Unwillingness of banks to grant loans to consumers in order to stabilize their balance should be noted as well. In general, taking into account the unusually low savings level in the pre-crisis period and the further rapid worsening of household welfare, the wish to save will be more explicit than before the crisis.

Having regard to the depth of economic downturn in the USA, its recovery is still likely to be slow, and growth will be much weaker than in other post-crisis

[1] In the preparation of the section, periodicals "World Economic Outlook October 2010" published by the International Monetary Fund and "European Economy 7|2010" published by the European Commission have been used.

periods. In 2010, the increase of GDP will be 2.6% and in 2011 – 2.3%. It means that a notable difference between the actual and potential production volume will remain, despite the significant decline in potential volume due to the crisis. The unemployment rate will remain high and inflation will remain low – 1.4% in 2010 and 1% in 2011.

Asian countries have overcome the global crisis more successfully than countries of other regions, and further recovery is successful. The domestic demand is stable in majority of regional countries, which due to active policy stimuli has compensated for the reduction of revenue from decrease of export. Comparing to other countries of the region, growth of the manufacturing industry and retail has been very strong in China and India, thus contributing to the overall growth of the region. The strong and stable growth of China over the last few years has advanced the global trade, which is particularly advantageous for those countries that are exporting both consumer goods and capital goods to China. Unlike the previous post-crisis periods, the significant inflow of private capital strengthens the domestic demand, ensuring access to foreign financing.

In general, growth of the region is forecasted to increase by 7.9% in 2010 and by 6.7% in 2011. The growth could be more moderate starting from the second half of 2010 due to the weakening influence of the economic policy, as well as due to adjustments in economic policies of the developed countries.

Table 2.2

The Main Macroeconomic Indicators of the Developed EU Member States

(percentage)

	GDP growth				Consumption prices				Current account balance (% of GDP)			
	2008	2009	2010f	2011f	2008	2009	2010f	2011f	2008	2009	2010f	2011f
EU, total inter alia:	**0.8**	**-4.1**	**1.7**	**1.7**	**3.7**	**0.9**	**1.9**	**1.8**	**-1.0**	**-0.3**	**-0.1**	**0.1**
Austria	2.2	-3.9	1.6	1.6	3.2	0.4	1.5	1.7	3.3	2.3	2.3	2.4
Belgium	0.8	-2.7	1.6	1.7	4.5	0.0	2.0	1.9	-2.9	0.3	0.5	1.8
Denmark	-0.9	-4.7	2.0	2.3	3.4	1.3	2.0	2.0	1.9	4.2	3.4	3.0
Finland	0.9	-8.0	2.4	2.0	3.9	1.6	1.4	1.8	3.1	1.3	1.4	1.6
France	0.1	-2.5	1.6	1.6	3.2	0.1	1.6	1.6	-1.9	-1.9	-1.8	-1.8
Germany	1.0	-4.7	3.3	2.0	2.8	0.2	1.3	1.4	6.7	4.9	6.1	5.8
Greece	2.0	-2.0	-4.0	-2.6	4.2	1.4	4.6	2.2	-14.6	-11.2	-10.8	-7.7
Ireland	-3.5	-7.6	-0.3	2.3	3.1	-1.7	-1.6	-0.5	-5.2	-3.0	-2.7	-1.1
Italy	-1.3	-5.0	1.0	1.0	3.5	0.8	1.6	1.7	-3.4	-3.2	-2.9	-2.7
Luxemburg	0.0	-4.1	3.0	3.1	3.4	0.4	2.3	1.9	5.3	5.7	6.9	7.2
Netherlands	1.9	-3.9	1.8	1.7	2.2	1.0	1.3	1.1	4.8	5.4	5.7	6.8
Portugal	0.0	-2.6	1.1	-0.1	2.7	-0.9	0.9	1.2	-11.6	-10.0	-10.0	-9.2
Spain	0.9	-3.7	-0.3	0.7	4.1	-0.2	1.5	1.1	-9.7	-5.5	-5.2	-4.8
Sweden	-0.4	-5.1	4.4	2.6	3.3	2.0	1.8	1.9	7.6	7.2	5.9	5.7
United Kingdom	-0.1	-4.9	1.7	2.0	3.6	2.1	3.1	2.5	-1.6	-1.1	-2.2	-2.0

Source: "The World Economic Outlook October 2010", International Monetary Fund; f – forecast

The economic recovery of **the developed EU countries** is uneven. In some countries, elimination consequences of the crisis and the measures of warming the economy were reduced before actual recovery of the economy was achieved due to excessive budget deficit and rapidly growing government debts that could endanger the stability of the global financial system and of the European and global recovery.

Despite the increase of goods export over the last few months, the recovery in Germany will be moderate due to the weak growth in its trade partnership countries. Small growth is forecasted also in France due to cancelled stimulating measures and high unemployment rate that weakens the private consumption. In Italy the growth will be even weaker, which will mainly depend on the low export competitiveness and planned fiscal consolidation that weakens the private consumption. The fiscal disbalance and competitiveness issues are the key factors that hinder the growth in Greece, Ireland, and Spain. Therefore, the growth in these countries is forecasted to be very weak. In Great Britain, the domestic demand will remain relatively low, especially after measures for reduction of the budget deficit.

The **Baltic States** have been hit by the global crisis most severely. After the rapid growth in 2001-2007, the GDP of the Baltic States in 2009 decreased by approximately 15%, which was mainly caused by the significant external and internal disbalance. Yet, in

2010, the growth in the Baltic States is forecasted to be positive.

Growth in the Baltic States is mainly based on reduced expenses, which improves competitiveness of the country and promotes development of export. Also the private consumption will have further positive impact on the growth. Recovery of the financial sector is expected as well, thus promoting financial flows. As a result of introducing the euro, the overall confidence has improved in Estonia. However, in the near future, the growth of the region will be considerably slower than in the pre-crisis period.

Table 2.3

The Main Macro-economic Indicators of the new EU member states
(percentage)

	GDP growth				Consumption prices				Current account balance (% of GDP)			
	2008	**2009**	**2010f**	**2011f**	**2008**	**2009**	**2010f**	**2011f**	**2008**	**2009**	**2010f**	**2011f**
EU, total inter alia:	**0.8**	**-4.1**	**1.7**	**1.7**	**3.7**	**0.9**	**1.9**	**1.8**	**-1.0**	**-0.3**	**-0.1**	**0.1**
Bulgaria	6.0	-5.0	0.0	2.0	12.0	2.5	2.2	2.9	-24.2	-9.5	-3.0	-3.1
Cyprus	3.6	-1.7	0.4	1.8	4.4	0.2	2.2	2.3	-17.5	-8.3	-7.9	-7.4
Czech Republic	2.5	-4.1	2.0	2.2	6.3	1.0	1.6	2.0	-0.6	-1.1	-1.2	-0.6
Estonia	-5.1	-13.9	1.8	3.5	10.4	-0.1	2.5	2.0	-9.7	4.5	4.2	3.4
Hungary	0.6	-6.3	0.6	2.0	6.1	4.2	4.7	3.3	-7.1	0.2	0.5	0.7
Latvia	-4.2	-18.0	-1.0	3.3	15.3	3.3	-1.4	0.9	-13.1	8.6	5.5	2.9
Lithuania	2.8	-14.8	1.3	3.1	11.1	4.2	1.0	1.3	-12.2	4.2	1.9	0.2
Malta	2.6	-2.1	1.7	1.7	4.7	1.8	1.9	2.1	-5.6	-6.1	-5.4	-5.3
Poland	5.0	1.7	3.4	3.7	4.2	3.5	2.4	2.7	-5.1	-1.7	-2.4	-2.6
Romania	7.4	-7.1	-1.9	1.5	7.8	5.6	5.9	5.2	-11.9	-4.5	-5.1	-5.4
Slovakia	6.2	-4.7	4.1	4.3	3.9	0.9	0.7	1.9	-6.6	-3.2	-1.4	-2.6
Slovenia	3.5	-7.8	0.8	2.4	5.7	0.9	1.5	2.3	-6.7	-1.5	-0.7	-0.7

Source: "The World Economic Outlook October 2010", International Monetary Fund; f – forecast

The recovery of the **CIS** region is based on the high prices for resources, normalization of trade, and restoration of capital flow. Growth of the region is fostered by gradual recovery of the economy of Russia.

In Russia, despite the relatively high oil prices, growth will be moderate. Bank crediting is cautious, the real wages are slightly increasing and the unemployment is decreasing, therefore promoting consumption.

The high prices of consumer goods will also foster growth of other energy exporting countries in the region. Increase in large investments and gas export will foster growth in Turkmenistan. Considerable growth is expected also in Uzbekistan, but due to the enduring recovery of the financial system, growth of Kazakhstan will be slower.

Like in other regions, growth of the CIS countries will also be uneven. Development of importing countries is mainly influenced by prices of raw materials, as well as by the level of integration in the global financial markets, by preparation of supporting policies, etc.

Growth of the CIS region is forecasted to increase by 4.3% in 2010 and 4.6% in 2011, among them in Russia – by 4% in 2010 and by 4.3% in 2011.

Table 2.4

Main Macroeconomic Indicators of the CIS
(percentage)

	2008	**2009**	**2010f**	**2011f**
GDP growth	5.3	-6.5	4.3	4.6
int. al. Russia	5.2	-7.9	4.0	4.3
Consumer prices	15.6	11.2	7.0	7.9
int. al. Russia	14.1	11.7	6.6	7.4
Current account balance (% of GDP)	4.9	2.6	3.8	3.0
int. al. Russia	6.2	4.0	4.7	3.7

Source: "The World Economic Outlook October 2010", International Monetary Fund; f – forecasts.

In general, recovery of the global economy is successful but uneven – it is slower in developed countries and more rapid in most of the less developed and developing countries. The majority of the developed countries and some of the developing countries are still faced with significant economic adjustments. The recovery rate will depend on both restoration of domestic balance and external balancing in trade deficit countries.

3. Growth

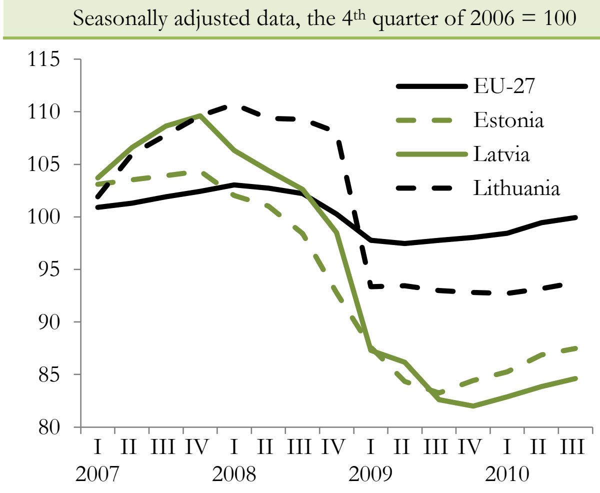
3.1. GDP Dynamics and Aggregate Demand

3.1.1. Development Trends

The global financial crisis has severely affected the economy of Latvia. The GDP during the crisis has decreased by 25% (the fourth quarter of 2009 compared to the fourth quarter of 2007, which was the final quarter showing positive growth). The GDP decrease in 2008 was by 4.2%, but in 2009 – by 18%. The growth resumed in 2010. In the first quarter of the year, the GDP increased by 1% (in comparison with previous quarter according to seasonally adjusted data), in the second quarter – by 1.2%, and in the third quarter – by 0.9 percent.

Figure 3.1

GDP Dynamics by Quarters



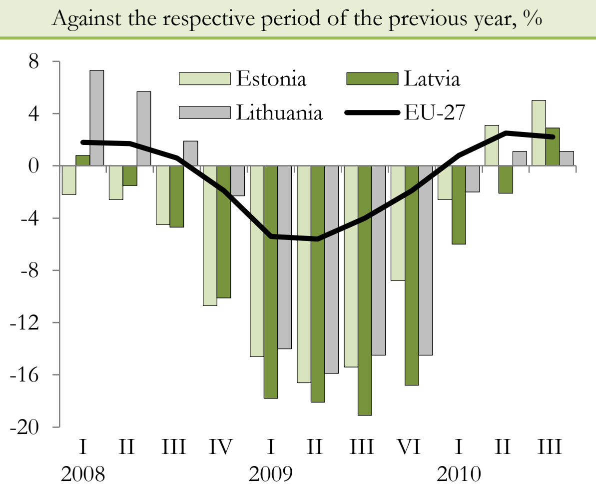


Table 3.1

GDP of Latvia by Expenditure Items

	2008	2009	2010e	2010			2008	2009	2010e
				I	II	III			
	changes in % compared to the corresponding period						contribution to growth, %		
Private consumption	-5.2	-24.1	0.8	-5.7	-1.3	2.5	-3.8	-17.3	0.5
Public consumption	1.5	-9.2	-7.7	-18.2	-11.5	-2.3	0.2	-1.3	-1.3
Gross fixed capital formation	-13.6	-37.3	-19.2	-44.4	-35.9	0.0	-4.9	-12.1	-4.8
Inventories	–	–	–	–	–	–	-4.1	-1.5	6.2
Exports	2.0	-14.1	9.3	3.2	7.5	15.5	0.8	-6.3	4.3
Imports	-11.2	-33.5	10.2	-4.4	10.0	12.8	7.4	20.5	-5.1
GDP	**-4.2**	**-18.0**	**0.0**	**-6.0**	**-2.1**	**2.9**	**-4.2**	**-18.0**	**0.0**

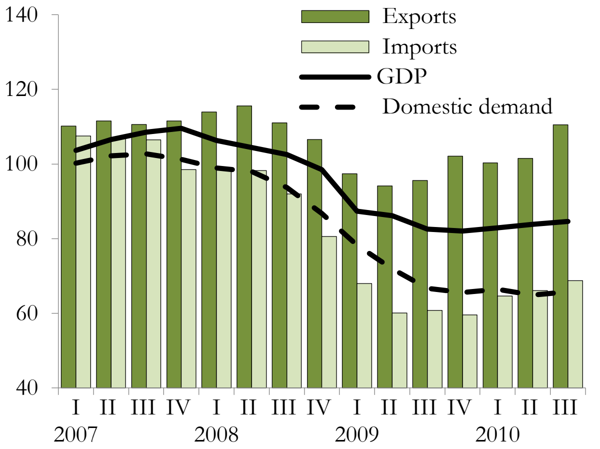
e – evaluation of the Ministry of Economics

The depth of the financial crisis has been intensified by a markedly unbalanced position of the external sector of Latvia, which has developed during the previous years of rapid growth. A considerable growth of private consumption and investment, which was more rapid than the overall economic growth, was largely based on substantial inflow of foreign capital. It has also determined a high current account deficit of the balance of payments and therefore has increased vulnerability of the economy of Latvia. Due to the decrease of financial inflow, a rapid decline of private consumption and investment is observed, along with substantial economic adjustments, which result in improvement of the trade balance of goods and services along with the decline of economic activities upon decreasing domestic demand.

As already mentioned, the recovery of economics resumed in 2010. The key driver of growth was export (see Figure 3.2). In the third quarter of 2010, export was close to the pre-crisis level. Other items of the total demand are recovering considerably slower.

Figure 3.2

Quarterly Changes in GDP and Major Expenditure Items
(4th quarter of 2006 = 100)



Domestic demand in the third quarter of 2010 lags behind the level of the third quarter of 2007 by almost a third (without changes in reserves). Investments in fixed assets are particularly low. These have been reduced by almost a half in the corresponding period. Private consumption has decreased slower – by 30 percent.

Along with a significant decline of private consumption and investments, even a faster decrease of imports can be observed. As a result, 2010 showed considerable positive contribution of net exports to the overall changes of GDP.

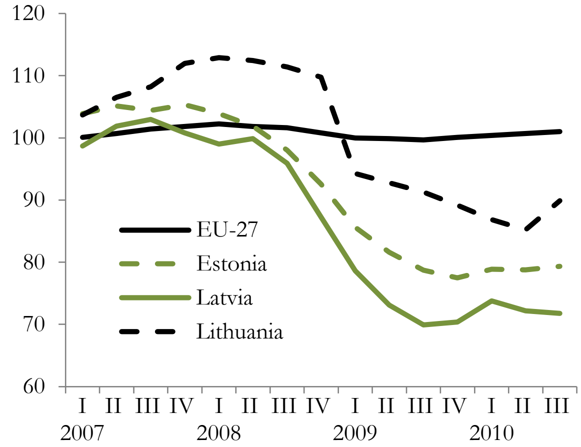
3.1.2. Private and Public Consumption

The decrease of **private consumption** started already in the fourth quarter of 2007 and continued for seven successive quarters. In 2008, the private consumption was by 5.2% lower than in the previous year. In 2009, a considerable decline in private consumption continued – by 24.1%. In total, the private consumption has decreased by a third in the fourth quarter of 2009 compared to the fourth quarter of 2007, which was faster than the decline of GDP.

The substantial decrease of private consumption in 2008 was largely determined by the decline of household crediting. During the previous rapid growth years, availability of credit resources significantly affected also the possibility to increase the domestic demand, however, when crediting resources started decreasing, the domestic demand plummeted. In 2009, the decrease of private consumption has been more significantly affected by the decrease of real wages and the increase of unemployment.

Figure 3.3

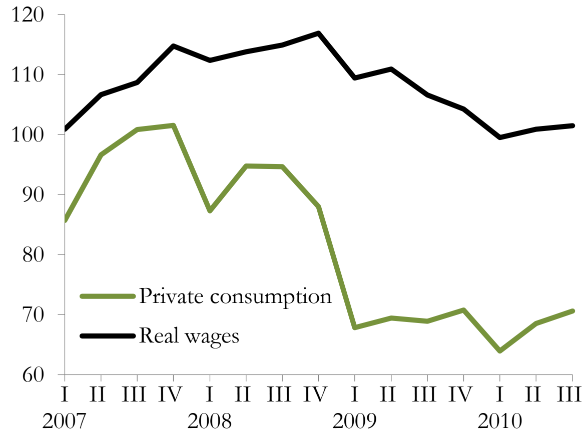
Changes of Private Consumption by Quarters
(seasonally adjusted data, 4th quarter of 2006 = 100)



Private consumption resumed growing in 2010. In the third quarter of 2010, private consumption has increased by 2.5% in comparison with the same period of previous year. This is the first positive annual increase of private consumption since the first quarter of 2008. The gradual increase of private consumption is mainly fostered by improving the situation in the labour market – employment is increasing and the wages are no longer decreasing.

Figure 3.4

Dynamics of Real Wages and Private Consumption by Quarters
(4th quarter of 2006 = 100)

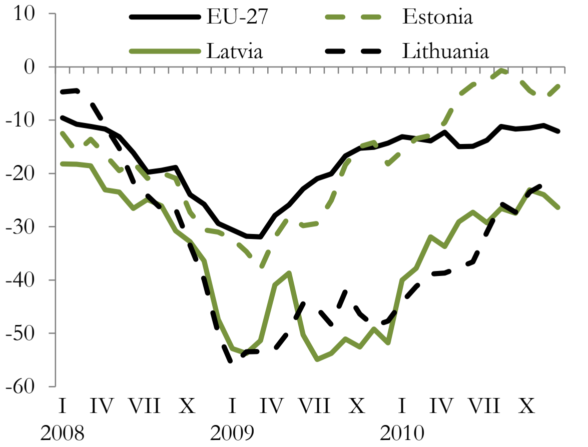


The changes of private consumption in the nearest future will be determined by reducing unemployment. Yet, a moderate rise in wages is expected thus less affecting the total income of households.

Figure 3.5

Consumer Confidence Indicator*

(seasonally adjusted data)



* Consumer confidence indicator is being calculated as the average balance of responses to the 4 questions regarding financial situation, overall economic situation, assessment of unemployment and savings for the next 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.

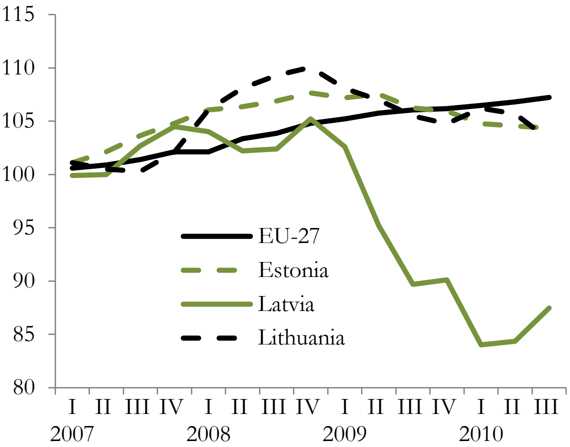
Public consumption started decreasing only in 2009, when the budget consolidation measures were implemented. In 2009, its volume was by 9.2% lower than in 2008 and it was 19.6% of GDP.

In the three quarters of 2010, the volume of public consumption was 10.9% lower than in the corresponding period of the previous year and its share in GDP expenditure has decreased by 3 percentage points.

Figure 3.6

Changes of Public Consumption by Quarters

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



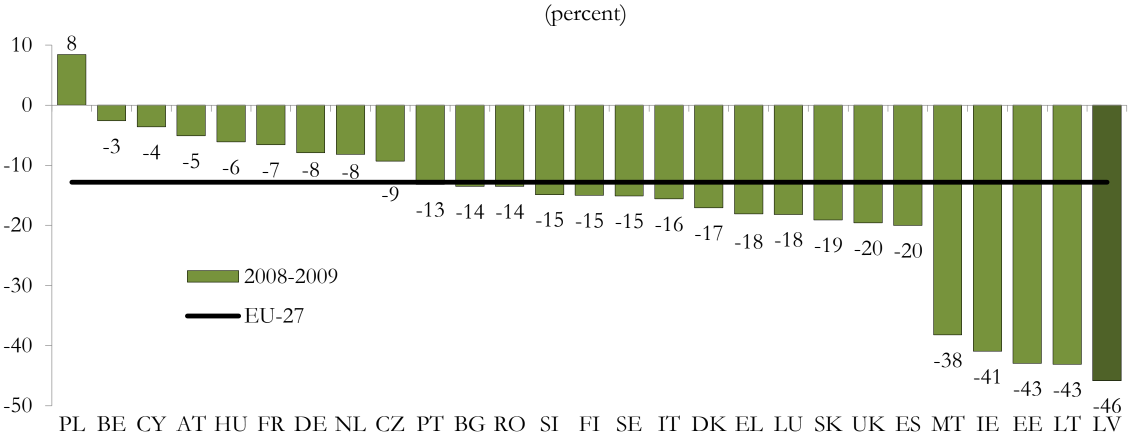
3.1.3. Investments

Investment activities in Latvia are on a very low level. Recovery thereof is slow and uneven. In the three quarters of 2010, comparing to the same period of the previous year, investments in the national economy of Latvia was by 26.1% less than in the respective period of the previous year. The share of investments in GDP has decreased twice since 2007 and in nine months of 2010 was 16.5% of GDP. Overcoming the investment crisis is hindered by limited companies finance and low crediting level of banks, etc.

Figure 3.7

Changes of Investment Volumes in the EU Member States from 2008 till 2009

(percent)



The global economic development experience shows that adjustment of investments during the crisis is stronger than the GDP adjustment. Sensitivity of investors to fluctuating economic conjuncture relies to a great extent on worsening financial situation of companies due to rapidly narrowing markets. A significant decline in investments is observed in all EU member states. Since 2008, investments in the EU countries have decreased on average by 12.8% in two years, i.e., almost ten times faster than GDP. It must be noted that the only EU member country, which has shown positive investment dynamics, is Poland (in 2009, comparing to 2007, investments increased by 8.4%). However, the decrease of the investment volumes in the Baltic States, as well as in Ireland and Malta was almost four times the EU average.

The depth of investment adjustment in Latvia was intensified by the huge debts of enterprises accumulated during the rapid growth years, as well as by worsening creditworthiness of the Latvian banking system. In 2008, the investment volume in the national economy of Latvia was by 13.6% lower than in 2007. Worsening investment climate, low domestic and external demand, as well as manufacturing capacity load had negative impact on investment processes in 2009. Investment volume was by 37.3% lower than in 2008. Overall, since 2008, the investment volume has decreased by half in two years.

Table 3.2

Gross Capital Formation

	2004-2007 (average annually)	2007	2008	2009	2010 9 months
	Actual growth (%)				
GDP	10.4	10.0	-4.2	-18.0	-1.5
Gross Capital Formation	15.3	11.6	-23.6	-44.8	0.7
– gross fixed capital formation	17.8	7.5	-13.6	-37.3	-26.1
	% of GDP				
Gross Capital Formation	37.6	40.4	31.2	20.3	20.2
– gross fixed capital formation	31.7	33.7	29.3	21.5	16.5
– changes in reserves	6.0	6.7	1.8	-1.2	3.7

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 is insufficient. The capacity load in manufacturing is gradually increasing. In October 2010, it reached 67%, which is 10 percentage points above the level of previous year, yet lower than before the crisis. It means that the potential of existing manufacturing is still beyond the employed potential and increase of demand is likely to contribute to the increase of the capacity load, but not to the increase of investments.

The negative dynamics of private investments were influenced also by a decrease of state investment volumes due to the necessity to introduce budget consolidation measures. State investments were reduced accordingly by 15.4% and 30% in 2008 and 2009. As a result, state investments could not reduce the negative consequences of cyclical fluctuations of private investments. In 2009, the state investments formed 18.4% of the total investments in the national economy of Latvia. In the first half of 2010, the volume of state investments was by 65% lower than in the corresponding period of 2009 and constituted 9.3% of the total investments. Despite the reduced state investments, the role of the state in the investment process is important because the state provides significant support to private investments with the co-financing from the EU structural funds.

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

Many sectors have maintained the positive investment dynamics in 2008. In comparison with 2007, investments in agriculture have increased by 23.5%, real estate transactions – by 23.2%, investments in hotel and restaurant business have increased almost twice. Yet, the investment volume in other sectors was less in comparison to 2007. A particularly large 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%. Overall, investments in the goods manufacturing sector decreased by 18%, but in the services sector increased by 6 percent.

As the economic crisis intensified, in 2009, the investment activities continued to decrease in all sectors, including the sector of goods manufacturing by 36.7% and in the services sector – by 32.6% in comparison with the previous year. The most significant decrease of investments has occurred in the construction sector (by 72.6%), finances and insurance sector (by 56.8%), and in real estate transactions (by 56.1%).

According to the provisional data, also the nine months of 2010 show that the investment process has been very weak in all sectors. Investments decreased by almost a third in service sectors and goods manufacturing as compared with the corresponding period of the previous year. However, it must be noted that in nine months of 2010, comparing to the same period of the previous year, the investments in the sector of real estate transactions increased (by 1.7%). In the first quarter of the year, investments in information and communication service sectors increased by 27.7%, in comparison with the corresponding period of the previous year.

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

Table 3.3

Sectoral Dynamics and Structure of Investments

	Growth rates				Structure			
	2004-2007 (average annually)	**2008**	**2009***	**2010 9 months***	**2004-2007 (average annually)**	**2008**	**2009***	**2010 9 months***
Primary sectors	7.6	20.8	-38.5	-30.6	4.4	4.3	4.5	5.1
Manufacturing industry	17.9	-23.6	-40.4	-16.9	16.2	13.3	14.2	17.6
Electricity, gas, and water supply	13.2	-28.5	-17.5	-36.9	7.8	6.2	15.1	14.0
Construction	26.1	-14.7	-72.6	-54.7	7.2	7.1	1.9	1.4
Trade	5.0	-3.2	-53.8	-42.6	13.2	10.6	8.7	7.6
Transport and communications	3.0	5.7	-17.2	-11.1	13.2	12.1	18.0	20.6
Other commercial services	22.8	10.5	-60.5	-25.0	23.4	30.0	8.3	9.5
Public services	19.5	4.7	-13.9	-37.8	14.7	16.4	29.3	24.1
Total	**15.6**	**-15.6**	**-34.1**	**-33.8**	**100**	**100**	**100**	**100**

* estimated by using quarterly data

The investment level in the manufacturing is still low. Investments in the manufacturing significantly decreased due to the financial crisis. In 2009, they constituted a half of what they were in 2007. To a great extent it was determined by the decrease of investments in the food industry, wood processing, and in production of chemical substances and its products.

In 2010, investments in manufacturing continued decreasing, yet slower than last year. In nine months of 2010, the investment volumes were by 16.9% lower than in the corresponding period of the previous year. At the same time, increase of investments is observed in some manufacturing sectors. In nine months of 2010, investments in wood processing and publishing and reproduction of recorded media were by almost 65% higher than in the corresponding period of the previous year.

Positive investment tendencies in 2010 are also observed in metal processing and production of vehicles.

Table 3.4

Dynamics and Structure of Investments in Manufacturing

(percent)

	Growth rates				Structure			
	2004-2007 (average annually)	**2008**	**2009***	**2010 9 months***	**2004-2007 (average annually)**	**2008**	**2009***	**2010 9 months***
Food industry	-1.8	-12.3	-59.2	-39.5	21.8	15.7	18.3	13.3
Light industry	-13.3	-34.4	-32.1	-74.0	2.7	1.8	3.7	1.1
Wood processing	18.2	-11.1	-78.4	64.1	26.4	33.0	7.1	14.0
Paper industry and publishing	20.2	-52.0	-81.7	5.9	7.2	4.6	1.4	1.7
Chemical industry and related industries	24.3	-53.1	-43.2	-43.2	7.6	5.0	21.1	14.4
Production of other non-metallic mineral products	79.0	-19.6	146.0	-7.8	14.4	22.7	39.7	44.1
Production of metals and metal articles	20.5	-22.4	-64.1	11.3	7.1	7.9	4.4	5.9
Production of machinery and equipment	9.0	-36.4	-68.7	-24.9	2.1	2.0	0.8	0.7
Production of electrical and optical equipment	7.1	-2.6	-72.9	-14.4	2.5	1.6	0.9	0.9
Production of vehicles	25.0	-26.0	-51.8	84.1	2.3	2.5	1.1	2.4
Other industries	20.9	-72.0	-57.5	-29.3	5.8	3.1	1.7	1.4

* estimated by using quarterly data

Investments in "production of vehicle, trailers, and semi-trailers" sector increased almost 8 times, but investments in production of metal and metal articles – by 11.3 percent.

Since 2004, the positive investment dynamics in sectors of manufacturing of construction materials have been observed. Moreover, during the period of 2006-2007, the annual investment growth rates were more rapid if compared to the two preceding years. Investment volumes in manufacturing construction materials dropped almost by 20% due to the worsening situation in the real estate market in 2008, nonetheless, already in 2009 they were almost 2.5 times higher than in 2008. Although in nine months of 2010, slightly fewer investments were made in the sector of manufacturing of construction materials (by 7.8%) than in the corresponding period of the previous year, investments in this sector formed almost a half of the total investments in the national economy of Latvia.

In the near future, the negative investment dynamics is likely to decrease and, as the economic situation in foreign and domestic markets improves, the investments will gradually increase. The investment processes in Latvia, like in other countries affected by the financial crisis, will be largely determined by availability of the financial resources, increase of the overall demand, and implementation of state aid measures for facilitating business activities.

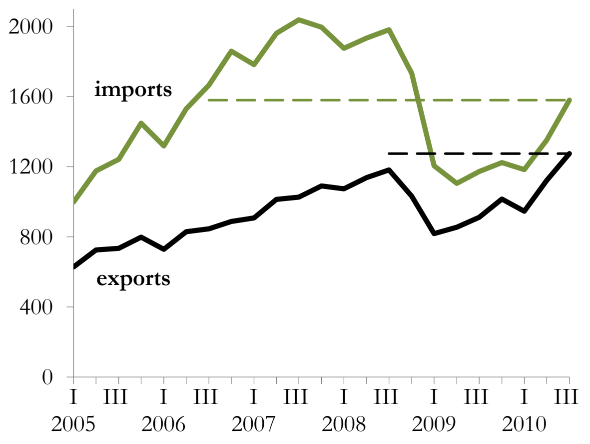
3.1.4. Exports and Imports

Exports and imports of goods

Volume of Latvian export goods started to decrease rapidly in actual prices at the end of 2008. In 2009, export resumed to increase slowly. However, in 2010, the export growth rate was quite significant and in the third quarter, volume of export slightly exceeded the pre-crisis level. In the three quarters of 2010, volume of export was by 29% higher (in comparable prices by 20%), in comparison with the respective period of 2009 (see Figure 3.8).

Figure 3.8

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



Imports of goods, however, started to decrease in the second half of 2007 as the domestic demand started decreasing. The import decrease was larger than that of export and continued until the second quarter of 2009, reaching the level of the beginning of 2005. Similar to export, import also started to grow slowly at the end of 2009, and in the third quarter of 2010 it exceeded the level of the previous year by 18% in actual prices (in comparable prices by – by 11%).

As shown in Figure 3.8, volumes of export and import have come significantly closer to each other and in the third quarter of 2010, import exceeds export by 24% (at the end of 2006, import was double the export).

In the three quarters of 2010, changes in the trading conditions positively influenced **exports of goods**, as the prices of export rose slightly more rapidly than those of import. The most significant reduction of an export unit value was for wood and timber, as well as for metal and metal products. But the export unit value for food products has slightly decreased.

Exports of goods have decreased almost in all groups of goods in 2009; a particularly fast decrease occurred in the export of metal articles and export of wood and timber products.

In January-November of 2010, if compared to the January-November of 2009, growth is observed in all goods export groups (in total by 29%). Almost a third of all increase of export is ensured by wood and timber products. A significant contribution to this increase was due to the increase in exports of metal and metal articles, as well as of agricultural and food products.

Figure 3.9

Export Dynamics of Latvian Goods by Months
(million LVL)

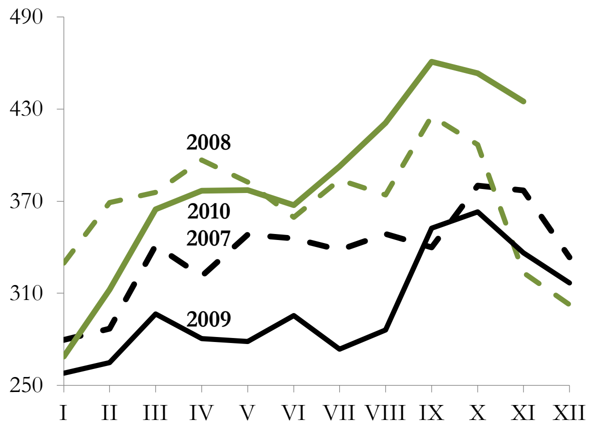


Table 3.5

Main Commodity Groups for Export

(%, in current FOB prices)

	2009		January-November 2010	
	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**	**-18.7**	**28.8**	**28.8**
wood and wood products	16.5	-19.0	51.9	8.6
metal and metal articles	12.4	-39.4	41.7	5.2
light industry products	5.7	-24.3	11.0	0.6
agriculture and food products	18.6	-10.6	20.9	3.9
products of chemical industry and related industries, plastics	11.4	-17.6	25.0	2.8
machinery products	14.1	-8.0	16.6	2.3
minerals	5.5	8.5	43.1	2.4
vehicles	7.1	-22.0	8.4	0.6
other goods	8.7	-16.7	26.6	2.3

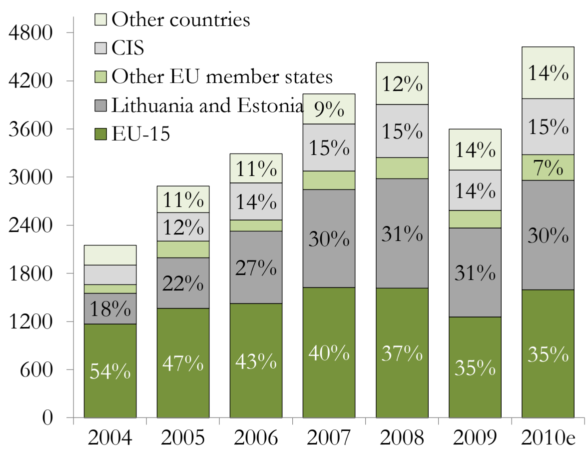
Export to the EU member states decreased by 20% in 2009, but, in January-November of 2010, already increased by 28%. The pre-crisis level of export to the EU countries has been basically regained. Considering the large proportion of the EU member states in the exports of Latvia, the group of these countries was the main influencing factor on the overall tendencies of Latvian export.

The largest export increase to the EU member states in the overall export of Latvia was observed for wood and timber product groups (more than a 1/3 of all increase), metal and metal articles, as well as agricultural and food products groups.

Figure 3.10

Structure of Latvian Export by Groups of Countries

(million LVL)



e – estimation

In 2009, export to the CIS countries decreased by 24%, however, in January-November of 2010, it increased by 40%, thus completely reaching pre-crisis volumes of export to the CIS countries. The largest contribution to export to the CIS countries was due to agricultural and food products group (about 1/3 of all export to the CIS countries), as well as due to products of the chemical industry (1/4).

In 2009, **the imports of goods** decreased in all groups of goods, especially in machinery manufacturing and vehicle groups. At the beginning of 2010, volumes of import started to increase and in January-November, volumes of import exceeded the level of the previous year by 21%. The largest contribution to import was due to increase in volumes of import of metal processing, chemical industry and machinery products which all together constitute about 60% of the total increase of import.

Import from the EU and the CIS countries has increased similarly as the overall import.

Figure 3.11

Import Dynamics of Latvian Goods by Months

(million LVL)

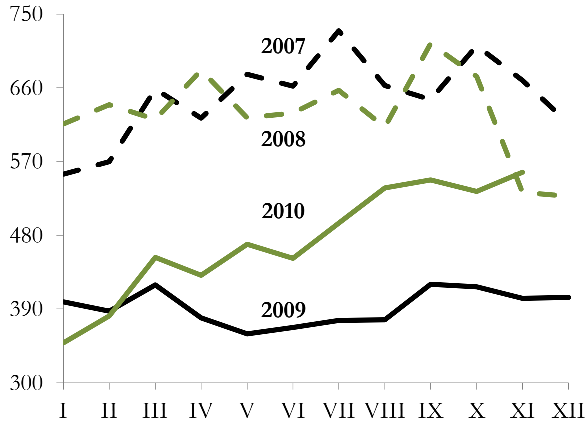


Table 3.6

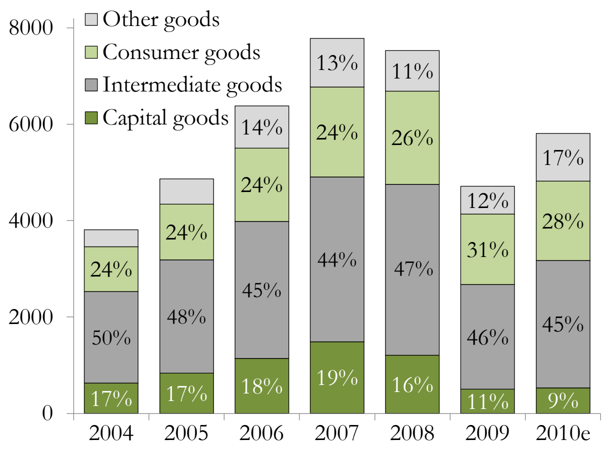
Main Groups of Commodities of Latvian Import
(%, in current CIF prices)

	2009		January-November 2010	
	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**	**-37.4**	**21.0**	**21.0**
wood and wood products	1.4	-52.8	45.1	0.6
metal and metal articles	8.1	-51.0	51.7	4.6
light industry products	6.3	-4.8	7.5	0.6
agriculture and food products	18.3	-16.4	7.9	1.3
products of chemical industry and related industries, plastics	16.9	-27.0	24.8	4.2
machinery products	15.7	-46.1	21.6	4.0
minerals	17.2	-31.0	10.3	2.2
vehicles	6.5	-62.3	23.7	2.1
other goods	9.6	-38.7	13.4	1.4

Over the last years, the imports of capital goods decreased considerably and it is due to the decrease of investments. Proportion of import of intermediate goods slightly decreased, but the proportion of consumption goods has slightly increased in comparison with the pre-crisis period.

Figure 3.12

Import by Classification of the Broad Economic Categories
(relating to the basic sections of national accounts, in current CIF prices, million LVL)

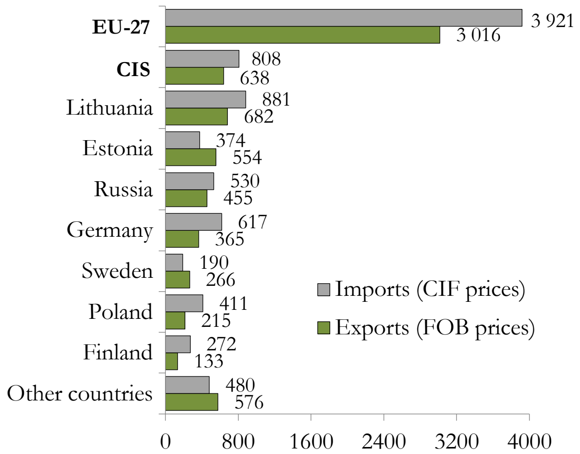


e – estimation

The main **trade partners** of Latvia in January-November 2010 were Lithuania – 16.6% from the total foreign trade turnover, Russia and Germany – 10.4%, Estonia – 9.8%, Poland – 6.6%, Sweden – 4.8%, as well as Finland – 4.3 percent.

Figure 3.13

Foreign Trade Turnover of Latvia in January-November 2010
(million LVL)

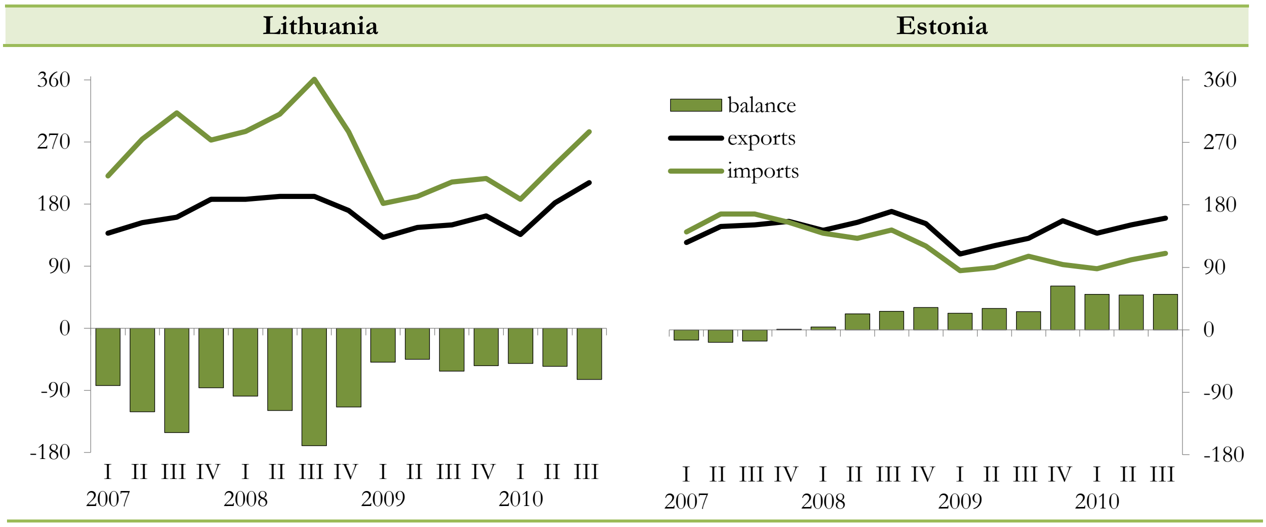


The key foreign trade partner countries of Latvia are **Lithuania** and **Estonia**. Over the last years, the share of these countries in the total share of foreign trade has been continuously increasing. Significant deterioration of the trade balance of Latvia with both countries was observed during the rapid growth of the Baltic States. Yet, starting with the second half of 2008, when the total import volumes started to fall, the foreign trade balance with Lithuania and Estonia started to improve (see Figure 3.14).

Foreign trade balance with Estonia since 2008 has been positive, but with Lithuania it stays negative. The imports from Lithuania in January-November 2010 exceeded the exports by 29% (in 2009 – by 36%), while the exports to Estonia exceeded imports by 48% (in 2009 – by 38%). Overall, the trade balance with both countries is almost balanced – import exceeds export only by 3%. The main groups of goods exported to Estonia and Lithuania are agricultural and food products, products of machinery manufacturing, as well as products of the chemical industry. The main groups of goods imported from Lithuania and Estonia are agricultural and food products, mineral products, as well as products of the chemical industry.

Figure 3.14

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



Exports and imports of services

The positive service balance in January-September 2010 almost completely covered the negative goods trade balance. Volumes of the service export and import have not significantly changed in a year, thus maintaining an explicitly positive service balance.

The revenues from transit transport constitute slightly more than a half of the services export. Overall, transport export has slightly decreased, the revenues from sea transport have decreased, but air transport revenues have increased corresponding to similar volumes. The revenues from tourists coming to Latvia have also decreased, which was compensated by increase in export of commercial services.

Table 3.7

Export and Import of Services
(percentage)

	2009				**January-September 2010**			
	structure		**change compared to the previous year**		**structure**		**change compared to the corresponding period of the previous year**	
	export	**import**	**export**	**import**	**export**	**import**	**export**	**import**
Services – total	**100**	**100**	**-10.7**	**-24.8**	**100**	**100**	**-0.2**	**-0.6**
including:								
Transport services	50.6	25.3	-10.9	-25.9	50.3	29.9	-2.6	15.5
– sea transport	17.9	7.5	-3.4	-2.9	15.5	7.9	-16.8	3.7
– air transport	8.3	8.2	-7.6	-26.0	10.0	11.0	18.2	3.3
– other transport	24.5	9.6	-16.7	-37.5	24.9	11.0	1.0	11.5
Travel	18.8	35.1	-5.4	-26.2	17.6	30.2	-9.2	-18.4
Commercial services	29.6	37.8	-13.0	-22.4	30.8	38.7	10.1	7.1
Other services	1.1	1.7	-21.1	-31.0	1.2	1.3	7.3	-23.8

Export of services to the EU member states constitutes about a half of the total export of services of Latvia and in January-September of 2010 its volumes has slightly decreased (by 3%). The revenues from visiting tourists have shrunk a little more, and export of commercial services has decreased as well. Yet, a slight increase is observed in transit haulage to the EU member states.

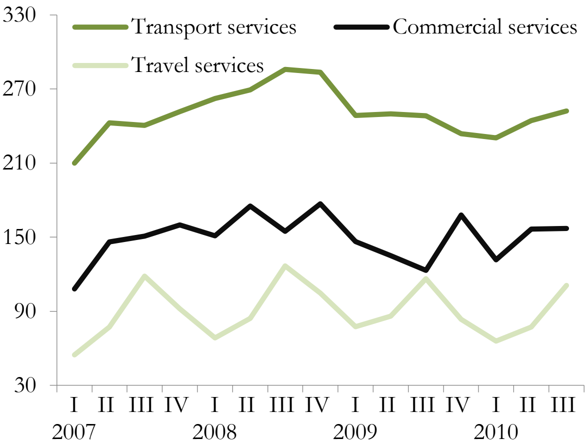
Export of services to the CIS member states in 2009 constituted about 9% of the total export of services, but in January-September 2010, taking into account the rapid increase of its volumes (by 50%), the proportion of export of services to the CIS member states has grown to 13%. The largest contribution to this increase was due to the increase of export of commercial services, as well as due to the increase of transit haulage export. The revenues from visiting tourists coming from the CIS member states have also slightly increased.

A considerable part of export of services consists of exports to Lithuania and Estonia respectively 7% and 6%. Export of services has decreased both to Lithuania and Estonia (respectively by 5% and 6%). Transit haulage export to both countries and the revenues from visiting tourists has also decreased, but export of commercial services has increased.

Figure 3.15

Export of Services by Quarters

(million LVL)



3.2. Contribution of Sectors

3.2.1. Structure of the Economy and Development Tendencies of Sectors

The rapid growth in the previous years, which was fostered mainly by domestic demand, has changed the structure of the economy of Latvia in favour of the services sectors. During the years of rapid growth (2004-2007), GDP increased by more than 10% annually. 3/4 of all increase was due to growth of construction, trade, and commercial services sectors. But contribution of the manufacturing was considerably smaller – only 5% of the overall growth. A very low share of manufacturing developed in the economy of Latvia, thus falling far below the average EU level.

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

Table 3.8

Structure of the Economy

(percentage)

	By value added			By number of employed		
	2005	**2009**	**2010e**	**2005**	**2009**	**2010e**
Primary sectors	4.3	3.8	4.6	12.3	9.3	9.6
Manufacturing	12.6	9.9	12.2	14.9	14.1	14.4
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	8.0	6.7
Trade, hotels, and restaurants	21.5	16.6	18.0	18.0	19.7	19.7
Transport and communications	13.9	11.4	12.8	9.2	9.9	10.1
Public services	15.0	17.1	15.0	22.3	21.2	21.6
Other commercial services	24.1	31.0	28.3	12.3	16.1	16.1
Total	**100**	**100**	**100**	**100**	**100**	**100**

e – estimation

Economic activities of the national economy are closely related to the dynamics of both domestic and external demand. Output decreases more rapidly in domestic demand-oriented sectors. In 2009, volumes of services provided by trade, hotel, and restaurant sectors (by 29%) and volumes of construction products (by 33.6%) shrank the most. These sectors had the biggest impact on decline of GDP in 2009 – by 7.5 percentage points or more than a third of the total decline of GDP. In some service sectors, like transport and communication, public services, as well as real estate transactions, the output decreased slightly slower.

At the beginning of 2009, the decrease of manufacturing output was significantly affected by the weak external demand. In the second half of 2009, increase of external demand ensured positive stimuli for Latvian producers as well – the decline rate of Latvian manufacturing reduced. Overall the production volumes of the manufacturing sector, comparing to 2008, have shrunk by 19.2% in 2009.

Table 3.9

Dynamics of GDP

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

	2004-2007*	2008	2009	2010e	2009				2010		
					I	II	III	IV	I	II	III
changes in volumes											
Primary sectors	5.3	0.5	3.0	4.2	-3.5	3.2	2.3	9.2	5.9	7.1	2.6
Manufacturing	4.2	-6.5	-19.2	16.0	-25.9	-23.4	-18.3	-9.0	6.8	15.3	20.2
Electricity, gas, and water supply	3.1	-2.4	-7.2	15.0	-9.8	-10.4	-14.2	2.3	17.4	11.0	15.1
Construction	17.5	-2.6	-33.6	-23.9	-27.6	-30.7	-34.2	-39.7	-43.2	-35.3	-13.1
Trade, hotels, and restaurants	16.2	-8.4	-29.0	4.0	-26.6	-29.6	-28.9	-31.2	-8.4	-0.2	11.0
Transport and communications	8.7	0.5	-14.8	4.1	-15.4	-15.0	-18.2	-10.3	2.3	2.5	5.4
Public services	4.2	1.3	-6.3	-6.7	-3.4	-5.2	-9.8	-6.7	-11.8	-8.8	-5.4
Other commercial services	13.2	0.0	-5.5	-4.9	-6.3	-5.4	-3.8	-6.5	-8.3	-3.4	-4.3
GDP	**10.9**	**-4.2**	**-18.0**	**0.0**	**-17.8**	**-18.1**	**-19.1**	**-16.8**	**-6.0**	**-2.1**	**2.9**
contribution to changes in volumes											
Primary sectors	0.2	0.0	0.1	0.0	-0.1	0.1	0.1	0.3	0.2	0.3	0.2
Manufacturing	0.6	-1.1	-2.4	0.3	-3.4	-3.0	-2.3	-1.1	0.7	1.5	2.3
Electricity, gas, and water supply	0.1	-0.1	-0.2	0.1	-0.4	-0.2	-0.3	0.1	0.7	0.2	0.3
Construction	1.3	-0.3	-3.2	-0.2	-2.0	-3.0	-3.7	-3.9	-2.3	-2.3	-1.0
Trade, hotels, and restaurants	3.7	-3.0	-7.4	0.1	-7.3	-7.3	-7.7	-7.6	-1.7	0.0	2.3
Transport and communications	1.3	0.1	-2.3	0.1	-2.3	-2.5	-3.0	-1.6	0.3	0.3	0.8
Public services	0.6	0.2	-0.9	-0.1	-0.4	-0.8	-1.2	-1.1	-1.5	-1.2	-0.6
Other commercial services	3.2	0.0	-1.6	-0.2	-1.8	-1.5	-1.1	-2.0	-2.3	-0.9	-1.2
GDP	**10.9**	**-4.2**	**-18.0**	**0.0**	**-17.8**	**-18.1**	**-19.1**	**-16.8**	**-6.0**	**-2.1**	**2.9**

* average per year; e – estimation

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

Growth in the three quarters of 2010 was observed in all sectors producing goods. In the third quarter of 2010, in comparison with the corresponding quarter of 2009, the manufacturing has increased by 20.2%, electricity, gas, and water supply sector – by 15.1% and the primary sectors – by 2.6%. Overall, the growth of these sectors contributed to the growth of GDP by 2.7 percentage points.

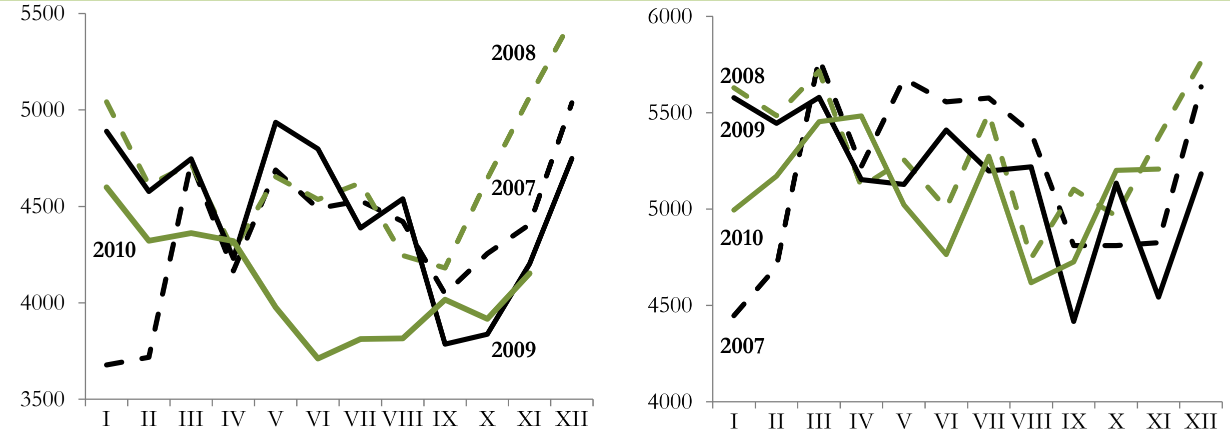
Despite the reduced freight turnover on railroads and ports, in the three quarters of 2010, growth was observed in transport and communication sector (in the third quarter of 2010, increase by 5.4% compared to the third quarter of the previous year). Increase in volumes of services provided in trade, hotel, and restaurant sector in the third quarter of 2010 must be noted as well (by 11%, compared to the respective period of 2009) achieved basically on the basis of the increase of wholesale volumes. Considering the large share of the sector in the national economy, the significant increase of volumes had an impact on growth of GDP by 2.3 percentage points.

However, output of other service sectors still was below the level of 2009. The output of the third quarter has shrunk by 4.3% in the commercial services sector, but limited state expenditures significantly influenced the public services sector where volume of the provided services was by 5.4% lower than in the third quarter of 2009. The deepest decline of production volumes is experienced in the construction sector – in the third quarter of 2010, the output of the sector was 13.1% below the level of the third quarter of 2009. Overall, the tendencies in services sectors and construction depended on the decrease of GDP by 2.8 percentage points (including construction – by 1 percentage point).

Figure 3.17

Freight Turnover

Freight traffic by railway, thousand t | Delivered and received cargo in ports, thousand t

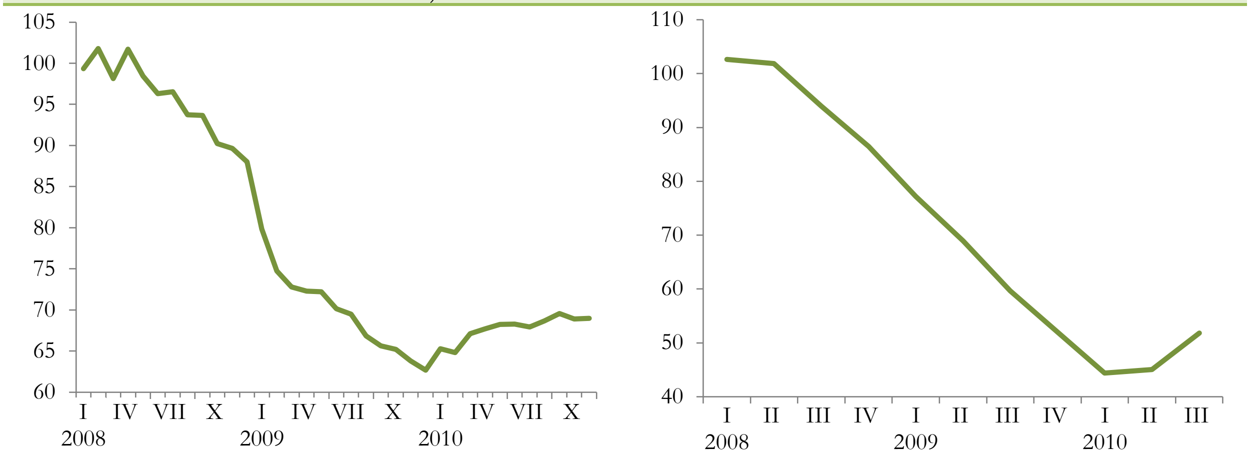


Due to stabilization of domestic demand, the situation in retail trade continued to improve gradually. The retail trade turnover has increased by 10% from December 2009 to November 2010 (in comparable prices, according to seasonally adjusted data). However, in 11 months of 2010, retail turnover still was by 3.6% lower than in January-November of 2009 (food commodities turnover shrank by 6.1%, fuel retail volumes – by 7.6%, but non-food goods turnover remains practically on the level of the corresponding period of the previous year). Comparing November 2010 to November of the previous year, the total retail turnover in comparable prices has increased by 8.1%. Since August 2010, retail turnover exceeds the level of the corresponding months of the previous year.

Figure 3.18

Retail Trade Turnover
(in comparable prices, seasonally adjusted data, December of 2007 = 100)

Construction Volume Index
(seasonally adjusted data, 4th quarter of 2007 = 100)



Due to the decrease of investments in the economy, construction volumes declined as well. In 9 months of 2010, compared to January-September of 2009, construction volumes in comparable prices have decreased by 28.5%. Among them building construction volumes have decrease by 30.3% but construction of engineering structures – by 27.1 percent.

In the third quarter of 2010, construction volumes increased (by 15.1% incomparable prices according to seasonally adjusted data) in comparison with the second quarter of 2010. During the quarter, the increase of construction volumes was mainly determined by the increase of construction volumes of residential buildings, trade buildings, as well as manufacturing buildings and warehouses.

The role of tradable sectors in the growth will continue to increase along with positive tendencies of exports growth. However, growth stimuli for sectors related to domestic market will also emerge, when the domestic demand stabilizes.

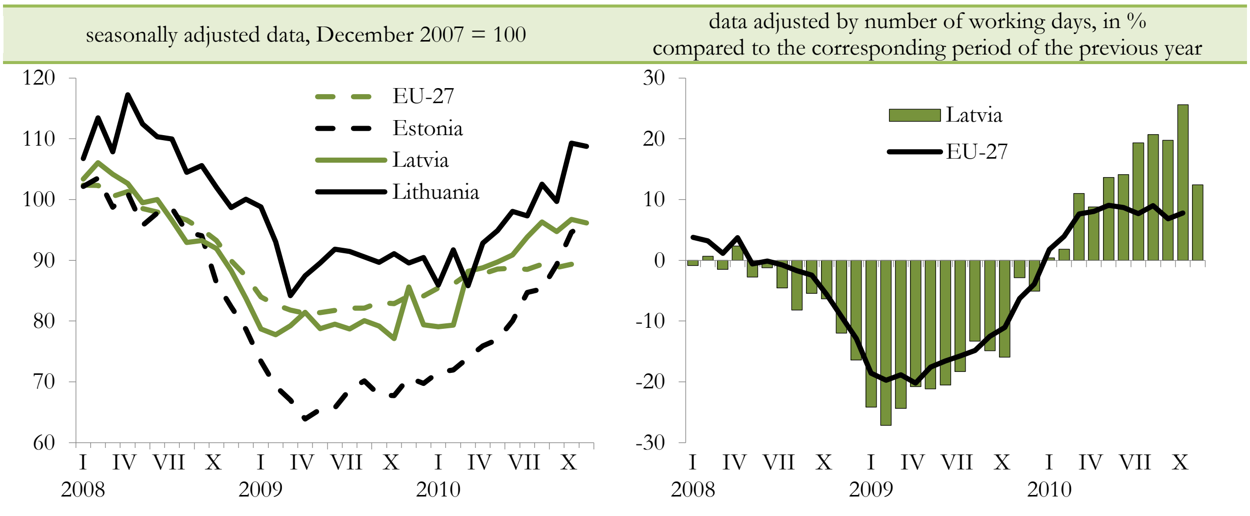
3.2.2. Manufacturing

The growth of manufacturing fell considerably behind the average growth rate of the economy during the period of rapid economic growth. Contribution of the manufacturing constituted only 5% of the total growth and a very low share of manufacturing developed in the economy of Latvia, thus falling far below the average EU level. The relative competiveness of manufacturing as a sector of economy of against other sectors decreased in this period. It was less attractive to entrepreneurs.

Both domestic and external demand significantly shrank under influence of the global crisis in 2008 and in the first half of 2009. Overall, in 2009, manufacturing production volumes have decreased by 18%. Huge decrease of manufacturing production volumes was typical not only in Latvia, but also in majority of the EU member states.

Figure 3.19

Manufacturing Physical Volume Index



In the second half of 2009, the revival of growth gradually replaced the decline of economic activities in the majority of trade partner countries of Latvia. The increase of external demand provided positive growth stimuli also to Latvian producers – production volumes resumed growing gradually in the second half of 2009 and production volumes in several sectors already at the end of 2009 exceeded the level of the respective period of the previous year.

Table 3.10

Structure of Manufacturing in 2010*

percentage

	By value added	By number of employed	Share of exports in the sales of sector
Manufacturing – total	**100**	**100.0**	**59.5**
Food industry	18.6	23.9	27.3
Light industry	4.9	11.7	81.9
Wood processing	26.3	18.2	74.9
Paper industry and publishing	9.2	6.5	53.5
Chemical industry and related industries	9.4	6.0	73.7
Production of other non-metallic mineral products	4.2	3.9	48.4
Production of metals and metal articles	11.3	9.3	73.3
Production of electrical and optical equipment	3.2	4.0	84.2
Production of machinery and equipment	4.5	3.5	85.9
Production of transport vehicles	4.1	6.2	87.9
Other industries	4.3	7.0	52.6

* estimation

The expansion of export opportunities and rise in competiveness due to increasing external demand is the reason for continued increase in the production volume of manufacturing which in November 2010 was by 15.7% higher than in the corresponding month of the previous year. Volume of manufactured production exceeded the level of eleven months of 2009 by 14.1% in January-November of 2010. Since December 2009, production volumes of the sector are increasing on average by 1.7 percent monthly.

Table 3.11

Changes of Production Volumes in Manufacturing*

(in percentage compared to the corresponding period of the previous year)

	2007	2008	2009	2010 I-XI
Manufacturing – total	**0.3**	**-4.7**	**-18.0**	**14.1**
Food industry	1.3	-5.3	-16.5	-2.9
Light industry	0.3	-11.0	-37.6	14.7
Wood processing	-6.0	-12.1	2.6	29.2
Paper industry and publishing	0.2	-4.2	-15.8	19.5
Chemical industry and related industries	3.1	-2.6	-18.4	7.1
Production of other non-metallic mineral products	-17.1	-5.6	-34.3	8.8
Production of metals and metal articles	11.5	1.8	-23.6	21.4
Production of electrical and optical equipment	3.8	4.5	-26.5	27.6
Production of machinery and equipment	5.0	12.2	-47.6	16.1
Production of transport vehicles	10.7	8.1	-48.8	41.3
Other industries	3.0	-8.0	-18.8	-3.2

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

Recovery after the crisis is uneven in manufacturing sectors. Wood processing has contributed the most to the growth; in 11 months of 2010, the production volume there has been almost by 30% higher than in the respective period of the previous year. Production volumes of metal and metal articles sector have increased by over 20% in the same period. Positive tendencies can be observed also in the paper industry and publishing, production of electric and optical equipment, as well as production of transport vehicles and machinery sectors. At the same time, production volumes in January-November of this year, compared to the same period of last year, have decreased in the food industry. Despite the increase of export volumes, due to the still weak domestic consumption, production volumes of the food industry fall behind the level of the respective period of 2009 almost by 3%.

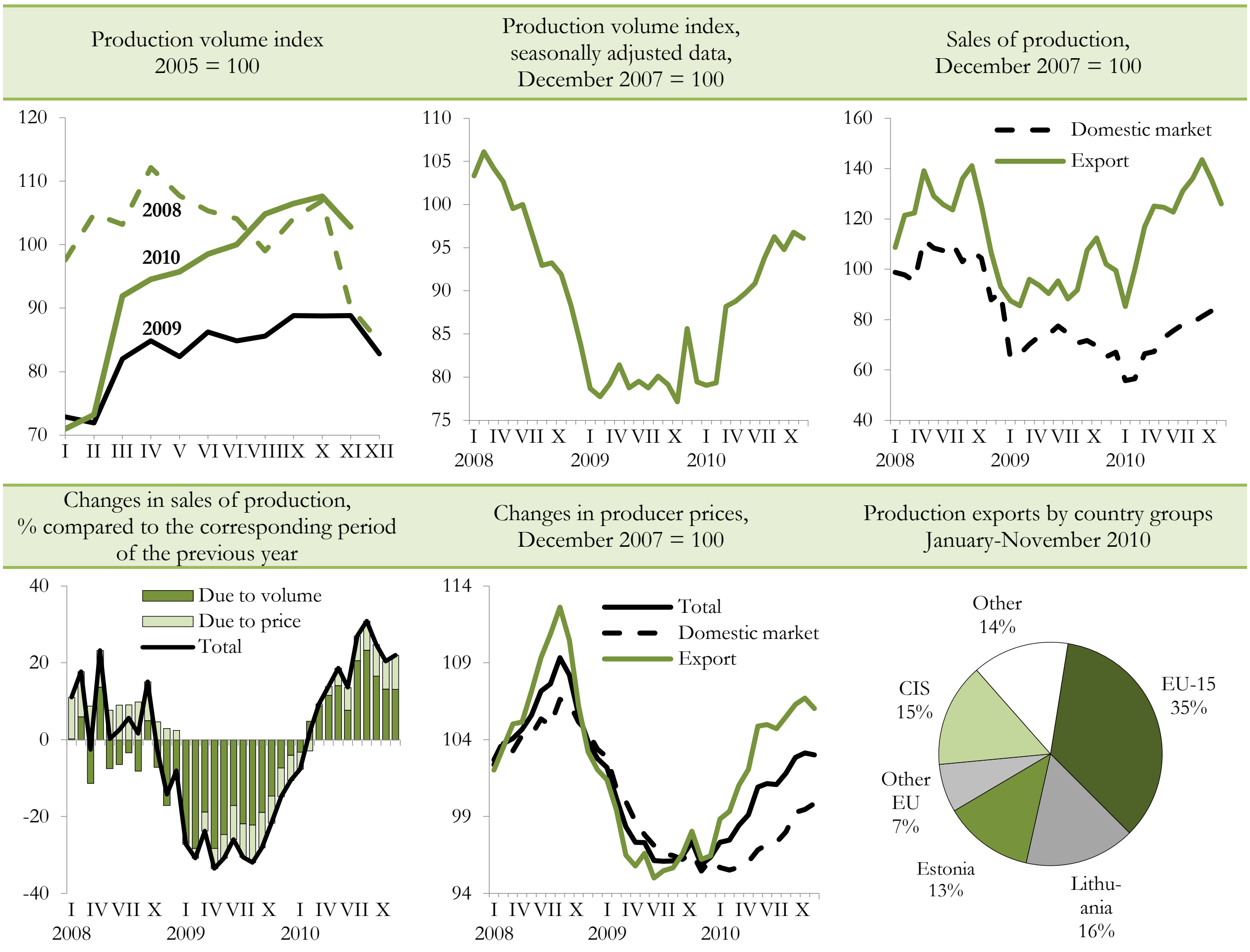
In 2009, the sales of production of manufacturing in current prices were by 26.3% lower. The rapid decline of the revenues from sales was related not only to the decline in production volumes, but also to the decrease of producer prices in domestic and foreign markets.

In the 11 months of 2010, the revenues from manufacturing sales were by 16.2% higher than in the corresponding period of the previous year. As a result of the weak domestic demand, the production sales in the domestic market have increased only by 2.1% in this period. However, the sales of exported production increased by 28.2 percent.

In November 2010, the producer prices in manufacturing were by 7.5% higher than in the previous year. As a result of the low demand, producer prices for production sold in the domestic market have increased by 4.6% over 12 months, but producer prices for exported production were by 10.3% higher than in November 2009. The highest increase of producer prices can be observed in those sectors of manufacturing in which the demand in foreign markets is rapidly increasing and which depend on the fluctuations in the world prices. For example, in the metal processing industry, producer prices in November 2010 were by 21.4% higher than a year ago but producer prices in the wood processing sector grew by 12.3% over 12 months. Producer prices in the food industry increased by 6.9 percent within a year.

Figure 3.20

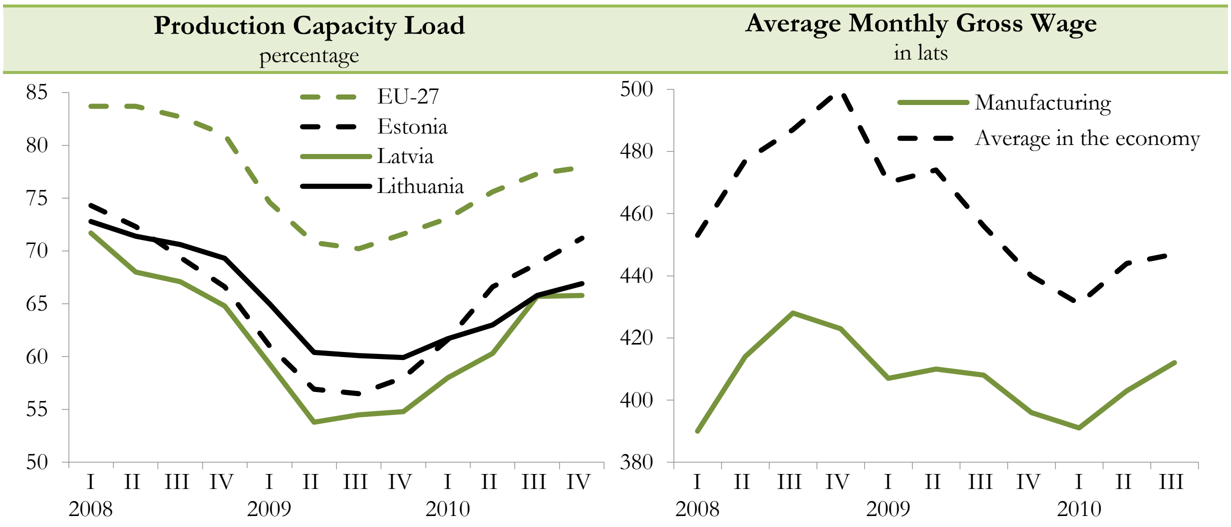
Indicators Characterising Manufacturing



Due to the weak domestic demand and considerable increase of external demand, the share of exports has increased. In the eleven months of 2010, it was almost 60% of the total sales of production. At the same time, the structure of manufacturing exports has not changed significantly over the recent years. A slightly more than 70% of production exports is related to the markets of the EU member states, of which slightly more than a half is related to the EU-15 member states and almost 29% – to Lithuania and Estonia. 15% of production has been exported to the CIS countries within four months of 2010.

The level of production capacity in manufacturing in the third and fourth quarter of 2010 remained basically unchanged within 66%, which overall corresponds to the average level of 2008. However, monthly gross wage of an employee in manufacturing slightly increased at the beginning of 2010. Comparing to the pre-crisis level, a decrease of wages in manufacturing was considerably smaller than on average in the economy.

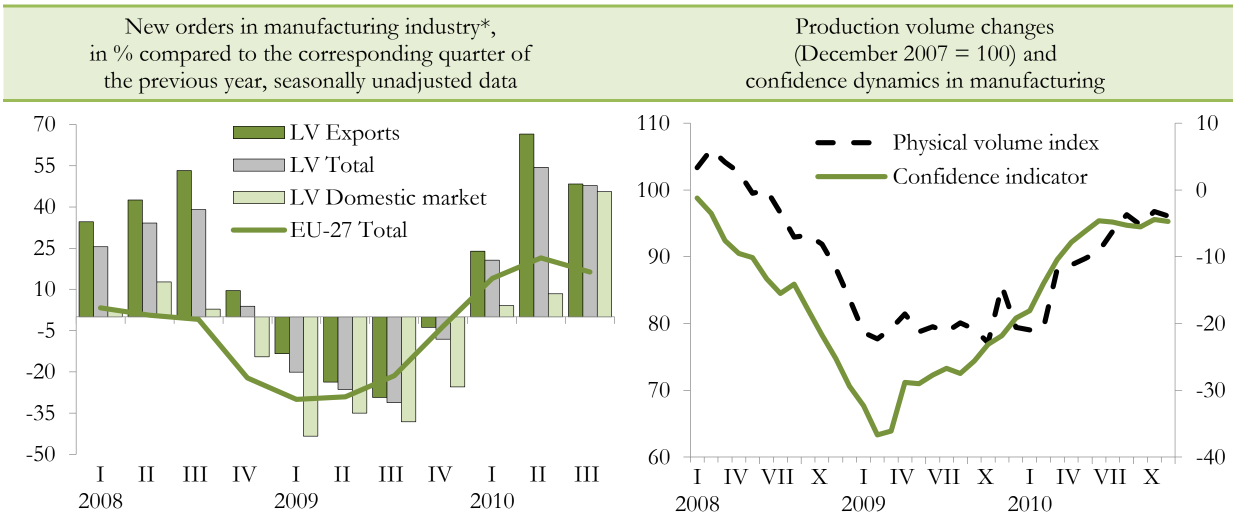
Figure 3.21



Though slightly slower than at the beginning of 2010, the volume of new orders in manufacturing is growing relatively steadily. The increase of new orders is based on a growing demand in export markets, yet, unlike the first two quarters of 2010, the number of new orders in the domestic market has significantly increased in the third quarter, compared to the third quarter of 2009 – especially in sectors of the chemical industry, production of electrical and optical equipment, as well as production of machinery.

Figure 3.22

Development Tendencies of Manufacturing*



* Data is collected only for those manufacturing sectors, which are working mainly on orders

The results of conjuncture surveys also show that evaluation of entrepreneurs regarding further growth possibilities continues to improve. Total confidence indicator of manufacturing in December 2010 was -4.4 points. That is 32 points more than in February 2009 when the indicator reached the lowest level.

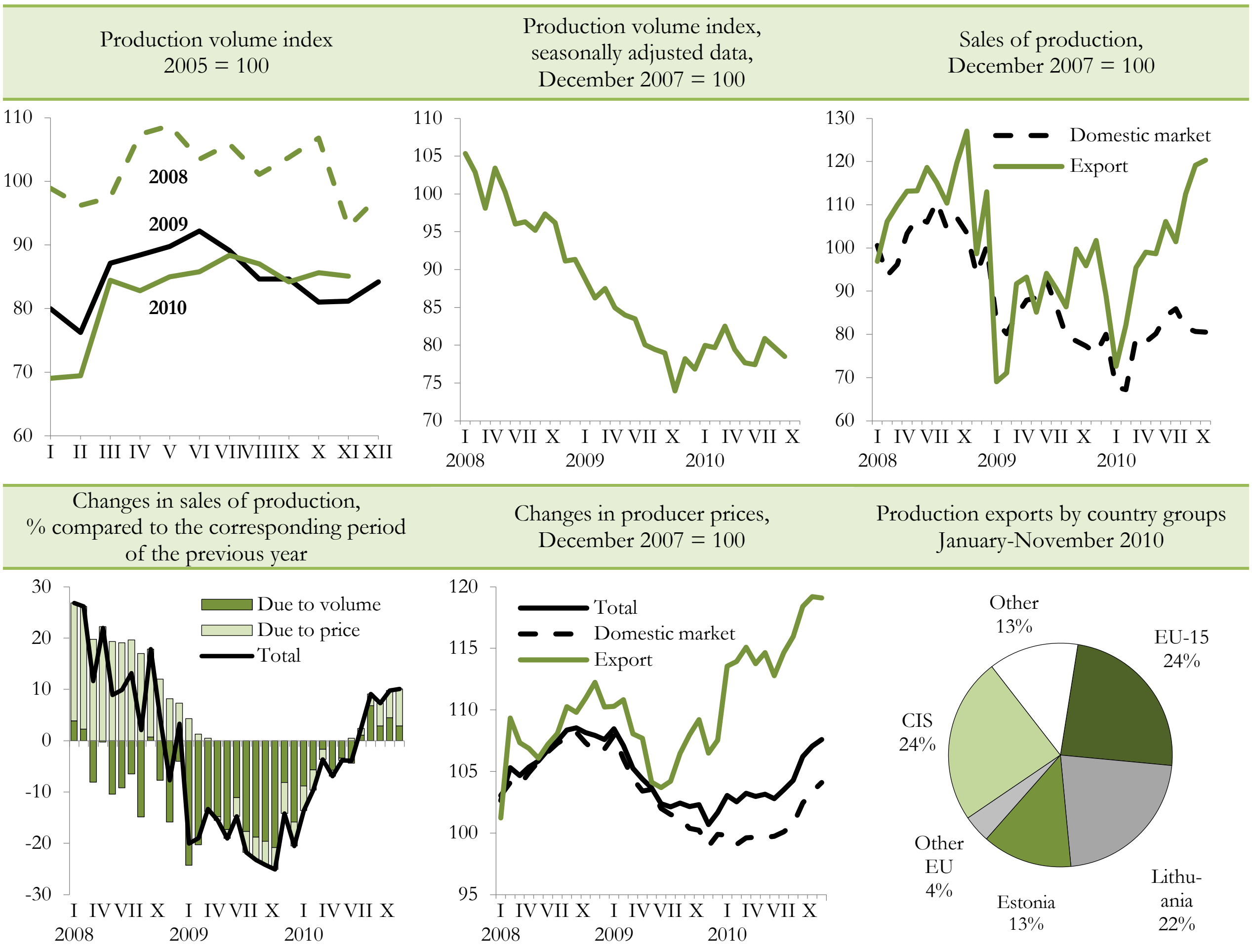
The dynamics of manufacturing confidence indicators depends on increasing uncertainty about perspectives of the main trade partners in 2011. Relatively slower improvement of conjuncture indicators in the last few months of 2010 was based on a more cautious attitude of entrepreneurs and consumers towards future perspectives related to development and adoption of state budget of 2011.

The food industry is one of the largest manufacturing sectors both by value added and by the number of employed. The sector is mainly oriented towards the domestic market therefore along with the decreasing domestic demand, production volumes of the sector decreased rapidly as well. In 2009, the output of the sector was by 16.5% lower than in 2008. Recovery of the food industry after crisis was a little slower than that of other manufacturing sectors. In 11 months of 2010, production volume of the sector was by 2.9% lower than the level of January-November 2009.

The sales of the sector production in export markets have increased by 14.5% in eleven months of 2010, in comparison with the corresponding period of the previous year. Yet, despite the significant increase of export, total revenues from the sales of the sector remained on the level of the corresponding period of 2009. Contribution of export to the growth of the sector, comparing to other manufacturing sectors, is small – only slightly over 27% of manufactured production is exported. A more rapid increase of export volumes in 2010 was hindered by the still weak domestic demand in our neighbour countries – Lithuania and Estonia. 35% of the exports of the sector are exported to these countries. In 11 months of 2010, the sales of manufactured production have shrunk by almost 5 percent.

Figure 3.23

Indicators Characterising Food Industry



Comparing to 11 months of 2009, volumes of meat and meat products, as well as volumes of fish production and processing decreased in 2010. However, the increase in fruit and vegetable processing, as well as in production of dairy products was observed in the same period. Volumes of pastry and flour products in 11 months of 2010 remained on the level of January-November, 2009.

The rise in prices for food products in the world was reflected also in changes of Latvian producer prices. Overall, producer prices in November 2010 were by 6.9% higher than in November 2009. However, due to the remaining low domestic demand, changes in 12-months producer prices for production sold in domestic market was 5.2% in November 2010. But due to the increasing demand in foreign markets, Latvian producer prices increased by almost 12 percent in the same period.

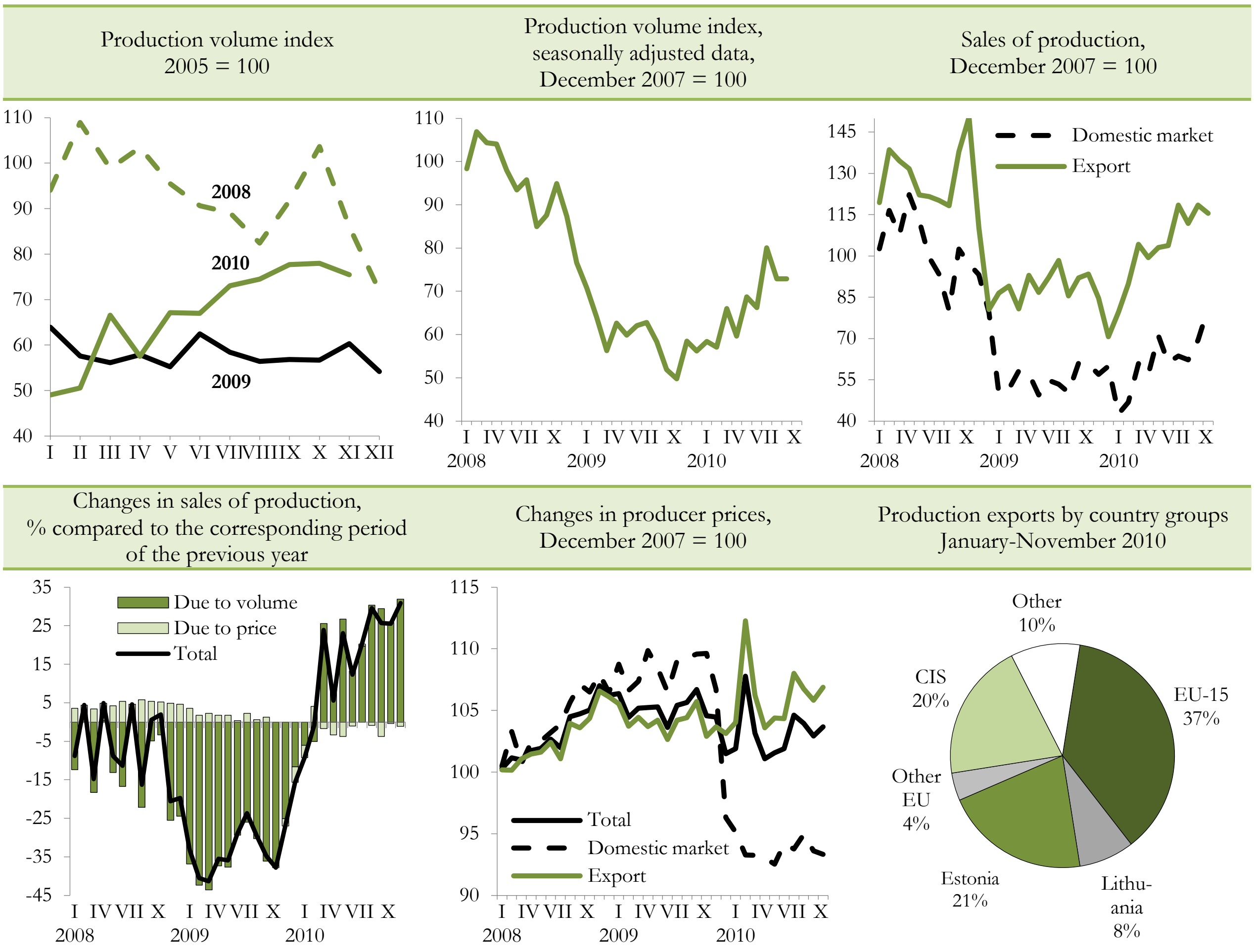
The share of ***light industry*** is mainly oriented to export. Over 80% of manufactured production is sold in foreign markets. As the key markets of light industry are the old EU member states, which is why the world economic crisis and decline of economic activities in Western Europe had a significant impact on the development of the sector in 2009 when production volumes shrank by 37.6%. A particularly rapid decline in production volume was observed at the end of 2008 and at the beginning of 2009.

At the end of 2009, the situation in the sector has stabilized and positive tendencies remained also in 2010 – production volumes of the sector in eleven months exceeded the level of the corresponding period of the previous year by 14.7%. Last year, a significant increase of volumes was observed in production of textiles (by 18%) and clothes (by 12.6%).

The sales revenues of the sector after the huge decline in 2009 (by 32.8% compared to 2008) gradually increased in 2010 and in January-November, already exceeded the level of the corresponding period of the previous year by 17%. The sales revenues of the sector increased for production sold in both export markets (by 17.6%) and the domestic market (by 13.9%).

Figure 3.24

Indicators Characterising Light Industry



As during the global financial crisis, the production volumes of light industry decreased all over the world, then due to restored demand, a goods deficit developed in the world market. The demand increased rapidly also in the CIS member states, moreover, the exchange rate of the Ruble against the Euro was relatively high at the beginning of 2010 and therefore production exported to the CIS countries was comparatively cheaper. As a result, 20% of production sold in foreign markets was exported to the CIS member states in January-November 2010. That is by 4 percentage points more than a year ago.

Despite the very low demand, producer prices of the light industry remained almost unchanged in 2009. In 2010, along with the restored external demand, producer prices for exported production increased and in November was by 2.1% higher than in the same month of 2009. But producer prices in the domestic market continued decreasing rapidly at the beginning of 2010 and in November 2010 were by 11.7% lower than a year ago.

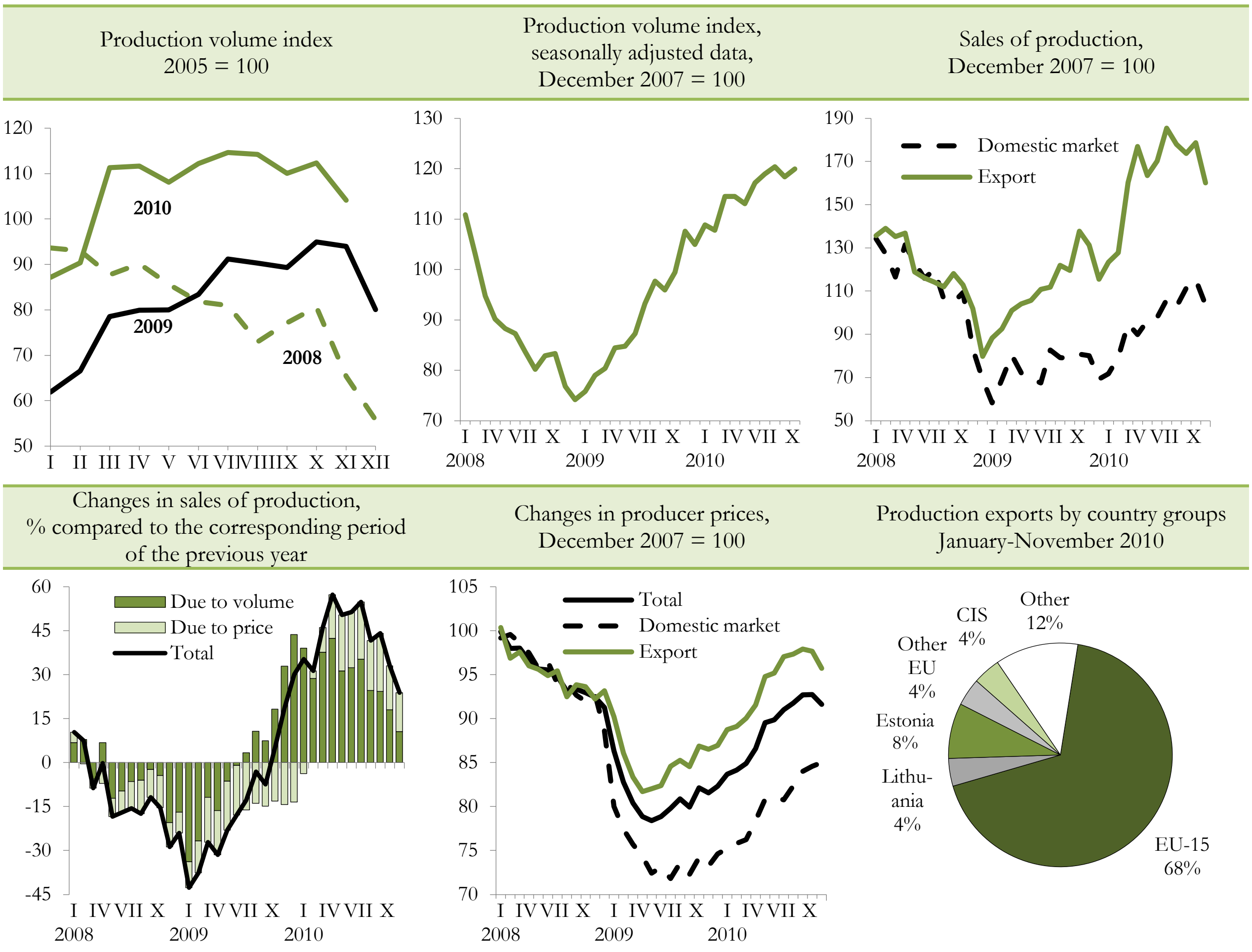
Wood processing is the largest manufacturing sector which has successfully overcome the consequences of the crisis. Already in 2009, by increasing significantly the cutting volumes in national forests, the output of the wood processing sector increased by 2.6%, compared to 2008. From January 2009 to November 2010, production volumes of the sector have increased on average by 2% per month.

The sector turnover in 11 months of 2010 has increased by over 40% in comparison with January-November of 2009. The sales of the sector in both domestic market and export have increased in this period – by 30.5% and 46.8%, respectively.

The wood processing sector exports ¾ of production and the main export markets are the old EU member states. The share of the third countries within the export structure compared to 2009 has increased.

Figure 3.25

Indicators Characterising Wood Processing



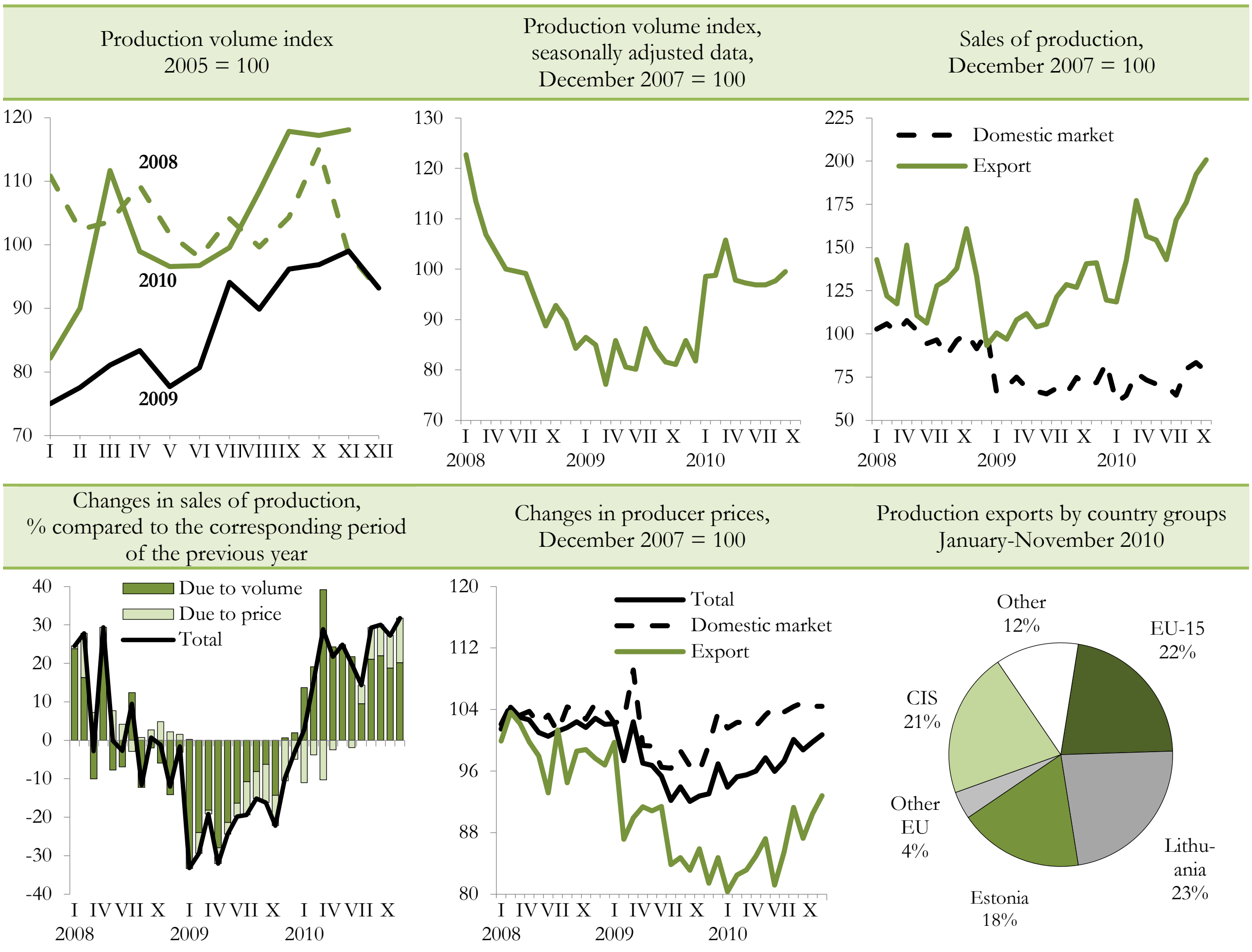
The huge increase was based not only on the increase of production volume but also on the rise in producer prices. Although due to the rapid decrease of demand, a fall in producer prices for production sold in both domestic and export markets was observed in the first half of 2009, the producer prices of the wood processing sector gradually increased since the middle of 2009 till they reached the pre-crisis level in the spring 2010. In November 2010, the producer prices were increased by 12.3% within a year. One of the hugest rises in producer prices is observed in wood processing, which is based on both rapidly increasing demand in foreign markets and dependence on price fluctuations in the world. Producer prices for exported production in wood processing sector in November 2010 were by 10.6% higher than a year ago; however, as the prices started to rise from a fairly low level, the producer prices for production sold in the domestic market have increased by more than 16 percent.

Paper industry and publishing sector has managed to successfully increase the share of export in total turnover during crisis. If export did not exceed 40% in total turnover of the sector in pre-crisis years, then it constitutes almost 55% in 2010.

During the crisis, the development of the sector was significantly influenced by the decline in both domestic and external demand due to the global financial crisis. The production volumes decreased most rapidly at the end of 2008 and at the beginning of 2009. Although the situation has been gradually improving since the mid-2009, the total annual output has been by 15.8% lower than in 2008. Due to the gradual stabilization of situation in the domestic market, as well as the expanding export possibilities, production volume of the sector continued increasing in 2010. In 11 months of 2010, the output of the sector exceeded the level of the corresponding period of previous year by 19.5 percent.

Figure 3.26

Indicators Characterising Paper and Publishing Industry



In January-November of 2010, the turnover of the sector was by 22.8% higher than in 11 months of 2009. The increase of export contributed the most (by 42.5%). The sales in the domestic market have increased almost by 6% in the same period. The share of the EU-15 member states and the CIS member states has increased in the export structure in comparison with 2008, but the share of export to our neighbour countries – Lithuanian and Estonia – has significantly reduced at the same time.

Just as in other sectors, due to a decrease of demand, a decline in producer prices at the beginning of 2009 was observed in the paper industry and publishing. As the situation became stable, producer prices of the sector started to increase. In November 2010, the level of producer prices on production sold in the domestic market is by 5% higher than a year before, whereas prices on exported production decreased by 14% within a year.

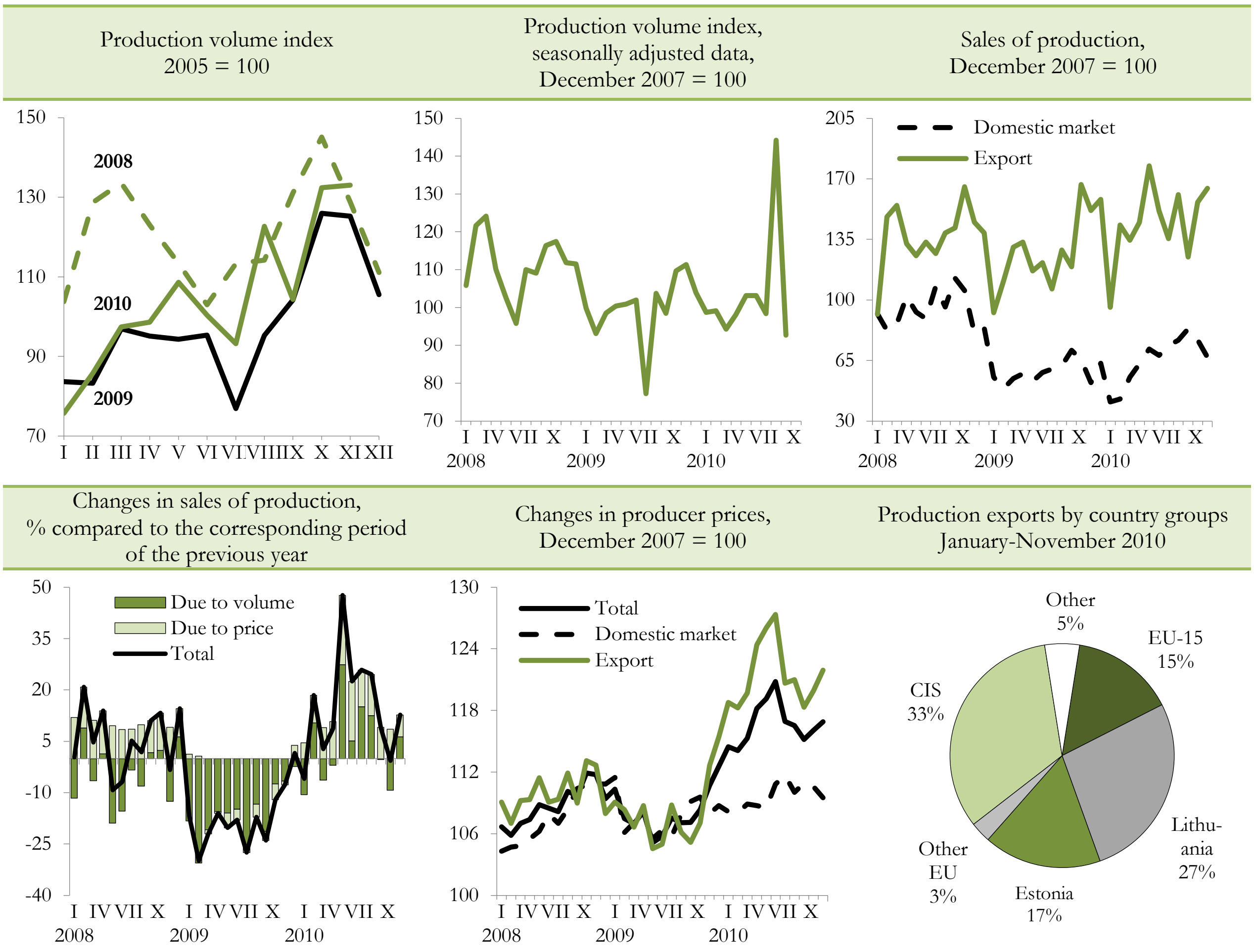
The chemical industry includes production of chemical substances and products, pharmaceutical raw substances and products, as well as rubber and plastic articles. The share of this sector in the total value added of manufacturing accounted for almost 1/10.

Development tendencies of chemical industry sub-sectors differed during the economic downturn and in the post-crisis period. In 2009, production volumes of the sector have decreased by 18.4%. At the same time, production volumes of chemical substances and products decrease was moderate – by 3.7%, but the production volumes of pharmaceutical raw substances and products shrank by 16.5% and production volumes of rubber and plastic articles – by almost 30 percent.

In January-November of 2010, the production volumes of the chemical industry exceeded the level of the corresponding period of 2009 by 7%. The most rapid increase of the production volumes was observed in production of chemical substances and products – by 16.6%. Production volumes of rubber and plastic articles have increased by almost 10%, compared to January-November of 2009. Yet, the production volumes of pharmaceutics in 11 months of 2010 fell behind the level of the respective period of 2009 by 5 percent.

Figure 3.27

Indicators Characterising Chemical Industry and Related Industries



In 11 months of 2010, the turnover of the chemical industry sector exceeds the level of January-November of 2009 by 14.6%. Almost 3/4 of manufactured production are sold in foreign markets. Due to the gradual increase of external demand, the turnover of production exported in 11 months of 2010 exceeds the level of the corresponding period of 2009 by 15.3%. The turnover in the domestic market has increased slightly slower in the same period – by 12.7 percent.

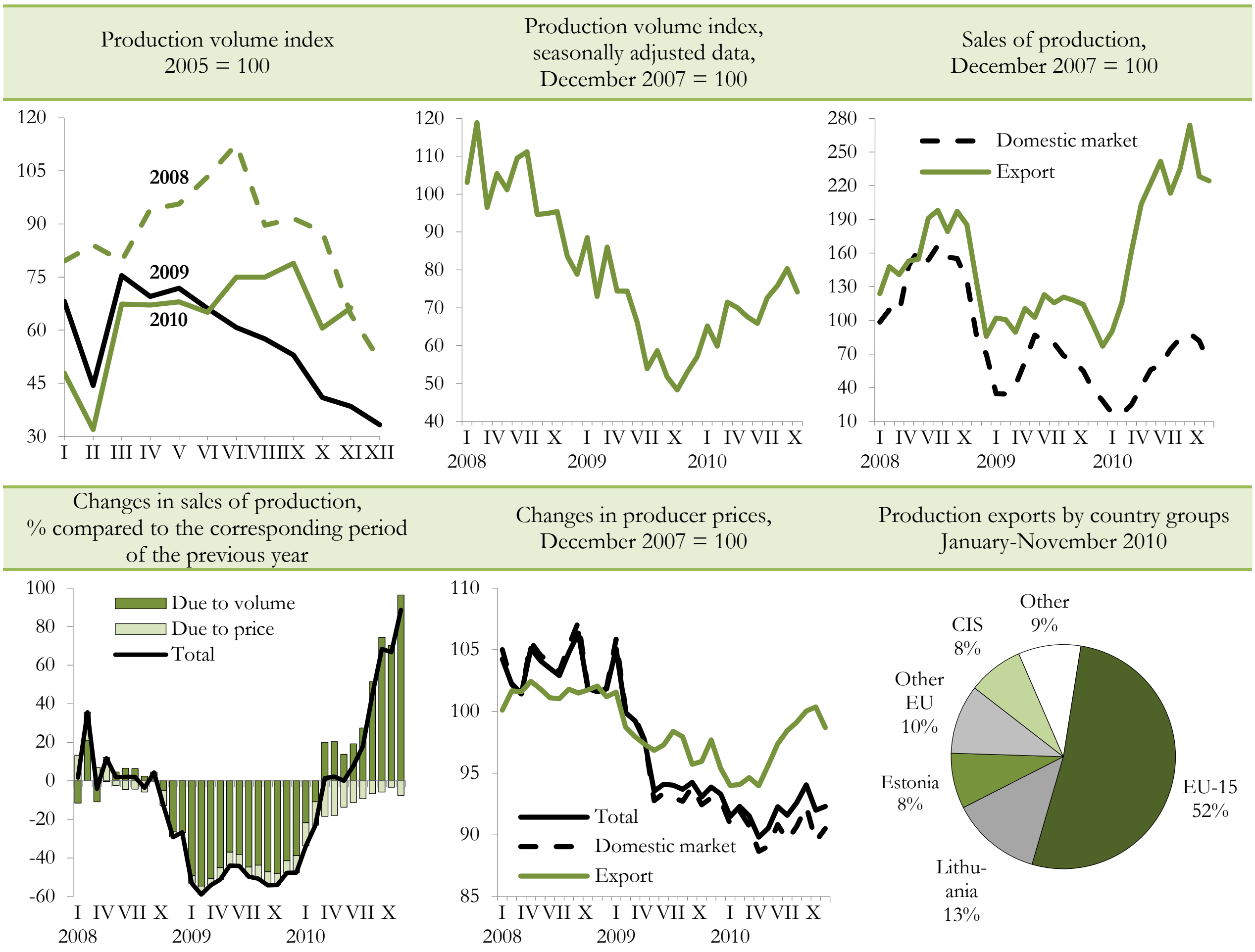
During the economic downturn, the decline in producer prices of the chemical industry was moderate. Yet, producer prices have significantly increased since the second half of 2009 and the increase rate reduced only at the end of 2010. In November 2010, the level of producer prices exceeded that of the November 2009 by 5.6%. That was mainly due to the rise in prices for exported production (by 8.2%), but the producer prices for production sold in the domestic market increased by 1.4% within a year.

Other non-metallic mineral products sector is closely related to development of the construction sector. Therefore during the crisis, production volumes of non-metallic minerals have significantly reduced due to the decrease of construction volumes. The output of the sector has shrunk by 34.3% in 2009. At the end of 2009, the level of production was approximately 40% of the average indicator of 2005 at the end of 2009.

In the pre-crisis period, the sector non-metallic mineral products was mainly oriented to the domestic market – only about 20% of manufactured production was exported. In 2010, due to the remaining low level of domestic demand, the sector gradually re-oriented towards foreign markets. In 11 months of 2010, the share of exported production was almost a half of the total turnover. The successful entering into foreign markets was a reason for gradual increase of production volumes in the sector. Volumes of production manufactured in 11 months of 2010 exceed the level of January-November of 2009 by 8.8 percent.

Figure 3.28

Indicators Characterising Production of Other Non-Metallic Mineral Products



In January-November of 2010, the turnover of production exceeds the level of the corresponding period of 2009 by almost 23%. The turnover of exported production has increased by over 85% in the same period. The main output markets of the sector are the EU-15 member states to which over a half of the exported production of the sector was exported in 11 months of 2010.

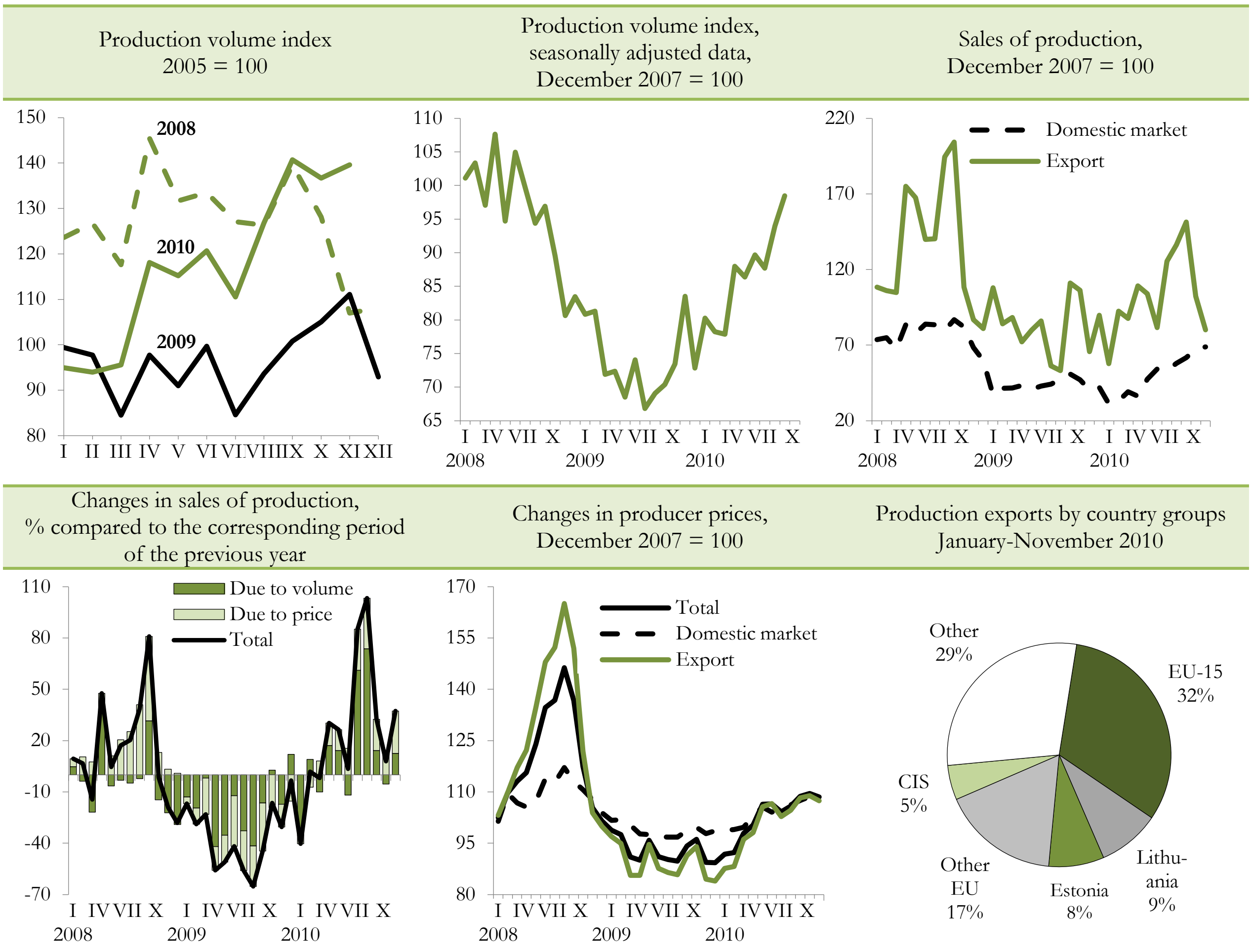
In 2009, producer prices reduced significantly due to the rapid decrease of demand. In 2010, due to the gradual stabilization of demand, the overall decline in prices was diminished. In November 2010, producer prices have decreased by 1.7% within a year, including prices for production sold in the domestic market by 2.7%. But producer prices for exported prices in November 2010 were by 1.1% above the level of November 2009.

Metals and metal articles sector is closely related to foreign markets – over 70% of manufactured production are being exported. Taking into account the comparatively large export share of the sector sales, the global economic recession considerably influenced the development of the sector. In 2009, the output of the sector decreased by 23.6% and the sales volumes decreased by approximately 40 percent.

As the economic situation in the main trade partner countries stabilised, production volumes of the metal processing sector started increasing since the mid-2009. The recovery of the sector from the crisis is relatively fast. In November 2010, the production volumes correspond to the level of 2008. Since reaching the lowest point of production volumes (July 2009), the production volumes of the sector has been increasing on average by 2.8% monthly (according to seasonally adjusted data). Overall, in 11 months of 2010, the total volume of output exceeds the level of the 11 months of 2009 by over 21 percent.

Figure 3.29

Indicators Characterising Production of Metals and Metal Articles



Along with the increasing demand in the foreign markets and stabilizing situation in the domestic market, the turnover has increased in 2010. The sales in the 11 months of 2010 in the domestic market are by 15.4% lower and in the export market – by 23.9% over than in the 11 months of the previous year.

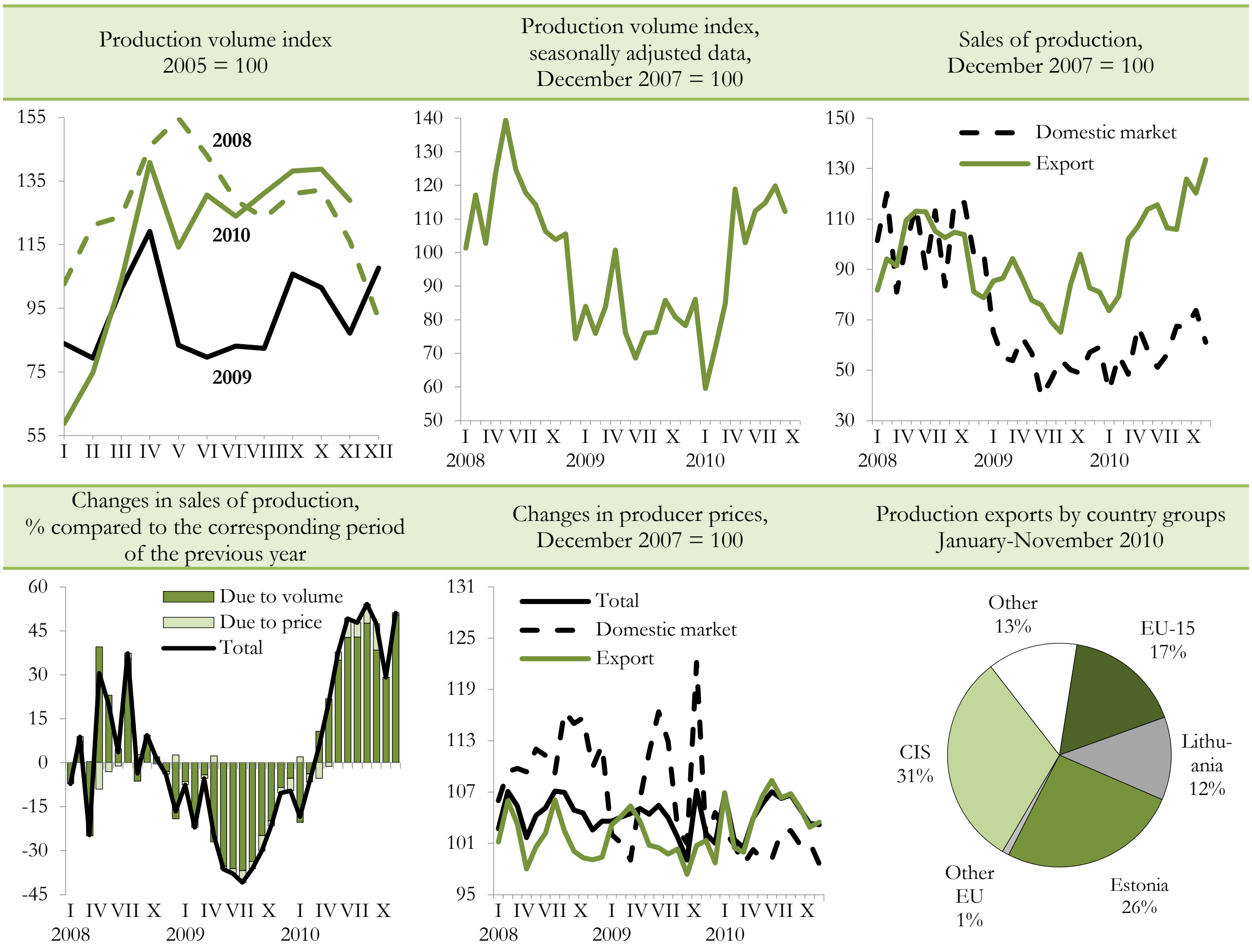
As a result of the global economic crisis and the rapidly decreasing demand for metals and metal articles, a considerable decline in producer prices has been observed at the beginning of 2008 and at the beginning of 2009. Since the beginning of 2010, a slight increase in producer prices on production both sold in domestic market and exported could be observed. In November 2010 compared to November 2009, prices have increased by 10.9% and 27.1%, respectively.

Due to the rapidly decreasing domestic and external demand, the production volumes of ***electrical and optical equipment*** sector have declined by 26.5% in 2009. The most rapid decline of the output of production of electrical and optical equipment could be observed already in the mid-2008; however, at the beginning of 2009, unlike majority of manufacturing sectors, the decline of the production volumes was quite small.

Since the beginning of 2010, the production volumes are gradually increasing which is mainly due to the increase of external demand. Export constitutes almost 85% of the total turnover in the sector. In January-November of 2010, the production volumes exceeded the level of corresponding period of 2009 by 27.6%. Production of electrical equipment has contributed the most to the growth of the sector (increase of 35.3%), but production volumes of computer, electronic, and optical equipment have increased more moderate – by 18.6 percent.

Figure 3.30

Indicators Characterising Production of Electrical and Optical Equipment



The main output markets of the sector in 2010 were the EU member states to which almost 60% of production was exported. The CIS member states also constitute a large share in export structure – almost 30%. In 11 months of 2010, the turnover of export exceeds the level of the respective period of 2009 by 31%. The turnover in the domestic market has increased by almost 10% in the same period. The dynamics of the sales revenues of the sector depends mainly on the changes in production volumes, but producer prices have no significant impact on changes in turnover.

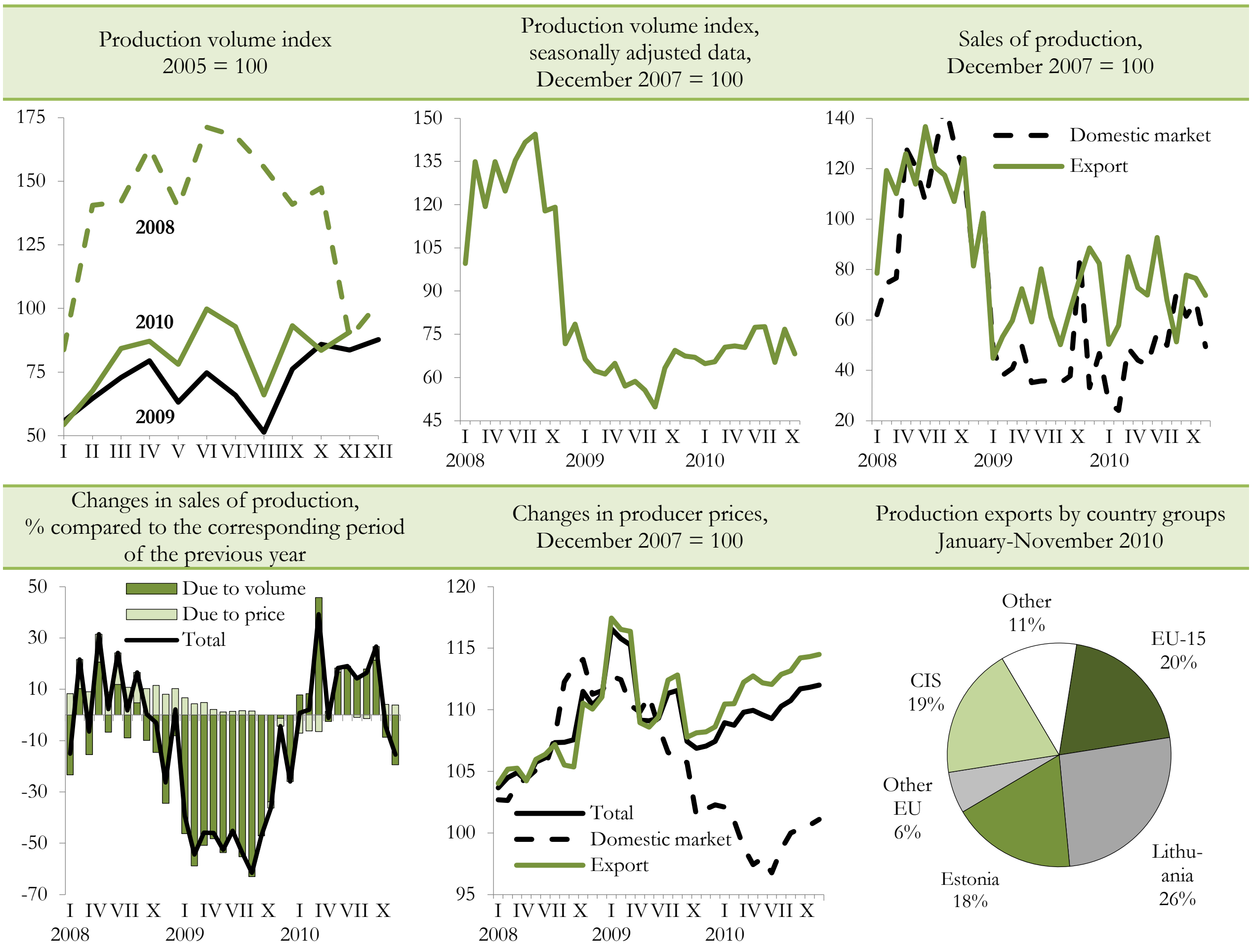
Despite the low level of demand, producer prices in the sector remained basically unchanged in 2009. Furthermore, even though the demand is recovering, producer prices are not tended to increase considerably. Since November 2009, producer prices for production sold in the domestic market have shrunk – by 2.8%, but prices for exported production have increased – by 2.1 percent.

The production of machinery and equipment sector is the main supplier of manufacturing materials and technologies to other sectors; thus, the economic crisis has hit this sector particularly hard, just like elsewhere in Europe. Moreover, the turnover of both exported production and production sold in the domestic market declined equally rapidly. In the mid-2009, situation in the sector has stabilized; however, the overall production level of 2009 was almost by 50% lower than in 2008.

Like the majority of the sectors, also development of production of machinery and equipment is closely related to the changes in external demand. Already in the mid-2009, the situation in foreign markets had stabilized and demand gradually increased. Positive tendencies continued also in 2010. Production volumes in 11 months of the year exceeded the level of January-November of 2009 by over 16 percent.

Figure 3.31

Indicators Characterising Production of Machinery and Equipment



The production of machinery and equipment sector is oriented towards export. In 2010, over 85% of production was sold in foreign markets. In 11 months of 2010, the turnover of exported production after the huge decline in 2009 (by over 40%) exceeds the level of the corresponding period of 2009 by 8.6%. Volumes of production sold in the domestic market have increased by almost 14% in the same period, yet, it must be noted that in 2009, volumes of production sold in the domestic market decreased considerably faster than those of exported production. The main export markets of the sector remain in the EU member states. Moreover, more than 40% of exports are sold in Lithuania and Estonia. A relatively large part of exports of the sector is associated with the markets of the CIS and other countries.

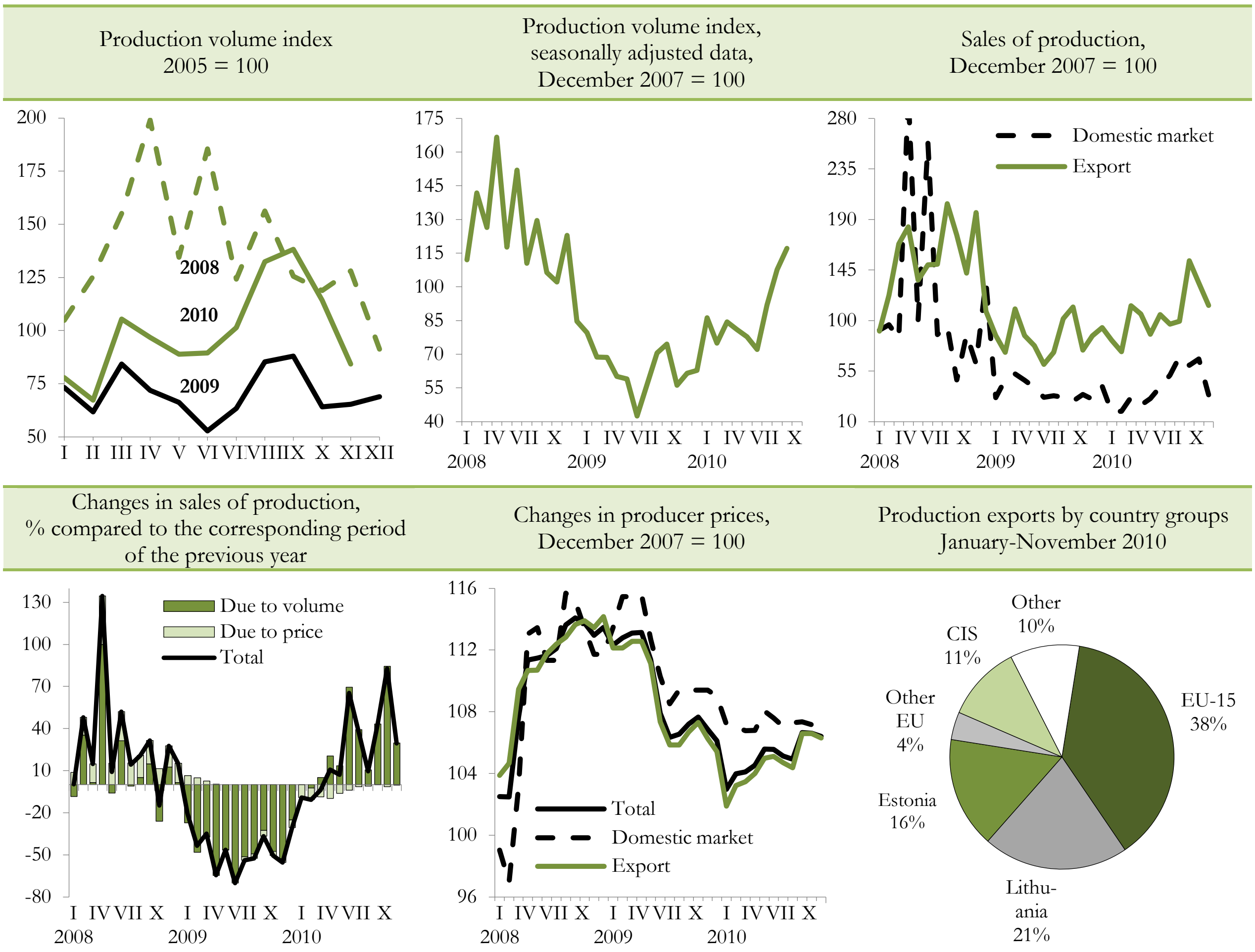
A decline of both, external and domestic demand affected the producer prices. Since the end of 2009, when the demand in the global markets was rising, the producer prices for exported production increased as well. In November 2010, producer prices were by 5.8% higher than in November 2009. Meanwhile, producer prices for production sold in the domestic market continued decreasing until the mid-2010. In November 2010, producer prices are by almost 1% lower than a year before.

Production of transport vehicles sector is a relatively small manufacturing sector, which is characterized by marked fluctuations of production volumes. As almost 90% of production is being exported, fluctuations of external demand have major impact on development of the sector.

In 2009, due to the global financial crisis and rapidly decreasing demand, production volumes of the sector were half of the volumes in 2008. Since the mid-2009, due to improving situation in foreign markets, production volumes of the transport vehicle sector resumed increasing. In 11 months of 2010, volumes exceeded the corresponding level of 2009 by 41.3%. The main export markets remained in the old EU member states, where 40% of all exported production is sold. Lithuania and Estonia are also important trade partners. Overall, almost 80% of total exported production is being exported to the EU member states.

Figure 3.32

Indicators Characterising Production of Transport Vehicles



In January-November of 2010, the turnover of the sector has increased by almost 22%, including export markets by 23.7% and domestic market by 9.6%, in comparison with the corresponding period of 2009. The transport vehicle production sector is oriented towards orders. According to the dynamics of the volumes of new orders, in the third quarter of 2010, the volumes of new orders to export markets have increased by 35%, but the new orders in the domestic markets have slightly decreased, in comparison with the third quarter of 2009.

Changes in producer prices are closely related to the changes in foreign markets. Due to the decreasing demand, prices for exported production also decreased in 2009. However, in 2010, as the demand in foreign market resumed increasing, the producer prices for exported production increased as well. In November 2010, prices reached the level of November 2009. At the same time producer prices for production sold in the domestic market was by 2% lower.

3.2.3. Energy Sector

Both the imported (coal, coke, petroleum products, natural gas, electricity) and local (used tyres, municipal waste for heating, peat, fuelwood, charcoal, straw, biogas, bioethanol, biodiesel) energy resources are used in Latvia to supply fuel, electricity and heat to sectors of economy, commercial consumers and residents. A part of electricity is generated by Latvian

HPPs, CHPs, landfill biogas and wind power plants, whereas the other part is imported. Mainly the imported fuels (natural gas and residual fuel oil) and local fuels (fuelwood) are used in heat generation.

In 2009, energy resource production and recycled products in Latvia formed 87.9 PJ. The import of energy resources provided 161.2 PJ, out of which 58.6 PJ was provided by the imported natural gas.

In 2009, the total consumption of primary energy resources in Latvia amounted to 183.3 PJ, and self-sufficiency in the total consumption of primary energy resources was 35.9%. Fuelwood, with its total consumption forming 28.7%, was the most widely used local energy resource in the total consumption of primary energy sources, whereas electricity generated by Latvian HPPs and wind power stations was 6.9% of the total energy consumption.

Table 3.12

Consumption of Primary Energy Resources in Latvia, PJ

	2003	2004	2005	2006	2007	2008	2009
Total consumption* including:	**184.3**	**188.4**	**191.9**	**199.0**	**204.6**	**196.5**	**183.3**
coal and coke	2.8	2.8	3.3	3.6	4.4	4.4	3.5
peat	0.9	0.1	0.1	0.1	0.1	0.1	0.0
petroleum products	59.3	61.0	61.9	67.5	73.3	69.3	56.7
natural gas	56.4	55.8	56.9	58.9	56.9	55.8	51.4
fuelwood	47.0	49.4	49.4	49.7	48.7	46.0	52.6
electricity	17.8	18.9	19.9	18.9	20.8	20.5	18.6
other energy resources**	0.2	0.3	0.5	0.4	0.4	0.5	0.5

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

The volume of ***electricity*** generation depends directly on the flow in the Daugava River. After closing Ignalina NPP at the end of 2009, the situation in electrical power market in the Baltic States has changed. Latvia is no more the only state in this region, which is unable to generate sufficient amount of electrical power in its power plants in order to meet its own demand.

At the moment, Lithuania is also importing electrical power. Therefore mostly the suppliers from Estonia and Russia compete for exporting electricity to Latvia.

Table 3.13

Electricity Supply in Latvia, TWh

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

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

In 2009, JSC "Latvenergo" generated 67% of the total electricity supply, 10% was purchased from small producers of electricity, but 23% were formed by the net electricity import. Total electricity supply has reduced by 8% in comparison to the preceding year.

The consumption structure of ***centralised heat supply*** has not changed in the recent years, with central heating comprising 65-70% and hot water supply accounting for 30-35%. Of the total amount of heat sold, 1.4% was sold to industry, 73.7% to households, and 24.9% to other consumers. The amount of heat sold in regions is the following: Riga – 51.7%, Pierīga region – 11.5%, Vidzeme region – 6.2%, Kurzeme region – 10.2%, Zemgale region – 7.8% and Latgale region – 12.6 percent.

Heat for selling is produced in 679 boiler houses and 56 cogeneration stations, which in 2009 produced 7.31 TWh of heat.

Natural gas was mainly used to produce heat in 2009. Share of the produced heat using natural gas as fuel was 76.8%, while using woodchips – 12.5%, firewood – 3.6%, residual fuel oil – 3%, and other types of fuel – 4 percent.

The largest consumers of ***natural gas*** are CHPs of JSC "Latvenergo" and heat supply enterprises – 62.5%, industry – 17.3% and other consumers ~20%. The region of Riga accounts for about 70% of the total natural gas consumption in Latvia.

3.3. Forecasts

The Ministry of Economics has developed medium-term economic development forecasts for the period until 2016.

The economic development scenarios have been developed in relation with the future economic development opportunities, which are largely determined by the response of the global economy to the financial crisis and by the possibilities of overcoming it and of reviving growth, as well as by the efficiency of economic recovery policy implemented by Latvia.

The global economic recovery is more rapid than forecasted before. However, the future development perspectives should be assessed cautiously. The main political priority in the global economy is still related to the recovery of the financial system, taking into account the sub-influence of the real sector downturn in it.

Economic Development in 2011 and 2012

Just like in 2010, export will be the key economic driver also in the coming years.

Therefore the main risk of the growth of Latvia is related to the development of the global economy which might slow down in future, thus narrowing the possibilities of Latvian export. The tension with the possible reversed effect on the real sector still exists in the financial markets. The recovery of economy might be prevented by a rise in prices of oil and other goods. The recovery of economic activity in many countries to a great extent will be limited by fiscal consolidation measures, increase of the government debt level, and by the intense situation in the labour market. The other forecasts scenario prepared by the Ministry of Economics envisaging a considerably slower growth rate in a medium-term is more suitable to this pessimistic situation due to the weak demand.

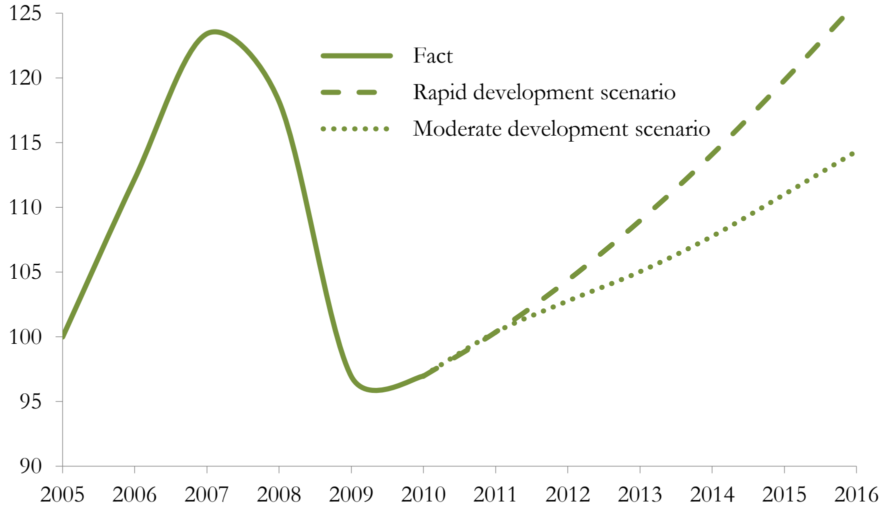
None of the scenarios forecasts a significant increase of domestic demand. Although, private consumption will gradually recover, a rapid increase thereof will be hindered by huge debt commitments of households and the relatively high unemployment rate as well, despite the improving situation in labour market.

The dynamics of investments will be affected by a cautious crediting policy of banks. Decrease of investments in the private sector will be mainly affected by the anticipatory behaviour of entrepreneurs regarding future perspectives which is influenced by the still weak overall demand. Investment financing problems will be partially solved by the government's policy implemented to improve access to financial resources, as well as the EU structural funds.

Figure 3.33

Forecast of Latvian GDP

(%, 2005 = 100)



Rates of changes in export and import will equalize because 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. But the remaining low level of private consumption will cause no extra pressure on the increase of import.

Table 3.14

Forecast of Latvian GDP by Expenditure Items

	2011	2012	2013-2016* (average annually)
	growth rates, % over the previous year		
Gross domestic product	**3.5**	**4.0 / 2.4**	**4.8 / 2.7**
Private consumption	3.7	4.0 / 1.5	4.9 / 2.6
Public consumption	-0.6	0.0 / 0.0	2.0 / 1.0
Gross fixed capital formation	7.0	6.0 / 3.0	8.0 / 4.4
Exports	6.2	7.0 / 3.0	7.0 / 4.5
Imports	6.3	7.2 / 2.4	7.6 / 3.6
	structure, %		
Gross domestic product	**100**	**100**	**100****
Private consumption	65.7	65.7 / 65.1	66.5 / 65.1
Public consumption	15.1	14.3 / 14.5	12.1 / 12.8
Gross fixed capital formation	18.9	19.3 / 19.1	22.4 / 20.9
Changes in inventories	2.3	3.0 / 3.2	3.6 / 1.5
Exports	55.3	57.0 / 55.6	62.7 / 60.5
Imports	-57.3	-59.3 / 57.6	-67.4 / -60.6
Exports-imports balance	-1.9	-2.4 / -1.9	-4.7 / -0.3

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

In 2011, almost all sectors of economy will experience positive growth rates; but the growth rates of export-oriented sectors (manufacturing, agriculture and forestry, transport services) will be even higher than the average in economy. However, it should be noted that the growth rate of manufacturing in 2011 will not be as rapid as it was in 2010.

The reduction of the state budget expenditures will affect the public services sector where the output will be smaller than in 2010.

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 / 2.2**	**4.8 / 2.7**
Primary sectors	3.6	3.4 / 2.0	3.5 / 2.3
Manufacturing	8.2	5.0 / 5.0	5.6 / 3.8
Electricity, gas, and water supply	5.3	1.9 / 0.9	2.2 / 1.3
Construction	6.2	5.2 / 2.1	6.5 / 3.4
Trade, hotels, and restaurants	7.4	3.9 / 1.1	4.5 / 1.6
Transport and communications	2.9	6.0 / 2.6	6.1 / 3.9
Other commercial services	0.4	4.3 / 3.8	5.4 / 3.2
Public services	-3.7	0.4 / 0.2	2.2 / 1.1

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

Development Perspectives in 2013-2016

Also in the medium-term, the main growth stimulus will be related to the expansion of export opportunities. Therefore, a particular role in ensuring growth is played by the main export-oriented sectors – competitiveness of manufacturing in both international and domestic markets.

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 limitation, 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. However, it should be taken into consideration that under circumstances of free movement of workers 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 complexity of export products will play a critical role, allowing to compete in the international markets much more successfully.

According to the rapid growth scenario, in order to ensure the average growth of 4.8% in 2013-2016, the production volumes of manufacturing should increase by at least 5.6% annually.

It is forecasted, that in the medium-term growth will be not as rapid as it has been observed in 2005-2007, since its driving force will be not the large financial inflows that have stimulated domestic demand and fostered mainly the development of services and activities in the real estate sector.

The main risk for further growth is an inefficiently implemented structural policy for improving competitiveness of the economy, as well as the limited financing (both private and state support) for restructuration of the economy.

4. Macroeconomic Stability

4.1. Public Finances

4.1.1. Fiscal Policy and Public Debt

As it is shown in Table 4.1, deterioration of the economic situation has had a significant impact on the fiscal position of Latvia. The general sector budget deficit in Latvia was LVL 672 million or 4.1% of the gross domestic product (GDP) in 2008 and in 2009 it had increased by LVL 1334 million or 10.2% of the gross domestic product.

Table 4.1

General Government Budget

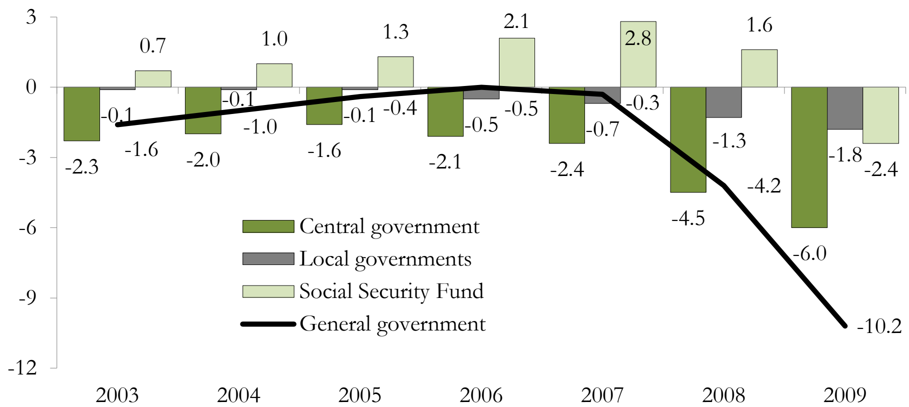
	2005	2006	2007	2008	2009
Revenues (million LVL)	3188.5	4208.0	5236.7	5605.9	4443.4
(% of GDP)	35.2	37.7	35.4	34.6	34.0
Expenditures (million LVL)	3225.2	4261.2	5283.1	6277.5	5777.2
(% of GDP)	35.6	38.1	35.7	38.8	44.2
Balance (million LVL)	-36.7	-53.1	-46.5	-671.5	-1333.8
(% of GDP)	-0.4	-0.5	-0.3	-4.1	-10.2

In 2009 the general government budget deficit was determined by the deficit in the central government budget and in the local government budget as well as in the Social Security Fund (see Figure 4.1). The social insurance budget has run at a surplus in the previous years, however, in 2009 the deficit has appeared therein.

Figure 4.1

General Government Budget Balance by Sub-Sectors

(% of GDP)

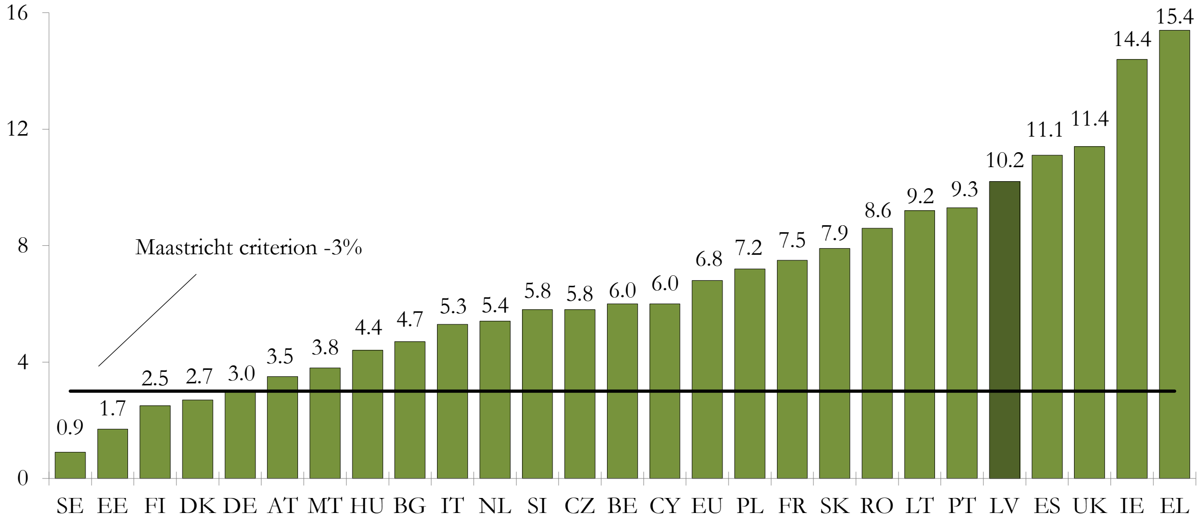


Also, the average level of the budget deficit in the EU Member States continued to grow in 2009. As it can be seen in Figure 4.2, in all 27 EU Member States, budget deficit was recorded in 2009. The average level of budget deficit in the EU Member States was 6.8% of GDP in 2009 (2.3% of GDP in 2008, 0.9% of GDP in 2007). The budget position has deteriorated in 25 EU Member States in 2009. It only improved in Estonia and Malta. In 2009, the highest general government budget deficit as a percentage of GDP was observed in Greece, Ireland, Great Britain, Spain, and Latvia. In these countries, the budget deficit exceeded 10% of GDP.

According to the forecasts by the European Commission in the autumn of 2010, the budget situation in the EU Member States in 2010 will not improve in general, however, it is forecasted that starting from 2011 the situation will gradually improve. In 2010, the average budget deficit of the EU Member States is forecasted to be in the amount of 6.8% of GDP, while in 2011 – 5.1% of GDP. In 2010, the largest budget deficit exceeding 10% of GDP is to be expected in Ireland and United Kingdom, but slightly less, approximately 9% of GDP – in Greece and Spain.

Figure 4.2

General Government Budget Deficit in EU Member States in 2009
(% of GDP)



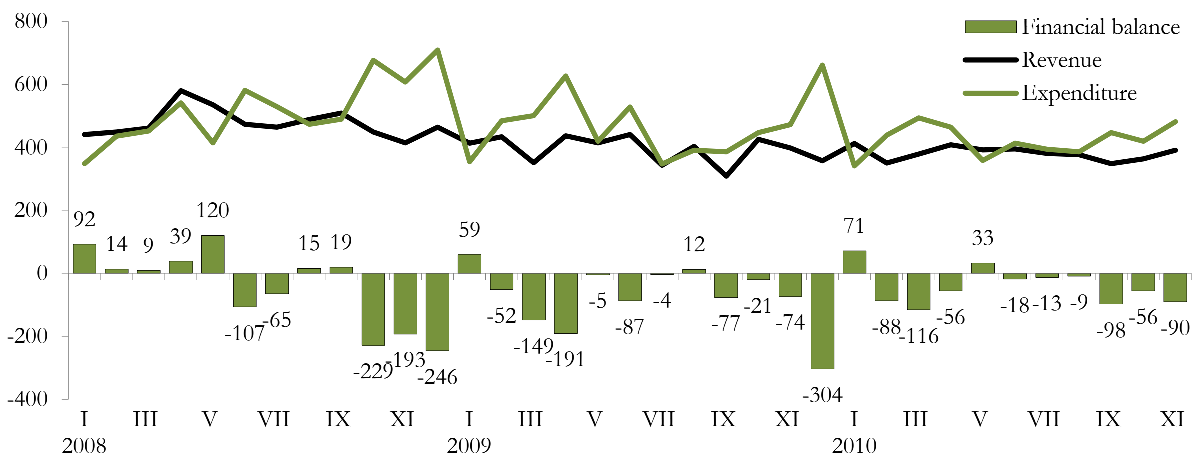
Significant budget consolidation measures have been taken in Latvia, thus implementing the cumulative fiscal adjustment in 2009-2010 in the amount of 10.5% of GDP (over 9.5% taking into account the necessity to repay the withheld pensions) by both reducing expenditures and increasing revenue. Reforms for optimization of public administration structure have been carried out – by liquidating secretariats of special assignments ministers, reducing the number of public agencies by 50%, as well as by savings in the area of support functions by centralisation thereof.

According to provisional data, in 2010, the general government budget deficit in Latvia did not exceed the expected 8.5% of GDP (which complies with the pledge given by Latvia upon concluding the Memorandum of Understanding with the EU and signing the Letter of Intent with the IMF). The total revenue of the government budget in 2010 was LVL 3.8 billion, expenditures – LVL 4.7 billion, thus constituting a financial deficit of LVL 917 million which is less than expected (LVL 1.03 billion) as it is shown by the State Treasury operative data on budget execution in 2010. Calculations according to the cash flow method show that the amount of the government budget deficit in 2010 was 7.3% of GDP.

Dynamics of financial indicators of the government consolidated budget is shown in Figure 4.3. In eleven months of 2010, the revenue of the general government consolidated budget was lower than in the corresponding period of the previous year, although the decline rate of the budget revenue has slowed down as a result of stabilisation of economy. However, expenditures of the general budget have reduced more rapidly than revenue in eleven months of 2010.

Figure 4.3

Financial Indicators of the Government Consolidated Budget
(million LVL)



The objective of the Latvian fiscal policy for 2011 is that the deficit would not exceed 6% of GDP, but in 2012 the deficit would be below 3% of GDP according to the ESA 95 methodology. It will help Latvia to recover trustworthiness in international financial markets, prevent further increase of the government debt and promote fulfilment of the Maastricht criteria, so that Latvia could be able to introduce the EU single currency – euro – on January 1, 2014.

In order to ensure development of sustainable fiscal policy and ensure its counter-cyclicality, the Draft *Law on Fiscal Discipline* has been worked out stipulating binding fiscal conditions for both annual government budget and medium term budget. The draft law sets basic principles, instruments and fiscal conditions for development of the fiscal policy. Amendments to the Constitution (*Satversme*) have been prepared in order for these systemic new approaches to development of fiscal policy and discipline observance to be sustainable without being constantly amended or even cancelled. In addition to these law proposals, amendments to the *Law on Budget and Financial Management* have been prepared to improve budget quality and the link thereof with planning documents.

The draft law on the budget for 2011 approved by the Cabinet of Ministers envisages revenue of LVL 4.2 billion, expenditure of LVL 4.79 billion and deficit of LVL 584 million in the government budget of 2011, which is 4.5% of GDP (according to cash flow methodology). In 2011, the revenue of the government budget will increase by LVL 341.9 million or 8.9% compared to 2010, but the expenditure – by LVL 402.1 million or 9.2 percent.

However, the expected total revenue of the general government consolidated budget (government budget and local government budgets) in 2011 will be LVL 5.1 billion, the expenditure – LVL 5.7 billion, the deficit according to the ESA 95 methodology – 5.4% of GDP.

In order to ensure recovery of economic growth in Latvia, expenditures planned in the government budget for absorption of EU funds and other foreign financial aid is LVL 1.167 billion.

In order to follow the fiscal objectives, the government upon planning the draft budget for 2011 accepted fiscal consolidation measures in the amount of LVL 292 million – LVL 88.8 million for expenditures, LVL 158.1 million for revenue and LVL 44.9 million keeping a fixed contribution rate in the funded pension scheme.

Along with the draft law on the budget for 2011, the accompanying package of draft laws consisting of 94 laws was submitted to the Saeima. Most of them – 53 laws – will ensure structural reforms of the government, by liquidating the Ministry of Regional Development and Local Government. Among the rest, the most important are amendments to tax laws – amendments to the *Law on Value Added Tax* envisage an increase in the standard VAT rate from 21% to 22% and an increase in the reduced VAT rate from 10% to 12%; amendments to the *Law on Personal Income Tax* envisage reducing the personal income tax rate from 26% to 25% (it is expected that the breakdown proportion of the personal income tax between government budget and local government budgets will be 18% and 82%); amendments to the *Law on Corporate Income tax* envisage granting income tax discounts to enterprises for large investment projects; amendments to the *Law on Real Estate Tax* envisage raising tax on housing; amendments to the *Law on Excise tax* envisage raising general rate for fuel containing 5% of biofuel and raising excise tax for non-alcoholic beverages; two new laws are proposed – on vehicle tax and company vehicle tax and on financial stability duty.

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

In 2009, the EU average level of the general government debt was 74% of GDP (61.8% of GDP in 2008, 58.8% of GDP in 2007). The general government debt exceeded the Maastricht criterion that is 60% of GDP in 12 EU Member States in 2009. In 2009, the highest general government debt in percentage of GDP was observed in Greece, Italy, and Belgium, while the lowest general government debt in percentage of GDP was registered in Estonia, Luxembourg, and Bulgaria. According to the European Commission forecasts in autumn 2010, the average level of the government debt in the EU will reach 79.1% of GDP in 2010.

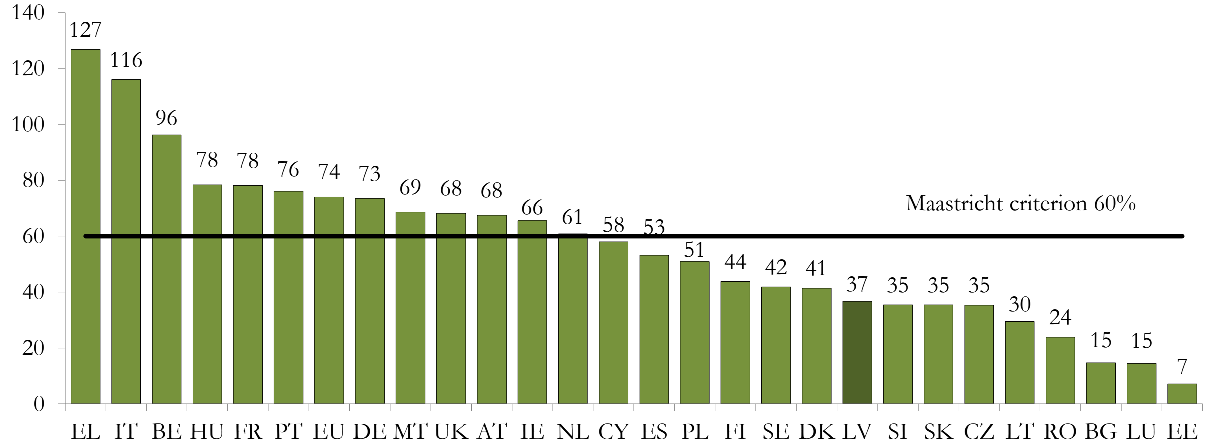
The general government debt in Latvia has gradually increased until 2007 – from LVL 933.9 million at the end of 2003 to LVL 1329.8 million at the end of 2007, it has even decreased in percentage of GDP from 14.6% to 9%. However, it increased very rapidly in 2008 to finance the national funding commitments and reached LVL 3181.4 million or 19.7% of GDP at the end of 2008, but at the end of 2009 – LVL 4801.9 million or 36.7% of GDP (see Figure 4.5). The level of the general government debt is mainly influenced by the central government debt, which was LVL 5241.4 million at the end of 2009 thus constituting 40.1% of the general government debt.

The general government debt continued to increase in 2010 and at the end of the 2nd quarter it reached LVL 5374.4 million.

At the end of 2008, on the basis of the *Economic Stabilisation and Growth Revival Programme of Latvia,* the International Monetary Fund, European Commission, World Bank, European Bank for Reconstruction and Development and several EU Member States have agreed on providing financial support to Latvia in the amount of EUR 7.5 billion. The allocated funding will be available from 2008 until 2011 and will determine the increase of the central government debt in the following years.

Figure 4.4

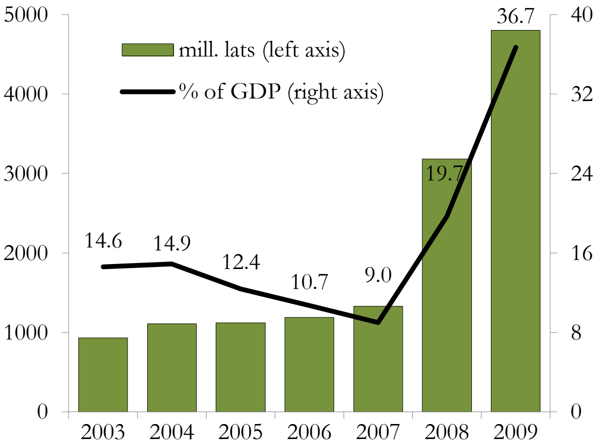
General government debt in EU Member States in 2009
(% of GDP)



In the framework of International Financial Assistance, until October 31, 2010, Latvia has received funds in the amount of LVL 3064.4 million, from which altogether LVL 2035.5 million were used for financing the government budget deficit, granting the government budget loan, repaying the government budget, as well as supporting the stability of the financial sector. A part of the received support (in the amount of LVL 455.9 million) in accordance with the requirements of the creditors is intended for specific objectives – possible measures of the financial sector stabilisation.

Figure 4.5

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



In addition to the loans above, short-term issues of government Treasury bills with the initial maturity of 6 and 12 months are being currently used for covering financial necessity. With stabilisation of the situation in domestic market, in 2010, the Treasury also implemented the programmes of government Treasury bills for two-, three- and five-year terms to reduce the risk of refinancing. Also in future, with the remaining stable market situation and positive economic development tendencies, debt securities of longer term are planned to be offered, thus increasing the share of lats in the debt portfolio in accordance with the Strategy of the Central Government Debt Management of Latvia.

Further medium-term plans envisage to attract resources in both domestic and foreign financial market to prevent a significant increase of the government debt refinancing risk and to ensure pre-conditions for due repayment of the loans granted in the framework of the international financial assistance. With stabilisation of the macroeconomic situation in Latvia and improving pre-conditions for new issues, including, improving credit rating of Latvia, it is planned to resume borrowing from the international financial markets.

Taking into consideration the planned borrowing strategy, the central government budget is forecasted to be approximately 47% of GDP by the end of 2013. If the debt level of local governments will not significantly rise in the upcoming years, it is expected that the debt level of the general government in the middle term will not exceed the criterion of debt specified in the Maastricht Treaty that is 60% of GDP.

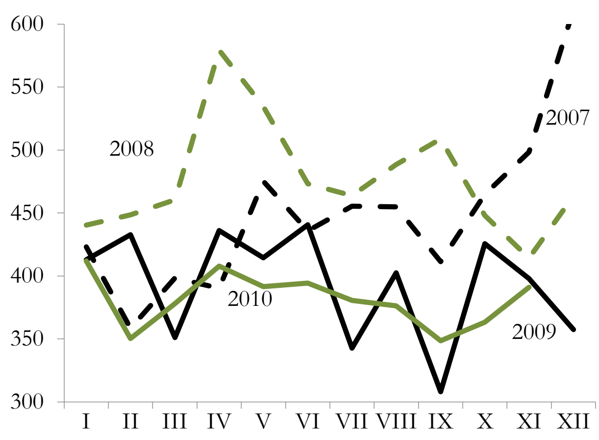
4.1.2. Budget Revenues

Decrease of economic activities and domestic demand negatively influence budget revenues that started reducing at the end of 2008. Due to the remaining low level of economic activities, the total revenues of the government consolidated budget did not increase also at the beginning of 2010, yet, the decrease rate was reduced. In 11 months of 2010, the total revenue of the government consolidated budget was LVL 4193.6 million, which is by 3.9% less than in the respective period of the previous year. It was mainly determined by the decrease of tax and non-tax revenues.

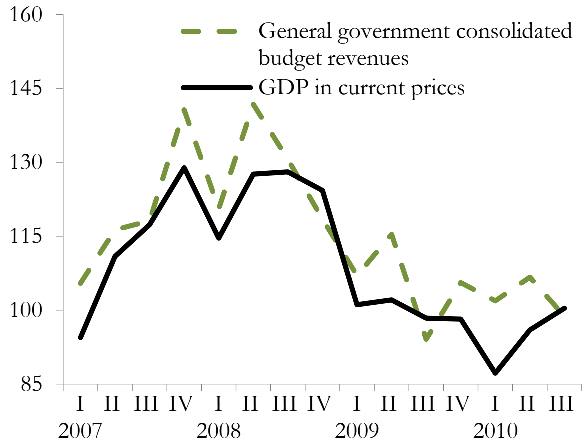
Taxes collected in the three quarters of 2010 formed almost 74% of all budget revenues. In 11 months of 2010, the total tax revenues decreased by 3.8% and constituted LVL 3111.7 million in comparison with the respective period of the previous year.

Figure 4.6

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



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



* according to official data of monthly reports of the State Treasury

Decrease of tax revenues was affected by the limitation of economic activities – decrease in household revenue, decline of retail turnover, increase of unemployment, etc. In the three quarters of 2010, the share of tax levy in the total revenues has slightly increased.

Table 4.2

Budget Revenues*
(% of GDP)

	2007	2008	2009	2010 I-III
General government consolidated budget revenues	**36.2**	**35.4**	**36.2**	**37.1**
I Tax revenues	**29.5**	**29.3**	**26.9**	**27.3**
1. Indirect taxes	*11.4*	*10.4*	*10.1*	10.6
– value added tax	8.1	6.9	6.1	6.8
– excise tax	3.0	3.3	3.9	3.7
– customs duties	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	6.3
– 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 Non-tax revenues	**6.7**	**6.1**	**9.3**	**9.8**

* according to the official data of the State Treasury

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

Figure 4.7

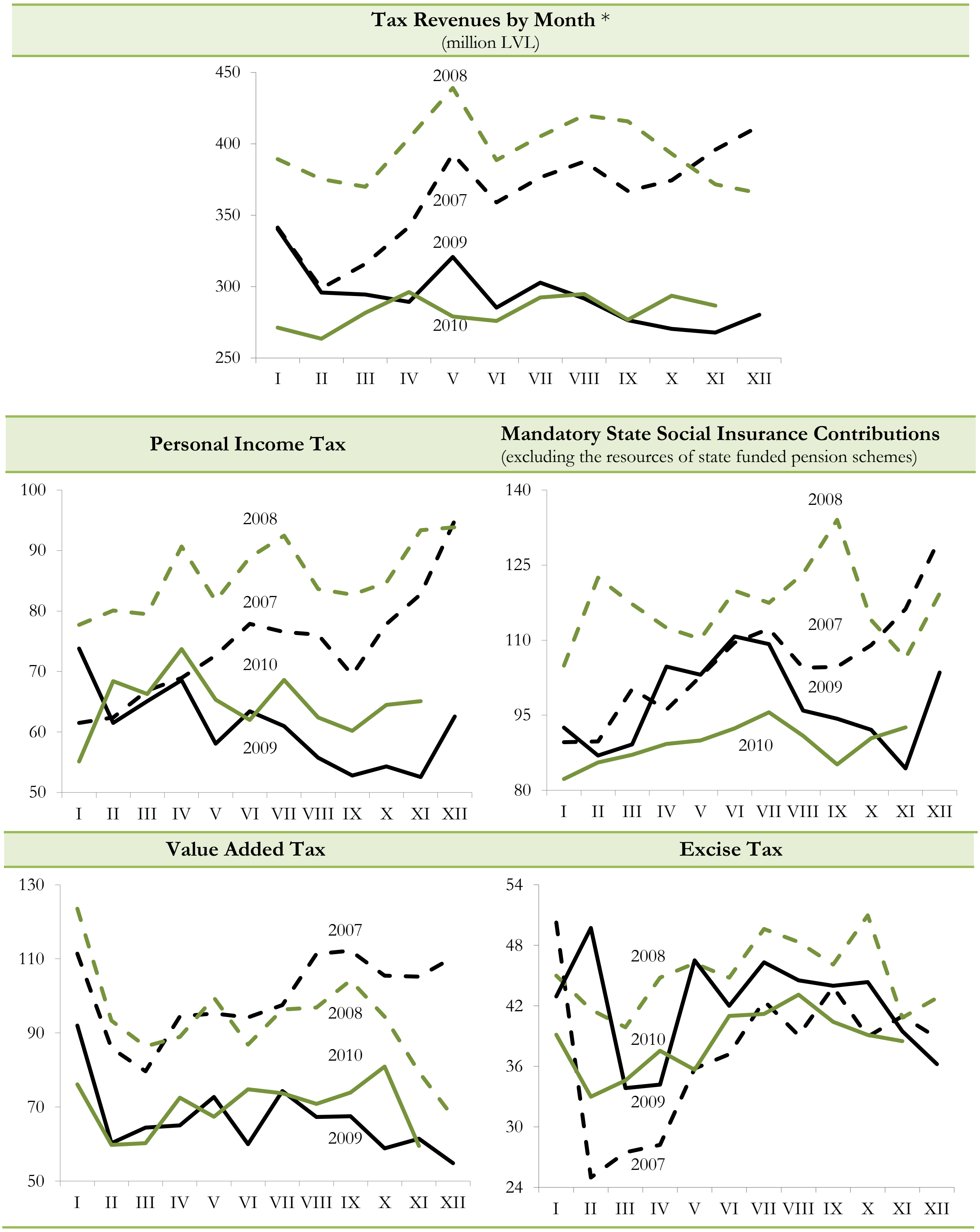
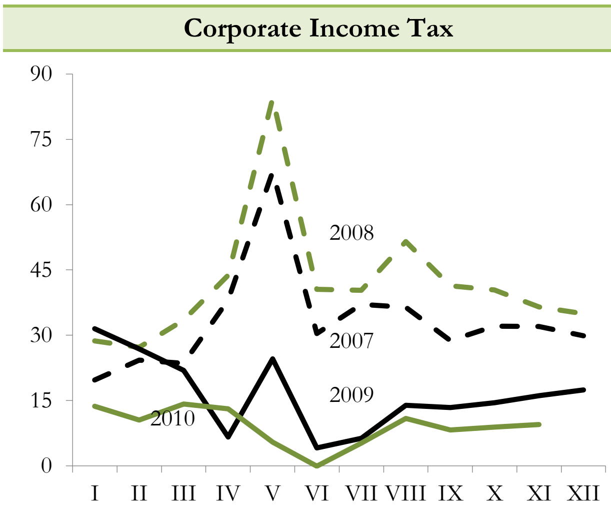
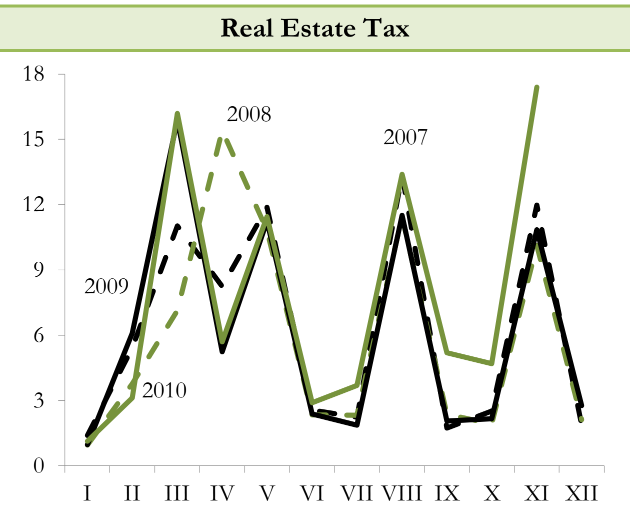

Tax Revenues by Month *
(million LVL)
450
400
350
300
250
2008
2007
2009
2010
I II III IV V VI VII VIII IX X XI XII
Personal Income Tax
100
90
80
70
60
50
2008
2007
2010
2009
I II III IV V VI VII VIII IX X XI XII
Mandatory State Social Insurance Contributions
(excluding the resources of state funded pension schemes)
140
125
110
95
80
2008
2007
2009
2010
I II III IV V VI VII VIII IX X XI XII
Value Added Tax
130
110
90
70
50
2007
2008
2010
2009
I II III IV V VI VII VIII IX X XI XII
Excise Tax
54
48
42
36
30
24
2008
2010
2009
2007
I II III IV V VI VII VIII IX X XI XII

Figure 4.7 continued





* according to official data of monthly reports of the State Treasury

Almost 54.4% of all the tax revenues in the three quarters of 2010 were made of **the employment tax**. Reduction of unemployment, reduced work pay, as well as a growing share of shadow economy mainly determined the decrease of the employment tax levy. In 11 months of 2010, the share of the employment tax in the total tax revenue has shrunk by 2.6% in comparison with the corresponding period of the previous year.

As of January 1, 2010, new amendments to the Law *On Personal Income Tax* came into force. The general rate of the tax was increased from 23% to 26%, the basis of the personal income tax was expanded including all profits from capital – dividends and interest income will be subject to a 10% rate, but the capital increase – 15%. Personal income tax is also imposed for using an employer's passenger car for private needs; the income tax for self-employed persons is raised subjecting them to the general rate of personal income tax and other changes will take place. As of January 1, 2011, new amendments to the Law *On Personal Income Tax* came into force envisaging reduction of the tax rate from 26% to 25 percent.

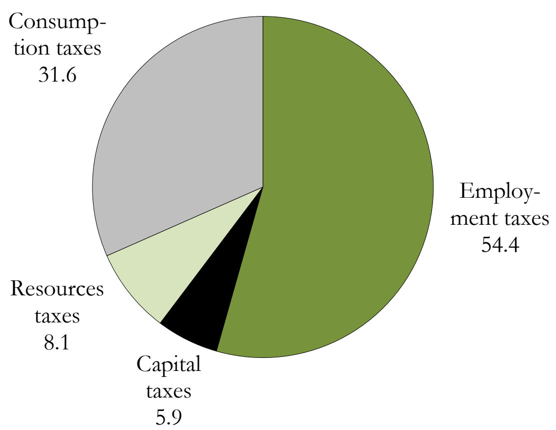
The law envisages also exemption from personal income tax for income of the unemployed gained from the operational programme *Human Resources and Employment* of the European Social Funds or state budget financing for active employment measures in 2010, 2011, and 2012 and which are qualified for grants by the State Employment Agency. In 11 months of 2010, the personal income tax levy was LVL 711.3 million, which means an increase of 6.7% in comparison with the corresponding period of 2009.

The Law *On State Social Insurance* was also amended stipulating that as of January 1, 2011 the rate of state social mandatory contributions generally will be 35.1%, of which 24.09% is paid by the employer, but an employee pays 11% instead of the current 9%. The revenues from mandatory state social security contributions from January-November of 2010, were LVL 981.3 million. That is by LVL 7.7 million or 8.9% less that in the respective period of 2009.

Figure 4.8

General Government Consolidated Budget Tax Revenues by Tax Groups in the 3 quarters of 2010

(%)



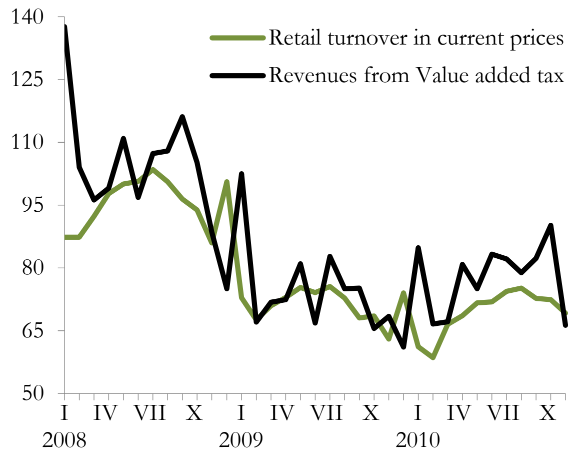
The share of **the consumption tax** in the tax structure has reduced from 33.7% in 2007 to 31.6% in the three quarters of 2010. During the years of fast growth, the revenues from the consumption tax substantially increased. It was promoted by the growing domestic demand and high inflation. As from the end of 2008, due to the decrease of domestic demand and consumer price pressure, the consumption tax levy started to decrease.

On January 1, 2009, the standard rate of the value added tax was increased from 18% to 21%.

As of January 1, 2011, the VAT standard rate was raised from 21% to 22%, but the reduced tax rate applicable to some goods and services was raised from 10% to 12%. Starting from January 1, the standard rate in the amount of 22% will be applied to electricity supply for inhabitants.

Figure 4.9

Retail Turnover in Current Prices and Revenues from Value Added Tax
(December 2007 = 100)



From January 1, 2010, amendments in the Law *On Value Added Tax* came into force. The norms of the new law are aimed to develop business environment and to promote competitiveness of small enterprises. These amendments simplify or abolish statutory requirements (for example, regarding presentation of value added tax invoices and submitting the annual value added tax declaration), thus reducing the administrative burden for entrepreneurs.

In the 11 months of 2010, the value added tax revenues were LVL 769.5 million, which is by 3.5% more than in the respective period of 2009. VAT revenues are linked with the changes in the amount of retail turnover. However, the retail turnover in current prices in 11 months of 2010 still was by 3.6% less than in the corresponding period of 2009.

Yet, the revenues from excise duty in the consumption share in 2009 shrank by 14.6% despite the increase of the excise tax rates, especially for tobacco products. The amendments to the Law *On Excise Duty* envisage applying a standard tax rate to fuel containing 5% of bio-fuel and raising the excise duty for non-alcoholic beverages in 2011. Furthermore, the new rates established for some tobacco products in October 2010 came into force.

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 11 months of 2010, the revenues for the excise duty were LVL 423.2 million. That is by 9.5% less than in January-November of 2009. The decrease in revenues from the excise duty was affected by the decline of alcohol and cigarette sales amount, which is indicative of expansion of the illegal market.

The share of **the capital tax** in the total tax revenues gradually increased till 2008 (12.1%). In 2009, along with decelerating economic activities and an increasing number of insolvent companies, corporate income tax revenues have dropped sharply, namely, by LVL 197.2 million or by 60.8% less than in 2008.

A decrease of the capital tax revenues is observed also in the 11 months of 2010, when corporate income tax revenues were LVL 99.7 million. That is by 44.5% less than in the respective months of 2009. A decrease in revenues from the corporate income tax mainly is affected by the sector of financial services that has suffered serious losses (the decrease constitutes approximately a half of the total decline of the revenue from the corporate income tax).

It must be noted with regards 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 not associated with economic activity and maintenance of the social infrastructure objects, which is not included in the expenditures, has increased 1.5 times; the options for the taxpayer have been expanded to decide whether to pay reduced advanced payments if the amount of profit has been decreased. On November 10, 2010, the new amendments to the Law *On Corporate Income Tax* came into force specifying application of the tax and tax rebates for large investments.

In 11 months of 2010, the real estate tax levy has significantly increased reaching LVL 84.8 million. That is by 20.7% higher than in the corresponding period of the previous year.

As from January 1, 2010, the real estate tax rate is raised for land and buildings used for commercial activity to 1.5%, the minimum tax payment is fixed at LVL 5 for each taxable object, uncultivated lands are subject to the increased rate of 3%, the real estate tax must also be paid for engineering-technical buildings. Starting with January 1, 2010, the real estate tax base is expanded – the residential houses with cadastral value below LVL 40 thousand are subject to 0.1% of the cadastral value, with cadastral value of LVL 40 001-75 000 – 0.2%, with cadastral value above LVL 75 thousand – 0.3%.

Changes in the group of **resources tax** are mainly related to the excise tax on oil products, because natural resources tax forms almost 3% of revenues of this group. In the three quarters of 2010, the share of the group of resources tax was 8.1% of all tax revenues. In 2009, the excise tax on oil products was collected in the amount of LVL 284.1 million, which exceeded the collection of the year 2008 by 0.3%. This was mostly related to the increase of the excise tax rate on oil products. From January-November of 2010, the excise tax revenues on oil products were LVL 243.9 million. That is by 7.5% less than in the respective period of 2009. The decline of the tax revenues is linked to the decrease of oil product consumption corresponding to the current economic situation in the country. However, the natural resources tax in 11 months of 2010 increased by

21.3% in comparison with the respective period of the previous year.

4.1.3. Budget Expenditures

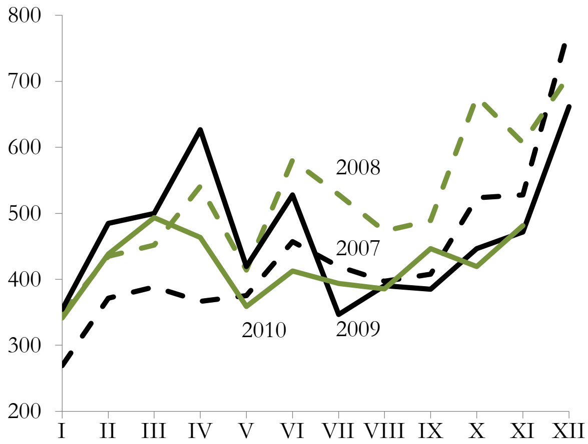
The declining budget revenues forced the government to implement a policy for reducing the budget deficit which in the short-term creates additional pressure on the diminishing domestic demand.

In the 11 months of 2010, the total expenditures of the general government consolidated budget were LVL 4633.6 million, which is by 6.4% less than in the respective period of the previous year. The budget expenditures decreased faster than the revenues in this period. The decrease of expenditures was observed in almost all expenditure items of the general government consolidated budget; however, the most significant overall decrease of expenditures depended on a decrease of expenditures for subsidies and grants.

Figure 4.10

General Government Consolidated Budget Expenditures by Months*

(million LVL)



* according to official monthly report data of the State Treasury

Taking into consideration the huge expenditure cut, the expenditures for subsidies and grants in 11 months of 2010 decreased by 13.5%, compared to the respective period of the previous year. The decrease was mainly based on consolidation measures of the budget for 2010 and insufficiently expediently absorbed financing of the EU structural funds. Expenditures for subsidies and grants constitute almost a half of all expenditures of the state consolidated budget.

In 2009, the capital expenditures were reduced very considerably. They constituted LVL 507.4 million which was by 34.6% less than in 2008. In 11 months of 2010, the expenditures have decreased by 13.6% in comparison to the corresponding period of 2009.

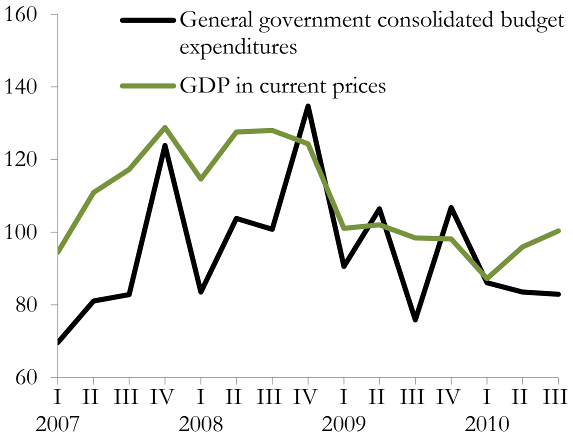
A high share in expenditures remained for current expenditures, which were reduced by 18.3% in 2009, but in 11 months of 2010 – by 15.1%, if compared to the corresponding period of the previous year.

In 11 months of 2010, in proportion with the expenditures in the functional categories, the expenditures increased for social benefits (by 7.4% if compared to the corresponding period of 2009), which was due to repayment of the withheld pensions.

Figure 4.11

GDP in Current Prices and General Government Consolidated Budget Expenditures by Quarters

(4th quarter of 2006, = 100)

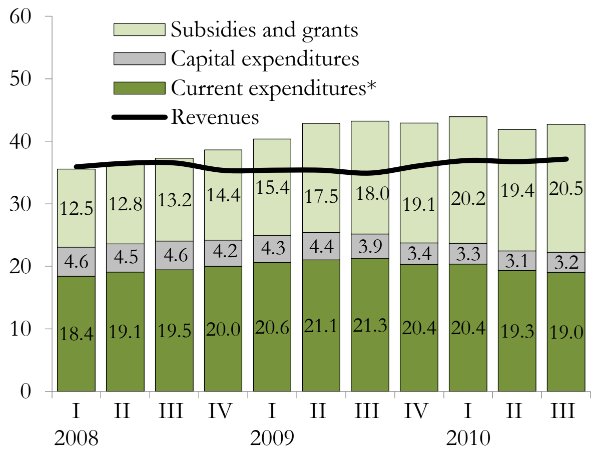


From January-November of 2010, the biggest share was for social security (33.8% of all expenditures), followed by expenditures for education (16.7%), economic activity (16%), and general government services (13.4%), but the smallest share of all expenditures was for environmental protection (1.1%).

Figure 4.12

General Government Consolidated Budget Revenue and Expenditures

(moving average of 4 quarters, % of GDP)



* including payments for borrowings and loans as well as payments to the EU

In order to reach the aim – budget deficit less than 3% of GDP in 2012 – during the upcoming years, the government will be forced to continue reducing the budget expenditures.

Table 4.3

Expenditures of the General Government Consolidated Budget by Functions*

(percentage)

	2008		2009		3rd quarter of 2010	
	structure	of GDP	structure	of GDP	structure	of GDP
Expenditures – total	**100**	**38.6**	**100**	**42.9**	**100**	**40.2**
General public services	13.6	5.3	14.8	6.3	13.4	5.4
Defence	3.5	1.3	2.4	1.0	2.0	0.8
Public order and safety	5.0	1.9	4.5	1.9	4.4	1.8
Economic affairs	18.1	7.0	15.7	6.7	16.0	6.4
Environmental protection	2.4	0.9	2.2	0.9	1.1	0.4
Housing and community amenities	3.6	1.4	2.1	0.9	2.5	1.0
Health	8.1	3.1	7.5	3.2	7.2	2.9
Recreation, culture, and religion	4.0	1.5	3.4	1.5	2.9	1.2
Education	20.2	7.8	19.6	8.4	16.7	6.7
Social security	21.5	8.3	27.9	12.0	33.8	13.6

* according to the official data of the State 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 investments using the budget resources.

Table 4.4

Public Demand

(%)

	% of GDP			Changes in comparison with the previous year		
	2007	2008	2009	2007	2008	2009
Public Demand	**23.1**	**24.4**	**24.0**	**10.0**	**-3.6**	**-12.8**
Public consumption	17.4	19.6	19.6	3.7	1.5	-9.2
– central government*	9.5	10.7	11.4	1.4	0.8	-2.6
– local governments	7.9	8.9	8.2	6.6	2.4	-17.0
Gross fixed capital formation	5.7	4.8	4.3	27.8	-15.4	-23.0
– central government*	2.8	1.8	1.6	-3.7	-38.2	-22.9
– local governments	2.8	3.1	2.7	91.3	7.7	-23.0

* with the Social Security Fund

In 2008, the public demand decreased slightly slower than GDP. The reduced demand was mainly due to reduction of expenditures by almost 40% of gross fixed capital formation of the central government, if compared to 2007. At the same time, the expenditures of local governments for investments increased by 7.7% in 2008.

Also in 2009, the social demand decreased at a slower rate than GDP. If compared to 2008, public consumption in the previous year decreased by slightly more than 9%. Similarly, the expenditures for state investments (by 23%) continue the rapid decrease. It must be noted that the central government reduces expenditures more rapidly for the total fixed capital development, but the reduction rate of expenditures of local governments is more moderate.

Overall, social demand reduced by 12.8% in 2009.

4.2. Prices

4.2.1. Consumer Prices

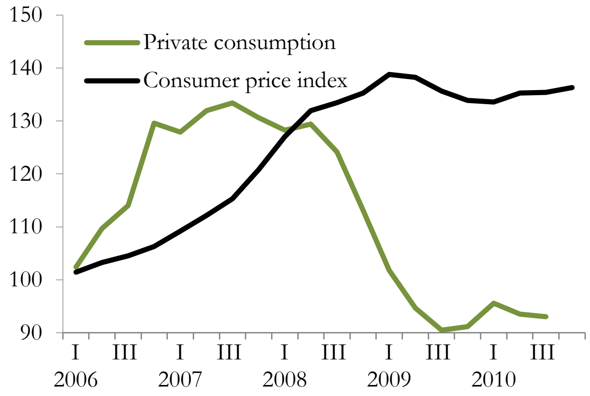
The decrease of consumer prices which started at the end of 2008 and continued in 2009 was mainly based on the rapid decrease of private consumption. Since the end of 2009, the prices began to increase gradually as the private consumption has stopped declining and it no longer is a factor that could reduce the overall price level. The overall price level is more affected by external factors.

In 2010, the consumer prices have increased by 2.5%. (12-month inflation), however, considering the deflation in 2009, the average price level was by 1.1% lower than a year ago.

Figure 4.13

Private Consumption and Consumer Price Index

(4th quarter of 2005 = 100)



The price rise in 2010 was mainly influenced by a rise in world prices for food and oil products. Rise in food products determined the increase of the total consumer price index by 2 percentage points, heat energy price – by 0.8, and fuel price – by 0.9 percentage points.

Table 4.5

Consumer Price Changes by Months

(percentage)

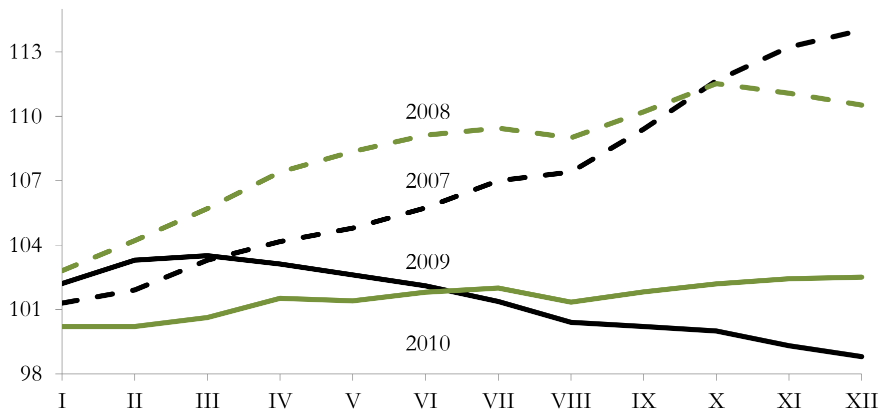
	Compared to the previous month		Compared to the respective month of the previous year		Average during the year	
	2009	**2010**	**2009**	**2010**	**2009**	**2010**
January	2.2	0.2	9.8	-3.1	14.9	2.5
February	1.1	0.0	9.6	-4.2	14.3	1.3
March	0.2	0.5	8.2	-3.9	13.5	0.3
April	-0.4	0.9	6.2	-2.7	12.5	-0.4
May	-0.5	-0.1	4.7	-2.3	11.4	-1.0
June	-0.5	0.4	3.4	-1.4	10.2	-1.4
July	-0.6	0.2	2.5	-0.6	9.1	-1.6
August	-1.0	-0.7	1.8	-0.3	7.9	-1.8
September	-0.2	0.4	0.5	0.4	6.7	-1.8
October	-0.2	0.4	-0.9	1.0	5.5	-1.6
November	-0.7	0.2	-1.2	1.9	4.5	-1.4
December	-0.5	0.1	-1.2	2.5	3.5	-1.1

Changes of other goods and services groups generally slightly reduced the consumer price index in 2010.

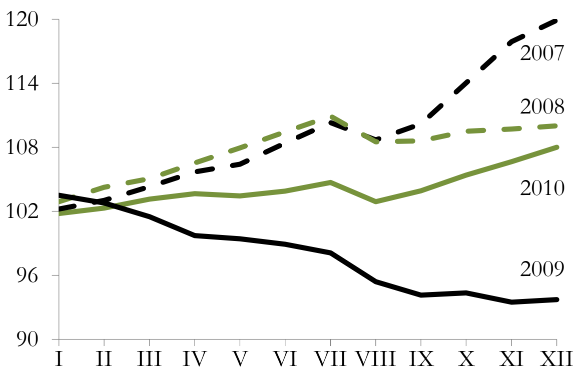
Figure 4.14

Consumer Price Index by Groups and Sub-Groups

(December of the previous year = 100)



Food and soft drinks



Administratively regulated prices

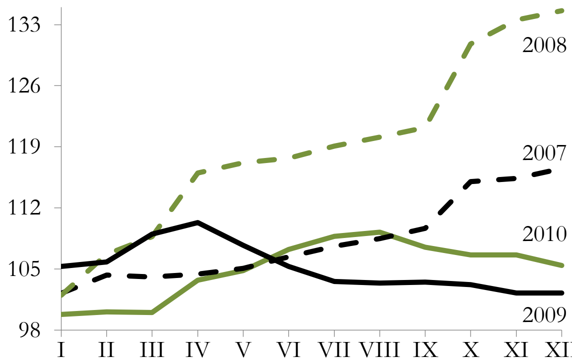
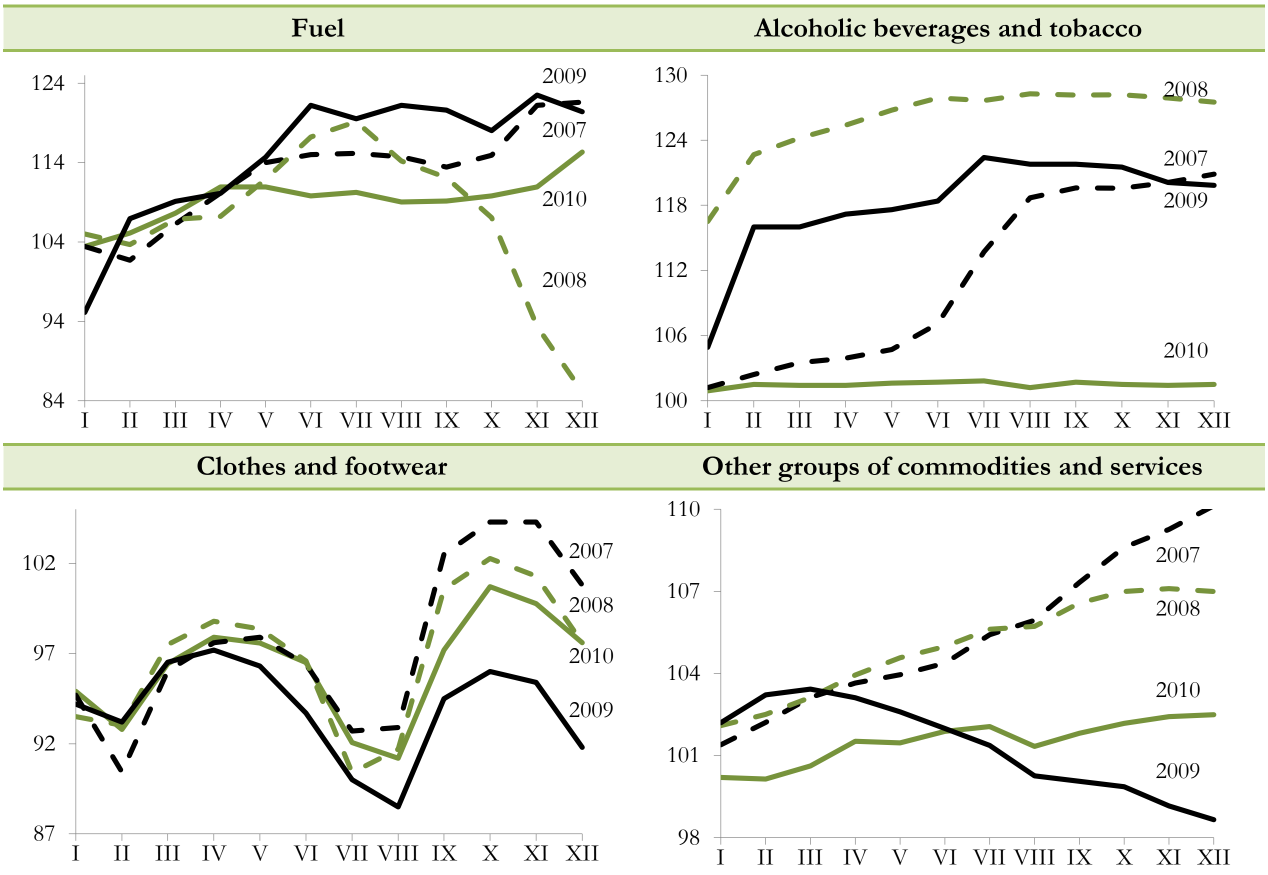


Figure 4.14 continued



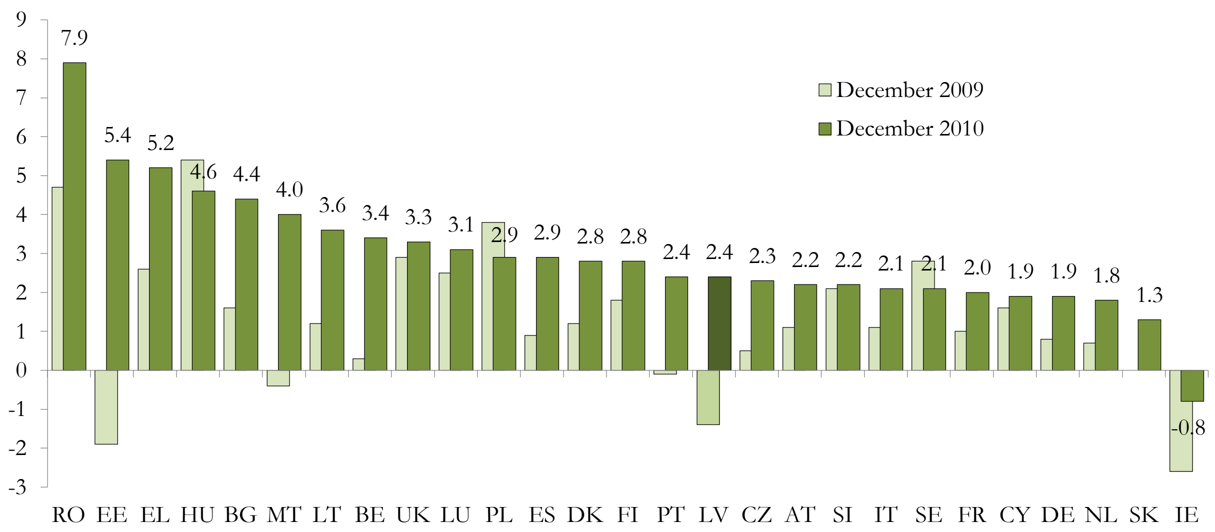
In 2010, the average price level in the European Union has increased faster than in Latvia – by 2.6%, if compared to 2009. Just like in Latvia, it was based on a rise in prices for food products and energy. The rise in prices for oil products had a subordinate impact on increase of producer prices in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

Having evaluated further activities and taking into consideration crude oil prices, as well as future contractual prices for oil sold in exchange market; the inflation is expected to increase at the beginning of 2011.

Figure 4.15

Changes of the Harmonised Consumer Price Index in the EU Member States in December 2009 and December 2010

(12-month inflation, %)

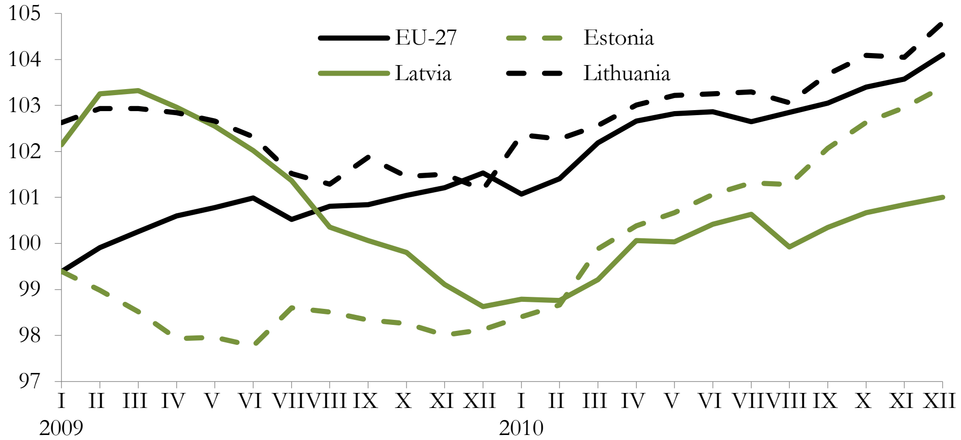


Source: Eurostat

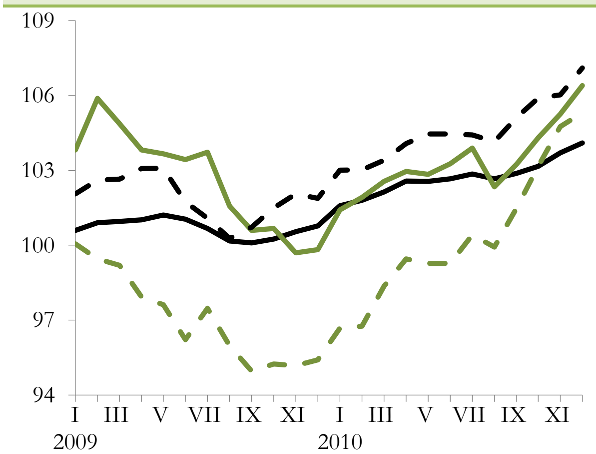
In 2010, if compared to 2009, the price inflation in Romania increased by 3.2 percentage points, in Estonia – by 7.3, in Greece – by 2.6 percentage points, thus becoming the countries with the highest inflation rate in the European Union. Hence, prices in Romania have increased by 7.9%, in Estonia – by 5.4% and in Greece – by 5.2%. The lowest inflation was in Slovakia – 1.3%, the Netherlands – 1.8%, but in Germany and Cyprus – 1.9%. Deflation in 2010 was experienced in Ireland – by 0.8 percent.

Figure 4.16

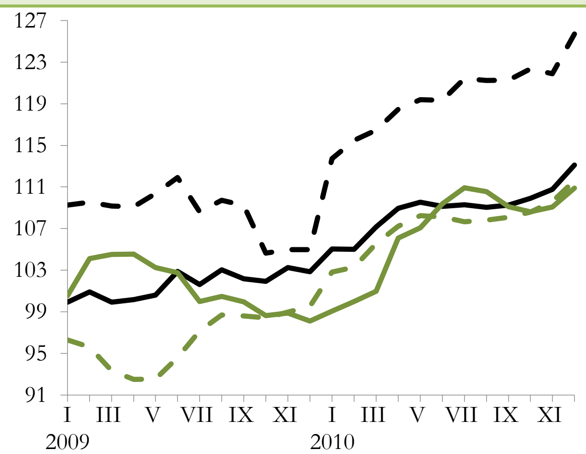
Harmonised Consumer Price Index by Months in 2009-2010
(December 2008 = 100)



Food products
(including alcohol and tobacco)



Energy



The consumer prices in 2010, if compared to 2009, increased for the food product group and energy in the Baltic States.

The rise in food prices in the EU in 2010 occurred due to the significant decline in prices a year before. At the same time, it should be noted that bad weather also had some influence causing mainly a rise in prices for fruits and vegetables, as well as the increasing demand for food in the developing countries.

The highest increase of prices in the Baltic States in the food product group was observed in Estonia – by 10.3%, but in Latvia the prices increased by 6.5% and in Lithuania – by 5.1%.

The energy price level in 2010 increased most rapidly in Lithuania – by 19.7%, Latvia – by 13%, and Estonia – by 12.1 percent.

4.2.2. Producer and Foreign Trade Price Changes

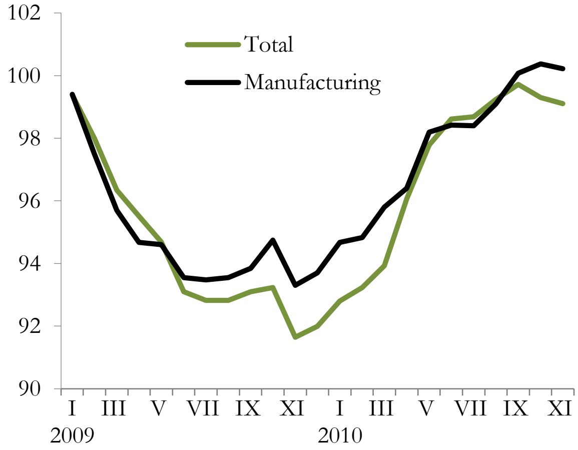
After the decrease of prices in 2009, the **producer prices** started to grow again in 2010. In November 2010, if compared to November 2009, the overall producer prices in manufacturing increased by 8.2%, prices for production sold in the domestic market increased by 6.7%, but prices for exported products increased more rapidly – by 10.4%. The most rapid increase was observed in production of metals, production of wood and timber products (except furniture), gas, heat supply, and food production – by 41.1%, 12.3%, 10.3%, and 8.2% respectively.

The rise in prices for production sold in the domestic market was based on stabilization of domestic demand, but the prices for exported production were mainly based on the rise in prices for the key export goods of Latvia, namely timber products, metal articles and food products in the world markets.

Figure 4.17

Producer Price Changes

(December 2008 = 100)

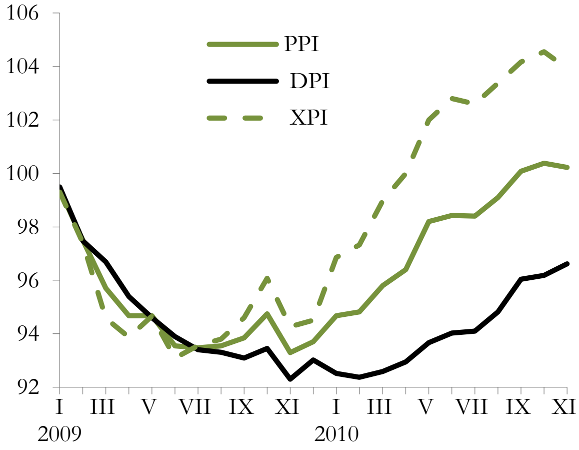


Overall, the producer prices in the European Union have became stable in 2010. The increase of the price level mainly relied on price components of energy and intermediate goods, which had an impact on the rise in prices for other raw materials. Apart from prices for food and agricultural products, also prices for manufacturing raw materials and metals significantly increased, which was mainly determined by the increase of global demand.

Figure 4.18

Dynamics of Producer Price Changes in Manufacturing

(December 2008 = 100)

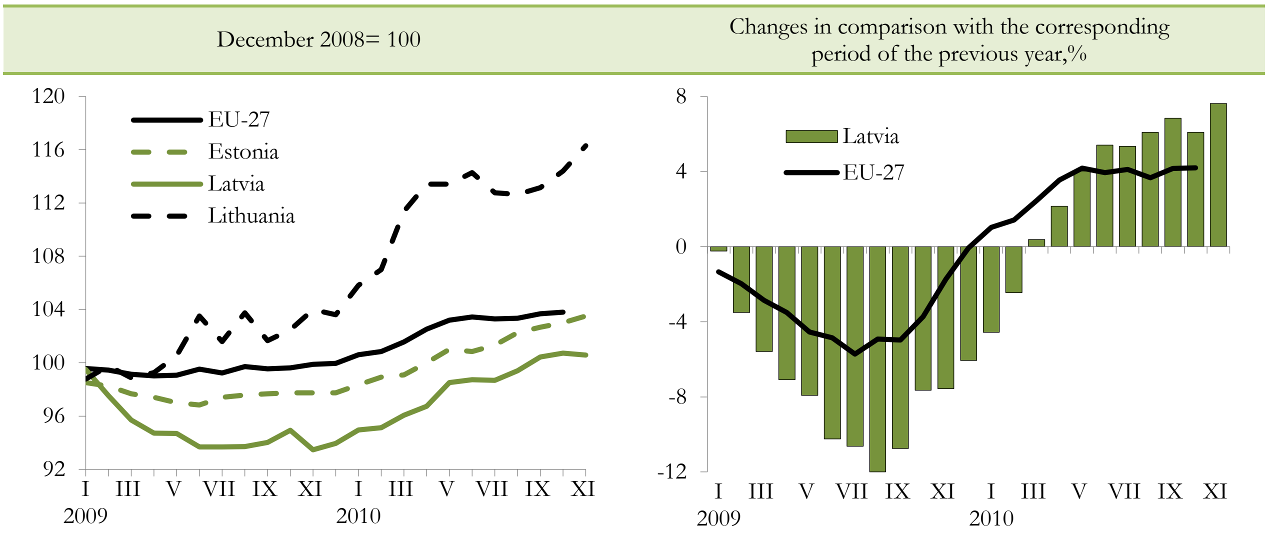


PPI – producer price index;
DPI – producer price index for products sold in the domestic market;
XPI – producer price index for exported products

If making a comparison among the Baltic States, the most rapid overall increase of the producer price index in 2010 was observed in Lithuania, the most moderate – in Latvia.

Figure 4.19

Producer Price Index by Months in Manufacturing



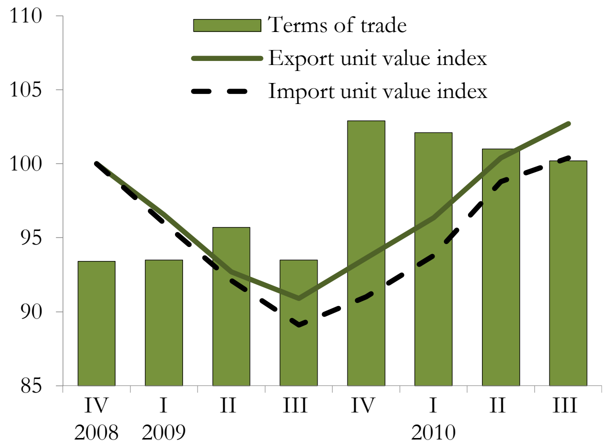
At the beginning of 2010, the trade conditions considerably improved in comparison with the beginning of the previous year, because the import prices in 2009 decreased faster than those of export, besides, as the prices started to grow again, the export prices increased faster. In the third quarter of 2010, the unit value of exported goods increased by 13% and that of imported goods – by 12.7%, if compared to the corresponding period in 2009.

The average export unit value level was mainly raised by the increase of the value for a unit of wood and its products, metals and metal articles, plastic and its products, as well as food products. However, the increase of the value for a unit of transport vehicles and their equipment, textile and textile products, as well as mineral products had the most significant impact on the average unit value level.

Figure 4.20

Export and Import Unit Value Indices and Terms of Trade Index

(export and import unit value index in the 4th quarter of 2008 = 100; terms of trade index in % compared to the respective quarter of the previous year)



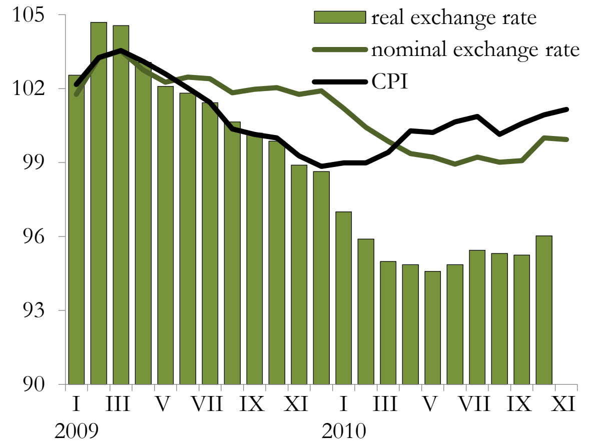
Since 2009, the real effective exchange rate of the Latvian lats has decreased rapidly, which means that competitiveness of Latvian enterprises has improved. Currently, the real effective exchange rate of Latvian lats is slightly growing, however generally it is low.

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

Figure 4.21

Effective Exchange Rate of Lats*

(December 2008 = 100)



* Effective exchange rate of lats has been calculated in relation with 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

Substantial adjustments to the balance of payments of the current account are observed in Latvia. It began in the second half of 2007, when the inflow of foreign investments rapidly decreased due to the global crisis and as a result, balance of the current account moved from the lowest level in the history (in the third quarter of 2007 the deficit was 24.8% of GDP) reaching the highest level in history (the fourth quarter of 2009 – surplus 10.7% of GDP).

Also in nine months of 2010, balance of current account was positive – 5% of GDP (8.6% in the first quarter, 5.8% in the second quarter and 1.1% in the 3rd quarter). The quarterly dynamics of current account in 2010 shows another change in direction, i.e. decrease of positive balance and coming closer to the state of deficit which was typical in Latvia for several years.

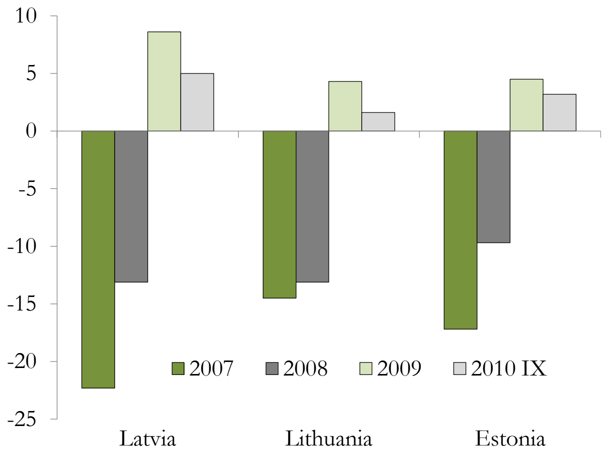
Similarly to Latvia, substantial adjustments to the balance of payments of the current account are taking place also in our neighbouring countries. In Estonia, the current account surplus in 2009 reached 4.5% of GDP compared to the 9.7% deficit a year before. However, in Lithuania, the positive balance of the current account was 4.3% of GDP in 2009 (deficit in 2008 – 13.1% of GDP). In 9 months of 2010, the current account surplus in Estonia and Lithuania was correspondingly 3.2% and 1.6%.

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

Figure 4.22

Current Account Balance in the Baltic States

(% of GDP)



Source: *Eurostat*

A foreign trade deficit of Latvia in 2009 compared to the previous year has decreased and was 7.1% of GDP. The decrease of the negative foreign trade balance in 2009 was determined by the faster decrease of imports than of exports. The foreign trade balance continued improving also in 2010. In 9 months of the year, the deficit of the foreign trade balance reached 6.5% of GDP, which was almost one and a half percentage point less than a year ago. It was mainly because export increased faster than import. In 9 months of 2010, the goods export increased by 28.3% but import – by 16.6% in comparison with the corresponding period of the previous year. It should be noted that the negative trade balance has shrunk almost three times since 2008.

Contrary to the balance of goods, adjustment of the balance of services is moderate. In 2009, the surplus of the balance of services reached 6% of GDP exceeding the level of 2008 by 2 percentage points. The improvement of the balance of services was determined by the rapid decline of imports in the first quarter of 2009; however, the decline of exports was almost ten times slower – by 2.2%. Since the second quarter of 2009, the dynamics of both imports and exports is stable.

In 9 months of 2010, the balance of services reached the level of 6.4% of GDP (in 9 months of 2009 – 6%) and almost fully covered the negative trade balance of goods.

Figure 4.23

Current Account Deficit, Investments, and Savings

(% of GDP)

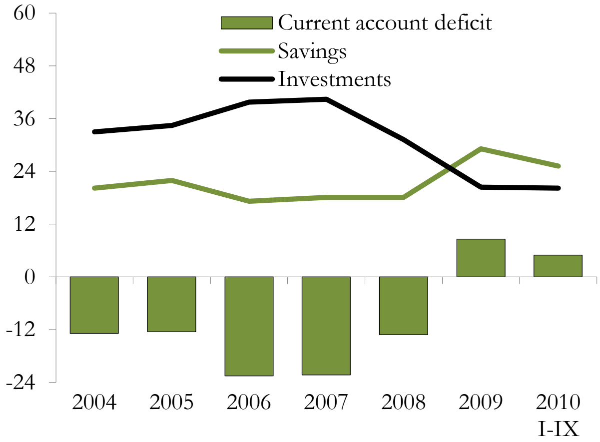


Table 4.6

Balance of Payments of Latvia

(% of GDP)

	2006	2007	2008	2009	2009 I-IX	2010 I-IX
A. Current account	**-22.5**	**-22.3**	**-13.1**	**8.6**	**7.9**	**5.0**
Trade balance	-25.6	-23.9	-17.7	-7.1	-7.9	-6.5
Exports	30.7	28.5	28.3	28.3	26.8	36.6
Imports	-56.3	-52.4	-46.0	-35.5	-34.8	-43.1
Balance of services	3.3	3.5	4.0	6.0	6.0	6.4
Net revenues	-2.7	-3.2	-1.6	6.3	6.6	1.7
Current transfers, net	2.4	1.3	2.2	3.4	3.3	3.4
B. Capital account	**1.2**	**1.9**	**1.5**	**2.4**	**2.5**	**2.3**
C. Financial account*	**30.5**	**24.6**	**11.4**	**-7.8**	**-6.4**	**-0.9**
Direct investments	7.5	6.8	3.0	0.4	0.6	0.2
Abroad	-0.9	-1.3	-0.7	0.1	0.4	-0.7
in Latvia	8.3	8.1	3.7	0.3	0.2	1.0
Portfolio investments**	0.2	-1.6	0.8	3.2	2.7	-0.7
Assets	-1.3	-1.0	1.8	4.1	3.8	1.0
Liabilities	1.5	-0.5	-1.0	-0.9	-1.2	-1.8
Other investments	22.6	19.3	7.6	-11.3	-9.7	-0.4
Assets	-9.7	-21.7	-1.4	-5.5	-3.3	3.0
Liabilities	32.2	40.1	8.9	-5.8	-6.4	-3.5
D. Net errors and omissions	**0.6**	**-0.8**	**-1.8**	**0.8**	**1.2**	**0.2**
E. Reserve assets	**-9.9**	**-3.4**	**2.0**	**-5.0**	**-5.3**	**-6.6**

* 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 fourth quarter of 2008. The income balance surplus reached the highest level in the second quarter of 2009 (9.4% of GDP), however, it was continuously decreasing in the next quarters, and in the third quarter of 2010, the income balance was already negative (0.7% of GDP). The decrease of the positive income balance surplus in the first and the second quarter of 2010 was due to the decrease of non-resident enterprises losses, as well as significant increase in the amount of paid dividends, particularly in the second quarter (almost 5 times if compared to the first quarter). Yet, the formation of the negative income balance surplus in the third quarter of 2010 was based on the increase of non-resident investment income (including reinvested profits). In 9 months of 2010, the income balance surplus was positive (1.7% of GDP), which is almost 3 times less than a year ago.

Due to the impact of the global financial crisis, when the capital inflow went down, 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 savings of households. Along with the increase in the level of savings, the investments are decreasing rapidly. In 2009, the share of investments in GDP was 20.4% or almost two times less than in 2008. However, the level of savings in 2009 was 30% of GDP. The level of savings exceeds the level of investments also in 9 months of 2010, though this difference has been reduced in comparison with the corresponding period of the previous year.

4.3.2. Financial Flows

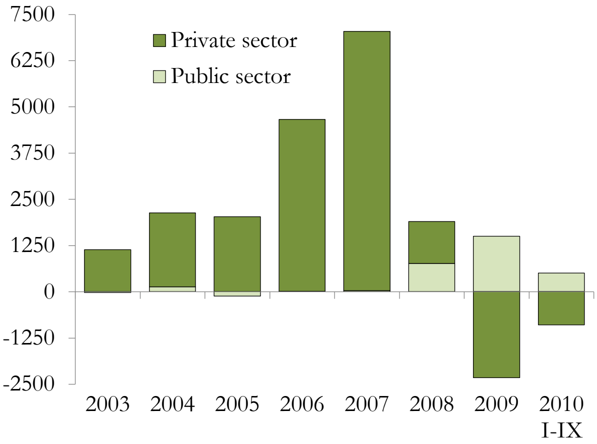
Inflow of foreign capital started increasing in Latvia at the beginning of transition, which was fostered by liberalization of financial flows. There are no limitations with regard to conversion of the national currency in Latvia. Foreign companies may freely withdraw their investments and profits after paying taxes. Also all residents of Latvia are free to use the financial services of any foreign company. There are no restrictions for transactions with securities.

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 by almost 3.5 times.

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

Figure 4.24

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



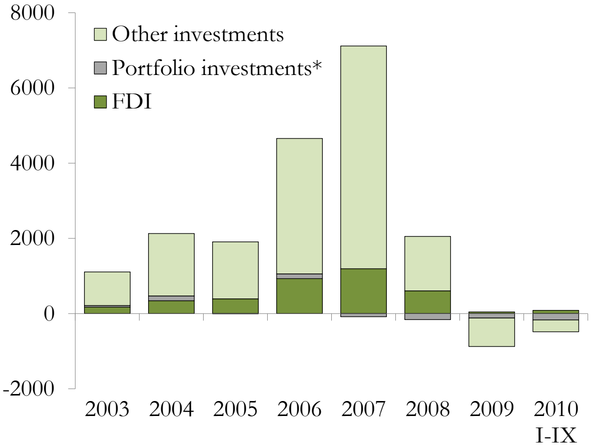
In the first half of 2010, the capital outflow continued although in smaller amounts than a year ago, however, in the third quarter, for the first time since the end of 2008, capital inflow into the private sector is observed, that was significantly influenced by the increase of reinvested profit which is indicative of improving results of non-resident enterprises.

In 9 months of 2009, deficit was observed in the financial account of the balance of payments, though the negative influence caused by the outflow of private capital was a little reduced by long-term public sector loans.

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

Figure 4.25

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



* portfolio investments and derivative financial instruments

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 reached 30% of the negative balance of the current account. In 2009, the incoming FDI flows were only 6% of the indicator of the previous year. Yet, in 9 months of 2010, the FDI flows exceeded the indicator of the corresponding period of the previous year by 5.7% and formed 1% of GDP. Fluctuations of the incoming FDI flows are linked to investments in foreign enterprises equity capital.

The share of portfolio investments in the incoming financial flows is small and has not been exceeding 10% over last three years. In 2009 and in 9 months of 2010, the balance of portfolio investments was positive, which was mainly related to financing attracted by the government in a form of treasury bills and bonds, as well as on the account of banks reducing the foreign debt securities holdings.

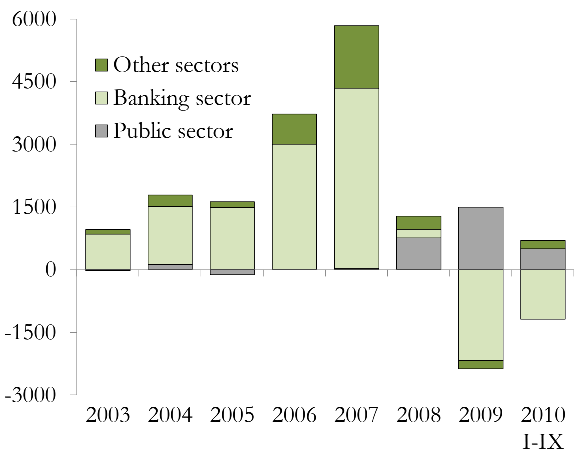
A large share of the total foreign investments consists of other investments, i.e. financial transactions that are not included in the direct and portfolio investments. These are trade loans, other loans and borrowings, cash and deposits, etc. Since 2005, these investments have increased 4.4 times. Yet, decrease of short-term flows was observed in 2008. In 2009, other investment flows were negative (-9.8% of GDP) mainly due to the rapid decrease of foreign liabilities of the banking sector. However, in 9 months of 2010, the negative surplus of other investment balance was only 0.4% of GDP which was determined by government long-term loans and reduction of debts of the banks.

The foreign capital flows were negative in 2009 and in 9 months of 2010.

Figure 4.26

Incoming Foreign Investment Flows by Sectors*

(million LVL)



* excluding foreign direct investments

The debt of Latvia to the rest of the world at the end of the third quarter of 2010 was 162.6% of GDP, including government debt – 32.2% of GDP. Over the 2009 government's external debt increased almost by 21.5 percent.

4.3.3. Foreign Direct Investment

Due to the impact of the global financial crisis, foreign capital flow in the economy of Latvia has 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 in the world, is considerably weaker than before the crisis. It is explained with the considerable losses of entrepreneurs during the period of rapid downturn, which weakened the investment capacity, as well as reduced tendency to invest. According to the data published by the United Nations Conference on Trade and Development (UNCTAD) the FDI flows in the world have decreased almost twice over two years (since the end of 2007) and now are maintained at a very low level that is comparable to the level of 2006.

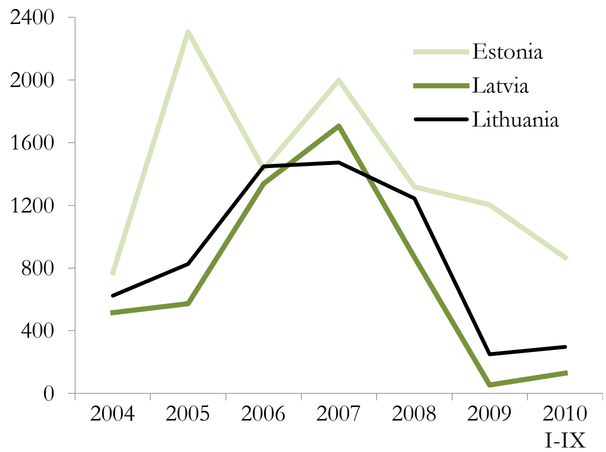
Decrease of FDI inflow is observed also in our neighbour countries. In 2009, the volume of incoming FDI in Estonia was only by 8.6% lower than in 2008, it was due to significant investments in the financial intermediation sector. But in 9 months of 2010, the incoming FDI flows have decreased by 67.3%. The FDI flows in Lithuania and Latvia in 2009 were correspondingly by 80% and 94% less than a year ago. An increase of FDI is observed in 2010.

Since 2008, the activities of Latvian investors abroad have decreased as well: compared to 2007, foreign direct investments of Latvian entrepreneurs reduced almost twice, and were negative in 2009. The activities of Latvian investors are rising in 2010.

Figure 4.27

Inflow of FDI in the Baltic States

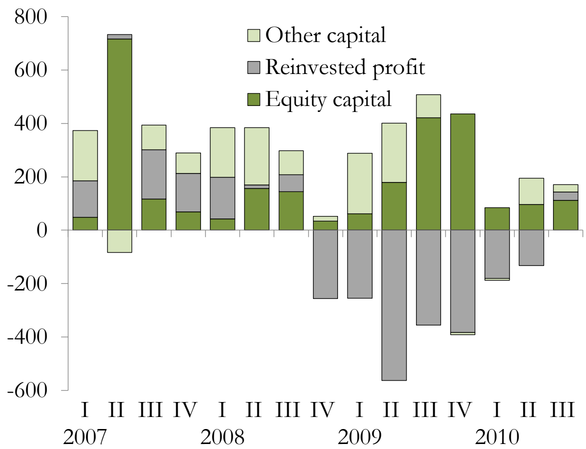
(million EUR)



The structure of the incoming FDI shows that since the fourth 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 first quarter of 2010, the investments in own capital were almost 3 times lower than the losses of the direct investment 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 is observed in the third quarter of 2010. Overall, the incoming FDI flows were positive in 9 months of 2010.

Figure 4.28

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



According to the international investment balance of Latvia at the end of the third quarter of 2010, the FDI stock in the economy of Latvia reached LVL 6116 million, which is by 5.8% more than a year ago. Their share in the structure of accrued foreign capital has increased by 1.6 percentage points and at the end of September 2010 it was 25%, which was determined by the decrease of other investment flows in the foreign capital inflows.

Investments of the EU member states prevail in the geopolitical structure of the FDI stock of Latvia. At the end of September 2010, it amounted to 80% of the total FDI stock, and one-third of it is related to investments of the new EU Member States and almost a half of them are investments of the euro zone countries.

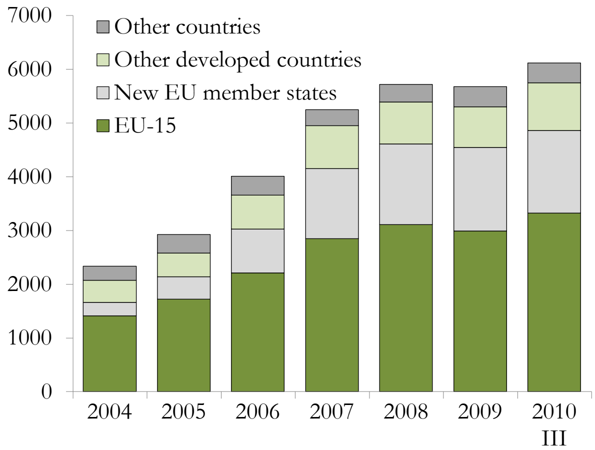
The biggest investor countries in the economy of Latvia are Sweden and Estonia. The FDI stock by these two countries at the end of September 2010 formed almost one third of the total FDI stock. They were mainly concentrated in the financial intermediation sector. Since the end of 2008, the FDI stock of the abovementioned countries in the financial intermediation sector has decreased by 4.5% and at the end of September 2010 formed 52% of the FDI stock in the sector that is by almost 6.4 percentage points less than at the end of 2007.

Large investments are also made by entrepreneurs from Denmark, Germany, and the Netherlands, whose investment volumes at the end of September 2010 constituted 19.2% of the FDI stock in the national economy of Latvia. It should be noted that annual investments of German entrepreneurs have been quite 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 third quarter of 2010 – only 6.2% of the FDI stock. The FDI of Germany is focused on the energy sector (25.5%), financial intermediation (21.2%) and real estate (18.8%). It should be also noted that the investments of Germany in the energy sector have decreased by almost a half since 2005.

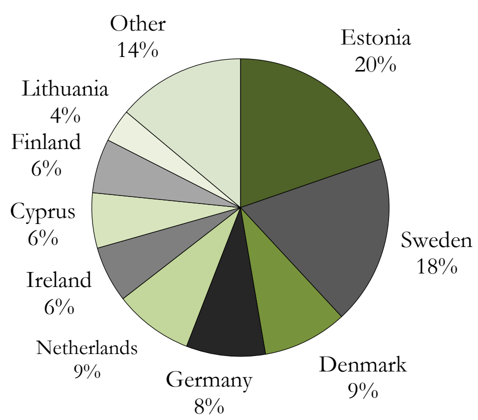
Figure 4.29

FDI Stock

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



FDI of EU Member States
(percentage, at the end of September, 2010)



Until 2008, the growth rates of the FDI in services sectors were almost one and a half times faster than in manufacturing sectors and the share of services sectors in the FDI stock formed 80% at the end of 2008. In 2009 and in 9 months of 2010, the foreign direct investments increased faster in sectors of manufacturing goods (respectively by 6.6% and

10.6%), while the level of the FDI stock in services sectors remained unchanged.

After accession of Latvia to the EU, foreign investors have made significant investments in the financial intermediation sectors, the share whereof in the FDI stock increased from 24% at the end of 2004 to 40% at the end of 2008. Also at the end of September 2010, the FDI stock level of this sector has remained equally high. It must be noted that the decrease of domestic demand had a negative impact on investments in trade and communication services, the FDI stock in the above-mentioned sectors at the end of September 2010 was respectively by 9.1% and 18.3% lower than at the end of 2008. The decrease of the FDI in these sectors was compensated by investments in the real estate sector (by 16.8%) therefore the level of the FDI stock in the services sectors has not changed since the end of 2008.

During the period from the end of 2008 till the end of September 2010, a particularly rapid increase of the FDI stock in production of goods was observed in energy and manufacturing sectors – respectively by 12% and 17.4%. The increase of the FDI stock in manufacturing was to a great extent influenced by substantial investments in production of construction materials (increase of 40.4%) and wood processing (increase of 10.8%). The share of the above-mentioned sectors in the FDI stock constituted 62% in manufacturing at the end of the third quarter of 2010 (at the end of 2008 – 55.6%).

Table 4.7

FDI Stock by Sectors

(end of period, million LVL)

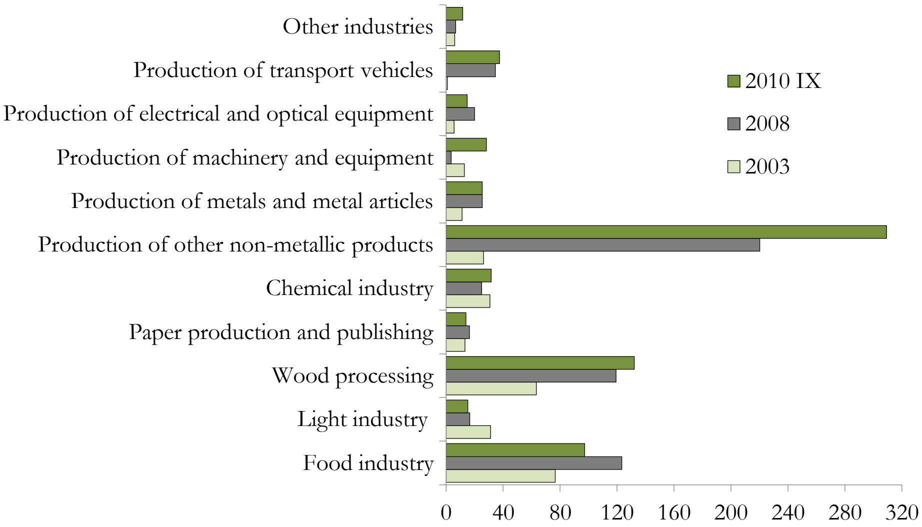
	2004	2005	2006	2007	2008	2009	2010 IX
Primary sectors	49.8	59.5	71.6	113.1	145.2	167.5	198.9
Manufacturing	276.1	376.0	395.8	516.8	611.0	654.5	717.1
Energy	164.7	327.6	348.1	270.7	204.9	190.5	229.3
Construction	36.5	49.7	67.6	85.5	107.1	126.6	114.4
Trade	395.7	437.8	562.3	676.4	862.0	856.5	776.9
Transport and communications	333.3	336.4	347.0	392.5	466.3	428.1	423.7
Financial intermediation	375.9	625.4	964.6	1486.2	1647.3	1645.1	1666.1
Other services	439.2	529.0	795.3	1223.5	1251.3	1371.3	1438.6

Overall, having evaluated the FDI structure in the manufacturing industry, it can be concluded that it is constantly changing. In some sectors, like the light industry, the FDI are decreasing since 2005 and the main reason is loss of competition is foreign markets. The volume of the FDI stocks 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 21.2% decrease of the FDI stock in 2010 by was mainly based on a decreasing demand in the domestic market, if compared to 2008. At the end of September 2010, the share of food production in the FDI stock of manufacturing constituted 13.6%, which is almost one and a half less than in 2008. The foreign direct investments in paper production and publishing sector have also decreased (by 14.7%) as well as those in production of optical equipment (by 26%).

Figure 4.30

FDI Stock in Manufacturing

(end of period, million LVL)



It should be noted that overall, interest of foreign investors about the manufacturing has not decreased during the crisis and it has even increased in some manufacturing sub-sectors. Extensive investments have been made in the sector of producing chemical substances, its products, and chemical fibres. At the end of the third quarter of 2010, the FDI stock in this sector exceeded one-and-a half times the level of 2008. Foreign investments in production of machinery and equipment, as well as production of transport vehicles are significantly growing. The share of sectors above in the structure of the FDI stock in manufacturing keeps rising and formed 9.2% at the end of September 2010 (at the end of 2007 – 3.6%). Changes of the FDI stock in other manufacturing sub-sectors are insignificant.

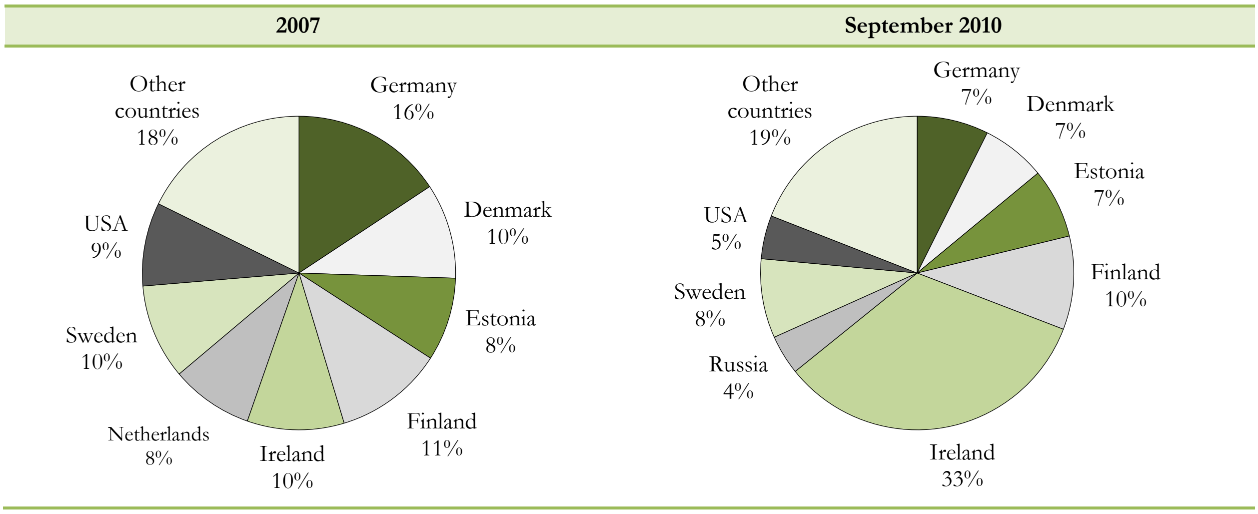
Having evaluated the changes of the FDI stock structure in manufacturing, it can be concluded that due to more rapid dynamics of investments in the high and medium-high technologies, their share has increased by almost 3 percentage points since 2008 and reached 14 percent at the end of September 2010.

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 countries above constituted 70% of the FDI stock in manufacturing. It should be noted that by the end of 2007, none of the countries held a 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 the third quarter of 2010, the capital of Ireland is dominating in the structure of the FDI stock constituting more than a third of the FDI stock in manufacturing, which was greatly influenced by the rapid increase in investments of this country. It has increased almost one-and-a-half 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 8.7% and 5.1%, as well as the USA – by 20%. At the same time investment stocks of Russian entrepreneurs in manufacturing at the end of September 2010 were by 30% larger than in 2008 and constituted 4.1% of the FDI stocks in manufacturing.

Figure 4.31

Structure of the FDI stocks in manufacturing of Latvia by countries

(at the end of the period, percentage)



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

IDAL continues developing its range of services and supply 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 experts from IDAL in the process of project implementation.

Having evaluated the interest of investors as they turn to IDAL, as well as the work with requests and projects, particular interest is observed in the sectors of renewable resources or the green technologies, and it is expected that it will increase in 2011 along with the recovery of economy. The number of projects in the wood industry and IT has an important role in the joint project portfolio. If compared to the first and the second quarter of 2010, when the investors were mainly interested in the services sectors (especially in financial and administrative external services), in the third quarter, the number of requests for information and number of projects in manufacturing has increased. The number of investors' visits has grown twice in comparison with the second quarter (by 30% if compared to the third quarter of 2009). In 9 months of 2010, about 25.6% of investment requests were developed into projects in the framework of which the investors seriously evaluate Latvia as a place for implementing projects. IDAL is working with 41 such investment projects, among them 18 projects launched in the previous period and 23 new projects (for example, Switzerland/Estonia – production of electronics; Spain/Germany – production of aluminium profiles/metal processing; Italy – education/sports; USA, the Netherlands, Great Britain – renewable resources/wood processing; Germany – IT/call centre; Great Britain – production of furniture, France – production of peat). The most frequently asked question of investors relates to the available state support for investments.

In 9 months of 2010, positive decisions to implement projects in Latvia were made both in the services sector – administrative services (USA, Lithuania) and manufacturing – metal processing (Sopena Group, Spain; a company from Greece), food processing (Germany). Having successfully implemented investment projects in Latvia, several companies have made a decision to invest in production expansion (Brabantia, the Netherlands; AGA, Germany; a company from Finland, Germany). As the projects will be implemented, investments in the amount of EUR 30.3 million are expected, thus creating 453-520 new workplaces.

However, a lot of foreign investment projects are lost due to still unsolved problematic issues, for instance, lack of industrial land and infrastructure, deficiencies in territorial planning, as well as due to the inadequate education system for the sectoral needs and growth, and due to lack of qualified labour. In order for Latvia to be competitive among other European countries, investment environment needs to be improved, activities of stakeholders must be coordinated and targeted, tax system must be stabilized, as well as support instruments and investment stimuli for attraction of foreign investments are necessary.

Experience of those countries that are long-term leaders in attraction of foreign investments (like Ireland and Singapore) shows that targeted investment attraction strategy is the key to success for new jobs and broader economic growth, because these countries are implementing strategies based on investment attraction and implementation in specific sectors. Thus, the countries and regions that have identified and developed their strong points in the foreign investment market, will take a competitive position in seeking new foreign investments in future.

In order to improve attraction of investments important for Latvia, IDAL continues implementing the methodology of investment attraction *Polaris* which envisages unified and coordinated action of ministries, local governments, infrastructure enterprises and public institutions in implementation of strategically important local and foreign investment projects, as well as involving private sector, universities and scientific institutions in this process. In the framework of *Polaris* process, the Coordination Council for Large and Strategically Important Investment Projects has been established to solve issues related to implementation of specific investment projects and improvement of investment environment.

4.4. Financial and Capital Markets

4.4.1. Monetary Policy and Exchange Rate

The *Law on the Bank of Latvia*[1] envisages that the main goal of the Bank of Latvia in implementing the monetary policy is to regulate the money in circulation in order to maintain price stability in the country. The central bank is an independent decision-making institution, which is not subordinated to the decisions or instructions of the government or governmental institutions. The Bank of Latvia performs its functions under the supervision of the Saeima.

Since the mid-February 1994, the Bank of Latvia had unofficially pegged the exchange rate of the lat (LVL) to the SDR[2] currency basket (1 SDR = LVL 0.7997) thus *de facto* implementing the fixed exchange rate policy. On January 1, 2005, the peg of the lat to the SDR basket was replaced with the peg to the Euro (1 EUR = LVL 0.702804). The change of the peg of the lat 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)[3]. On March 16, 2010 the Cabinet of Ministers, upon accepting amendments *On Latvia's National Euro Changeover Plan*, decided that January 1, 2014 is the target date for the euro introduction in Latvia.

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

The Bank of Latvia operates like the so-called currency board, freely buying and selling foreign

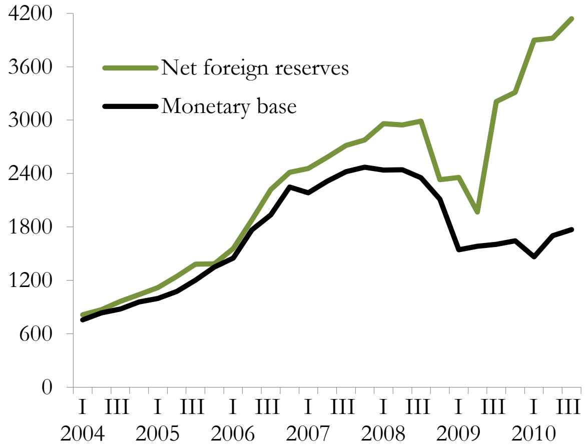
[1] The Bank of Latvia is the central bank of the country.
[2] Special Drawing Rights (SDR) – special currency code in accordance with the international currency classifier ISO 4217 – XDR.
[3] Participation in the EMU has been defined in the EU Accession Treaty, but Latvia is allowed to choose the most appropriate time for introducing the Euro.

currencies. The Bank of Latvia has managed to gain credibility without using the formal currency board system and to get experience while 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. In Latvia, there have been no problems in this respect – net foreign reserves of the Bank of Latvia constantly cover the monetary base of Latvia, and their amount equals to the amount of goods and non-factorial services imported by the country within several months (see Figure 4.32).

Figure 4.32

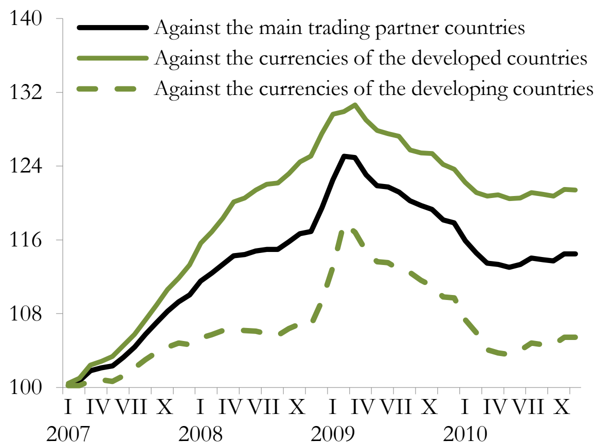
Net Foreign Reserves of the Bank of Latvia and Monetary Base, Quarterly Profile
(million LVL, at the end of the period)



Coverage of the monetary base (currency in circulation and deposits in the Bank of Latvia) with net foreign reserves was 251% at the end of October 2010 (at the end of April 2009 – 199%).

Figure 4.33

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 currency reserves are invested 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 organisations. Foreign reserves of the Bank of Latvia (including gold reserves) amounted to USD 8395 million at the end of October 2010 (USD 6906 million at the end of 2009, USD 5248 million at the end of 2008, USD 1535 million at the end of 2003).

The Bank of Latvia calculates the real effective exchange rate of the lats[1] against the currencies of 13 countries, which are the main trading partners of Latvia[2]. It shows the relative export competitiveness of Latvia in the global markets (see Figure 4.33).

Due to the comparatively high inflation during the years of rapid growth, the real effective exchange rate of the lats increased against the currencies of the developed countries and the currencies of the developing countries. An especially rapid increase of the real effective exchange rate of the lats occurred during the 2nd half of 2008 and at the beginning of 2009, which was mainly related to the devaluation of national currencies of our trading partner countries. 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 moderate tendency to decrease, but since June the real effective exchange rate of the lats is increasing.

4.4.2. Market Structure and Development

At the end of the third quarter of 2010, 21 **banks** operated in Latvia and 10 branches of foreign banks were registered. 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 troubles have also affected the Latvian banking system. In order to help the second largest bank (its assets constituted 13.8% of total assets of the Latvian banking sector), in terms of assets, to avoid problems created by the global financial crisis, in November 2008, the state, with intermediation of the Mortgage and Land Bank of Latvia, took over the controlling stock of shares of

[1] The real exchange rate of the lats includes changes of the nominal exchange rate of the lats against the currency of a trading partner 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 USA are included in the group of developed countries, while Estonia, Lithuania, Russia, and Poland are included in the group of developing countries.

JSC "Parex banka" (51% shares), by restructuring the bank, as a result of which the bank "Citadele" commenced its operations, which is a new credit institution formed in the framework of the restructuring plan for JSC "Parex banka" and its founder is SJSC "Privatizācijas aģentūra"'. After division of JSC "Parex banka", a part of its assets has remained in the so-called solution bank, which continues to work under the name of Parex bank. After division of the Parex bank, SJSC "Privatizācijas aģentūra" owns 82% of the Parex bank 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 voting rights and 15% of Parex bank shares.

On December 3, 2009 the conception *Transformation of the State Joint Stock Company "Mortgage and Land Bank of Latvia" into development bank* was accepted by the order of the Cabinet of Ministers. The conception stipulated the optimal way for transforming the Mortgage and Land Bank of Latvia into a development institution, focusing its activity on directions that are currently crucial for the national economy. In August 2010, for ensuring the transformation process, a consultant "SEB Enskilda" was involved to develop a detailed plan for implementation of the conception. The transformation process of the bank is currently continuing. The aim of the transformation is to form a development institution for implementing state support programmes.

In three quarters of 2010, all indices of the banks of Latvia complied with the regulatory requirements. In January 2010, the banking sector liquidity ratio was 61.4% and in September it increased to 66.4% percent (minimum normative requirement is 30%).

Although the crediting rates decrease, the resources become more expensive and the accessible resources for savings decrease. 13 banks of Latvia have increased their capital during the year 2009, overall by LVL 998.2 million, but since the beginning of 2010, 12 banks have increased the capital – overall by LVL 280.8 million. Although 7 banks of Latvia and 2 foreign branches gained profit in the three quarters of 2010 (total LVL 7.3 million), in general, the banking sector operated with losses which amounted to LVL 314 million at the end of the third quarter of 2010, which is by 54.7% less than in the corresponding period of 2009. The overall losses of the banking sector occurred mainly due to accumulation of costs for unsecured credits.

At the end of 2009, the average capital adequacy ratio was high – 14.6% (the minimum requirement stipulated by law is 8%) and at the end of the third quarter of 2010 it has increased to 15.2%. In August and September 2010, the capital adequacy ratio has been the highest in last three years. But the return on assets (ROA)[1] of the banking sector at the end of the third quarter of 2010 was 2%. Meanwhile, at the end of 2009, the return on equity (ROE)[2] was 41.6%, but at the end of the third quarter of 2010 – 24.5 percent.

At the end of the third quarter of 2010, 13 **insurance companies**, four of which provided life insurance and 9 – non-life insurance, as well as 11 branches of foreign insurance companies, operated in Latvia.

In 2010, the amount of gross premiums written in the insurance market is still reducing. In three quarters of 2010 it was LVL 138.4 million, which is by 20.7% less than in the corresponding period of 2009. In 2010, the amount of paid gross claims continues reducing, and in three quarters of 2010 was by LVL 85 million or 27.7% less than in the corresponding period of 2009.

In three quarters of 2010, the majority of premiums in the portfolio of gross premiums signed in the insurance market were signed on life and health insurance – correspondingly 75.7% and 21.8%. In three quarters of 2010, in comparison with the corresponding period of last year, the amount of signed gross premiums per one inhabitant has reduced by 18.2 percent.

The situation in the global financial markets has significantly affected the Latvian **securities market**: in 2008 and 2009, it was the global financial crisis, economic recession, and rise in oil prices, but in 2010 – the unstable financial situation.

At the beginning of 2010, the share prices increased, but at the end of the second quarter, the share prices slightly fell followed by a gradual rise and on December 31, 2010, the OMX Baltic Benchmark GI value reached 533.99 points which, in comparison with corresponding period of 2010, is by 69.8% more. In the first quarters of 2010, the increase tendency of OMX Riga index was similar to other Baltic indexes, however in the middle of the third quarter it began to reduce and at the end of the year it was considerably below other Baltic indexes. On December 31, 2010, the rate OMX Riga index was 393.53 points which, in comparison with corresponding period of 2010, is by 41.1% more. Increase of OMX Riga index depended on several improving macroeconomic indicators.

The stock exchange market in Latvia is still rather poorly developed and its influence on the economic growth of the country is minor.

4.4.3. Assets, Deposits and Credits

Bank assets constitute the largest share of total assets in the Latvian financial and capital market. At the end of the third quarter of 2010, in comparison with the corresponding period of last year, Latvian bank assets have decreased by 2.2%. At the end of the

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

third quarter of 2010, Latvian bank assets were LVL 21.1 billion (at the end of the third quarter of 2009 – LVL 21.6 billion). Bank credits constituted the largest part of bank assets (69.6%), 11% – claims against credit institutions, 8% – cash balance and deposits in the Bank of Latvia and 7.4% – securities. At the end of the third quarter of 2010, in comparison with the corresponding period of last year, the deposits in the Bank of Latvia have increased most rapidly among the bank assets.

Table 4.8

Monetary Indicators of the Banking System of Latvia

	2007	2008	2009	3rd quarter of 2010
at the end of the period, million LVL				
Net foreign assets	-4482.8	-5914.6	-3022.0	-1320.1
Net domestic assets	10654.0	11846.1	8842.3	7510.4
Domestic credits	13 018.2	14 279.7	12 204.3	11 271.4
to government (net)	-87.4	-370.0	-1474.6	-1748.1
to companies and individuals	13 105.6	14 649.7	13 678.9	13 019.5
Other assets (net)	-2364.2	-2433.6	-3362.0	-3761.0
Broad money M2X	6171.3	5931.4	5820.3	6190.3
Currency in circulation (less vault cash balance)	900.0	866.1	667.3	760.1
Deposits of individuals and companies	5271.3	5065.3	5153.0	5430.2
including:				
demand deposits	2864.9	2308.0	2206.2	2476.6
time deposits	2406.4	2757.3	2946.8	2953.6
changes in comparison with the corresponding period of the previous year, %				
Domestic credits	31.8	9.7	-14.5	-8.3
including:				
to companies and individuals	34.0	11.8	-6.6	-7.3
Broad money M2X	12.6	-3.9	-1.9	12.7
Currency in circulation (less vault cash balance)	-7.1	-3.8	-23.0	16.7
Deposits of individuals and companies	16.9	-3.9	1.7	11.5
GDP (in current prices)	**32.3**	**9.5**	**-19.2**	**2.0**

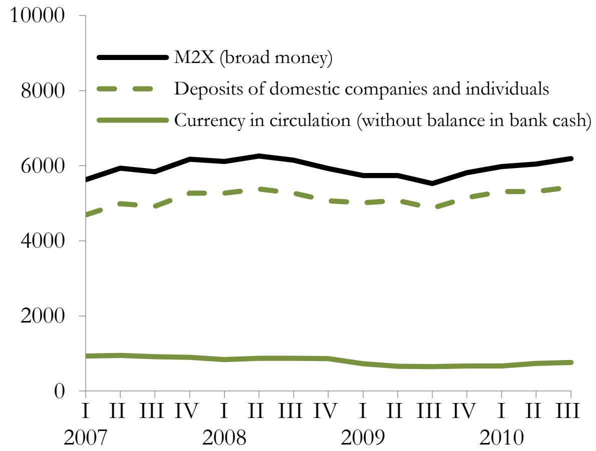
Along with the first signs of national economy growth, the amount of currency in circulation has been slightly increasing since the beginning of 2010. At the end of the third quarter of 2010, LVL 760.1 million of currency was in circulation which is by 16.7% more than in the corresponding period of 2009. It mainly depends on the increase of **deposits** attracted from banks that began at the end of the fourth quarter of 2009 and continued also in the first three months of 2010. At the end of the third quarter of 2010, the deposits attracted from the residents at the financial institutions, private non-financial corporations, households, as well as public non-financial corporations, in comparison with the corresponding period of the previous year, increased by 11.5%. It was promoted by both increase of export and growth of several national economy sectors.

At the end of the third quarter of 2010, deposits of individuals and companies amounted to LVL 5430.2 million which is by LVL 558.4 million more than in corresponding period of 2009. In the third quarter of 2010 the broad money increased by LVL 666.9 million or 12.1%, in comparison with the corresponding period of previous year, thus reaching LVL 6190.3 million.

Figure 4.34

Dynamics of Broad Money (M2X) and its Components, Quarterly Profile

(end of the period, million LVL)



At the beginning of 2010, changes of the deposit currency structure continued. At the end of the third quarter of 2010, the amounts of residents' deposits in LVL increased in comparison with the corresponding time period of year 2009 thus constituting 45.5% of all residents' deposits. The greatest part of residents' deposits (48.7%) is still in EUR, however, the amount of these deposits is decreasing.

At the beginning of 2010, the balance of bank **credits** granted to domestic companies, individuals, and the government continues decreasing. The balance of credits granted to companies at the end of the third quarter of 2010, in comparison with the corresponding time period at the end of 2009, decreased by 8.9%, while the credits granted to households – by 5.4%. Since the beginning of 2009, a particularly rapid decrease has been observed with respect to the bank credits to the government, but at the beginning of 2010 it decreased again, and such tendency was observed also in the second and third quarter of 2010.

In September, 2010, growth of the credit balance declined by 7.8% in comparison with the respective month of the previous year, and the growth of balance of credits granted within the third quarter of 2010 decreased by 1.5% in comparison with the second quarter.

Figure 4.35

Dynamics of Credits Granted by the Banks to Domestic Companies, Individuals and Government, Quarterly Profile

(end of the period, million LVL)

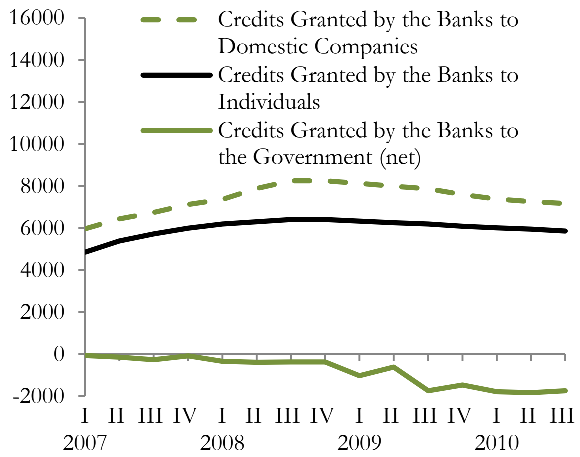
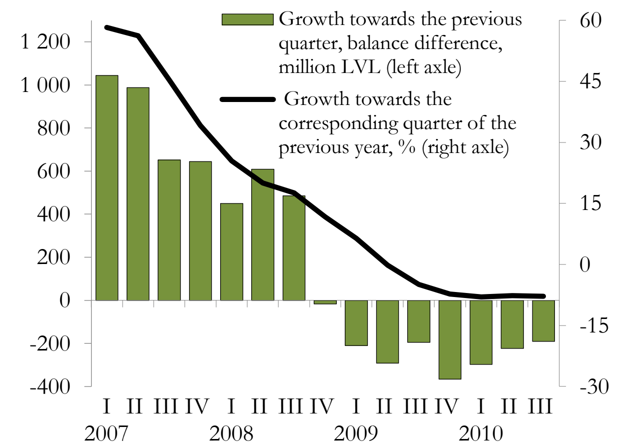


Figure 4.36

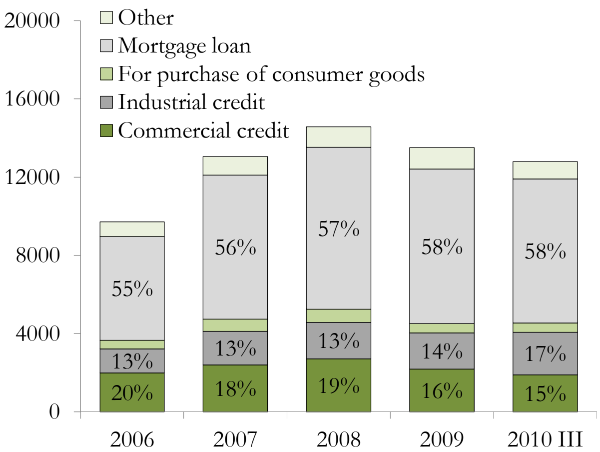
Total Credits Granted to Resident Financial Institutions, Non-financial Corporations and Households

(total)



Amount and Structure of Credits Granted to Domestic Companies and Individuals

(end of the period, million LVL)



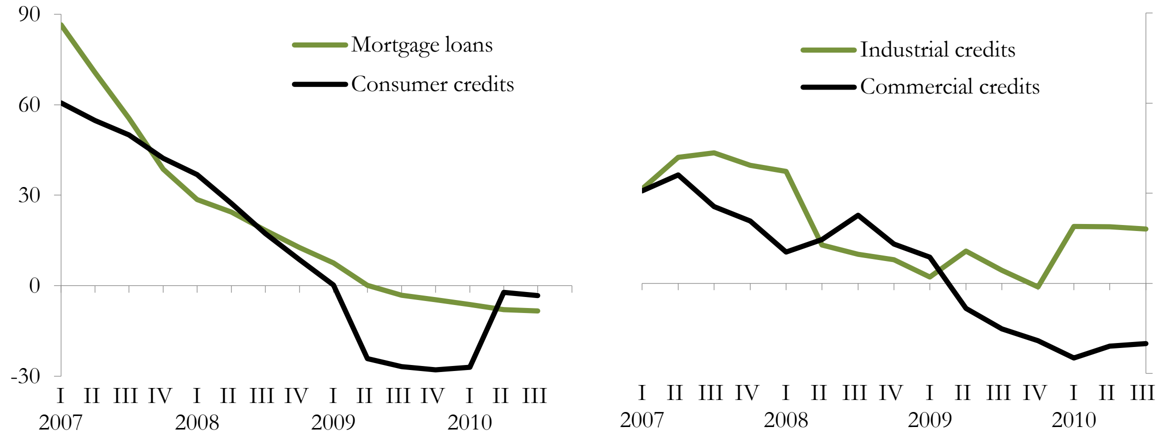
In the third quarter of 2010, just like before, the structure of credits granted to domestic companies and individuals is dominated by mortgage loans, the proportion of which in the total credit structure is 57.5%. However, the proportion of major loans – commercial credits and industrial credits (for purchase of fixed assets and funding of long-term investment projects) – for increasing the current assets of companies overall was only 31.8 percent, which in comparison with the beginning of the year has slightly increased.

The amount of the granted **mortgages** grew very rapidly over the preceding years (by 39% in 2007 and by 13% in 2008). In 2009, granting mortgages basically stopped, and this tendency continued also in 2010. At the beginning of 2010 (at the end of January), the mortgage loan balance decreased by 5.2% in comparison with the corresponding time period of the year 2009, at the end of the third quarter of 2010, in comparison with the same period in 2009, – by 8.4 percent.

The growth of **the consumer credit balance** has significantly decreased since the end of the second quarter of 2009 (in comparison with the corresponding period of the previous year, it decreased by 24.2%) and continued till the second quarter of 2010 when the credit balance significantly increased and reached the level of the beginning of the year 2009.

Figure 4.37

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



The monthly balance of **commercial credits** has been decreasing since November 2008 and continued declining also in 2009 and at the beginning of 2010. At the end of the third quarter of 2010, the balance of commercial credits granted to residents decreased by 20.1% in comparison with the corresponding period of 2009.

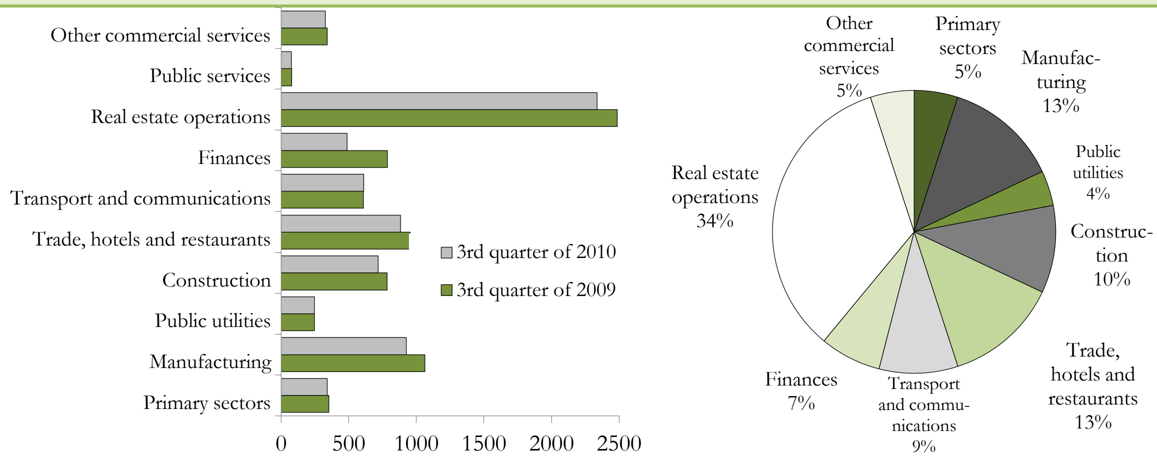
The balance of **industrial credits** has significantly increased in the first quarters of 2010 possibly due to several signs of improvement in the business sector, especially in respect of the growth of export potential.

Figure 4.38

Credits to Residents by Sectors of Economy

Balance of credits granted
(at the end of the 3rd quarter of 2009 and the 3rd quarter of 2010, million LVL)

Structure of balance of credits granted
(at the end of the 3rd quarter of 2010, %)



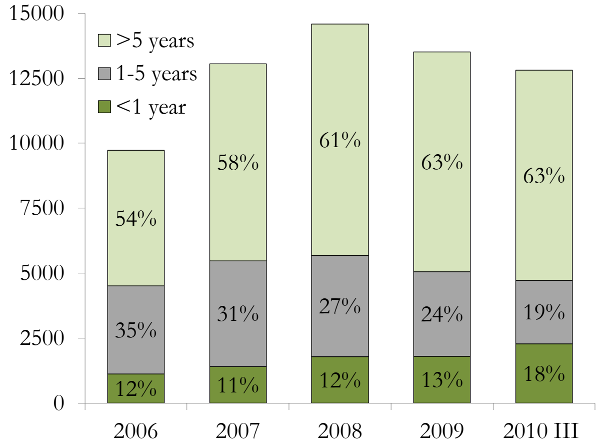
At the end of the third quarter of 2010, credits in the amount of LVL 6953.1 million were granted in national economy, which is by 9.7% less than at the end of the third quarter of 2009 when credits in the amount of LVL 7696.3 million were granted. The most rapid decline of credit balance was shown in the financial sector – at the end of the third quarter of 2010, in comparison with the corresponding period of 2009, decrease by 37.8% was observed, manufacturing by 12.9%, construction – by 8.3% and in trade, hotel and restaurant sector by 7.6%. The balance of granted credits increased only in transport and communication sector (by 0.4%) and remained the same in the electric energy, gas and water supply sector. The largest credit balances are still related to real estate activities – LVL 233.8 million (34% of the total credits granted to the economic sectors). Credits granted to the manufacturing, trade, hotels and restaurants, as well as to the construction sectors also constitute a comparatively large proportion. 7.4% of all credits granted to the residents are credits in lats. The majority of the credits (89.5%) are granted in EUR possibly due to much lower interest rates for credits granted in EUR.

Over the recent years, the proportion of short-term and long-term credits has grown in the total maturity profile. The proportion of long-term credits has basically remained unchanged in 2009 and in the third quarter of 2010. Although at the end of the third quarter of 2010, in comparison with the results at the end of year 2009, the balance of long-term credits decreased by 4.5%, though the proportion in the credit portfolio increased, reaching 63.1% at the end of the third quarter of 2010 (at the end of year 2009 – 62.6%). Yet, at the end of the third quarter of 2010, in comparison with the results at the end of 2009, the balance of short-term credits increased by 26.2%, and the proportion of the total credit amount was 17.8% at the end of the third quarter of 2010.

Figure 4.39

Term structure of Credits Granted to Domestic Companies and Individuals

(end of the period, million LVL)



The most rapid decline was observed in medium-term credits, which at the end of the third quarter of 2010 decreased by 24.6% in comparison with the results at the end of 2009. The proportion of medium-term credits in the total amount of credits was 19.1% at the end of the third quarter of 2010 (24% at the end of 2009).

In 2010, the amount of credits with overdue payments continues increasing. 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 third quarter of 2010 already 28.5% or LVL 4.2 billion of the overall credit portfolio of banks. At the end of the third quarter of 2010, the share of credits with payments overdue above 90 days reached 19.4% in the credit portfolio (14.5% in the corresponding period of 2009). The proportion of credits with payments overdue above 180 days has significantly increased in the total credit portfolio. At the end of the third quarter of 2010, there were 54.4% more credits with payments overdue above 180 days than in the same period of the previous year.

In 2010, the banks continued to cooperate with the clients facing difficulties to repay the credits. The amount of restructured credits in the total credit portfolio increased from 16.1% at the end of 2009 to 20% or LVL 2.9 billion at the end of the third quarter of 2010. The largest part of restructured credits was credits to enterprises (50.6%) and households (33.2%). Credits to micro companies and small companies constitute the largest part of the amount of restructured credits of enterprises.

In the third quarter of 2010, the amount of credits currently being recovered (credits in work-out process) continued increasing thus reaching 14.8% or LVL 2.2 billion of the overall credit portfolio of banks at the end of the third quarter of 2010. The largest part of the amount of credits currently being recovered is also constituted by credits to companies (54.7%) and households (40.6%). Overall, the largest part of restructured credits and credits currently being recovered in the national economy is made of credits to wholesale and retail trade, agriculture, forestry and fishing, as well as manufacturing and operations with real estate. The largest part of credits currently being recovered is made of credits to the construction sector. At the end of the third quarter of 2010, the bank reserves for unsecured credits reached LVL 1.7 billion or 11.4% of the total credit portfolio of banks. Overall, by August, 2010, 1.2 million credits are granted to individuals, 358.1 thousand or 30% of them are delayed credits with overdue principal sum for the amount of LVL 564.5 million. 62.2 thousand credits are granted to companies, 26.4 thousand or 42% of them are delayed credits with overdue principal sum for the amount of LVL 1.3 billion.

At the end of the second quarter of 2009, the weighted average **interest rate** on short-term credits granted to companies 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 lat. Since the end of 2009, the weighted average interest rate on short-term credits granted to companies and individuals has been reduced and at the end of the third quarter of 2010 it was 8%, which means that the situation has slightly stabilized. Considering that LVL is pegged to EUR, the stabilization of situation is proved by the convergence of LVL exchange rate with EUR exchange rate.

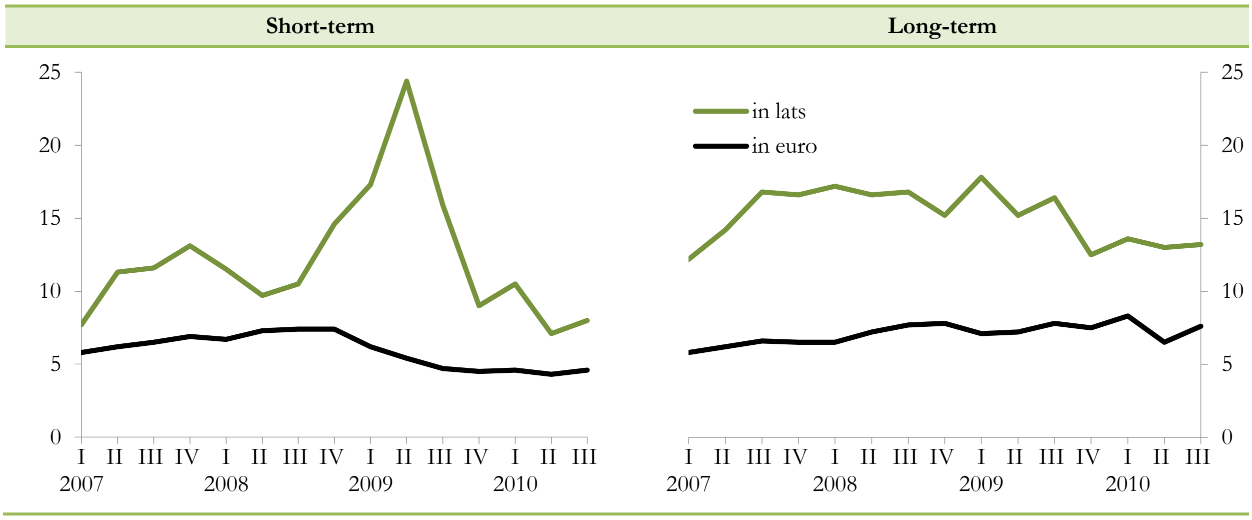
Over the year, more moderate fluctuations were observed in the weighted average interest rates on long-term credits, which decreased from 16.4% at the end of the third quarter of 2009 to 13.2% by the end of the third quarter of 2010.

The interest rates on credits granted in EUR were as usual lower and their fluctuations less explicit. Respectively, at the end of the third quarter of 2010, the weighted average interest rate on short-term credits granted in EUR was 4.6%, but on long-term credits – 7.6%. The weighted average interest rates on long-term credits granted in euro currency even slightly increased at the beginning of 2010 and reached the highest indicator over the last years, however, it slightly decreased again during the next two quarters.

Figure 4.40

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

(percentage)

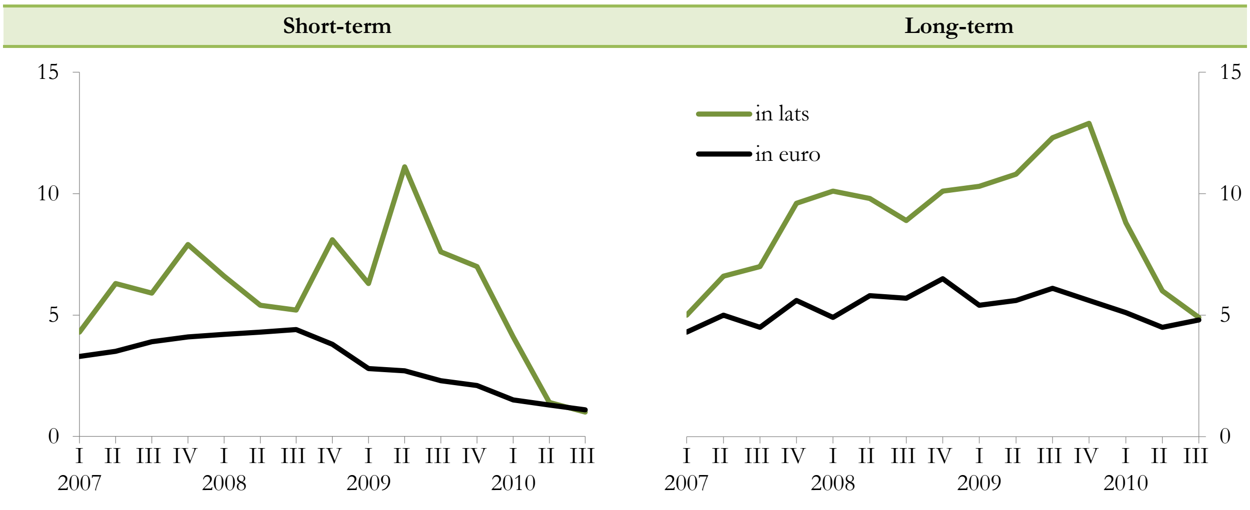


In the mid-2009, the weighted average interest rate in LVL in respect to attracted long-term deposits in credit institutions increased, reaching 12.9% at the end of 2009, but it decreased at the end of the first quarter of 2010 to 8.8%, and decline was observed also in the following quarters. The interest rates on short-term credits showed the most rapid growth in the second quarter of 2009, reaching 11.1%, and later gradually decreasing until falling to 1% at the end of the third quarter of 2010, which meant that the weighted average interest rates on attracted short-term deposits in LVL and EUR in credit institutions in the second and third quarter of 2010 are almost equally low.

Figure 4.41

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

(percentage)



At the end of 2009 and at the beginning of 2010, the weighted average interest rate in Euro with respect to the attracted long-term deposits has slightly decreased – from 6.1% at the end of the third quarter of 2009 to 4.8% at the end of the third quarter of 2010.

5. LABOUR MARKET

5.1. Employment and Unemployment

Due to the economic crisis, situation in labour market has been significantly deteriorating since the end of 2008 – unemployment rapidly increased and the number of the employed decreased. The lowest point was reached in the first quarter of 2010 when the employment rate shrank to 57.7% (population aged 15-64 years), but the unemployment rate of population aged 15-74 increased to 20.4 percent[1].

As already experienced at the beginning of the crisis period, changes in the labour market slightly lag behind the changes in economic activities (on average by 4-6 months). The economic situation became stable already at the end of 2009 while positive tendencies in the labour market appeared in the second quarter of 2010.

In general, the situation in the labour market is slowly becoming stable. The number of employed persons has increased by 0.6% in a year (the third quarter of 2010 compared to the third quarter of the previous year) or 5.2 thousand people. The unemployment rate also has increased and in the third quarter of 2010 was 60.6% in comparison with 59.8% in the respective quarter, a year before.

The increase has been rather minor taking into account the significant decline in labour demand caused by the economic recession. It should be noted that no further rapid increase in the number of the employed is expected as the growth will be mainly based on the increase of productivity.

In the period from the third quarter of 2009 to the third quarter of 2010, the unemployment rate has reduced only by 0.4 percentage points. In November 2010, Latvia had the third highest unemployment rate in the EU (18.2% seasonally adjusted harmonised unemployment rate).

According to data of the State Employment Agency, 162.9 thousand unemployed persons were registered at the end of 2010, which is 14.3% of the economically active population in the country.

The economic activity of population has remained high. The economic activity rate was 74.1% in the third quarter of 2010.

Table 5.1

Key Indicators of Employment and Unemployment

Indicators	2005	2006	2007	2008	2009	3rd quarter of 2010
Number of employed persons (aged 15-74, thousand)	1035.9	1087.6	1119.0	1124.1	986.7	937.7
Economic activity rate (aged 15-64, %)	69.5	71.3	72.9	74.5	73.9	73.4
Employment rate (aged 15-64, %)	63.4	66.3	68.4	68.6	61.1	59.1
Unemployment rate (share of job-seekers aged 15-74, %)	8.7	6.8	6.0	7.5	16.9	19.3
Registered unemployed persons (end of period, thousand)	78.5	68.9	52.3	76.4	179.2	165.4

The most considerable changes are observed in male employment. In the second and third quarter of 2010, the male employment rate after the significant decline during the period from the fourth quarter of 2008 to the first quarter of 2010 has increased faster than the female unemployment rate, and in the third quarter of 2010, the male employment rate once again exceeded the female employment rate – the male employment rate was 61%, but that of female – 60.2 percent.

Female unemployment has not changed significantly in a year, but male unemployment has rapidly decreased in the first quarters of 2010. The male unemployment rate was 20% in the third quarter of 2010 (compared to 25.6% in the first quarter of 2010), yet, it still significantly exceeds (by 4.1 percentage points) the female unemployment rate.

[1] According to the EU adopted methodology, the employment indicators are reflected for age group 15-64 years but the unemployment indicators (except for the registered unemployment) – 15-74 years.

Figure 5.1

Employment and Unemployment in Latvia

(percentage)

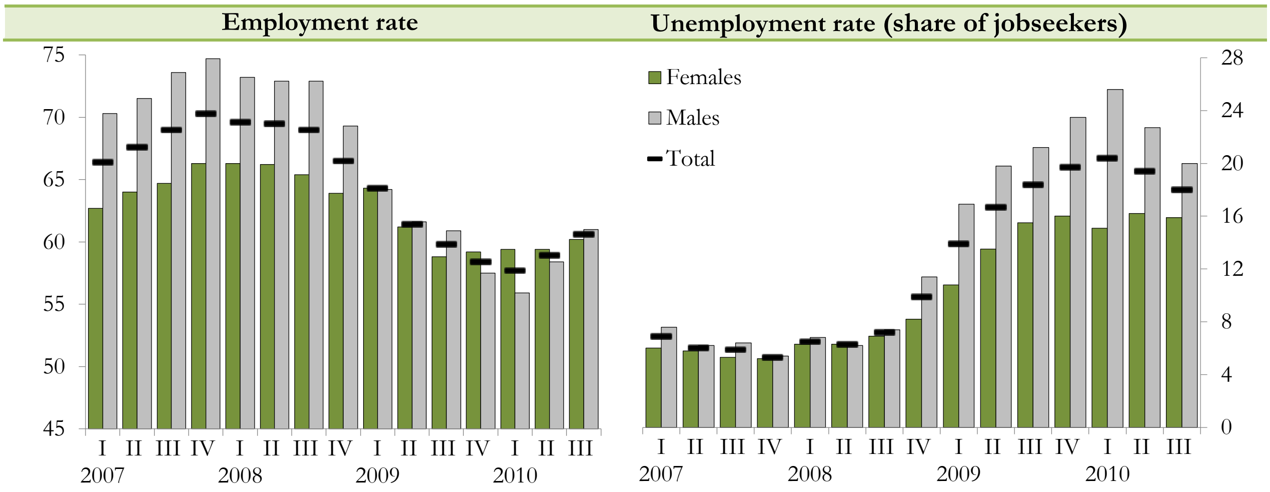
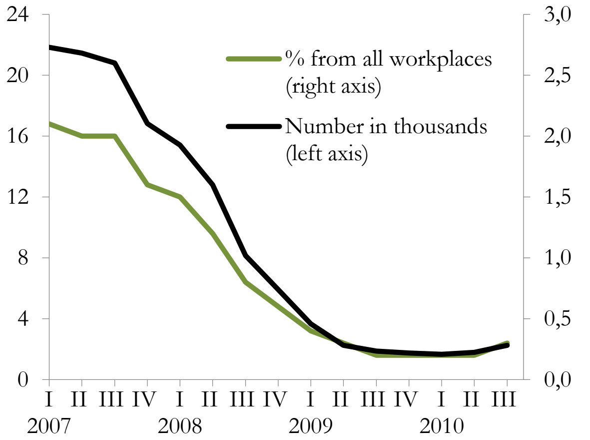


Figure 5.2

Job Vacancies



Decrease in the number of job vacancies also is indicative of the rapid decrease of labour demand (see Figure 5.2.).

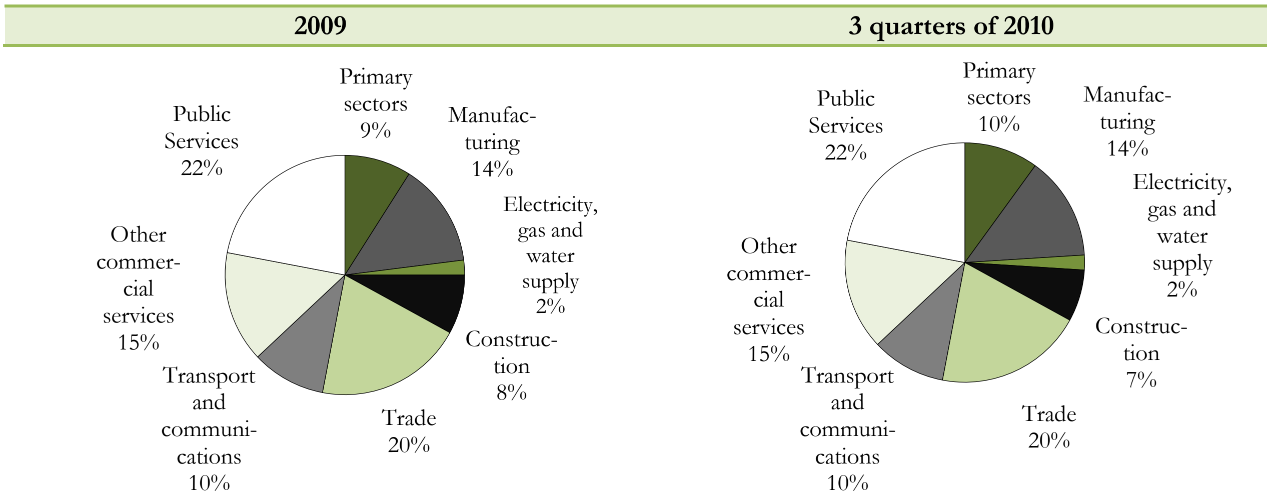
Since the beginning of the second half of 2007, the number of job vacancies has started to go down. It means that the majority of Latvian enterprises have not been planning to increase production volumes since the mid-2007. The number of job vacancies has stabilized at a very low level after a rapid decrease in 2008. There were 2.2 thousand job vacancies at the end of the third quarter of 2010.

Over the course of a year (the third quarter of 2010 compared to the third quarter of 2009), the number of the employed persons has slightly increased in all sectors, except for a slight decrease in the trade and hotel sector and in commercial services. The number of employed in both sectors decreased by about 4% or correspondingly by 8.1 and 5.7 thousand people.

Figure 5.3

Structure of Employed Persons by Sectors of Economy*

(aged 15-74, %)



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

In this period, the highest increase in the number of employed persons was in manufacturing and electricity, gas, and water supply, where the number of employed persons has increased respectively by 11.1 thousand people or 8.9% and 3.8 thousand people or 33.7%.

In the three quarters of 2010, the structure of the employed population has remained more or less the same if compared to 2009 (see Figure 5.3).

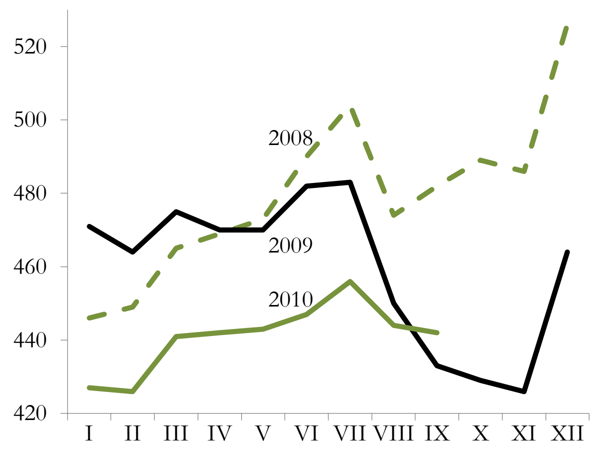
5.2. Labour Costs and Productivity

The decrease of economic activities in 2008 firstly reflected in the unemployment rate, while the level of wages was still rather high. However, a decrease of employment and wages was observed in 2009 and at the beginning of 2010. Yet, as the economic situation became stable, the wages and the number of employed persons has slightly increased since the second quarter of 2010.

Figure 5.4

Average Gross Monthly Wage of Employed

(in lats)



The dynamics of wages shows that a significant decrease of wages was observed in the second half of 2009. In the first quarter and at the beginning of the second quarter, the level of wages was slightly above the level of corresponding quarters of 2008, but in the third quarter and the fourth quarter it was respectively by 6.4% and 12.1% lower.

The average annual gross wage in 2009 was LVL 460, i.e. by 3.8% lower than in the previous year (in 2008 – LVL 479), but by almost 16% higher than in 2007. Such wage adjustment is quite insignificant taking into account the depth of the economic recession.

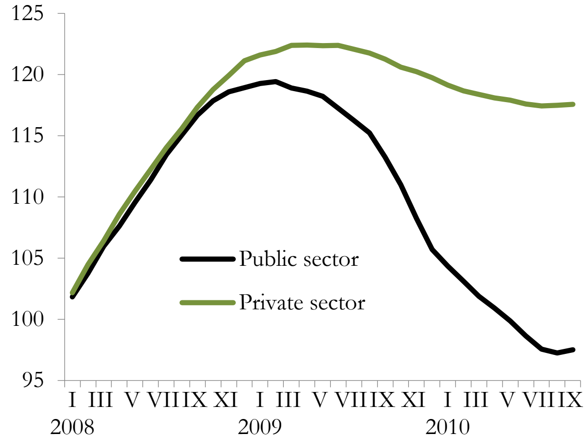
In 2010, the dynamics of wages became stable, thus nearing the level of the previous year with each quarter. In the first quarter of 2010, the level of wages was by 8.2% lower than in the corresponding period of the previous year, however in the second quarter and the third quarter of 2010 it was by 6.3% and 1.9% lower, respectively.

The adjustment process of wages was considerably different sector by sector. Wages in the public sector experienced the most rapid decrease which is mainly related to budget consolidation measures. Wages in the public sector in 2009 were on average by 11% lower than a year ago.

Figure 5.5

Average Gross Monthly Wage of the Employed in Public and Private Sectors

(12 month moving average)

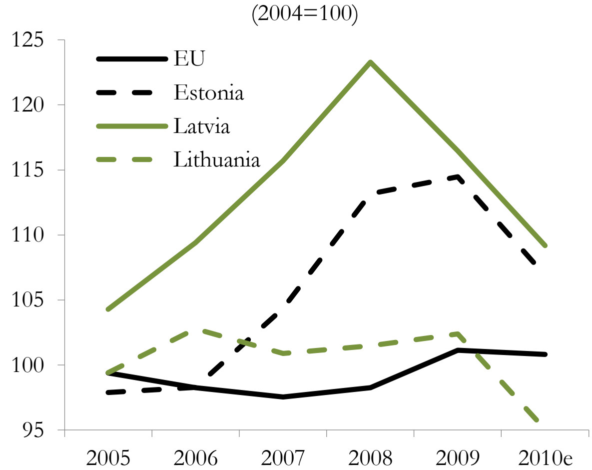


Yet, the decrease of wages in the private sector was less significant (by 1% in 2009), because entrepreneurs preferred reducing the number of employees in order to cut their costs. This tendency remained also in 2010. In nine months of 2010, wages of the employed in the public sector were by 10.1% and in the private sector – by 2.5% lower than in the corresponding period a year before.

Figure 5.6

Changes of Real ULC in the EU and Baltic States

(2004=100)



e – estimation; source: *Eurostat*

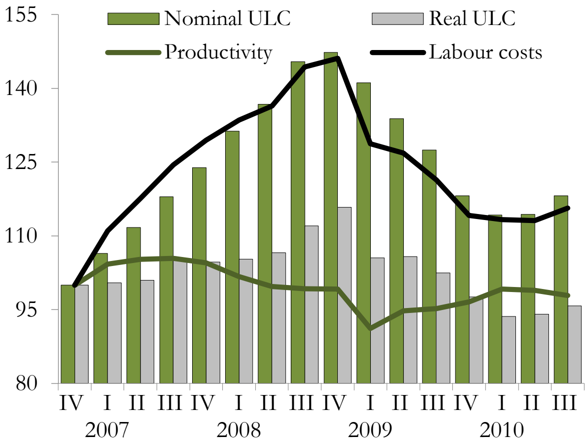
The production unit labour costs (ULC)[1] decreased significantly in 2009. The ULC is one of the indicators characterising competitiveness (as a state in general, as well as in individual sectors). The dynamics of this indicator indicate that the competitiveness of Latvia has increased among the EU member states.

The real ULC in the EU has increased on average by 2.9% in 2009 compared with the previous year. Our neighbouring countries also showed positive dynamics of the ULC. The real ULC in Estonia and Lithuania increased by 1.2% and 0.8% respectively, but in Latvia – decreased by 5.5%. According to evaluation of *Eurostat*, the real ULC in 2010 is decreasing in all three Baltic States in comparison with the previous year.

Figure 5.7

Changes of Labour Costs in Latvia

(4th quarter of 2006=100)



Source: *Eurostat*

The changes in the ULC dynamics in 2008 and 2009 are mainly related to the cyclical factors unlike the years before the crisis, when changes in the ULC (growth) were determined by structural factors.

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 influence on the situation in the markets of goods. The GDP decreased in 2008 by 4.2% compared to the year before, but the relevant adjustments in the labour markets did not take place at the same time, and it was the main reason for growth of the real ULC. The real ULC in 2008 were almost by 5% higher than in the previous year.

Significant adjustments in the labour market started in 2009, which influenced the dynamics of both productivity and labour costs. Productivity has decreased by 5.5%, but the labour costs – by 5.9% compared to 2008. As a result, the real ULC decreased by 6.4 percent.

In the first quarter of 2010, the real ULC still continued to decrease (by 4.1%) compared to the previous quarter, but in the second and third quarter of 2010 it increased respectively by 0.5% and 1.8% as the labour costs increased faster than productivity. Overall, the dynamics of productivity and labour costs in the three quarters of 2010 was equal, however, the increase of labour costs was compensated by a more rapid rise in prices resulting in 2% lower real ULC in the third quarter of 2010.

The tendencies of 2010 show that adjustment of labour costs caused by the crisis is over and the increase in competiveness of Latvia no longer can be based on this factor, taking into account that it will not be possible to keep low wages in a situation of free movement of labour.

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 second quarter of 2010, positive changes have been observed also in the labour market.

The situation in the labour market will continue to improve in 2011, a slight decrease of employment due to seasonality is expected in the first quarter of the year, however as of the second quarter, the employment will increase again along with new seasonal jobs. In general, the number of employed persons in 2011 is expected to be by 2.5% higher than the average in 2010, yet it still will not exceed the average level of 2009.

In 2011, the employment rate (aged 15-64) might be 61.5% which will be by 2 percentage points higher than in 2010. Employment rate will continue to grow also during the upcoming years and might be near 70% in 2016.

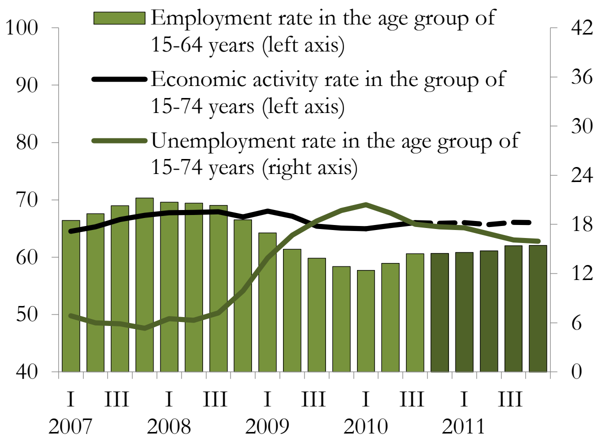
In general, the employment rate will be more moderate than the growth as the increase in output will be based not only on increase in the number of employed persons but also on the growth of productivity.

The unemployment rate decreased in line with the increase of employment in 2010. According to evaluation of the Ministry of Economics, the average unemployment rate in 2010 might be between 18-19%. Unemployment will continue to decrease in 2011 and as the economic activity of population will grow slower than in 2010, the unemployment indicators will decrease faster and the average unemployment rate of the year will be about 16-17%.

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

Figure 5.8

Labour Market Development Trends*



* the actual data are reflected until the third quarter of 2010

Although unemployment will continue to decrease also in the upcoming years, a high labour force surplus will remain in the economy until 2014. Situation will change from 2015 on, when processes in the labour market will be mainly determined by the declining labour force due to negative demographic tendencies. The unemployment rate in 2015 could be 8%, but in 2016 – approximately 6-7%.

Figure 5.9

Forecasts of Labour force Demand and Supply*

(thousand persons)

*the actual annual data are reflected until 2009

In 2010, the tradable sectors – manufacturing, agriculture and transport and communications recovered relatively fast from the consequences caused by the crisis. However, growth of these sectors was mainly based on the growth of productivity therefore the positive effect on employment was rather insignificant. According to an evaluation by the Ministry of Economics, the labour force demand in 2010 has grown in manufacturing (0.9%) and in electricity, gas, and water supply (4.8%) while in other sectors of the national economy, the labour force demand continued to decrease, in comparison with 2009.

The situation will slightly change in 2011, taking into consideration the relatively low labour costs, the growth next year may be based more on the increase of employment, which will have a positive impact on the labour market. Comparatively sharp increase of labour force demand is expected in manufacturing (4.6%), as well as in trade and commercial services sector (4.5%).

The most significant increase in labour demand in the medium-term is also expected in manufacturing and commercial services sector. The number of persons employed in manufacturing by 2016 might increase by 19%, but in commercial services sector – by 18% in comparison with 2009.

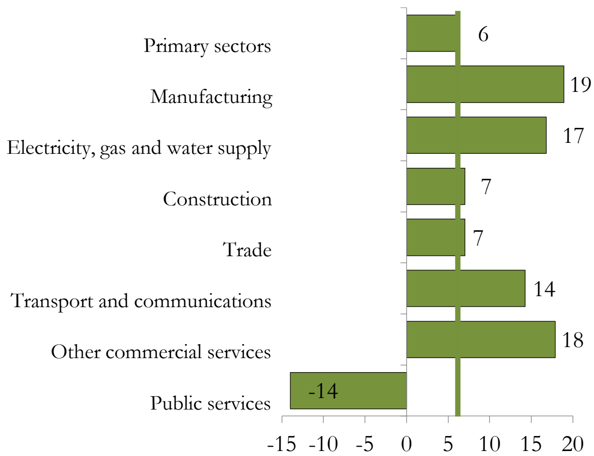
Situation in the construction sector will improve gradually from 2011, however if compared to the period of pre-crisis, the increase of labour demand will be minor – on average 4% per year.

Contrary to other sectors, employment in the public services sector will decrease until 2016, which will mainly be based on the 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 be by 14% lower than the average in 2009. At the same time, the number of persons employed in the public sector will be affected by the implemented structural reforms in state administration. In medium-term the number of employed can decrease in education sector. It will be based on the low birth rate of the 90's. As a result, number of pupils will decrease.

Figure 5.10

Changes in the number of employed population in 2016, compared to 2009 by sectors

(percentage)



The current economic development tendencies show, that the economic recovery in Latvia and in the world is taking place much faster than it was initially expected. Despite the fact, that there will be substantial labour surplus in the medium term, in a longer period of time new challenges are expected, which could radically change 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 10% until 2020 compared to the level of 2009. At the same time, the demographic load could increase by 21%. Thus, the key long term challenges contrary to the medium term will be mainly related to the aging 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 before 2020 the employment level for population aged 20-64 years is at 75 percent.

Yet, at the national level, each member state is preparing the national reform programmes for implementation of the *EU 2020 Strategy,* reflecting activity directions and measures to be carried out. The draft of the national reform programme of Latvia for implementation of the *EU 2020 Strategy* was adopted on November 16, 2010 by the Cabinet of Ministers. The final version of the programme will be prepared by April 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% in the age group of 20-64 by 2020. In order to reach the objective, policy directions are planned on both labour demand side and labour supply side.

Policy directions for improving the labour supply:

- active labour market and lifelong learning policy measures which correspond to the situation in the labour market and are flexible to implement;
- improvement of quality of work environment, development of normative framework of legal relationships in the labour market and labour protection;
- timely identification of labour market needs;
- reduction of undeclared employment;
- promotion of self-employment and business;
- improvement of social infrastructure and care services and increase of availability thereof;
- reforms in the educational system.

Policy directions for improving the labour demand:

- structural reforms in goods and services markets;
- improvement of business environment.

On the national level, the State Employment Agency (SEA) is the authority implementing the state policy in the field of unemployment reduction and support to job seekers. In performance of its functions, the SEA influences the labour market by both the active employment measures and the preventive unemployment reduction measures. The changing labour market needs determine the necessity for a regular revision and improvement of these activities.

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

- professional training, re-training, and improvement of professional skills;
- measures for particular groups of persons;
- measures to improve competitiveness;
- work practice with a grant (in 2010 and 2011 it will be completely replaced by the measure *Paid Temporary Work*);
- measure for business or self-employment start-ups;
- complex support measures.

During the years of economic growth, the need 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 high level. Overall, in 2007, 64.6 thousand unemployed were involved in the active employment measures, in 2008 – 84.8 thousand unemployed, in 2009 – 237.9 thousand unemployed, but in three quarters of 2010, their number was 196.8 thousand (one unemployed person is allowed to be involved in several activities).

The majority of the unemployed is involved in the measures to improve competitiveness; in three quarters of 2010, the number of such unemployed was 135.9 thousand. The rest of the measures were implemented to the following extent: 7.3 thousand unemployed persons participated in professional training, re-training, and improving the qualifications; 499 unemployed persons have started training with an employee; 1091 unemployed persons participated in the measures for particular groups of persons; 39.8 thousand unemployed persons – in the measure *Work Practice with a Grant*, and 12.2 thousand unemployed persons participated in the complex support measures.

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

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

The career consultations help the customers increase awareness about their professional direction.

In terms of the number of serviced customers, this is the most important preventive unemployment reduction measure. In three quarters of 2010, the career consultation services were provided to 71.3 thousand people, 57.1 thousand of them were the 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.

According to the socio-economic situation and in order to reduce the social impact of the crisis, implementation of short-term activities by raising co-financing of the EU funds was launched in the year 2009. 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 Employed Persons, who are Subject to the Risk of Unemployment* is planned to be 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 are no longer receiving unemployment benefit, providing the unemployed with a monthly grant in the amount of LVL 100 for public benefit work. The unemployed person is provided with a supervisor, equipment, as well as compensated transport costs. In 2009, 19.3 thousand unemployed were involved in the measure *Work Practice with a Grant* and the funding amounted to LVL 8 million. In three quarters of 2010, the number of the involved unemployed has reached 39.8 thousand, and LVL 18.1 million has been used during this period.

The short-term measure *Training Programmes for Employed Persons, who are Subject to the Risk of Unemployment* is intended to support persons at the risk of unemployment. It offers training opportunities for employees in enterprises which are experiencing temporary idle time 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 training programme and training establishment. The measure was commenced in September 2009, and until the end of the year, 3253 persons at the risk of unemployment were involved (the funding used during this period was LVL 0.7 million). In three quarters of 2010, 2468 persons were involved in the measure (funding used during this period – LVL 3.1 million). The measure is planned to be implemented until the end of the year 2010.

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

- 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 third quarter of 2010 is taking over the results and work of the measure *Training Programmes for the Employed Persons, who are Subject to the Risk of Unemployment*, for example, in connection with administration of the coupon system. The aim is to promote availability of lifelong learning, by giving an opportunity for people from target groups to increase and improve knowledge and skills necessary for work. The target group is employed and self-employed persons (except public service employees) who have reached the age of 25, but have not reached the age needed for granting the old age pension. Unlike the measure *Training Programmes for the Employed Persons Subject to the Risk of Unemployment*, the persons involved in the new measure will no longer receive a grant and they will have to co-finance the training coupon in the amount of its value (releasing certain groups of persons from co-financing) in order for the participants to consider their decisions concerning education more properly. By September 30, 2010, 2467 coupons have been issued and 428 persons have started the training. The financing for 2010 is LVL 0.9 million.

In 2010, a new training measure *Mastering the First and Second Level Professional Higher Education Programmes* was launched in the framework of professional training, re-training and improvement of professional skills of the unemployed. The target group of the measure is unemployed persons with incomplete higher education who want to complete the commenced studies by applying the education coupon method. Overall in the third quarter of 2010, 667 unemployed persons are participating in the measure. Administration issues, high expenses incompliant with the current limited budget were reasons for re-evaluation whether it is useful to implement the measure. Therefore it was decided not to continue the measure in the upcoming years.

Due to the reduced budget, implementation of several measures was terminated in 2009; these measures 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 the pupils 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 working and living conditions in Latvia, thus promoting possible returning to their ethnic native country. The measure *Promoting Regional Mobility of Persons Employed by Enterprises* for elimination of regional differences in the labour market is no longer implemented as well.

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

Flexicurity comprises 4 fields of activity, which must promote labour market flexibility and employment security by mutual co-operation. 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. In case of necessity, the active labour market policies must efficiently facilitate the transfer from one workplace to another or from the status of an unemployed person to employment. The lifelong learning systems should be improved enabling an employee to be employed during the entire period of the working age. 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 plays an important role in the implementation of the flexicurity principles. Several measures are being implemented to improve the social dialogue both on national and regional level. In order to ensure development of employment partnerships and social dialogue, the capacity of institutions involved in employment partnerships – Employers' Confederation of Latvia, Free Trade Union Confederation of Latvia, local governments of Latvia, and Latvian Association of Local and Regional Governments – has been strengthened using the support of the EU Structural Funds.

It is important to ensure conditions for safe and healthy work environment, by **providing safety at work.** The goal of the guidelines envisages improvement of the working conditions in enterprises and reduction of the number of fatalities at work by 30% (per 100 thousand employed) by the year 2013 in comparison to the year 2007. By 2010, the number of fatalities at work must be reduced by 10% in comparison to the year 2007, thus gradually reducing the number of fatalities at work. It must be noted that in 2009, the number of fatalities at work per 100 thousand employed persons decreased by 24%, in comparison with the year 2007.

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

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 conditions in enterprises, prolongation of working life and improvement of the entire public welfare level, the *Draft Plan of Labour Protection Development for 2011-2013* has been elaborated.

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 sustaining unfair competitiveness and reducing the social security of employees.

In order to limit the budget conditions effectively and to use the accessible resources in a coordinated manner, a *Draft Action Plan for Reducing Unemployment for 2010-2013* was elaborated. In April 2010, the Cabinet of Ministers accepted the action plan prepared by the Ministry of Welfare. The measures are implemented in the following key directions: application of the undeclared employment control mechanism; decreasing 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 are tax policy, elimination of administrative burden, support to the honest entrepreneurs, and promotion of transition to legal economy, improving capacity of controlling institutions, elaboration of legal acts, penalties policy, work with the 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.

6. ECONOMIC POLICY AND PRIORITIES OF STRUCTURAL POLICY

6.1. *EU 2020* Strategy and Draft *National Reform Programme of Latvia*

6.1.1. *ES 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 *EU 2020* strategy. *EU 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*

EU 2020 strategy is developed taking into consideration long-term challenges – globalization, limited availability of resources and the process of population aging. 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. *EU 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 EU 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 R&D;
– to reduce greenhouse gas emissions by 20% compared to 1990 (including the increase of greenhouse gas emissions reduction by 30%, if the conditions are right), to increase the share of renewable energy resources in 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 *EU 2020* strategy needs implementation of a range of measures at national, EU and international level. For this purpose, the European Commission's communication offers **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 that create growth and jobs;
– *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 high-speed internet and enjoying the benefits of a digital single market for households and firms;
– *Resource efficient Europe* – will be published at the beginning of 2011: envisages helping to decouple economic growth from the use of resources, support the shift towards a low carbon economy, increase the use of renewable energy resources, modernise 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 and sustainable industrial base able to compete globally;
– *An agenda for new skills and jobs* – will be published at the beginning of 2011: envisages to modernise labour markets and empower 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* – will be published at the beginning of 2011: envisages ensuring social and territorial cohesion so that the benefits of growth and jobs are widely spread and people experiencing poverty and social exclusion are enabled to live in dignity and take an active part in society.

The European Commission in its communication also indicates that economic, social and territorial cohesion will remain at the heart of the *EU 2020* strategy to ensure that all energies and capacities are mobilised and focused on the pursuit of the strategy's priorities. The European Commission also emphasises that the cohesion policy and structural funds, while important in their own right, are the key delivery mechanisms 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 *EU 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 draft national reform programmes. The draft national reform programmes of the EU member states had to be submitted to the European Commission by November 12, 2010.

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* Article148 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 *EU 2020* strategy, and on the basis of which the European Commission carries out annual evaluation and issues recommendations to each EU member state. The Article 121.4 of the *TFEU* envisages that in case if 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*, by making its recommendations public.

The EU Council approved 10 *Integrated Guidelines*:

Broad Economic Policy Guidelines

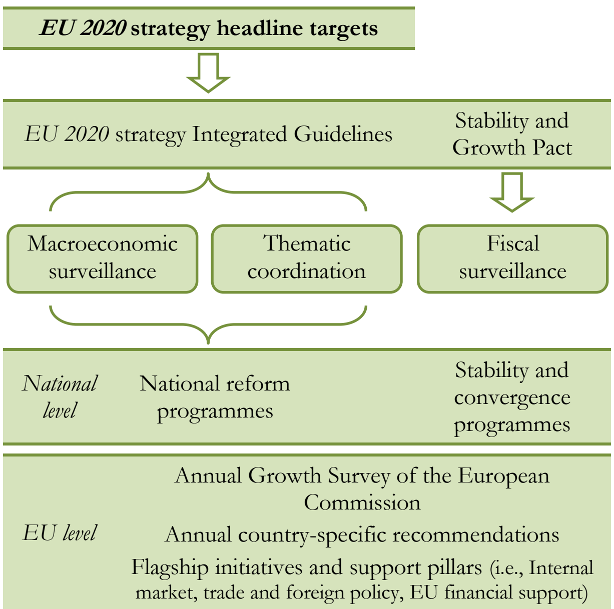
Guideline 1 Ensuring the quality and sustainability of public finances.
Guideline 2 Addressing macroeconomic imbalances.
Guideline 3 Reducing imbalances within the euro area.
Guideline 4 Optimising support for R&D and innovation, strengthening the knowledge triangle (i.e. education, research and innovation) 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 modernising 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

Stronger surveillance mechanism of the National reform programmes and the Stability and convergence programmes of the EU member states

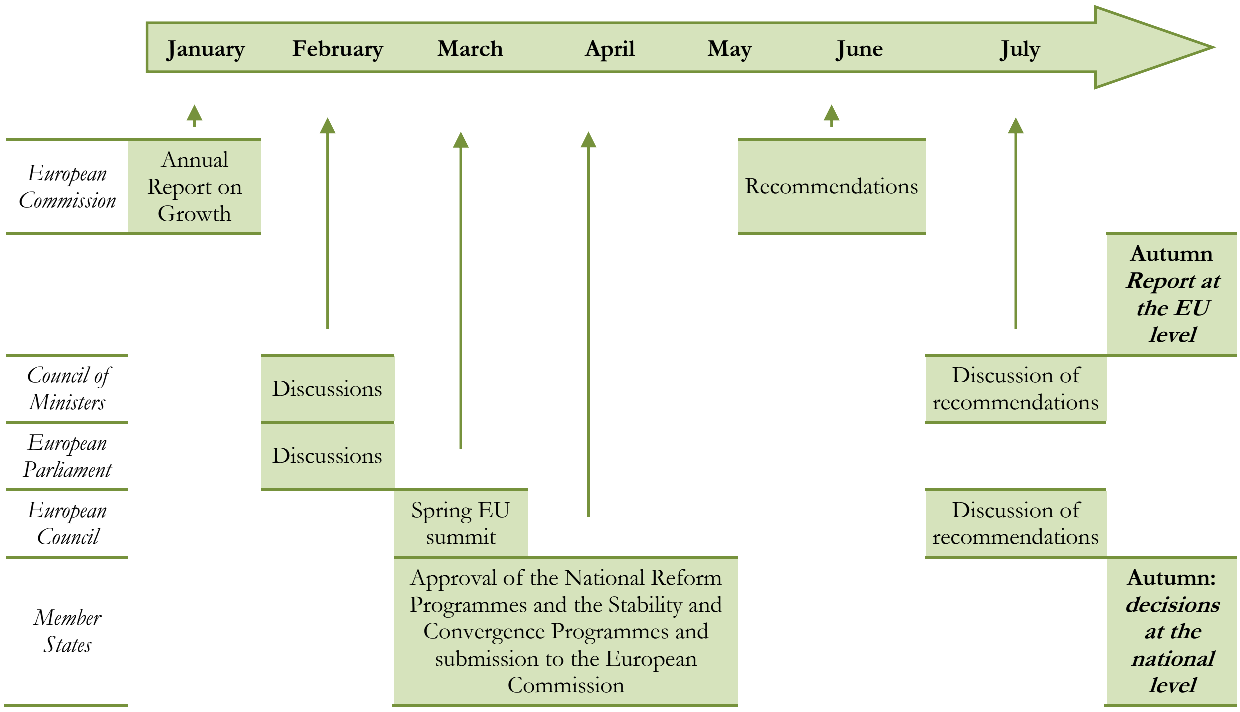


It should be noted that the management and control mechanism of implementation of the *EU 2020* strategy and national reform programmes of the EU member states has been strengthened in comparison with the *Lisbon Strategy* (see Figure 6.1). The idea of such strengthened surveillance mechanism is the following: the surveillance consists of two pillars – macroeconomic surveillance and thematic coordination (evaluation of national reform programmes of the EU member states for implementation of the *EU 2020* strategy and their conformity with the *Integrated Guidelines*), as well as fiscal surveillance (evaluation of the *Stability and Convergence Programmes* of the EU member states and their conformity with the *Stability and Growth Pact*).

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 of economic policy and surveillance at the EU level within the framework of the European Semester. The idea of the European Semester is reflected in Figure 6.2.

Figure 6.2

The European Semester and surveillance of national programmes of the EU member states



The aim of the European Semester is to carry out efficient coordination and surveillance of the economic policy of the EU member states at the EU level. Since January 1, 2011 the European Semester will be an annual process. As shown in Figure 6.2, duration of the European Semester is from the beginning of January until the end of June. It begins with the presentation of the *Annual Growth Survey* by the European Commission which will analyse the economic situation in the EU as a whole and member states. Then this *Annual Growth Survey* will be discussed in various EU Council formations (working groups, committees, councils) and approved by the Spring European Council in March. The EU member states have to submit to the European Commission both the S*tability and Convergence Programmes* and the *National Reform Programmes for Implementation of the EU 2020 strategy* by the end of April 2011. After submission of the abovementioned national programmes, the European Commission will evaluate their conformity with the *Integrated Guidelines* and publish its opinion, as well as recommendations to each EU member state which will be later approved by the European Council in July.

6.1.2. Draft *National Reform Programme of Latvia for Implementation of the EU 2020 Strategy*

The *EU 2020* strategy is closely related to the economic policy and priorities of structural policy of the EU member states, because, according to the *Treaty on the Functioning of the EU*, the EU member states should take into consideration the strategic development documents, such as strategies, guidelines, policy, etc., approved by the EU.

There are different medium-term and long-term policy planning documents, which are currently being developed/have been adopted/are planned in Latvia, such as *Sustainable Development Strategy of Latvia – Latvia 2030*[1], the *National Development Plan for 2014-2020,* etc. Moreover, the National reform programme of Latvia is closely related to the *Convergence Programme of Latvia*, and both programmes will be submitted at the same time to the European Commission by the end of April 2011. Taking into account the abovementioned, it is necessary to ensure a better link between the *EU 2020* strategy, the National reform programme of Latvia and the implementation of other medium-term and long-term policy planning documents of Latvia.

The specifics of the National reform programme of Latvia are related to the fact that development of such policy planning document in every EU member state is prescribed by the *TFEU* (see Box 6.2), within the framework of which the European Commission may address a policy warning, if economic policy of any particular EU member state is not in line with the *Integrated Guidelines* and targets set at the EU level.

Thus, the National reform programme of Latvia, unlike the abovementioned policy planning documents of Latvia, will be a specific policy planning document, which on the one hand will be based on the implementation of the *Integrated Guidelines* approved on June 17, 2010, and on the other hand – on targets,

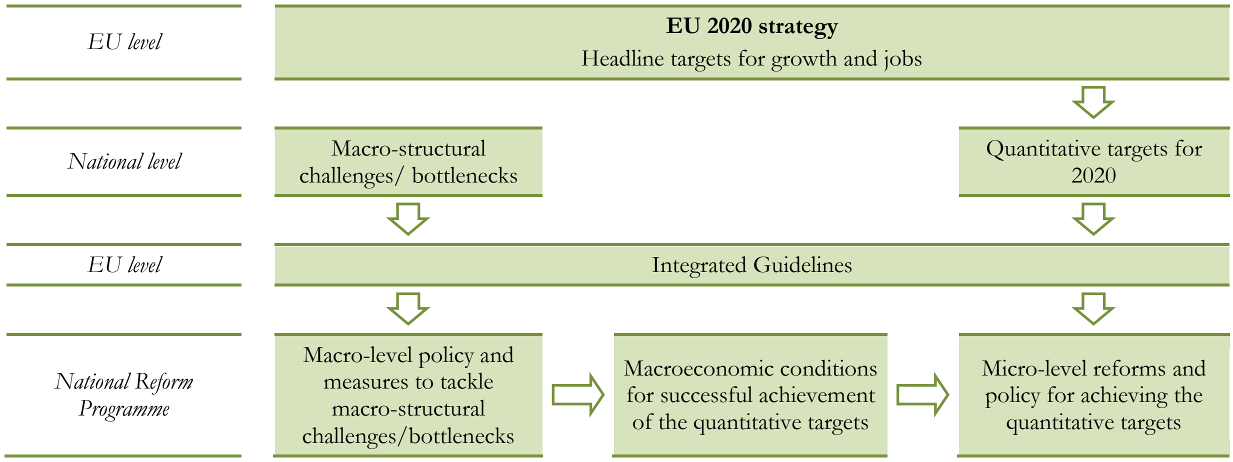
[1] *The Sustainable Development Strategy of Latvia until 2030, http://www.latvija2030.lv/upload/latvija2030_saeima.pdf*

goals, priorities and directions of activity set forth in the abovementioned policy planning documents of Latvia.

Figure 6.3 reflects the interaction of EU and national level in implementation of the *EU 2020* strategy. First of all, the EU member states and the European Commission agree on common EU-level targets. On the basis of the EU-level targets, each EU member state has to set national targets and identify main challenges (bottlenecks) that hinder achievement of the national targets. Taking into consideration the EU-level targets, the European Commission and the EU member states agree on the *Integrated Guidelines,* which can be considered as a set of tasks for the economic policy of the EU member states. On the basis of the Integrated Guidelines approved at the EU level, each EU member state prepares and submits to the European Commission its National reform programme for implementation of the *EU 2020* strategy, which reflects national level policy for overcoming the main challenges (bottlenecks) and achieving the quantitative targets for 2020.

Figure 6.3

Interaction of EU and National Level in Implementation of the *EU 2020* Strategy



On November 16, 2010 the Cabinet of Ministers approved the Draft *National Reform Programme of Latvia for Implementation of the EU 2020 strategy* (the Draft NRP of Latvia), which had been also submitted to the European Commission.

The Draft NRP of Latvia describes the medium-term macroeconomic scenario, reflects key macro-structural challenges (bottlenecks) of the national economy of Latvia and main directions of reforms, as well as quantitative targets of Latvia for 2020 in the context of the *EU 2020* strategy and main policy directions for their achievement.

According to the medium-term macroeconomic scenario, the growth of 3-4% mainly driven by exports is expected in Latvia in the upcoming years. The Draft NRP of Latvia identifies also the following macro-structural challenges (bottlenecks) of the national economy of Latvia:

– 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.

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

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

According to the quantitative targets of Latvia, it is planned to reach the employment level of 73% by 2020, to increase investment 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 poverty risk to 21%, to increase the share of renewable energy resources in gross energy consumption to 40%, etc.

Table 6.1

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

	EU-27		Latvia		
	Fact	Targets	Fact	Targets	
	2009	**2020**	2009	**2020**	***Latvia 2030***
Employment level (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 total contribution of Latvia in achievement of the EU common energy efficiency target**	< 150[5]
Share of renewable energy resources 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 – at-risk-of-poverty rate and/or material deprivation and/or 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.

Achievement of the quantitative targets of Latvia in the context of the *EU 2020* strategy depends on the following conditions:

- Overall growth of economy, which currently is negatively affected by the crisis;
- Demographic development in the framework of which, according to the projections, the number of the population of Latvia in the working age will continue to decrease until 2020;

– Possibilities of Latvia's budget, which until 2014 will be very limited that is defined by the necessary budget consolidation measures;
– Possible EU support, including support from EU funds in the framework of the new EU financial perspective after 2013. The support of the Cohesion policy for convergence of less developed EU member states and regions, as well as tackling the issues at the EU level regarding the equal competition conditions to all EU farmers should be particularly mentioned here.

In order to prepare the final version of the National reform programme of Latvia for implementation of the *EU 2020* strategy (the NRP of Latvia), the Ministry of Economics has established a special working group, which involves representatives from the responsible ministries, social partners (Latvian Employers' Confederation and Free Trade Union Confederation of Latvia) and non-governmental organizations (Latvian Chamber of Commerce and Industry and Latvian Association of Local and Regional Governments). The working group will work from January 2011 to April 2011 and discuss specific measures for tackling the macro-structural challenges (bottlenecks) of Latvia and for achieving the quantitative targets of Latvia for 2020 (see Table 6.1). Coordination of the NRP of Latvia with ministries, social partners and non-governmental organizations will take place in April 2011. When the NRP of Latvia is approved by the Cabinet of Ministers, it will be submitted to the European Commission at the end of April 2011.

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

6.2.1. Utilisation of the European Union Structural Funds and the Cohesion Fund

As an EU Member State, Latvia has access to the financial support from the instruments of the EU Structural Funds (SF) and the 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.

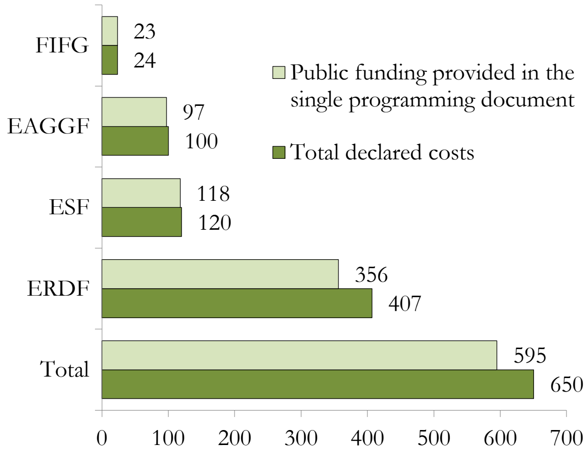
Latvia was one of the first EU member states to submit all closing documents for the EU Structural Funds programming period 2004-2006 to the EC by June 30, 2010 (three months prior to the term), to receive the final payment of the programme. The amount of the final payment is up to 5% of the Structural 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 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 total public funding provided for in the planning documents), among them funding from Structural Funds – LVL 462.4 million or 105% of the total Structural Funds allocation provided for in the planning documents. The excess in the amount of LVL 55.5 million (incl. Share of Structural Funds – LVL 21.8 million) is due to the national decision of Latvia to contribute more state co-funding and undertake over-commitment thus maintaining a reserve if Latvia or the EC finds ineligible costs and financial adjustments must be applied within the closing process. In such case, the reserve may be used by replacing the ineligible costs with declared reserve eligible costs.

Figure 6.1 reflects the total declared costs of the EU Structural Funds for the programming period 2004-2006.

Figure 6.1

Total declared costs of EU Structural Funds for the programming period 2004-2006, million lats, as of March 31, 2010



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

Implementation of CF projects in the programming period 2004-2006 is carried out until December 31, 2010 and by this date all construction works of projects have to be completed, as well as all eligible costs in the framework of the projects have to be made.

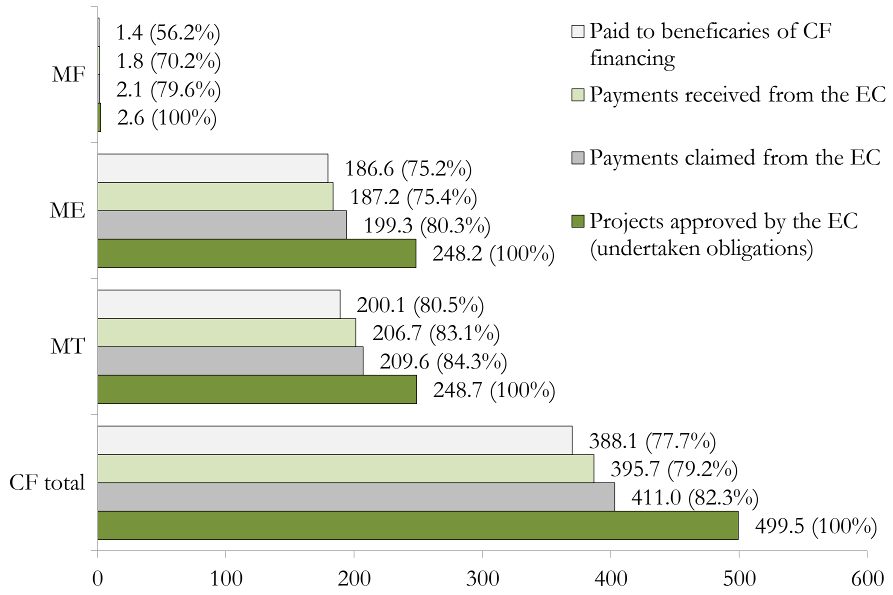
As of September 30, 2010, the CF funding beneficiaries had received LVL 388.2 million or 77.7% of the CF funding. In the EC has been declared LVL 410.9 million or 82.3% of CF funding. The EC payments have been received in the amount of LVL 395.7 million or 79.2% of the CF funding.

The CF absorption as of September 30, 2010 is reflected in Figure 6.2.

Figure 6.2

EU Cohesion Fund absorption in the programming period 20042006 (full financial flow) as of September 30, 2010

(million lats and %)



Programming period 2007-2013

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

For efficient absorption of SF and CF resources, the programming is implemented on 3 levels (EU level strategy or *Community Strategic Guidelines*, strategy of the Member States or the *National Strategic Framework Document*, and *Operational programmes* of the Member States).

The *National Strategic Framework Document* for the programming period of 2007-2013 (NSFD) is the main national level SF and CF programming document, which ensures the link between the cohesion policy and national priorities, as well as justifies the choice of these priorities and defines the fund absorption strategy, management framework, ensures coordination between the *Operational programmes* (OP) and other financial instruments.

NSFD, which is the basis for the distribution of the SF and CF financing in the amount of EUR 4.53 billion available to Latvia within the period of 2007-2013, was approved by the Cabinet of Ministers on June 19, 2007. On September 20, 2007, it was also approved by the EC, so that absorption of the programme and resources could be started.

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.

As of October 31, 2010, projects for the amount of more than a half (or 61.4%) of all financing of EU funds available for Latvia within the given programming period had been approved and contracts for a total of LVL 1 955.7 million had been concluded. As of October 31, 2010 the funding beneficiaries had received LVL 671.5 million.

The EU fund financial progress until October 31, 2010 is outlined in Table 6.2.

Table 6.2

EU fund financial progress in the programming period 2007-2013 by October 31, 2010

Fund	Funding of EU funds	Contracts concluded		Paid to the funding beneficiaries		EC's payments received (incl. advances)	
	million LVL	million LVL	%	million LVL	%	million LVL	%
ESF	387.0	282.8	73.1	118.9	30.7	126.9	32.8
ERDF	1714.8	944.9	55.1	344.3	20.1	372.2	21.7
CF	1082.1	727.9	67.3	208.2	19.2	246.5	22.8
Total	**3184.0**	**1955.7**	**61.4**	**671.5**	**21.1**	**745.7**	**23.4**

Information regarding activities for the programming period 2007-2013 that are under the responsibility of the Ministry of Economics has been summarized in the Box 6.3.

Box 6.3

Activities under the responsibility of the Ministry of Economics

A total of LVL 558.9 million is 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 November 1, 2010 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 Organised in Partnerships*, 13 contracts have been concluded for the total amount of LVL 1.8 million.
- Within activity *Support to Individually Organised Training for Enterprises*, 91 contracts have been concluded for the total amount of LVL 2.4 million.
- Within activity *Attraction of Highly Qualified Employees*, 3 contracts have been concluded for the total amount of LVL 106.2 thousand.
- Within activity *Technology Transfer Contact Points*, 8 contracts have been concluded for the total amount of LVL 1.9 million.
- Within activity *Development of New Products and Technologies*, 115 contracts have been concluded for the total amount of LVL 7.6 million.
- Within activity *Introduction of New Products and Technologies into Production*, 49 contracts have been concluded for the total amount of LVL 10.3 million.
- Within activity *Development of New Products and Technologies – Support to Strengthening Industrial Property*, 15 contracts have been concluded for the total amount of LVL 203.2 thousand.
- Within activity *High Added Value Investments*, 31 contracts have been concluded for the total amount of LVL 71.5 million.
- Within activity *Access to International Trade Markets – External Marketing*, 377 contracts have been concluded for the total amount of LVL 3 million.
- Within activity *Measures to Encourage Innovations and Business Start-ups*, 1 contract has been concluded for the total amount of LVL 2 million.
- Within activity *Co-financing to the Investments in Micro, Small and Medium-sized Enterprises Operating in the Specially Assisted Area*, 215 contracts have been concluded for the total amount of LVL 16.8 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 amount of LVL 8.7 million (ERDF).
- Within sub-activity *Development of Cycling Tourism Product of National Importance*, 6 contracts have been concluded for the total amount of LVL 3.7 million (ERDF).
- Within activity *Improvement of Heat Insulation of Multi-apartment Residential Buildings*, 85 contracts have been concluded for the total amount of LVL 4.4 million (ERDF).
- Within activity *Improvement of Heat Insulation of Social Residential Buildings*, 56 contracts have been concluded for the total amount of LVL 5.1 million (ERDF).
- Within activity Measures *for Raising Efficiency of Central Heat Supply Systems,* 11 contracts have been concluded for the total amount of LVL 6.6 million (CF).
- Within activity *Development of Cogeneration Power Plants Using Renewable Energy Resources,* 10 contracts have been concluded for the total amount of LVL 21.3 million (CF).

In the framework of the described activities, the enterprises will be allocated an investment in the equity capital (in cases of venture capital programmes), a loan (in cases of loan programmes), and a guarantee (in cases of guarantee programmes), not a grant, and 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 instruments will operate as long-term support instruments.

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

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

Box 6.3 continued

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 purposes of this programme, newly established companies are companies that have lawfully registered their activity not earlier than 3 years before requesting the support in the framework of the programme.

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

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, will be entitled to consultations, a loan and a grant for repayment of 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 31 March 2010, 676 agreements had been signed on the preparation of business plans, and 64 business plans had been approved for granting loans for the total amount of LVL 1 168 thousand.

Holding Fund

On July 16, 2008, an agreement 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 20072013 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 – the selection process has been concluded and the venture capital fund manager *BaltCap Management Latvia* has been selected and approved by the Council of the European Investment Fund. On January 22, 2010, EIF and *BaltCap Management Latvia* concluded a contract on foundation of the 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. In October 2010, "BaltCap Management Latvia" made the first venture capital investment to LLC "Primekss" in the amount of EUR 1.4 million;

(2) seed and start-up capital – the selection process has been concluded and the seed and start-up capital fund manager – *"Imprimatur Capital Baltics"* – has been approved by the Council of the European Investment Fund. In total, the planned funding available for seed and start-up capital investments constitutes EUR 20.4 million. In August 2010, "Imprimatur Capital Baltics" signed an agreement with LLC "Naco Technologies" on an investment in the amount of EUR 100 thousand;

(3) high-risk loans – the bank selection process has been concluded, and the Board of the EIF has concluded a contract with JSC "Swedbank" and JSC "SEB Banka". In total, the funding available for SMEs is LVL 73 million. By October 31, 2010 3 loan agreements for the amount of EUR 1.4 million have been concluded.

Activity *Guarantees for Development of Enterprise Competitiveness*

Since April 20, 2009, when a contract with LLC "Latvian Guarantee Agency" (LGA) was concluded, as of October 31, 2010, 451 guarantees for the total amount of LVL 57 million, and 32 export guarantees for the total amount of EUR 1.56 million have been granted.

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 1 million EUR per one deal in Latvian lats at the exchange rate of the Bank of Latvia on the day of assigning the guarantee.

Currently, the guarantees are issued for activities with the third countries, and since July 1, 2010 also for activities with the EU Member States and some member states of Organisation for Economic Co-operation and Development – Australia, Canada, Iceland, Japan, New Zealand, Norway, Switzerland, and the USA.

The main criterion for issuing guarantees of export activities to third countries is the following: the state of origin of the product to be exported must be Latvia, meaning that an essential processing or treatment operation has taken place as a result of which 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 transports or logistics, etc.

The guarantees for business activities to the EU Member States and Australia, Canada, Iceland, Japan, New Zealand, Norway, Switzerland, and the USA are issued to an enterprise or cooperative company of agriculture services, which has received a written guarantee rejection from a private enterprise of the insurance market sector and an agreement is concluded before December 31, 2010 in framework of which goods or services will be supplied by June 30, 2011.

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 action 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.

Box 6.3 continued

Two types of loans are available:

(1) for investments – up to LVL 5 million (min. – LVL 200 thousand, not applicable in case 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 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 in case if the funding is necessary for implementation of the EU SF projects), loan term – up to 5 years.

The total loans funding is LVL 210 million comprised of: ERDF and public funding – LVL 43 million; the state AS "Mortgage and Land Bank" of Latvia funding – LVL 15 million; the Northern Investment Bank funding – LVL 150 million.

As of November 15, 2010, 355 loans had been granted for the total amount of LVL 144.3 million, including the ERDF part of the programme – 47 loans for the amount of LVL 56.4 million, from which 31 loan have been granted in the amount of LVL 42 million.

Activity *Improvement of Heat Insulation of Multi-apartment Residential Buildings*

On February 10, 2009, the Cabinet of Ministers adopted a regulation on the operational programme *Infrastructure and services* complement activity *Improvement of Heat Insulation of Multi-apartment Residential Buildings*.

Support can be received for those apartment houses, which were commissioned from 1944 until 1993 (including), which are divided into apartment properties, and if one owner owns not more than 20% of the total number of apartment properties. Savings of the heat energy after the implementation of the renovation must be at least 20% per year from the standardized total consumption of heat energy.

Project applications have been accepted since April 14, 2009 until the notice of the termination of project applications acceptance, i.e. until the funding available in the framework of the activity will be used. Financing accessible in the framework of the activity is LVL 44.33 million.

As of November 1, 2010, 247 projects had been submitted for the total ERDF amount of LVL 26.7 million. Inter alia 85 contracts have been concluded for the total ERDF amount of LVL 4.4 million, implementation of 8 projects for the total ERDF amount of LVL 268 thousand has been finished, but for the implementation of 19 approved projects contracts have not yet been concluded (for the total amount of LVL 2.1 million). 49 projects for the total amount of LVL 5.2 million are being evaluated.

Projects have been submitted from 62 settlements. The majority of applications are from Valmiera – 37, Riga – 29, Liepaja – 27, Ventspils – 20, and Limbaži – 11.

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

As of September 30, 2010, 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 education, namely within the activity *Higher education and science*, where contracts have been concluded for the amount of LVL 80.7 million (88.3%) and in the priority *Education and Skills*, where contracts have been concluded for the amount of LVL 84.7 million (82.4%) of funding available for priorities. Contracts on financing from the EU funds in the amount of LVL 127.1 million have been concluded within the priority *Promotion of Employment and Health at Work*, contracts on financing from the EU funds in the amount of LVL 25.6 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 11.7 million have been concluded. In terms of payments made, the most significant progress is achieved in the priority *Promotion of Employment and Health at Work* – LVL 74.2 million (42.3%), and in priorities *Higher education and science* – LVL 29.4 million (32.2%), *Education and Skills* – LVL 13.9 million (13.5%), *Promotion of Social Inclusion* – LVL 6 million (14.5%), *Administrative Capacity Building* – LVL 1 million (5.1%).

As of September 30, 2010, in the framework of the operational programme *Entrepreneurship and Innovations*, implementation of several science and innovation support measures and activities thereof was continuing, aiming at promotion of technology transfer and innovation advertising to ensure cooperation between research and business sectors for development of new 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.

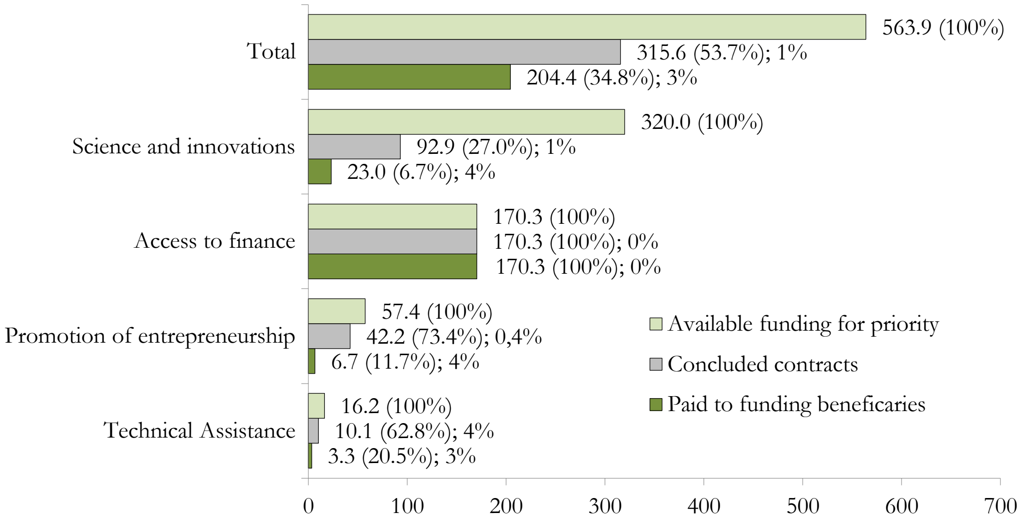
Information regarding fund absorption in the operational programme *Entrepreneurship and Innovations* is reflected in Figure 6.6.

As of September 30, 2010 the fund absorption progress in the operational programme *Infrastructure and Services* is satisfactory. However the progress regarding funding beneficiaries in 2010 is slow, and achievement of targets set for fund absorption lags far behind the expected results, including the 3rd quarter, which is mostly related to issues in the field of procurements, decrease in costs (including dumping) in almost all priorities, as well as discontinuation of projects (for example, in an urban environment measure), inaccurate, often too optimistic planning of funding beneficiaries. In general, it can be concluded that the absorption is the slowest in activities under responsibility of the Ministry of Culture, the Ministry of Regional Development and Local Government, the Ministry of Health, and the Ministry of Education and Science – at the end of September 2010, the financing absorption target in these institutions was achieved correspondingly by 0%, 48%, 48% and 51%.

Figure 6.6

Absorption of EU funds in the operational programme *Entrepreneurship and Innovations* by September 30, 2010

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

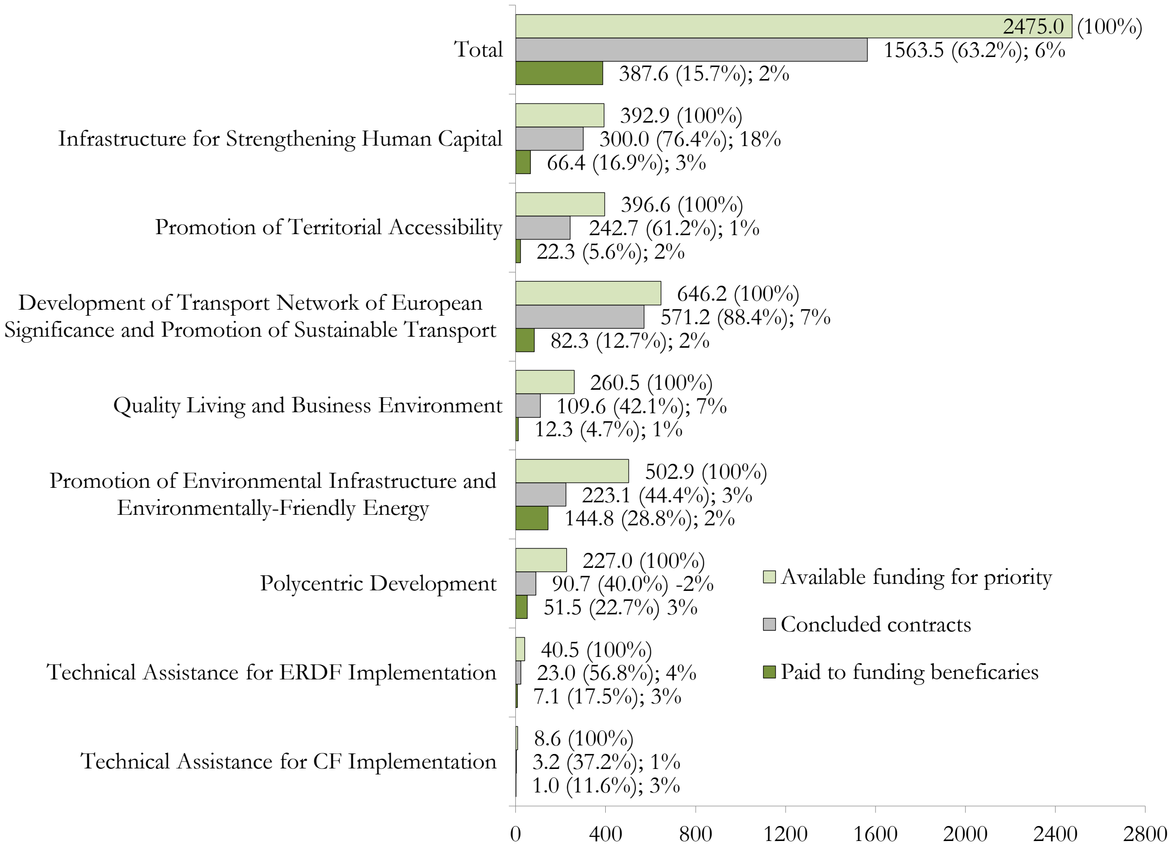


Information in fund absorption in the operational programme *Infrastructure and Services* is reflected in Figure 6.7.

Figure 6.7

Absorption of EU fund financing in the operational programme *Infrastructure and Services* as of September 30, 2010

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



Amendments to the operational programmes and additions thereto

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

On August 5, 2010, by an order of the Cabinet of Ministers, amendments to the addition of the operational programme were made, shifting funding in the amount of EUR 35 thousand from Sub-activity 1.5.1.3.1 *Development and Introduction of the Quality Management System* to the Sub-activity 1.5.1.3.2 *Improvement of Quality of Public Services at the National, Regional and Local Level*, in order to ensure approval of more qualitative projects.

On August 9, 2010, by an order of the Cabinet of Ministers, amendments proposed by the Ministry of Education and Science were made to the addition of the operational programme, planning the implementation of the sub-activity 1.1.2.2.1 *Improvement of Study Programme Contents, Its Implementation and Competence of Academic Personnel* in two selection rounds. In the framework of the first round, it is planned to carry out international assessment of higher education program quality, resource adequacy and sustainability by involving foreign experts, and to prepare proposals for further improvement and development of higher education. In the framework of the second round, the higher education institutions will be supported to improve study programmes in cooperation with employers, to develop new inter-university and interdisciplinary study programmes and courses, develop study programmes and courses in any of the European Union languages, thus promoting competiveness and exportability of higher education, as well as to improve professional qualification of the faculty, at the same time promoting resource consolidation, quality, efficiency, and competitiveness of higher education.

Operational programme *Entrepreneurship and Innovations* and an addition thereto

During the 3rd quarter of 2010, no amendments have been made to the operational programme or addition thereto; yet, the Ministry of Finance has launched discussions with the European Commission on funding eligibility in the framework of the activity 2.2.1.3 *Guarantees for development of enterprise competitiveness* to achieve single understanding about what shall be regarded as eligible for the purpose of Article 45 of the Commission *Regulation* (EC) *No 1828/2006* of December 8, 2006 (which sets out the rules for the implementation of Council *Regulation* (EC) *No. 1083/2006* on European Regional Development Fund, the European Social Fund and the Cohesion Fund, and *Regulation* (EC) *No. 1080/2006* of the European Parliament and the European Council on the European Regional Development Fund (Commission *Regulation* (EC) *No. 1828/2006*).

Within discussions with the European Commission, Latvia has agreed with the point of view of the Commission opining that guarantees issued to struggling enterprises after July 1, 2008, have not been issued in compliance with the legal framework of Article 45 of the Commission *Regulation* (EC) *No 1828/2006*. According to the instructions of the European Commission, amendments to the operational programme *Entrepreneurship and Innovations* submitted to the European Commission on October 30, 2009 were revoked and re-submitted on August 11, 2010.

In addition to the amendments to the operational programme *Entrepreneurship and Innovations*, justification for amendments and methods were submitted to the European Commission specifying whether a particular enterprise may be considered as a struggling enterprise and whether it is qualified to receive aid in the framework of financial instrument activities in the operational programme *Entrepreneurship and Innovations*, and which shall be observed when adjusting the amount of guarantees and loans that were not issued in compliance with Article 45 of the Commission *Regulation* No. *1828/2006*.

Operational programme *Infrastructure and Services* and addition thereof

On September 23, 2010 the European Commission adopted a decision to support amendments proposed by Latvia to the operational programme *Infrastructure and Services* (approved by the Cabinet of Ministers on February 24, 2010) by raising the share of funding from the European Regional Development Fund (ERDF) and the Cohesion Fund (CF) and by reducing the share of the budget funding of Latvia, at the same time reducing the necessary state budget funding by LVL 64.6 million. The amendments also include financial redistribution (in the amount of LVL 45.3 million), shifting funding to those ERDF and CF activities, which have the most direct impact on facilitation of economic recovery (energy efficiency measure and support for entrepreneurship, and complex development of municipalities), taking into account social-economic changes in the national economy of Latvia caused by the global economic crisis and efforts to adapt to the new situation, recognizing EU structural funds and Cohesion Fund as the most important instrument in overcoming the crisis.

In accordance with the Order of July 7, 2010 of the Cabinet of Ministers, amendments to the addition of the programme *Infrastructure and Services* were approved envisaging redistribution of the ERDF funding in amount of LVL 8.4 million, shifting the funding from activity 3.2.1.1 *Improvement of State Category 1 Motorway Network* to activity 3.2.1.2 *Improvement of Transit Streets in Cities*, therefore ensuring the approval of project applications that comply with the evaluation criteria of project applications and were submitted in the framework of the second call for project applications for the activity 3.2.1.2 *Improvement of Transit Streets in Cities*.

In accordance with the Order of July 28, 2010 of the Cabinet of Ministers, amendments to the addition of the programme *Infrastructure and Services* were approved envisaging defining the type of support and the target groups for the sub-activity 3.1.5.3.1 *Development of Providers of Stationary Health Care,* stipulating that a stationary health care establishment is allowed to provide ambulatory health care services as well.

In accordance with the Order of July 29, 2010 of the Cabinet of Ministers, amendments to the addition of the programme *Infrastructure and Services* were approved envisaging redistribution of the ERDF funding in the amount of LVL 2 million, shifting the funding from the sub-activity 3.2.2.1.1 *Development of Information Systems and Electronic Services* to the sub-activity 3.2.2.1.2 *Informatisation of Educational Institutions*.

In accordance with the Order of August 24, 2010 of the Cabinet of Ministers, the following amendments to the addition of the programme *Infrastructure and Services* were approved:

- Redistribution of CF funding in the amount of LVL 10 million from the sub-activity 3.5.1.2.3 *Development of separate waste management system* to activity 3.5.2.2 *Development of Cogeneration Power Plants Utilising Renewable Energy Sources*;
- Increasing the maximum amount of funding per one project for the amount of up to LVL 6 million for the activity 3.5.2.1 *Measures Regarding The Increase of Efficiency of Centralised Heat Supply Systems* to ensure the possibilities of attracting the CF funding to large-scale projects and promoting efficient absorption of the CF funding.

6.2.2. Foreign Trade Policy

In order to reduce downturn caused by the economic and financial crisis and restore sustainable growth, in 2010, the European Commission (EC) and the member states were looking for new ways that could contribute to achieving European objectives for sustainable development. In the EU Foreign Affairs Council of December 2010, the future EU Trade Policy Strategy for medium-term was adopted, envisaging expanding export market of third countries, while maintaining accessibility thereof, as well as promoting spread of fair trade conditions all over the world.

According to the tasks set in medium-term, the EU continues work on development and deepening of a multilateral trading system and bilateral trade conditions with third countries, as well as on implementation of new initiatives, among other things, regarding enhancement of public procurement market availability, improvement of the export control system and defining measures for support of small and medium-sized enterprises.

Multilateral relations

Strengthening of the Multilateral Trading System in the framework of the World Trade Organisation (WTO) is to be considered as the cornerstone of sustainable development of the global economy and is the main priority of the EU Common Trade Policy.

Also in 2010, the member states of the organisation have failed to achieve significant progress in **WTO Doha Round (DDA) negotiations** launched in 2001. However, after carrying out intensive work at different levels planned in the first months of 2011, in March/April it is expected to achieve deeper understanding regarding possibilities to complete the DDA in 2011. In order to reach it, the advanced and developing countries (especially the EU, USA, India, Brazil, and China) have to reach compromises regarding sensitive agricultural issues.

Right now, there are 30 candidate countries[1] **in the WTO accession process**. Among the key countries of Latvia's foreign trade, work on accession process of Russia, Kazakhstan, and Belarus customs union countries, as well as Azerbaijan, Tajikistan, and Serbia was activated last year. At the beginning of 2011, Russia was the closest to accession to the WTO of them, taking into account the strong support of the EU and USA and pledge of Russia to integrate into the multilateral trading system as soon as possible. Thus, as a result of intensive negotiations, the parties have managed to solve all bilateral issues opened so far. In 2011, the work is planned to be focused on multilateral negotiations on conformity of Russian legal acts to the WTO standards and on preparation of a package of accession documents.

Kazakhstan continues negotiations on conformity of its legal acts to the WTO standards, which is planned to be activated after concluding bilateral market access negotiations with the EU and USA. The accession negotiations of Belarus are still in the early stage.

Since 2008, Ukraine has been preventing accession of Montenegro to the WTO, and a bilateral market access negotiation with Ukraine is the main obstacle for Montenegro to enter this organisation.

In order to expand the conditions of the multilateral trading system, the WTO member states are working on **improving specific trading conditions** in various forms (multilateral, regional, bilateral etc.). In this context, a significant fact is that in 2010 work on the 4th revision of the Uruguay Round Agreement on Repeal of Tariffs on Pharmaceuticals (see Box 6.4) was finished, thus improving the conditions for access to the pharmaceutical product market.

At the same time, several countries[2], including the USA and the EU, responding to increasing international trade of counterfeit goods and

[1] Afghanistan, Algeria, Andorra, Azerbaijan, the Bahamas, Belarus, Bhutan, Bosnia and Herzegovina, the Comoros Islands, Equatorial Guinea, Ethiopia, Iran, Iraq, Kazakhstan, Laos, Lebanon, Liberia, Libya, Montenegro, Russia, Samoa Islands, Sao Tome and Principe, Serbia, the Seychelles, Sudan, Syria, Tadzhikistan, Uzbekistan, Vanuatu, Yemen

[2] Australia, Canada, EU, Japan, Mexico, Morocco, New Zealand, Singapore, South Korea, Switzerland, and USA

infringements of copyright, after a two-year work, on November 25, 2010 paraphed the multilateral Anti-Counterfeiting Trade Agreement (ACTA*)*, with which detailed conditions regarding application of intellectual property rights will be implemented and a mutual coordination mechanism will be established. In general, the ACTA is to be considered as a significant instrument for effective protection of intellectual property rights, promoting long-term development of knowledge-based economy.

Box 6.4

4th revision on Repeal of Tariffs on Pharmaceuticals

In 1994, several member states of the WTO (USA, Switzerland, EU, Japan, Canada, Norway and Macao (China)) in the framework of the Uruguay Round concluded the *Agreement on Repeal of Tariffs on Pharmaceuticals* (came into force on January 1, 1995), envisaging that the contracting parties apply duty-free treatment for mutual trade of pharmaceutical active ingredients bearing an "international non-proprietary name" (INN) from the World Health Organisation and specified products used for the manufacture of finished pharmaceuticals. At the same time, the contracting parties also agreed on revising the Pharmaceutical Agreement once every three years, adding new products to the list of pharmaceutical products for applying the duty-free treatment. The agreement has been revised three times so far – in 1996, 1998, and 2007.

In 2009, the fourth revision was launched. Currently the EU duty-free treatment is applied to import of 8619 pharmaceutical products and in addition to the revision of the agreement, where the Council *Regulation (EEC) No 2658/87* on the tariff and statistical nomenclature and on the Common Customs Tariff will be respectively amended, it is planned to apply the treatment to another 718 pharmaceutical products, including pharmaceutical ingredients important to Latvian pharmaceutical enterprises.

Bilateral relationships in 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, Georgia, Russia, China, Moldova, 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 new PCA's, which were continued in 2010. In the framework of these negotiations, among other matters, the parties discussed provisions of the trade and investment section. In 2010, the EU and Iraq PCA were paraphed and it is planned to be signed in the near future.

At the same time, the EU has concluded a number of preferential agreements comprising mutually **preferential trade** conditions. Up to 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, and Mexico.

At the moment, negotiations on the EU preferential trade agreements are in process with the third countries, among them negotiations on free trade agreements (FTA) with two countries of the Association of Southeast Asian Nations[3] – Singapore and Malaysia, the countries of the Southern Common Market[4] (*Mercosur*), India, Canada, Libya, the Gulf Cooperation Council countries[5] (GCC), Ukraine and Mediterranean countries[6], as well as negotiations on economic partnership agreements (EPA) with the majority of African, Caribbean, and Pacific Group of States (ACP). In the near future, it is planned to launch negotiations on preferential trade agreements with Armenia, Georgia, and Moldova, but after these countries enter the WTO – also with Azerbaijan, Russia, Kazakhstan, and Belarus.

It should be noted that on October 6, 2010 the EU-South Korea FTA was signed to enter into force on July 1, 2011 on an interim basis (until conclusion of ratification procedure). On May 16-19, 2010, an agreement on conclusion of trading negotiations with Andean countries[7], the Central American countries[8] was reached, and during the second half of 2010, the agreement was legally prepared for signing.

In addition to the described agreements, bilateral economic relationships between the EU and its most important global partners – China, Japan, and USA – are promoted in the framework of frequent regulatory dialogues.

It should be noted that during the autumn of 2010, public discussions at the EU level regarding future of trading and economic relations with Japan took place. Results of these discussions are planned to be available in preparation process for the EU-Japan summit 2011, during which the parties are likely to agree on the further cooperation form for deepening bilateral economic integration.

Promotion of accessibility to the third country markets

In order to ensure efficient access of exporters from the EU, incl., Latvia, to the markets of third countries, relevant instruments for ensuring market

1 Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Serbia, and Turkey
2 Iceland, Liechtenstein, and Norway
3 Brunei, Burma, Cambodia, Indonesia, Laos, Malaysia, the Philippines, Singapore, Thailand, and Vietnam
4 Argentina, Brazil, Paraguay, Uruguay, and Venezuela
5 Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates
6 Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian Authority, Syria, and Tunisia
7 Bolivia, Columbia, Ecuador, Peru
8 Costa Rica, Guatemala, Honduras, Nicaragua, Salvador and Panama after its involvement in the Central American economic integration process

access are applied for identifying, eliminating, and/or preventing barriers.

In 2010, the work on strengthening Market Access Partnership continued. At the end of the year, already 13 Working Groups[1] and 33 Market Access Teams[2] were working on solving particular issues for EU enterprises relating to trade barriers in the third countries, as well as matters of various sectors and regions.

In compliance with the supervision of world country trade policy instruments launched in 2009, in October 2010, the seventh, so-called early warning report on existing and planned trade restrictive measures in the third countries markets was prepared. Since the launch of this supervision, mainly trade restrictions have been imposed or planned to be imposed not only in such markets important to Latvian export as Russia, Ukraine, Belarus, and Kazakhstan, but also in markets of the global trade partners – Argentina, Brazil, China, India, USA, and Canada. The trade restrictions are mainly imposed on agricultural, steel, automotive industry, textiles, electronic products, raw materials and services trade, 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 safeguarding the domestic market, as well as compensations and anti-dumping measures.

In 2010, improvement of the EU Market Access database continued by updating information on the core issues regarding trade of the EU enterprises in markets of third countries, introducing an option to notify on existing trade obstacles in third countries, and preparing a database user manual in all EU member state languages[3].

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. In the framework thereof, Intergovernmental Commissions (IGC) have been established, ensuring supervision of validity of these agreements and opportunities to analyse how to improve further cooperation (see Box 6.5).

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

Sectoral issues of the EU foreign trade

Steel

Elasticity and multiple processing potential of steel make it one of the most widely used industry raw materials in the world. The metal processing industry forms a part of the general European competiveness in all links of the value chain, besides, the EU is the second largest steel producer in the world after China.

Also in 2010, the demand for iron and steel products in the EU was considerably lower than in 2007 and 2008. It must be stressed that the European Confederation of Iron and Steel Industries *Eurofer* expects market recovery in 2012-2013. Yet, almost all sectors using steel in 2010 experienced greater activity than previously expected.

The EU is currently applying 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, as well as agreed on its annual extension, envisaging an annual increase of 2.5% in quotas. Thus in 2011, the quotas in Russia were set for the amount of 3.3 million tons. With regard to Kazakhstan, autonomous measures are currently being applied, and also in 2011, the import quota is set at 0.2 million tons. After admission of Russia and Kazakhstan to the WTO, the EU steel agreements with these countries will lapse automatically. The EU applies the Prior Surveillance system for the import of particular steel products from all third countries for the purpose of the steel flow monitoring system.

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.

For a long time, in the multilateral negotiations of the WTO, the textile and clothing sector was an exception for the progressive trade liberalisation of industrial goods, until 1995, when the developing countries achieved that the WTO member states gradually over a period of 10 years introduced complete trade liberalisation of textile goods. Since

[1] Established Working Groups in sector of the EU market access – SPS/Animal products; SPS/Vegetation 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

[2] EU Market Access Teams are acting in Argentina, Algeria, Australia, Brazil, Canada, China – Hong Kong and Macao, Chile, 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

[3] *http://madb.europa.eu/mkaccdb2/userguide.htm*

May 5, 2010 the double-checking system (licensing) without quantitative restrictions applied to the import of certain textiles originating from Uzbekistan has been repealed. Thereby the EU is currently applying quantitative restrictions only to the import of textiles from Belarus and North Korea. It must be noted that these countries are not WTO member states.

Box 6.5

Current activities of intergovernmental commissions of Latvia and third countries from June until November 2010

– On June 4, 2010, the 4th session of the Latvia-**Russia** IGC covering the areas of economic, scientific, and technical, humanitarian and cultural cooperation issues took place in Pskov. By 2011, agreements concerning such fields as prevention of double taxation and tax default, facilitation of visa requirements for border territory inhabitants, tourism, elimination of emergency situations and combating organised crime could be signed. In order to promote Latvian food product export to Russia, the parties agreed to consider the possibility to conclude some memoranda on supply of meat and dairy products and pastry products to Russia. On June 3, 2010, the Latvia-Russia Entrepreneur Business Forum took place in Pskov. On April 28, 2010, the 5th session of the ICG Economic Cooperation Working Group took place in Moscow.
In the framework of the ICG, a Regional Cooperation Working Group has been established aimed at promoting regional economic cooperation, including investment projects for cooperation among regions of Latvia and Russia, and cooperation among municipalities of Latvia and Russia. The Working Group's first session took place on June 3, 2010 in Pskov. During the session, the parties agreed to develop economic cooperation between Latvia and the regions and republics of Russia, as well as between municipalities and business communities of Latvia and Russia. The parties agreed to work actively on improving the contractual legal base. In the framework of the Working Group, the parties agreed to establish a list of potential regional cooperation and investment projects to promote implementation thereof. On November 17, a meeting of the Regional cooperation working group leaders was held in Riga, during which the Regulation of the working group was signed, as well as it was decided that the 2nd session of the working group will be held in Riga, in March 2011.

– On July 29, the 3rd session of the Latvia-**Ukraine** IGC took place in Riga, covering the areas of economic, industrial, scientific, and technical cooperation issues. The parties expressed their readiness to continue preparation of Agreements on cargo transportation between Latvia and Ukraine and on transit through their territories, to promote cooperation in fields of automotive industry, energy, construction, tourism, food, chemistry, ship-building, aviation, electronics and electrotechnical industry, IT, as well as to activate cooperation in fields of investment, to share experience in fields of standardization, accreditation, certification, metrology, conformity assessment and consumer protection, furthermore, the parties discussed cooperation between both countries so far and further opportunities and perspectives in the field of agribusiness complex, agreed to consider possibilities to optimize mutually the procedures for food veterinary control and certification. In the framework of the session, the Latvia-Ukraine economic cooperation programme for 2010-2011 was signed.

– on September 29-30, 2010, the 6th session of Latvia-**Belarus** IGC covering the areas of economic, scientific, and technical cooperation issues took place in Minsk. During the session, the parties approved the dynamics of the current Latvia-Belarus bilateral relationship development and expressed readiness to promote cooperation of both countries in the field of economics. Several topical matters were discussed in order to promote bilateral cooperation in the fields of industry, energy, transport, communications, agriculture and food industry, forestry, standardization and metrology, as well as development of further trade and economic cooperation in the scientific-technical field and in other fields.

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For a long time, in the multilateral negotiations of the WTO, the textile and clothing sector was an exception for the progressive trade liberalisation of industrial goods, until 1995, when the developing countries achieved that the WTO member states gradually over a period of 10 years introduced complete trade liberalisation of textile goods. Since May 5, 2010 the double-checking system (licensing) without quantitative restrictions applied to the import of certain textiles originating from Uzbekistan has been repealed. Thereby the EU is currently applying quantitative restrictions only to the import of textiles from Belarus and North Korea. It must be noted that these countries are not WTO member states.

Trade Defence Instruments

Trade defence instruments of the European Community

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

During the second half of 2010, 129 anti-dumping and 11 anti-subsidy measures were applied in 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. Mainly iron and steel, as well as chemical industry products are subjected to the defence measures.

In Latvia, the producers, importers, traders and consumers of goods alike are affected by 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 glass fibre and glass fibre fabric from China. In this case, Latvia is fighting against unfair trading practice applied by China producers, supporting perspective and development-oriented growth of Latvian glass fibre producers and their competiveness in both domestic and export markets;

– an anti-dumping inspection with respect to import of high-resistance polyester threads from China. Considering that application of a duty will lead to a price increase for final products (wires, cords, bands and belts) produced using the good above, thus reducing competiveness of these products, in comparison with equal good, for example, from China, however, Latvia did not support application of the duty.

Trade defence instruments applied by third countries

In the same way as EU applies trade defence measures, other third party countries may also apply defence mechanisms, either against all exporters of the respective EU product (e.g., safeguard measures of domestic market) 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 recognised as unjustified and non-compliant with the WTO's norms, and must be revised in the near future. Although the US has promised to follow the WTO's recommendations, the result still is unsatisfactory.

On January 29, 2010, based on non-fulfilment of obligations, the EC asked the WTO to permit application of sanctions to products exported from the USA to the EU. Taking into account that the USA had objections against the amount of sanctions, the case was submitted to the WTO arbitrage for consideration, which had to make a decision by September 8, 2010. On September 7, 2010 the EU and the USA jointly submitted a request to postpone the arbitrage process because the USA has undertaken to implement the WTO recommendations as soon and possible.

6.2.3. Internal Market of the European Union

The EU internal market – 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, a uniform set of regulations is obtained within the framework of the EU for economic operators – 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 has not been fully employed yet and its improvement is continuing by promoting sustainable and stable development of the EU economy and prosperity for EU.

In Latvia, implementation of internal market directives is taking place successfully and sufficiently high results have been achieved regarding the transposition efficiency of the directives. Among 27 countries, Latvia is sharing 5-7th position, and its deficit of directive transposition stands at the rate of 0.5%, thus already ensuring the 2009 Lisbon target to transpose 99% of the directive requirements or to allow the directive transposition deficit of 1%.

In Latvia, the process of implementing the principles of free movement of goods and services and the right of establishment stated in the 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 by constantly identifying legal regulations that may potentially or actually hinder implementation of the freedoms in the EU internal market, *inter alia*, by assessing the legislative acts currently in a draft stage.

The procedure for submitting draft 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 requirement of legislative provisions that may create obstacles for free movement of goods and social services. Any business, not only the responsible institution of the Member States, may take part in this 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 exports of products or the cross-border provision of information society services of the businessman. Information on draft technical regulations of the Member States is freely accessible on the *Technical Regulations Information System* (TRIS) database. TRIS database is a free service and can be accessed on *www.europa.eu* portal. The majority of the notified draft technical regulations are available in all EU languages.

From May 1, 2004 until December 1, 2010, Latvia notified the European Commission about 92 draft technical regulations and received detailed objections from the European Commission in 18 cases. In most cases, the objections of the EC are related to the fact that draft laws and regulations did not comprise the principle of mutual recognition, which prescribes that products legally manufactured or placed in circulation in one of the EU Member States or Turkey, or legally manufactured in one of the European Free Trade Association countries, which is a signatory to the European Economic Area Agreement, should be granted free access to the Latvian market by the national authorities concerned.

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 practices of the national competent authorities, after a recommendation of the European Commission and with the support of the EU Member States, the European Parliament and Council Regulation (EC) No 764/2008 laying down the 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 was 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 Regulation envisages setting 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 lawfully manufactured in the European Economic Area countries or put into free circulation, distribution of rights and obligations among the national competent authorities and economic operators within the framework of mutual recognition procedure, as well as for the purposes of simplification of applicable administrative procedures the Regulation stipulates an obligation for the state to establish one or more information points for the informative support of performers of economic activity. The function of the product information contact point in Latvia is currently performed by the Ministry of Economics *(e-mail: pcp@em.gov.lv)*.

In order to promote business activity and innovations in the service sector, as well as to promote gradual modernisation and simplification of public administration, one of priorities set for Latvia within the EU is promotion of **free movement of services**.

The European Parliament and Council *Directive 2006/123/EC* on services in the internal market is essential for Latvia among EU legal acts of the recent years and must be implemented by the state before the end of 2009. *Law on free provision of services* is enforced on May 4, 2010 and it will ensure implementation of requirements stated in the directive in the horizontal legislation. The directive is aimed at creation of legal regulations necessary to promote implementation of the right of establishment and free movement of services within the EU internal market. Implementation of the Directive will render a positive contribution in the sector of services for the promotion of cross-border economic activities, as well as in improvement of business environment, especially in reduction of administrative burden for merchants.

In order to facilitate the process of starting and performing a business activity, the existing administrative barriers and procedures are continuously reviewed by eliminating and simplifying the requirements for the issue of permits (licences, certificates, certifications, and other documents), as well as by creating an opportunity to settle all the required procedures electronically. The permits terminated in certain spheres are planned to be replaced by open-ended term licenses and the permit prolongation procedures are being simplified, as well as the list and amount of the documents to be submitted is reviewed.

In order to improve administrative cooperation abilities between public administration authorities of the European Community, since November 2007, the **Internal Market Information (IMI)** system has been established and is available in Latvia. The system ensures secure and fast exchange of data among the corresponding institutions of the European Union Member States, allowing effective communication despite the barriers created by differences of languages and administrative structures. The Member State authorities can verify authenticity of company documents submitted by persons and issued in another Member State or solve other problems by communicating with the country of origin using IMI, which means that the entrepreneur does not need to go back to the country of origin to receive an additional notice and to certify it at a notary, etc. In addition, responsible authorities ensuring IMI system *Warning mechanism's* absolute activity are identified and registered in the IMI system. A *warning mechanism* of the IMI system 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 harm a person's health, safety or environment. 47 institutions have been registered in the IMI system, among them: 7 – in the sphere of professional qualification; 36 – in the sphere of services; 4 – in the sphere of professional qualification and services. National coordinator of the IMI system and the coordinator of IMI system's *warning mechanism* is the Ministry of Economics. From January until

November 2010, 19 requests for information were registered in Latvia in the IMI system.

From January until November 2010, 15 cases have been submitted in **SOLVIT Coordination Centre of Latvia**; 13 of these cases are closed, but two are being solved. 10 of the closed cases have been solved, one case is closed as unsolved, and 3 cases were rejected, because they did not conform to provisions for SOLVIT case solution. In 2009 and 2010, the number of complaints on residence permits for family members of Latvian citizens, as well as on benefits in other Member States has considerably increased. Also in 2010, SOLVIT continues the information campaign launched in the previous year by informing the society on the activity of SOLVIT in various seminars, as well as by using mass media. The task of the SOLVIT network is to find a quick and practical solution for EU internal market problems caused by the activity of state institutions, by incorrect transposition of legal regulations of the European Community. The SOLVIT solves problems of both residents and entrepreneurs, and its services are free of charge.

6.3. Sector-Specific Development Policies

6.3.1. Industrial Policy

Industrial policy in Latvia is being developed on the basis of the general industrial policy guidelines of the European Union and taking into consideration policy development directions of other fields, such as trade, domestic market, innovation, research and competition. In identifying and solving the issues topical for Latvian industrial enterprises, the implemented cooperation with the organisations representing employers, trade unions, industrial enterprises of sectors, nongovernmental organizations, and other social partners is also important.

Upon revising the framework of the **EU industrial policy** in October 2010, the European Commission released the Communication on *An Integrated Industrial Policy for the Globalisation Era*. The Communication is one of the seven flagship initiatives for implementation of the *EU 2020* strategy (see also section 6.1). In the Communication, the Commission sets out a strategy for development of new EU industrial policy framework, proposing pledges to be carried out at the level of both the EU and Member States, thus boosting growth and jobs and supporting transition to a low carbon emission and resource-efficient economy. The new industrial policy highlights both horizontal and sectoral approach focusing on competiveness and sustainability, understanding the industrial policy in its wider sense.

On December 10, 2010, the EU Competitiveness Council of Ministers approved *the Council Conclusions on the Integrated Industrial Policy for the Globalisation Era: Priority for Competiveness and Sustainability*, which was prepared on the base of the Communication released by the Commission. The Conclusions identify the main activities to restructure the EU industry and increase its global competiveness, at the same time asking the Commission to monitor the industrial policies implemented in the Member States and competiveness thereof.

The Council Conclusions stress that it is important for the EU manufacturing industry to implement the activities for development of business-friendly environment, emphasizing the central role of the small-and medium-sized enterprises, as well as that the access to finance has a crucial role in modernization of the EU industrial base, implementation of new technologies and job-creation. Also efficiently functioning single market, extending and improving European transport, energy and communication infrastructure, support to all kind of innovation, standardisation and skills are the key base for development of the EU manufacturing industry. The Conclusions stress that open global markets, access to raw materials, especially – access to raw materials from third countries, as well as prevention of unfair trading practice of third countries are important for competiveness of the EU industry as well. At the same time, the Conclusions emphasize that it is important to continue the direction towards safe, sustainable, low carbon emission, resource and energy-efficient economy, envisaging appropriate measures for further transition of the EU industry to an eco-efficient economy model. The Conclusions stress the importance of the space sector for competiveness and innovation of the EU industry.

Amendments to the *EU Emission Trading System Directive* adopted at the end of 2008 (Directive 2009/29/EC) are especially important for the energy-intensive sectors. One of the key issues in the directive is to establish a common system for allocating emission quotas and to identify those energy-intensive sectors that are subject to increased carbon leakage risk or to risk of delocalizing production outside the EU due to additional costs and loss of competitiveness that may be caused by direct or indirect participation in the EU emission trading system. The directive includes quantified criteria for determining sectors subjected to the carbon leakage risk, taking into account their involvement in international trade and expected increase of expenses.

On September 18, 2009, the *Working Group of the Committee on Climate Change of the European Commission* voted on the European Commission draft decision regarding the list of sectors subjected to a significant carbon leakage risk, which will be entitled to apply for free CO_2 emission quotas. The vote confirmed such energy-intensive sectors and subsectors important for Latvia as steel production, cement production, glass and glass fibre production, as well as production of plywood and wood-chip boards.

In order to evaluate development possibilities of the Latvian **military industry**, in 2009, a study *Development Opportunities of Defence and Related Sector Industry in Latvia* was performed. The study analyzed offset policy in the EU member states, as well as provided suggestions for offset policy development and implementation in Latvia

In summer 2010, amendments to the Article 4 of the *Public Procurement Law* came into force, providing for a possibility to apply offset to procurements of military nature. According to the amendments to the *Public Procurement Law* the Ministry of Economics in cooperation with experts from different public authorities, as well as organisations representing employers and industrial enterprises of different sectors developed *Regulations on the application of offsets to procurements for national defence purposes* approved by the Cabinet of Ministers on September 30, 2010.

The aim of introducing compensation or *offset* is to promote development of export-oriented local industry service and research sectors. The above-mentioned Regulations envisage the procedure for application of offsets provisions, when concluding public delivery agreements with suppliers of military important foreign goods. If the contractual amount exceeds LVL 2 million, the supplier of military goods shall compensate the purchase value to the economy of the purchasing country, for example, by ensuring involvement of local enterprises in manufacturing process, buying production of local enterprises, investing in national economy, or ensuring that means are returned to the economy of the purchasing country in any other way. Key beneficiaries from implementation of the offsets policy will be enterprises of related sectors (electronics, electrical engineering, metal working, mechanical engineering, information technologies, etc.), which can offer components and provide services to the military industry, and research institutions, by creating and maintaining competent and competitive technological and industrial base of national and European defence.

Also in 2010, the Ministry of Economics continues to support **cluster development** to promote cooperation of unrelated sector enterprises and related institutions (education and research institutions) by supporting implementation of common projects, thus promoting faster growth of competitiveness of the sectors and indirectly also the enterprises themselves, as well as promoting increase of export amounts, and innovations and production of new products.

From April 1, 2010 until April 26, 2010, a call for proposal *Conclusion of Co-Financing Contract for Implementation of Cluster Development Programme* was announced. Associations and foundations could apply for concluding co-funding contracts and funding for the promotion of cluster development. After project evaluation and approval, the Ministry of Economics concluded 9 contracts for granting co-financing in the amount of LVL 186 thousand for implementing the following cluster projects:

- Ventspils High Technology Park *Space Technologies Cluster Development Measures*;
- The Latvian Information and Communications Technology Association *Strengthening of IT Cluster Exportability and Promotion of International Cooperation*;
- Association of Mechanical Engineering and Metalworking Industries of Latvia *Cluster Development of Metalworking and Related Sectors*;
- Association of Light Industry Enterprises *Industrial Sample Preparation of Innovative Products of Textile and Related Sectors Cluster, and Testing and Qualities Tests of Finished Products*;
- The Association of Latvian Chemical and Pharmaceutical Industry *Promotion of Innovative Environment of Chemical and Pharmaceutical Sector Using Cluster Method*;
- Association "Latvijas Mēbeles" *Furniture Manufacturing and Related Sector Cluster Development*;
- Latvian Logistics Association *Latvian Supply Chain Cluster Development*;
- Latvian Electrical Engineering and Electronics Industry Association *Electronics and Electrical Engineering Sector Cluster Development Project*;
- Latvian Federation of Food Enterprises *Food Sector Cluster*.

In order to promote mutual and international cooperation of enterprises, the Ministry of Economics and the Investment and Development Agency of Latvia have engaged in implementation of the cross-border leading programme *Baltic Sea Region Programme for Innovation, Clusters and SMEs Networks* (*BSR Stars*) launched within the framework of the Operational Programme's priority *Full usage of the Regional Research and Innovation Potential* of the *EU Baltic Sea Region Strategy*.

For implementation of the *BSR Stars* programme a *StarDust* project application was developed for submission to the *Baltic Sea Region Programme 2007-2013*. The overall aim of the *StarDust* is to increase international cooperation of research environment, cluster and SME nets, establishing several global research and innovation centres in the Baltic Sea Region. *StarDust* project is based on 5 cross-border pilot projects which are implemented in such areas as environmentally-friendly technologies and future energy, welfare and health, future transport, digital business and services.

StarDust is the next stage of previously launched initiatives in the cluster field and it will promote development of clusters of Latvia and cooperation with the Baltic Sea Region (BSR) clusters. Besides, the Latvian IT cluster, the Art Academy of Latvia, and the Latvian Logistics Association have been approved as full-fledged members in the pilot projects of the programme *StarDust*.

In autumn 2010, the *StarDust* project was approved for financing in the *Baltic Sea Region Programme 2007-2013*. The project is planned to be running until the end of 2013 and the total budget thereof is approximately EUR 6.5 million.

Currently, the European **space industry** is highly developed. Also in the future, space and space related services are considered to be a perspective direction of industry and business. In order to promote elaboration of state national space policy and its implementation, the Ministry of Education and Science has established a *Working Group for National Space Technologies Development*. At the moment, the working group is elaborating the *Informative report for development of space technologies and establishment of space policy in the country*.

The necessity for space policy framework at a national level is also a requirement of the *European Space Agency* (ESA), for Latvia to become a full member state of the ESA. In order to establish the legal basis for cooperation of Latvia and ESA on study and peaceful usage of outer space, as well as to establish prerequisites for implementation of common projects, ESA and the government of the Republic of Latvia in summer of 2009 signed a contract on the study and utilization of outer space for peaceful aims. After becoming a cooperating state of the ESA (PECS) or in the future – a full member state, Latvian research institutions, as well as enterprises would be able to participate in the ESA project tenders for development of space research, technological development, and innovation. Considering that the ESA is in charge of several areas of space technologies (satellite telecommunication, satellite navigation, manned space flights, International space station, launch vehicle transport, etc.), the status of the ESA cooperating state would considerably facilitate possibilities for Latvian enterprises and scientific institutions to get involved in such European space technologies projects.

In order to evaluate Latvia's readiness to become the ESA cooperating state, and mainly the institutional and industrial potential of Latvia, ESA representatives organized an audit in March 2010. During the audit ESA representatives evaluated 11 scientific institutes, 13 enterprises and visited one Technology Park. ESA experts evaluated Latvian industrial and intellectual infrastructure and technical possibilities as potentially sufficient, at the same time giving a summary on weaknesses of Latvia, as well as recommendations regarding future actions.

Development of **industrial design** should be considered an important aspect for increasing competiveness of industry, which ensures possibility to position the manufactured production as original and new, thus increasing the added values of the end-product and raising demand and international competiveness. In the framework of the *Competitiveness and Innovation Framework Programme 2007-2013,* several measures are being implemented in the field of industrial design, for example, the creation and maintenance of the industrial design portal *www.designlatvia.lv*, consultations, and design audits in enterprises. Within the framework of the project *Design Bus* (*Dizaina autobuss)*, also in the year 2010, Latvian designers were offered an opportunity to visit manufacturing enterprises of different sectors. Within the framework of the project in 2010, 3 visits to manufacturing enterprises of different sectors were organised with the participation of 60 designers, overall visiting 8 manufacturing enterprises and cooperation partners. As a result, cooperation among designers and producers is initiated for development of specific new products.

In order to promote more successful development of new brands, IDAL together with design and brand management experts organized series of informative and educational off-site seminars *Six steps to successful brand* in Riga and regions of Latvia. In the framework of four seminars, discussions promoting successful cooperation among enterprises and designers were organized. These seminars were attended by 425 participants. At the same time, enterprises were also informed on possibilities to promote products and services using multimedia and new technologies.

In 2010, supporting activities in knowledge transfer project *Provision of product design development service to manufacturing enterprises* was organized, where 10 manufacturing enterprises participated, thus receiving product design development services. Within the framework of the project, both furniture, electronics, and food manufacturing enterprises were supported, and in cooperation with designers new, innovative product designs or new product series (collection) design were developed, as well as the design of existing products was considerably improved by developing conceptions for product packaging, thus finding new solutions for visual identity of products.

In order to promote recognition and sale of Latvian products in Estonian market, in the framework of Latvian Days *Taste Latvia* in November 2010, an opportunity to get acquainted with Latvian-made products (food, cosmetics, textile, and household items) in Estonia, Tallinn was ensured. The event was well-represented also by Latvian designers, thus ensuring the opportunity to buy their production.

In 2010, a new category *Industrial Design* is included in the contest *Export and Innovation Award* (see Box 6.21). Any enterprise registered in Latvia is invited to apply for the contest, if it has developed an industrial design for its product that is considerably better than the previous ones and/or other product designs currently in the market and has been available in the market for a period not exceeding three years. In the framework of the contest, 19 applications were received, 8 of these enterprises were selected for the 2nd round of the contest. In category *Industrial Design* the 1st place was given to the enterprise LLC "PAA", which developed a new design for sinks, while the second and third place was awarded correspondingly to LLC "VARIS Toys" for the design of a wooden toy set and to LLC "Angel Glass Design" for the design of glass and crystal dish collection.

6.3.2. Energy Policy

The main directions of the energy policy (see also Chapters 3.2.3 and 6.9) are aimed at improving security of energy supply of the country by encouraging diversification of supplies of the primary energy resources and by creating conditions for increasing self-provision of electricity generation, as well as by preventing isolation of the regional electricity market through new interconnections. Creation of competition conditions, promotion of use of renewable and local energy resources, and environmental protection also play 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.

In **electricity supply**, more than 90% of all electricity generated in Latvia is generated by JSC "Latvenergo", which also ensures import and supply of electricity to the consumers. Since September 1, 2005, all functions of electricity transmission system operator are performed by JSC "Augstsprieguma tīkls". Since July 1, 2007, all functions of an electricity distribution system operator are taken over by JSC "Sadales tīkls": the sole owner of both joint-stock companies is JSC "Latvenergo".

Latvia being an EU Member State has to ensure compliance with the single requirements set in the EU legal acts concerning the energy sector in the country (see Box 6.6). In the sphere of electricity supply, it means that the electricity sector in Latvia operates in compliance with the provisions of an EU directive concerning promotion of utilisation of renewable energy resources for production of electricity, joint electricity market regulations, cogeneration based on the useful heat demand, as well as safety of electricity supply and investment into the infrastructure.

Box 6.6

<u>Harmonisation of normative acts with the EU directives</u>

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

- **Creation of 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 requirements set forth in the Council *Directive 2006/67/EC* of July 24, 2006 imposing an obligation on Member States to maintain minimum stocks of crude oil and/or petroleum products, as well as with the requirements incorporated in the Council *Directive 2009/119/EC* of September 14, 2009 imposing an obligation on Member States to maintain minimum stocks of crude oil and/or petroleum products.
- On March 23, 2010 the Cabinet of Ministers approved a new *Concept on the Creation of State Oil Product Reserves.* The concept stipulates that the Ministry of Economics will start to perform functions of Central reserves maintenance structure as from September 1, 2010.
- The Regulations of the Cabinet of Ministers of March 12, 2002 *Procedures for Supply to Energy Users and Procedures for Sale of Heating Fuel during Announced Energy Crises* stipulate the procedure of supply of energy to the users during a country-wide or local energy crisis, as well as the procedure of selling fuel by energy service companies and entrepreneurs who have received an entrepreneurship licence for selling fuel according to the procedure stipulated in normative acts allowing them to sell fuel owned by them during energy crisis on demand of State Energy Crisis Centre or Municipal Energy Crisis Centre. On October 7, 2010, the ordinance by the Prime Minister *About State Energy Crisis Centre* was issued establishing the structure of the State Energy Crisis Centre.
- In order to transpose the requirements set out in the *Directive 2006/67/EC* and *Directive 2009/119/EC,* the Ministry of Economics opened tenders – *Provision of services concerning security stocks in order to create state oil product (fuel) stocks in the territory of Latvia in the amount of 25%* and *Provision of services concerning security stocks in order to create state (Republic of Latvia) oil product (fuel) stocks in the territory of the Member States of EU (Kingdom of Denmark, Republic of Estonia, Republic of Lithuania, Republic of Finland and Republic of Latvia) in the amount of 75%.*
- **Electrical power sector.** The regulation which applies to electricity market consists of the *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 and replaced the regulations previously issued by the Cabinet of Ministers. A tender was organised for the right to sell electrical power produced from renewable energy resources within the compulsory procurement organized in October 2010, in order to support production of electricity from renewable energy resources. A number of decisions on conferring the rights to sell electrical power produced from renewable energy resources, where the electrical power must be procured in the compulsory amount, were passed; among them: 18 decisions on biogas power plants determining the amount of the electrical power procurement up to 134 308.488 MWh per year, 6 decisions on biomass power plants determining the amount of the electrical power procurement up to 98 007.882 MWh per year, 4 decisions on wind power plants with capacity over 0.25 MW determining the electrical power procurement up to 63 665.241 MWh per year, as well as 7 decisions on wind power plants with capacity under 0.25 MW determining the electrical power procurement up to 3800 MWh per year. In 2010, also 13 decisions on hydro power plants with capacity up to 5MW were adopted determining the electrical power procurement up to 10 238.3 MWh per year. In general, in 2010, decisions on conferring the rights to sell electrical power produced from renewable energy resources in the form of compulsory procurable electrical power volume have been issued for 48 power plants with the total installed electrical power production capacity of 83.69 MW, thus stating the electrical power procurement up to 310 019.911 MWh per year.

Box 6.6 continued

- As for production of electrical power by cogeneration, the regulations of the Cabinet of Ministers of March 10, 2009 *Regulations Regarding Electricity Production and Price Determination upon Production of Electricity in Cogeneration* are applicable. These regulations also implement the decision of the European Commission (December 21, 2006) defining harmonized efficiency reference values for separate production of electrical power and heat 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 to the Regulations of the Cabinet of Ministers Regarding Electricity Production and Price Determination upon Production of Electricity in Cogeneration* came into force, not allowing cogeneration power plants, which use fossil energy resources or peat, apply for selling electrical power within the compulsory procurement or receiving a guaranteed payment for the set electrical capacity as from November 1, 2010.
- On May 15, 2008, the law on *Amendments to Electricity Market Law* came into force. These amendments stipulate that in case the report of the electricity transmission system operator states that the capacity insufficiency exposes the state electrical power supply to risk and this was not prevented by issuing licences to produce electrical power, the Government opens a tender for introducing new production capacities or reconstructing current plants. The winner of the tender will have the rights to receive payments for the new power plant capacities. Furthermore, the particular producer of electrical power will be entitled to participate in the electrical power market and sell the produced electrical power for an agreed price applying to any participant of the electrical power market.
- It is necessary to introduce new generating base capacities over 400 MW in Latvia by year 2020. For that reason, the Cabinet of Ministers adopted *Regulations on Tender for Covering Electrical Power Production Capacity to be Introduced* on December 22, 2008. The subject matter of the tender – for the purposes of Article 87 of *Treaty Establishing European Community*, the covering of production capacity to be introduced deems to be state support and its provision shall be agreed with the European Commission. On January 27, 2010, the European Commission found that the state support procedure for establishing a power plant using solid fuel (coal and biomass) transposed into the regulations of the Cabinet of Ministers is compatible with the internal market. The decision on opening the tender, as well as on the results of the tender will be adopted by the Cabinet of Ministers, but the tender will be opened and organized by the Public Utilities Commission.
- The requirements stipulated in the *Directive 2009/72/EC* of European Parliament and of the Council of July 13, 2009 concerning common rules for the internal market in electricity and repealing *Directive 2003/54/EC* must be introduced in the national normative acts of Latvia by March 3, 2011. The *Directive 2009/72/EC* aims to separate electricity production and supply from activities related to an electricity transmission system. According to the requirements of the *Directive 2009/72/EC*, ownership of the electricity transmission system operator (TSO) can be separated in one of the three ways:
  - by performing full ownership unbundling – separation of the assets of TSO and transmission system from the concern JSC "Latvenergo";
  - by appointing an independent system operator – separation of TSO of the concern JSC "Latvenergo" by keeping transmission system assets within the concern JSC "Latvenergo";
  - by appointing an independent transmission operator according to the requirements set out in the Directive – separation of the assets of TSO and transmission system for a subsidiary company of JSC "Latvenergo", which must comply with specific requirements concerning independence towards the concern JSC "Latvenergo". In order to select the most optimal action model for Latvia, criteria such as continuity of the functions of the transmission system operator, compliance with provisions stipulated in Article 20^1 of the *Energy Law* on keeping transmission assets in the concern JSC "Latvenergo", and proscription of alienation of shares owned by JSC "Latvenergo", as well as fulfilment of liabilities towards creditors and preferably less negative financial influence on the concern JSC "Latvenergo", the state budget, and rates;
- **Gas sector.** On May 26, 2005, Saeima passed the law on *Amendments to the Energy Law* determining the principles for operating the natural gas market. The aim of the law is to create conditions for competition in the natural gas market in Latvia, as well as to harmonise the regulatory normative acts with the requirements of the EU legislation. Transitional provisions of the law prescribe that the time and procedure for the legal norms, which regulate principles for operation of the natural gas market, coming into force are determined by a special law. Concerning *the procedure for enforcement of particular sections of the Energy Law*, the law prescribes that these provisions of the *Energy Law* will come into force as of April 4, 2014.
- It is necessary to transpose the requirements stipulated in the *Directive 2009/73/EC* of the European Parliament and of the Council of July 13, 2009 concerning common rules for the internal market in natural gas and repealing *Directive 2003/55/EC* into the national normative acts of Latvia by March 3, 2011. The latest requirement of the *Directive 2009/72/EC* for Latvia is introduction of a system allowing a third party to access transmission and distribution systems according to the published rates applied for all competent users. Delivery and utilisation of natural gas are regulated by the Regulations of December 16, 2008 of the Cabinet of Ministers *Regulation regarding Delivery and Utilisation of Natural Gas*.

Taking into account that on May 15, 2008, as Saeima amended the *Electricity Market Law,* the corresponding delegation of the Cabinet of Ministers to pass regulations on the trade and usage of electricity has been changed, the Cabinet of Ministers passed *Regulations Regarding the Trade and Use of Electricity* on July 21, 2009, which establish the procedure of how electrical power is supplied to the users and how its supply is terminated and set the rights and obligations of electrical power traders, system operators and users when supplying and using electrical power, as well as governs the payments on the received services, procedure of the change of traders, procedure of electricity supply to related users, users' rights to receive universal service in the power supply.

At present, JSC "Latvijas Gāze" is the only enterprise in the **natural gas market** of Latvia, which carries out transmission, distribution, storage, and sale of natural gas in compliance with the licences issued by the Public Utilities Commission.

The gas supply system of Latvia is not connected to the EU common gas supply system, and Latvia has only one gas supplier – JSC "Gazprom". Gas supply business environment in the region and gas supply agreements in force practically exclude third parties except a regional transmission system operator and access to Inčukalns underground gas storage. The capacity of the gas pipeline Valdaj-Pskov is not sufficient enough 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.

The Law on Procedure for Coming into Force of Particular Sections of the Energy Law stipulates the date of opening the market – April 4, 2014.

The general aim of Latvia is to increase the proportion of the energy produced from **renewable energy resources** in the total final gross consumption of energy from 32.6% in year 2005 up to 40% in year 2020. The Ministry of Economics being responsible for the energy policy of Latvia has elaborated the draft law *Renewable Energy Law*, in order to transpose the requirements stipulated in the *Directive 2009/28/EC,* and it has launched the preparation of drafts of the necessary regulations of the Cabinet of Ministers and amendments to normative acts.

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 and other renewable fuels for transport and requirements established in the *Biofuel Law* (adopted on July 15, 2005), by December 31, 2010 the proportion of biofuel in Latvia must be at least 5.75% of the total amount of fuel used in the transport.

In order to promote the use of biofuel in Latvia, compulsory addition of biofuel in the amount of 5% to the fossil fuel was determined on October 1, 2009. However, the requirement of the compulsory addition of biofuel in the amount of 5% does not apply to diesel oil used in arctic and severe winter weather conditions.

In accordance with the delegation set out in Section 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 energy performance of buildings, *Regulations Regarding 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 centralized heating systems in possession of licensed energy supply merchants and examination procedure of their conformity.

Investments in the energy sector

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

Increase in power supply safety 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 November 2008. *The Baltic Energy Market Interconnection Plan* (BEMIP) was elaborated for the implementation of the previously mentioned project. The BEMIP foresees to create an efficiently functioning energy market, to increase supply safety in the Baltic States by joining the power supply system of the Baltic States with other European Union Member States.

Measures to be performed are stated in the BEMIP to create an efficiently acting single Baltic energy market and to integrate the Baltic energy market in the energy market of the Nordic States. Formation of a functioning regional market is considered to be a necessary precondition for further integration of the Baltic States in the region of Nordic energy exchange NordPool, at the same time overtaking also the activity principles of the NordPool.

Currently, several projects included in the BEMIP are being implemented; these projects ensure successful integration of 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 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 Baltics. 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 is planning to invest EUR 131 million in the construction of the Lithuania-Sweden interconnection, furthermore EUR 44 million are granted for improvement of network infrastructure within the framework of the project Kurzemes 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 substation "Imanta", as well as 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 is planned within the second stage.

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

The report *Future Development of Energy and Gas Market in the Baltic Sea Region*, prepared by Nordic engineering consultancy company "Ramboll" for the European Commission on June 2009 establishes that Latvia has the third highest gas supply safety index[1] among the EU Member States.

In order to increase natural gas supply safety at the regional level, Latvia is currently focusing on implementation of a project on two-way gas flow between Latvia and Lithuania, as well as on investigation of possibilities to enlarge 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 JSC "Latvijas Gāze" and Lithuanian gas company AB "Lietuvos Dujos" on two-way gas flow between Latvia and Lithuania. JSC "Latvijas Gāze" will receive EUR 10 million, which forms a half of all the financing necessary for implementation of the joint project in Latvia.

Within the framework of the project, it is planned to reconstruct 15 drill holes in Inčukalns underground gas storage, to construct a new gas transmission line over the Daugava River by creating a new piston chamber in Latvia, as well as to modernise the gas compressor station in Panevezys and a part of Lithuania's gas-pipe system. The transmission line over the Daugava River and a new piston chamber should 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.

11 project applications for CF funding in the amount of LVL 6.7 million were approved within the first round of selection of project applications (from April 14, 2009 until May 26, 2009) in the context of 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, 2010 until December 1, 2010) the available funding amounts to LVL 35.6 million.

10 project applications for CF funding in the amount of LVL 21.4 million were approved within the first round of selection of project applications (from April 14, 2009 until August 31, 2009) in the framework of the activity 3.5.2.2 *Development of Cogeneration Power Plants Utilising Renewable Energy Resources* of Supplement to the operational programme *Infrastructure and Services*.

According to the ordinance of the Cabinet of Ministers of August 24, 2010 on Amendments to the Appendix of the operational programme *Infrastructure and Services,* the funding concerning the activity 3.5.2.2 was divided, 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 selection of the project applications.

6.3.3. Construction and Housing Policy

The main aim of the **construction policy** is to promote development of sustainable construction sector by ensuring favourable and competitive business environment, decreasing administrative barriers, improving the system of public procurements in the construction sphere, ensuring expedient circulation of the construction information and increasing productivity of entities rendering construction services, as well as promoting introduction of energy efficient and environmentally friendly construction.

The construction sector in Latvia has always been one of the leading economic sectors, and at the time when the state strives to reach the model of sustainable development emphasising the export, the construction sector should also adapt to this situation and it should be able to compete not only in the internal market, but also in external markets. To ensure competitiveness of construction sector in the international market as well, it has to continue its development, because only sustainable construction based on innovative technologies and construction materials, architectonic quality and qualified labour force has the potential to compete in external markets successfully.

One of the most significant preconditions of sustainable construction is the legal base for the construction that would facilitate and make the entire construction process more transparent starting from the intention to construct and concluding with the commissioning the building. Therefore the Ministry of Economics has drawn up a new draft *Construction Law*, which has been submitted for reviewing to the Saeima.

The draft law has been prepared in order to establish up-to-date and modern legal base for the construction process, which would promote development of the construction sector, as well as encourage participation of the civil society in the decision-making process, thus ensuring maximum protection of interests of the construction initiator and

[1] Supply safety index is a totality of quantitative parameters that includes, for example, the number of supplying states and the pipelines, production of local gas, gas storage, terminals of liquid natural gas, gas substitution and state risks for supply and transit states that are calculated and later compared.

the society, based on the essence of the draft law – construction is implementation of the territory plan.

The draft law proposes to reduce the number of construction harmonisation procedures, and it includes four of the most important principles that must be observed by construction participants, as well as state and municipal institutions during the construction process. It is expected that these principles will promote sustainable development of the construction sector in the state:

- principle of architectonic quality – when designing buildings, the qualitative aspect of architecture is observed highlighting the individual identity of natural or urban landscape and is easily integrated in the cultural environment, thus enriching it, 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 related decisions;
- principle of sustainable construction – the construction process creates the qualitative aspect of living environment, *inter alia* providing energy resources necessary for the building and for people of present and further generations, and promoting the 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

Construction sector data

In the third quarter of 2010, the construction production volumes (in current prices) were LVL 247.5 million, in the first quarter – LVL 107.1 million.

In the third quarter of 2010, the construction production volumes in accordance with balanced data of working days in comparable prices have decreased by 13.1% if compared to the corresponding quarter of the previous year.

In the third quarter of 2010, the Building and Construction Authorities have issued 541 construction permits for single dwelling-unit construction, capital repairs, reconstruction and renovation for the total area of 112.5 thousand m², which is 92.6% of all construction permits (584) issued in the third quarter of 2009.

Changes in volumes of construction work performed by construction organizations in the third quarter compared to the corresponding period of the previous year constitute 4.5% (in the first quarter of 2010 – -44.1%; in the second quarter – -31.9%).

In the third quarter of 2010, the volume of construction work (in current prices) performed by Latvian builders abroad was LVL 14.2 million, but in the third quarter of 2009 – LVL 10.1 million and that is by LVL 4.1 million more than in the third quarter of 2009. However, in the third quarter of 2010, foreign builders in Latvia have performed construction works in the amount of 2072.2 thousand lats, which is by LVL 1237.6 thousand more than in the third quarter of 2009 (LVL 834.6 million).

In the third quarter of 2010, the construction cost index decreased by 1.2% if compared to the third quarter of 2010. Costs for machinery and machines maintenance and use decreased by 6%, but prices for construction materials – by 0.6%. The wages of workers increased by 4.1%. The decline in costs for underground main pipeline construction and office construction had the biggest impact on the increase on the general level of construction costs.

During the course of the year, the overall level of construction costs increased by 0.1% (in comparison with September 2009). Among the main resource groups the wages of workers (by 5.5%) and prices of construction materials were increased (accordingly by 0.4%). Meanwhile the maintenance and operational costs of machinery and equipment fell by 4.5%.

The overall level of construction costs was mostly affected by the increase of costs in construction of transport objects, as well as in reconstruction and construction of industrial, agricultural, and trade buildings.

According to data provided by the Ministry of Economics, as of October 31, 2010, 508 construction merchants were registered in the Construction Merchants Register, which is by 176 construction merchants less than on October 31, 2009 (684 construction merchants). However, a total of 4250 construction merchants were registered in the Construction Merchants Register by October 31, 2010, while in the corresponding period of 2009, 5752 construction merchants were registered. Employers, who employ at least one person with permanent practice certification in any of the construction spheres, may register in the Construction Merchant Register. On October 31, 2010, 8412 persons received a Certificate in Construction Practice and 821 persons received a Certificate in Architectural Professional Practice

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

- regarding energy certification of buildings – new regulations for energy certification of buildings were adopted on June 8, 2010 by the Cabinet of Ministers, prescribing the minimum requirements of energy certification for new buildings and buildings to be reconstructed, if the total area of the building exceeds 1000 square metres and the total reconstruction costs exceed 25% of the cadastral value of the relevant building or the reconstruction works affect 25% of the scale of construction, as well as the procedure for energy certification, the type, sample, content, the procedures for the issuing and registration of the energy performance certificate of a building and temporary energy performance certificate of a building, the procedure for supervising the energy certification, the procedure for compiling, updating, and using the information regarding the issued energy performance certificates of buildings, the procedures for inspection of boilers with the rated output exceeding 20 kW and of air-conditioning systems with the rated output exceeding 12 kW;

– regarding heat technologies of building envelopes – on November 23, 2010 the Cabinet of Minister adopted amendments to the Latvian Construction Standard LBN 002-01 *Heat Technologies of Building Envelopes*, stipulating the design solutions for plastered façades of external wall 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 with rendering ETAG 004, thus ensuring quality of construction objects, appropriate use of state and local municipality means, as well as conformity of thermo-technical qualities of buildings to the requirements of construction standards. Such amendment was necessary because currently Latvian construction standards do not regulate solutions for façade heat-insulation designs. Under circumstances of harsh competition, building contractors are forced to look for the less expensive solutions without taking account the quality of the materials. Such situation endangers the quality of building insulation works;

– regarding requirements of building harmlessness – in order to improve situation in construction materials market and restrict the use of construction materials containing dangerous chemicals which can unfavourably affect the environment, be harmful to users of the building, as well as be harmful to health of people in the neighbourhood, on November 9, 2010 the Cabinet of Ministers adopted a new Latvian Construction Standard LBN 007 *Requirements of Building Harmlessness*, stipulating specific requirements for buildings and for the used built-in construction materials, thus significantly restricting the use of heavy metals and some organic compounds in construction materials. The normative act stipulates requirements of harmlessness to be observed when designing building and carrying out construction works thereof. Experience of other European Union member states (Denmark, France, Germany) was used in development of the construction standard, and restrictions included in Annex 2 to the construction standards are similar to those in the French construction standard regarding labelling of construction materials and decorative products concerning emission of volatile pollutants contained in such products;

– regarding building inspectors – the regulations on the Cabinet of Ministers adopted on October 26, 2010 regarding building inspectors prescribes the procedure by which a person acquires the building inspector rights, procedure for annulment of these rights, as well as requirements for persons wishing to acquire rights for the control of construction and environment accessibility, as well as rights and obligations of building inspectors while performing tasks specified in the *Construction Law* and other normative acts and procedure for supervision of professional activities thereof. Professional activities of building inspectors will be supervised and decisions related to the rights of construction control (as well as environment accessibility) will be made by the Ministry of Economics on the basis of an evaluation by a commission comprised of representatives from the Ministry of Economics and the Association of Latvian Building Inspectors and Building Supervisors.

The aim of the **housing policy** is to improve the quality and accessibility of buildings by ensuring a base of normative acts for efficient administration of residential buildings and by supporting energy-saving measures in residential buildings.

Effective administration of the housing fund

Until now, administration and management of residential buildings in many cases have been performed at poor quality thus becoming an ever topical matter of discussion in the society. Pretty often the owner(s) and managers of residential buildings do not take care of the buildings at all. Therefore, deterioration of the technical state of residential buildings has been observed, which can cause danger to life, health, safety, property of persons or to environment.

Law on Management of Residential Housing was enforced on January 1, 2010. This law stipulates the administration activities, tasks that need to be performed in the residential houses, provisions of administration agreements, professional qualification of the manager, as well as rights, obligations, and responsibility of the residential building manager.

For implementation of the *Law on Management of Residential Housing*, several regulations of the Cabinet of Ministers have been adopted prescribing the procedure by which the main administration activities must be carried out. A draft regulation of the Cabinet of Ministers has been prepared regarding development of a register of residential building managers, which would include information for owners of residential buildings, as well as for state and municipal institutions about managers operating or wishing to operate in the residential building management market, as well as information about residential buildings currently administered by a particular manager and qualification of the manager and personnel thereof.

On October 28, 2010, the *Law on Residential Property* was adopted by the Saeima, and will enter into force on January 1, 2011. The law stipulates the status of residential property, rights, obligations, and responsibility of a residential property owner, as well as competence of apartment owners' community and procedure for decision making.

Implementation of measures regarding energy efficiency of residential buildings

In order to foster activity of apartment owners for improvement of heat insulation of their residential buildings, from July 1, 2009 until December 31, 2010 the state has granted co-financing for energy audit of multi-apartment residential buildings, preparation of a technical inspection opinion and simplified renovation documentation or development of technical projects, i.e., preparation of documents required for starting the construction works to be carried out in the framework of renovation of multi-apartment residential building.

Overall, in 2009 and 2010, 296 owners of multi-apartment residential buildings were supported by granting state co-financing for 760 energy efficiency measures in the amount of LVL 731.6 thousand.

In 2009, 70 multi-apartment residential buildings were supported:

- 58 energy audits;
- 28 technical inspection conclusions;
- 9 simplified renovation documentation;
- 47 technical projects;
- 7 building renovations.

In 2010, 226 multi-apartment residential buildings were supported:

- 202 energy audits;
- 165 technical inspection conclusions;
- 195 simplified renovation documentation;
- 49 technical projects.

For improvement of energy efficiency in multi-apartment residential buildings to ensure sustainability of the housing fund and efficient use of energy resources, the activity *Measures for Multi-Apartment Residential Buildings* of the operational programme *Infrastructure and Services* is implemented, in the framework of which the ERDF co-financing is available for:

- start-up of construction work in parts of joint property owned by the property holders of multi-apartment residential building apartments ensuring the fulfilment of energy efficiency improvement measures specified in the energy audit report;
- preparation of project documentation and construction supervision and author's supervision of the design.

In the frameworks of the activity, the available ERDF co-financing has been increased to LVL 44.3 million in 2010 and correspondingly the co-financing of the funding beneficiaries – co-financing from property holders of multi-apartment residential building apartments – has been increased to LVL 32.1 million. Form April 14, 2009 until December 8, 2010, 268 project applications have been submitted with the total co-financing necessary for specified measures in the amount of LVL 13.7 million, but the amount of the necessary financing from apartment owners is LVL 29.3 million. Most of the project applications are received from Valmiera (35), Liepāja (34), Riga (30), Ventspils (19), and Limbaži municipality (11). 103 contracts on measures of heat insulation improvements in multi-apartment residential buildings have been concluded with the attracted ERDF co-financing in the amount of LVL 5.2 million. In total, renovation of 45 multi-apartment residential buildings has been concluded in the framework of this activity. Yet, in 2010 construction works are planned to be completed in 9 multi-apartment residential buildings, but in the spring 2011 – in 9 other multi-apartment residential buildings.

In order to facilitate obtaining information about house renovation processes and about benefits for the developers of housing renovation projects, thereby reducing the number of unclear questions, a Memorandum of Cooperation by the initiative of the Minister of Economics has been signed and an informative campaign *Live Warmer* has been launched. The Memorandum was signed by representatives of associations from 9 sectors, Riga Technical University, Regional Energy Agency, and three banks.

In 2010, the Ministry of Economics in cooperation with the Investment and Development Agency of Latvia, the Latvian Association of Local and Regional Governments and the Regional Structural Fund Information Centres organized 27 seminars in the framework of the campaign "*Live Warmer*". The aim of these seminars was to inform apartment owners and managers of residential buildings about possibilities to attract the ERDF co-financing and about good quality renovation of buildings, *int. al.* by using examples of good practice. The seminars were attended by 1650 participants.

In order to improve energy efficiency of the social housing fund of municipalities, at the same time increasing its quality and sustainability and ensuring adequate housing for socially vulnerable groups, the activity *Improvement of Heat Insulation of Social Residential Buildings* of the operational programme *Infrastructure and Services* is implemented, in the framework of which the ERDF co-financing is available for:

- preparation of project documentation and construction supervision, as well as author's supervision of the project;
- reduction of energy resources consumption in buildings, by ensuring fulfilment of at least two energy efficiency improvement measures given in the energy audit;
- renovation or reconstruction of buildings if implementation of at least two measures indicated in the energy audit is ensured.

In the framework of the activity, ERDF co-financing for the first call of project applications was available in the amount of LVL 2.9 million and co-financing from local government budget had to be ensured in the amount of at least LVL 960.2 thousand. The financing available for the next calls of project applications constitutes LVL 4 million, but the financing from local governments budget must be ensured in the amount of at least LVL 1.3 million. Contracts on implementation of heat insulation improvement measures in 56 social residential buildings have been concluded in the period from the end of 2008 until the end of 2010. For implementation of the above-mentioned measures, ERDF co-financing in the amount of LVL 5.1 million and financing from local government budgets in the amount of LVL 2 million has been attracted.

6.3.4. Tourism Policy

The main goal of Latvian 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 Ministry of Economics, other ministries and social partners of the tourism sector continue active work on solving different issues of the tourism sector. In order to promote cooperation between the ministries, local governments, enterprises, as well as associations and foundations, and to foster tourism development, the Latvian Tourism Advisory Council (LTAC) is actively continuing its work.

In 2010, the Advisory Council of the Latvian Tourism Development Agency (LTDA), comprised of authorised representatives from the Ministry of Foreign Affairs, Riga City Council, professional and regional tourism associations, as well as from the advertising sector, is also continuing its work.

Having regard to economical changes and new market situation related to the crisis, in close cooperation with representatives of tourism and advertising associations, Latvian universities and other social partners, LTDA has developed *Latvian Tourism Marketing Strategy for 2010-2015* (approved on March 16, 2010) specifying the vision and objectives of Latvian tourism development, as well as defining basic principles of Latvian tourism product development and marketing activities in target markets. Taking into account objectives and the vision of tourism development set out in the marketing strategy, new image of Latvian tourism, as well as the new slogan *Best enjoyed slowly* has been developed.

Cabinet Regulations No. 353 *Regulations regarding rights and duties of tourism operators, tourism agents and clients, the procedures for the preparation and implementation of package tourism service and the information to be provided to a client* came into force on June 14, 2010. At the same time, on June 14, 2010, free registration of tourism agents and tourism operators in the tourism agents and operator data base developed by the Ministry of Economics was launched.

In 2010, the Ministry of Economics has analysed possible legal framework for resort development, studied foreign experience and conducted a survey of enterprises. Currently amendments to the *Tourism Law*, as well as new regulations of the Cabinet of Ministers are being developed.

Box 6.8

The most significant changes in legislative acts regulating tourism

In 2010, the following significant changes have been made:

- reduced value added tax rate from 21% to 10% for guest accommodation services in tourist campsites (law of March 25, 2010 Amendment to the *Law on Value Added Tax*);
- provided relief to domestic producers – reduced requirements for acquisition of approved warehouse-keepers activity licences, right to receive relief for registration of excise duty security, as well as it is provided that trade of alcohol in summer cafes shall be regulated by binding rules of local municipalities (law of March 25, 2010 *Amendments to the Handling of Alcoholic Beverages Law*);
- specified procedure for displaying prices of alcoholic beverages offered for immediate consumption on the premises (*Procedure for displaying prices of products and services in cafes*, approved by the Cabinet of Ministers on 6 April, 2010);
- developed new regulation of the Cabinet specifying more precisely the obligations and responsibility of tourism agents and tourism operators, prescribing development of tourism agents and operators database, establishing a procedure for registration in the database, as well as for provision of security guarantee for money paid by customer *(Regulations regarding rights and duties of tourism operators, tourism agents and clients, the procedures for the preparation and implementation of package tourism service and the information to be provided to a client* , approved by the Cabinet of Ministers on April 13, 2010).

In order to ensure implementation of the state tourism policy as provided for in the *Tourism Law*, funding is allocated every year for tourism development in the framework of the public budget programme *Implementation of Tourism Policy* (in 2010, LVL 528.6 thousand are planned).

Box 6.9

Latvian tourism development indicators

The tourism sector has a significant role in Latvian national economy. According to tourism satellite account calculations of the Central Statistical Bureau, the share of tourism specific sectors in total value added has gradually grown to 8.3% in 2007. However, as a result of the economic downturn, decline was experienced also in the tourism. In 2008, the share of industries characterised by tourism in the total added value has reduced to 7.9 percent.

The tourism sector is a significant source of export income giving considerable contribution to national gross domestic product. According to CSB 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 2009, the number of border crossings made by foreign tourists reached 4.7 million, which is by 14.5% less than in 2008 (5.5 million). The average duration of visits of tourists in Latvia was 1.3 days, but average expenditures per day grew to LVL 56. Along with the decrease in the number of border crossings made by tourists, the number of total expenditures of foreign tourists in Latvia decreased as well, reaching LVL 344.1 million, that in comparison with 2008 (LVL 403.2 million) is by 14.7% less.

Although, taking into account the negative balance in outgoing tourism, the tourism balance of payments has been improving, nevertheless its indicators were still negative – expenditures of the residents of Latvia abroad in 2009 exceeded the expenditures of foreign tourists in Latvia by LVL 64.3.

According to data provided by the CSB, at the end of 2009, there were 559 tourism campsites in Latvia, which is by 68 campsites more than at the end of 2008. However, the number of persons served in hotels and other tourist campsites in 2009 decreased by 28.4%, reaching 1113.9 thousand.

In the Cabinet of Ministers meeting on September 21, 2010, the sub-activity 2.3.1.1.2 *Access to international trade markets – strengthening international competitiveness of industry sector* of the activity 2.3.1.1. *Access to international trade markets* of the amendment to the operational programme *Entrepreneurship and Innovations* was accepted, which was developed in order to implement targeted strengthening of international sector competiveness and to support enterprises entering into foreign markets. Within the framework of the above mentioned sub-activity, support in the amount of LVL 1.5 million was provided. Co-funding for LTDA is allocated for a period of three years (the maximum term for implementing activities is July 1, 2015), to organize national stands in international exhibitions abroad, as well as advertising campaigns to popularize Latvia as a tourist destination.

International cooperation in the field of tourism

In 2010, Latvia continued developing and strengthening closer cooperation in the field of tourism with other countries. 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.

Continuation of successful cooperation in the tourism sector was discussed during the 6th Meeting of the Latvia-Belarus Intergovernmental Commission for Economic and Scientific Cooperation in Minsk, 3rd Meeting of the Latvia-Kazakhstan Intergovernmental Commission for Economic, Scientific and Technical Cooperation in Riga, 4th Meeting of the Latvia-Russia Intergovernmental Commission for Economic, Scientific-technical, Humanitarian and Cultural Cooperation in Pskov, as well as 3rd Meeting of the Latvia-Ukraine Intergovernmental Commission for Economic, Industrial, Scientific and Technical Cooperation in Riga.

In 2010, the Ministry of Economics repeatedly ensured coordination and approval of the draft agreement between the Republic of Latvia and the Government of the Russian Federation on Cooperation in the Field of Tourism. The agreement was adopted and approved in the Cabinet of Ministers Meeting on November 23, 2010. It envisages strengthening the development of group and individual tourism, cooperation of public and private sector, information exchange, cooperation in the framework of international organisations, exchange of journalist and expert delegations, as well as implementation of training and research.

In order to ensure further international integration of Latvian tourism sector, representation of state interests, and adoption of better practice, international cooperation is being developed, e.g., taking part in the European Travel Commission of the United Nations World Tourism Organisation, Tourism Advisory Committee, and Sustainable Tourism Working Group of the European Commission.

Having regard to that for the very first time political support has been achieved at the European Union level, on June 30, 2010 the EC published the Communication *Europe, the world's No 1 tourist destination – a new political framework for tourism in Europe*, which is considered as a significant step towards development of a single EU tourism policy framework, keeping the status – Europe as the most attractive tourist destination in the world. In the annual European Tourism Forum, which took place in Malta on November 18-19, 2010, the EC presented the draft implementation plan of the Communication envisaging specific actions, key players for every action and timeframe according to the identified priorities.

6.4. Business Environment

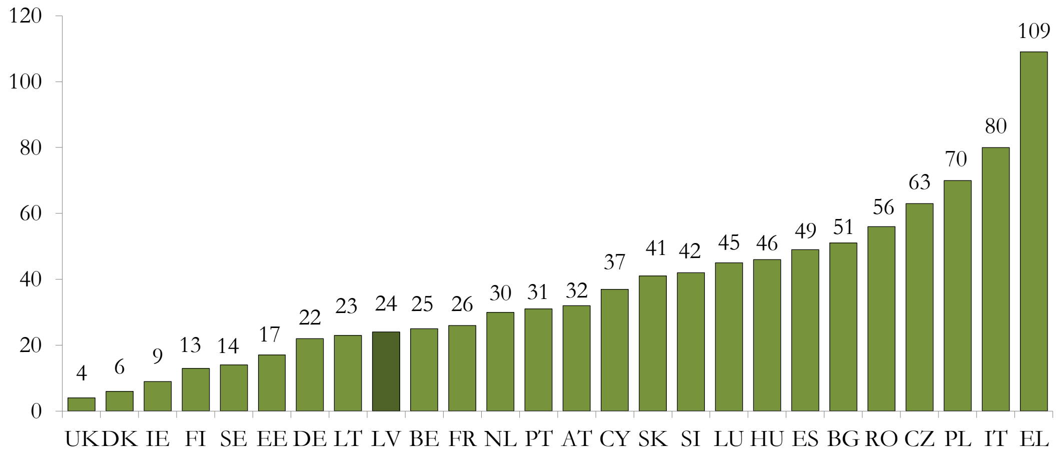
The study *Doing Business* (DB) performed by the World Bank, as well as the *Study of Administrative Procedure Impact Upon Business Environment* are the most popular measures for evaluating business environment, with the aid of which the opinion of entrepreneurs about the factors preventing their activity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

In 2011, Latvia holds the 24th position in the world in the DB rating, which is by 3 positions higher than in the report of 2010, while Estonia holds the 17th position, but Lithuania – the 23rd position. Latvia is ranked among those countries (85% of all countries covered in the DB study), where reforms carried out during last 5 years have facilitated entrepreneurship, meanwhile our neighbour countries Estonia and Lithuania have been placed in the group where it has become more difficult to carry out business activities.

Table 6.8

Positions of Latvia and other EU countries within the World Bank study *Doing Business* for 2011

(Business Environment (in general))



In 2011, the improvement of Latvia's position in the DB rating has been achieved due to the reforms implemented in the field of cross-border trade – by introducing an electronic customs declaration system, thus reducing the time required for export-import procedures, as well as reforms in the field of improving insolvency process, by introducing an out-of-court settlement process and by reducing the insolvency procedure period. Also, reforms in real estate registration procedures have contributed to the increase, by introducing the possibility for Land Register judges to verify the payment of real estate taxes online.

The objective of the Plan for 2010 is "faster, cheaper, less procedures" focusing on such fields as electronic government, starting a business, tax administration, trading across borders, registering real estate, improving regulation of construction. 22 measures for 2010 have been included within the Plan (38 sub-measures). 13 measures and 29 sub-measures have been fulfilled in the 3rd quarter of 2010, and the fulfilment of the other measures is continued.

Amendments to the *Commercial Law* came into force on May 1, 2010, envisaging the following in the **field of business start-ups**:

- the possibility to establish a limited liability company with equity capital below LVL 2000;
- not to submit samples of signatures of company officials, etc.

The total number of the reduced capital companies registered in the Commercial Register from May to October (including) 2010 is 3203 limited liability companies or 52% of the total number of limited liability (LTD) companies.

The *Law on Tax for Micro-enterprises* came into force on September 1, 2010. In the meeting of the Cabinet of Ministers of August 31, 2010, *Regulations on Micro-enterprises Tax Declaration and Procedure for Filling Thereof* were approved, envisaging a simplified micro-enterprises declaration form and procedure for filling thereof. Methodological guidelines for the law above have been developed. According to the State Revenue Service data, 1166 micro-enterprises tax payers were registered by November 5, 2010.

In the field of tax administration, a range of measures promoting business has been carried out:

- the possibility to submit an application for registration in the VAT payers register together with an application for an enterprise entry into the Commercial Register is ensured;
- the number of days necessary for registering VAT payers is reduced from 15 to 10;
- the conditions for writing-off bad debts have been simplified, providing an opportunity to

make savings for doubtful debts in the period of 2011-2013;

- the procedure for declaring and administering the European Union tariff quotas has been simplified, envisaging that an enterprise shall not submit two applications anymore – an application for a tariff quota declaration and an application for repayment of overpaid taxes are now included in one application;
- a fiscal representation institute is planned to be implemented in the near future, while promoting development of "distribution centres" in Latvia (as of December 1, 2010, the draft law Amendments to the *Law on Value Added Tax* has been approved in the second reading in the Saeima);
- it is planned to simplify the requirements for usage of VAT invoices as a source document in accounting (by December 1, 2010, the draft law Amendments to the *Law On Accounting* has been approved in the second reading in the Saeima);
- restriction aspects regarding repayment of overpaid VAT in case of criminal procedure against an enterprise are being revised and relevant amendments will be worked out, if necessary.

In the field of real estate, a draft law on Amendments to the *Law On Local Governments* has been adopted on October 1, 2010; this draft law proposes that the local governments should justify their pre-emption rights not only with the need to use this property for performing functions of the local government, but also with the documents on territory development planning of the respective real estate for performing this function. Likewise, the procedure and terms for using pre-emption rights of local municipalities is specified, defining that a notice of rejection on exercising the pre-emption rights shall be issued within 5 working days.

In the field of construction, the *Construction Law* was submitted to Saeima on June 6, 2010, envisaging a simplified construction administration process, refusing the numerous intermediate decisions in order to harmonize construction within 70 days.

In order to improve efficiency and transparency of purchases **in the field of electronic government,** the Cabinet of Ministers on April 20, 2010 approved a Plan for the *Improvement of Electronic Purchase System Usage for 2010-2012* that envisages a number of measures to promote usage and development of electronic purchases (e-purchases). According to the e-purchase type (electronic auction, e-competition and electronic catalogue) the improvements would allow simplifying the purchase process and ensuring more favourable provisions for the supply or rendering of services, as well as would ensure a number of other preferences.

In order to develop the necessary legal base, a *Draft Concept on the Implementation of One-Step-Agency Principle in the Accessibility of State and Local Government Services* is developed. The Draft project contains a strategy for improvement of the services delivery rendered by the state and local governments and ensuring their accessibility in all territory of the state until 2013 – in physical presence or absence (by organising delivery of services based on a unified system according to single principles in compliance with the administrative-territorial division of the country taking into account base of 118 local governments).

In order to determine the process of preparing and drawing up original documents, their derived versions, and duplicates, as well as documents included in the administration document system, Regulations of the Cabinet of Ministers of September 28, 2010 on *Procedure for Document Preparation and Drawing up* was approved, thus specifying the requirements and groups for documents constituting such systems to be observed when preparing and drawing up documents included in the administration document system.

At the same time, amendments to the Regulations of the Cabinet of Ministers of June 28, 2005 *On Procedures for the Preparation, Processing, Storage and Circulation of Electronic Documents in State and Local Government Institutions, and the Procedures according to which Electronic Documents are Circulated between State and Local Government Institutions, or Between These Institutions and Natural Persons and Legal Persons* were developed.

The State Chancellery has implemented two studies *Performance Assessment of Institutions Supervising Educational Institutions* and *Performance Assessment of Institutions Supervising Enterprises*. On this basis, the State Chancellery prepared report of functional audit. It includes an evaluation of the main controls of enterprises, supervision, inspection, certification and an accreditation function implemented by public institutions, as well as provides proposals for identifying minimum functions and tasks of enterprise control, supervision, inspection, certification and accreditation functions implemented by public institutions (state and municipal) to eliminate administrative obstacles and barriers.

Overall, a study in 11 sectors of Latvian economy was carried out (according to NACE classification). The conducted study was used for preparing more than 75 proposals for diminishing administrative burden. According to information provided by enterprises, the potential savings for enterprises in the 11 sectors above would be LVL 19.5 million per year. Moreover, considering that several proposals would apply to enterprises of other sectors, it is forecasted that the overall savings for enterprises in Latvia will be even larger.

By the end of 2010, a draft order of the Cabinet of Ministers on the measure to be carried out for diminishing administrative burden imposed on inhabitants and enterprises is planned to be developed.

At the same time, the State Chancellery continues to implement the project *Reduction of Administrative Burden and Simplification of Administrative Procedures* aimed at reducing administrative barriers (administrative burden) for enterprises, inhabitants and non-governmental organizations, thus improving the business environment, promoting simplified administrative procedures, as well as improving public service quality and availability. The project is planned to be implemented by February 28, 2014.

6.5. Innovation and New Technologies

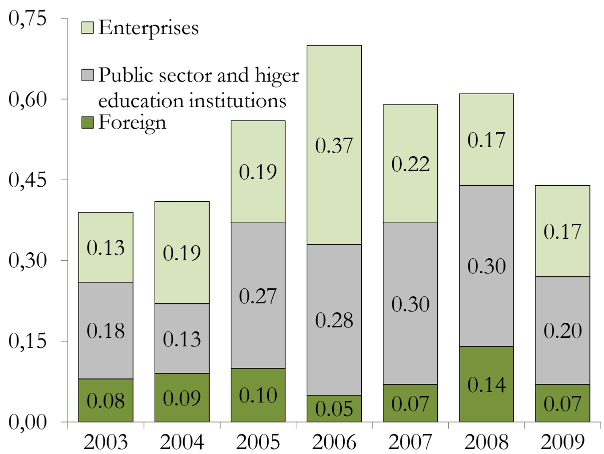
The total financing for research and development in Latvia in 2009 was reduced by almost 40% compared to last year and was LVL 59.9 million or 0.5% of the GDP. The most rapid decrease was observed in financing for research of foreign and public sectors. Financing from the foreign sector, including the EU Structural Funds financing for research and development, constituted LVL 9.2 million i.e. 0.07% of the GDP. Financing for research and development in the sector of public and higher education institutions in 2009 was 0.2% of the GDP or LVL 28.6 million, and the contribution to this sector has been reduced to the level of 2005. Yet, contribution originating from the private sector to research and development in 2009 was 0.2% of the GDP or LVL 22.1 million, which in actual figures is by 18% less than in 2008.

Total financing for research and development in 2010-2011 is likely to be reduced because the state budget financing for scientific activity and innovation supporting measures will continue to reduce. It is planned that partly this reduction could be compensated by the EU Structural Funds financing for such research and development activities as support for business researches, support for competence centres, and support for scientific infrastructure development.

Figure 6.9

Funding for research and development for 2003-2009 by sectors

(% of GDP)



In 2010, mainly the activities launched during the previous years were continued in order to foster industrial research, development of new products, and their introduction into the market.

In 2010, the IDAL (Investment and Development Agency of Latvia) launched implementation of the State Support Programme *Competence Centres*. The programme is mainly aimed at implementing cooperation of scientists and enterprises and at increasing competitiveness of enterprises by promoting cooperation of the research and industry sectors to implement new product and technology development projects. The programme is financed from ERDF resources. The total public funding for the programme is LVL 36 million and it will ensure the attraction of private sector funding for research and development measures in the amount of LVL 12.1 million. The Project applications were accepted from August 2, 2010 until September 30, 2010. The call for projects is planned to be concluded at the end of 2010 and the implementation of 5-6 competence centre projects will be launched in the first half of 2011.

In order to promote technology transfer, IDAL continues to support the activity of 8 technology transfer contact points (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 programme is financed from ERDF resources. The total public funding available within the framework of the activity until 2013 is LVL 1.93 million.

In the framework of the Enterprise Europe Network project for 2010, IDAL in cooperation with the Latvian Technological Centre continues to support technology transfer among enterprises. In 9 months of 2010, technology audits have been performed in 32 enterprises; conclusion of 7 technology transfer contracts has been initiated; 25 informative workshops regarding technology transfer issues, creative thinking and innovation have been organised.

IDAL in cooperation with LLC "Virtual CEO" continued to implement joint international technology development and commercialization project ***Commercialization Reactor*. The aim of the project is to establish rapidly growing, internationally competitive technology enterprises, by commercializing technological developments prepared in CIS states and Latvia**. In 2010, two reactor measures were organized in May 25-27 and November 9-11. Overall, 28 technologies were presented in both measures and during the measures several letters of intent on further technology commercialization were concluded. In the framework of the measures enterprises had an opportunity to get acquainted with different technology presentations, participate in establishment of specific teams (entrepreneur and scientist) and take part in an investment readiness seminar together with team partners and present their projects to potential investors. Besides, IDAL continues to provide advisory support to the established teams for foundation and development of enterprises also after completing the measure.

In 2010, IDAL continued to support projects approved within the framework of the EU Structural Funds programme *Support to Introduction of New Products and Technologies into Production* and *Development of New Products and Technologies*. In the framework of the EU Structural Funds programme *Support to Introduction of New Products and Technologies into Production*, enterprises have the possibility to submit their projects for the second project selection round from November 15, 2010 until February 1, 2011. Within the framework of the second project selection the available funding is LVL 34.02 million. In the framework of this programme, enterprises can receive support for such initial investments in fixed assets (equipment purchase and installation, patent and licence purchase) that directly ensure introduction of new products or technologies into manufacturing.

In 2010, IDAL continued implementation of the EU Structural Funds programme *Measures to Encourage Innovations and Business Start-ups*. The goal of the programme is to inform and encourage a maximum number of individuals, especially youth, to start business activities, raise the prestige of entrepreneurship, foster understanding of the society about the role of innovations in promotion competitiveness, as well as to inform the society about events related to innovations and about their potential, thus encouraging as large part of the society and entrepreneurs as possible to turn to development and use of innovative solutions. In the framework of the programme for 2010, debate competitions, technical innovation days, and several seminars in regions were organized, as well as a seminar cycle *Innovative Business Start-ups* was held. A Mentoring Programme was implemented for the new entrepreneurs, providing mentor services to 30 new enterprises. In 2010, special attention was paid to fostering pupils' interest in innovation and business. In the framework of these measures, around 600 pupils had the opportunity to learn about the basics of business start-ups and about the possibilities, as well as to learn about the experience of regional entrepreneurs in business development; the pupils also had an opportunity to participate in various creative activities. Also, the annual competition of business ideas *Idea Cup 2010* was implemented. Any citizen of Latvia may submit their own business idea for the competition and, in the framework of the competition, can get an evaluation of the idea and an opportunity to participate in educational workshops on business organization and management. 677 ideas were submitted for the competition of 2010, and the winning suggestion was an idea about developing a secure bicycle stand which guarantees absolute security of bicycles and protects them from stealing.

In order to stimulate broader discussion on topical issues in the field of innovations, the international conference *Baltic Dynamics 2010 – Knowledge Flow in Innovation System: From Idea to Action* was organized in September 15-17, 2010 in Riga. The conference was organized by the Latvian Technological Centre in cooperation with the Baltic Association of Science/Technology Parks and Innovation Centres and the Investment and Development Agency of Latvia. The European Commission, the International Association of Science Parks and the Enterprise Business Network supported the conference as well. Overall, 350 participants from 30 countries attended the conference.

6.6 Information Society

Information society is a social development phase based on free mutual exchange of information, 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 (ICT) [1] information and knowledge are increasingly used in work and in labour relations, education, and everyday life.

According to the data of the Central Statistical Bureau of Latvia (CSB)[2], the share of ICT sector in the GDP reached 3.3% in 2009. In 2009, 2636 companies operated in the ICT sector in Latvia, employing

[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 loaded electronic boards; manufacture of computers and peripheral equipment; manufacture of communication equipment; manufacture of consumer electronic equipment; manufacture of magnetic and optical media), ICT wholesale (wholesale of computers and their peripheral equipment and software; wholesale of electronic equipment, telecommunications equipment and its components) and rendering of ICT services (software publishing; telecommunications; computer programming, consulting and other related activities; data processing, hosting and other related activities, web portals; repairs of computers, their peripheral equipment and communication equipment).

[2] As the whole EU statistical system has experienced transition from the Statistical Classification of Economic Activities NACE 1.1 revision to NACE 2nd revision, the data published in this section concern only year 2008, 2009, and 2010. Due to the methodological changes above the data cannot be compared to those published in the previous years as the range of enterprises to be surveyed has significantly changed.

16 765 persons, the enterprise turnover reached LVL 1.3 billion, staff costs – LVL 178 million. The value added of ICT production reached LVL 15 million, provision of ICT services – LVL 344 million. The foreign trade balance of ICT was negative: LVL 57.4 million, because the imports exceeded exports considerably, which were LVL 259.3 million and LVL 201.9 million, respectively.

It should be noted that in 2009, import of ICT production decreased by 41.7%, while export remained unchanged, in comparison with 2008.

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 near the average EU level. The most rapid progress has been observed in broadband internet accessibility, 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) slightly exceeds the average EU level (60%), but usage purposes of internet are very varied. The number of those internet users who read news on the internet, use internet bank, 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.

Box 6.10

The usage of computers and internet in Latvia

According to the data of the 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 (computer – 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%). In total, 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). However, 53% of all households had broadband internet connection.

At the beginning of 2010, 95% of all enterprises having 10 and more employees had computers, 91% of such enterprises had internet connection and 49% of enterprises had their own internet website. In 2009, 73% of companies having 10 and more employees used internet for communications with the public and local government institutions. In 2010, 31% of all employees of enterprises used a computer on a regular basis, while computer 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 from 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.

Along with Latvia's accession to the EU, the EU initiatives related to development of the information society have become binding for Latvia
(see Box 6.11).

In the European Commission's communication *A Digital Agenda for Europe* adopted on August 26, 2010 a new aim is set – according to the *EU 2020 strategy* to gain economic and social benefits from digital single market based on fast and particularly fast internet. *A Digital Agenda for Europe* includes more than 101 legislative initiatives and a number of EU, regional and member states' measures of horizontal level of seven areas in three dimensions of the *EU 2020 strategy*: social, environmental, and global dimension (see Box 6.11).

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 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*, etc., as well as developed implementation programmes and action plans of these guidelines.

Development of information society and e-government is analyzed in informative reports. Among them, 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 submitted also the 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 EU structural funds, as well as state and local governments' budget is used for development of electronic government and information society. The total available ERDF funding constituted LVL 96.6 million.

Box 6.11

European Union initiatives in developing the information society

On November 18, 2009, in Malmö (Sweden) the ministers responsible for the e-government signed a declaration that provides common future vision and policy priorities that must be implemented by 2015. The main goals that must be achieved by the member states together with the European Commission within the next 5 years are the following:

– to provide an opportunity for enterprises and population for easier access to information when using e-government services and to involve them more actively in the policy development process;
– to promote mobility in the single market by unifying the e-government services for the foundation of enterprises, studying, working, living, and retiring in Europe;
– to increase efficiency of e-government by reducing administrative burden, improving government organization processes and using ICT for the improvement of energy efficiency that will make a bigger contribution in sustainable economy with low carbon dioxide emissions.

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 strategy*. The aim of this program is to gain economic and social benefit from a digital single market based on fast and particularly fast internet. 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 investments in research and development, broadening of digital competence skills and inclusion, as well as application of information and communication technologies, in order to solve problems topical for the society, for example, climate change and ageing of the society. Advantages include simpler electronic payments and invoices, opportunity to use fast remote health services, and 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 worked out 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 implemented mainly in 2010-2015.

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 to efficiency and competiveness of all manufacturing sectors and services. Three priorities are set for this purpose:

– to ensure availability of low-price, world-class communication infrastructure and all sort of services for enterprises and citizens;
– every single 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 support Latvia in development of information society, Riga was approved to be the location for the Body of European Regulators for Electronic Communications (BEREC) by voting of the Ministers of the European Transport, Telecommunications and Energy Council on May 31, 2010 in, Brussels.

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 6.12).

Box 6.12

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 EU 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 with the total eligible costs of LVL 62.2 million, and 21 planned projects with the total eligible costs of LVL 36.7 million. State budget financing forms 15%, but 85% is co-financing from the EU funds. The implementation of the projects is planned within 1.5-3 years.

The largest financing (at least LVL 2 million) is provided for such projects as the 2nd level 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 level of development of the Portal *www.skolas.lv* (LVL 3.1 million), the 2nd level 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 for the development of Information System of Electronic Health Card and Integrity Platform (LVL 2.5 million), E-services and development of its infrastructure (LVL 2.4 million), development of Geospatial Information System of the State Land Service geospatial data (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), as well as development of the Joint Geospatial Information Portal and linking of the sectoral GIS with the portal (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. Overall, funding in the amount of LVL 4.5 million or 4.6% of available funding was absorbed by September 30, 2010.

Electronic services

According to the *Eurostat* data, Latvia in 2009 had introduced 65% of 20 basic electronic services (EU average – 74%). As most of the EU member states have already introduced all 20 basic electronic services, the EU develops currently a new methodology that will allow analyzing accessibility of e-government also in the future. The internet portal *www.latvija.lv* is a single contact point for the services of the state and local governments in Latvia. In total, information about almost 1500 services is available in the public services catalogue. Since June 2010, it is possible to register an enterprise in the Register of Enterprises electronically.

Information on e-procurement and development of e-services is available now 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.vidm.gov.lv*).

On January 12, 2010, the Cabinet of Ministers approved the *Concept on Electronic Identification Cards* developed by 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 an e-signature carrier. The Office of Citizenship and Migration Affairs plans to start issuing cards on May 2011. In order to ensure that the electronic identification card could be used just as a passport in the whole territory of EU, a Draft Law *On Personal Identification Documents* has been prepared.

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 purchase in the centralized e-procurement system or e-catalogue such 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 the first half of 2010 reached LVL 2.1 million (in 2009 – LVL 3.4 million), the number of goods in e-catalogue reached 40 thousand. The largest part was made by the procurements of computer technologies, printing equipment and medicaments.

Broadband internet

According to the *Eurostat* data, in Latvia in 2009, the number of broadband internet access lines has reached 17.5 (EU average – 23.9) 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 latest data published on the internet about the speed measure on the website *speedtest.net* of the internet research company "Ookla Net Metrics" in December 2010, Latvia with the download speed 25.8 Mbit/s takes the 2nd place and with the upload speed 13.9 Mbit/s – 3rd place among 185 countries. Such results are reached due to investments of the largest Latvian telecommunication enterprises in development of the optical cable. For instance, the optical network internet of the enterprise "Lattelecom" by the end of 2010 was available for 300 thousand households mainly in Riga and 12 largest cities of Latvia, but by the end of 2011 the access is planned to be ensured for 400 thousand households in 23 cities of Latvia.

It is planned to improve the broadband internet infrastructure by attracting ERDF financing from the action programme *Infrastructure and Services*, and that would ensure 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 computer programme copyright protection organisation "Business Software Alliance", the level of computer piracy in Latvia remained at 56% in 2009 (the level has not changed since 2006), while the losses to Latvian economy caused by piracy have decreased to LVL 12 million.

The level of computer piracy is considerably reduced by possibilities to use free and open code software. In 2009, 12.5% of all enterprises used such software, in 2010, the number of such enterprises increased to 25.4 percent.

E-commerce

According to the CSB data, 39% of all internet users in 2009 had at least once in a life purchased and ordered goods or services over the internet for individual purposes. But 72% of internet users had used internet banking in 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 over the internet or other networks. The goods and services purchased by enterprises over the internet and other computer networks constituted 3.9% of the total purchases in 2009, but the turnover of the sold goods amounted to 6.5% of the total net turnover (EU average – 14%).

6.7. 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 growth and employment.

Box 6.13

The number of small and medium-sized enterprises in Latvia

There were 71 thousand economically active individual enterprises and commercial companies (provisional information) in Latvia in 2009 (excluding agricultural and fishing farms and self-employed persons, who perform economic activities), 99.5% of which belonged to the category of SMEs. The distribution of economically active SMEs in Latvia is the following: micro enterprises – 82.6%, small enterprises – 14%, medium-sized enterprises – 2.9%, large enterprises – 0.5%.

An important indicator characterising the economic activity is the number of economically active enterprises and commercial companies per 1000 inhabitants. This indicator in Latvia has grown constantly over the last 8 years from 17 in 2001 to 31 in 2009.

However, it is equally important to emphasize the number of performers of individual work (self-employed persons) in 2009 (provisional information) – 45.2 thousand (20 per 1000 inhabitants), as well as the number of agricultural and fishing 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 the indicator characterising the economic activity as the number of enterprises per 1000 inhabitants, it is difficult to conduct objective comparative analysis of this indicator. The current practice of the responsible EU institutions shows that calculation of the number of enterprises per 1000 inhabitants includes not only businesses and commercial companies, but also self-employed, agricultural and fishing farms, etc. Therefore, applying an analogous practice accordingly, in 2009, Latvia had 57 performers of economic activity per 1000 inhabitants.

According to the statistical data of "Lursoft" and Register of Enterprises, in year 2009, 9228 subjects were registered in the Register of Enterprises and Commercial Register and 5725 subjects of the Register of Enterprises and Commercial Register were liquidated. 11 770 subjects were registered, but 8433 – liquidated within 11 months of the year 2010.

Aid to SMEs in Latvia is regulated by the *Law on Control of Aid to Commercial Activity*, which came into force on January 1, 2003.

Box 6.14

Definition of SMEs

Definition of SMEs 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 accordingly for 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 annual balance sheet value is under EUR 43 million;

small enterprises:
- number of employees: 10-49;
- annual turnover does not exceed EUR 10 million;
- total annual balance sheet value is under EUR 10 million;

micro enterprises:
- number of employees: 1-9;
- annual turnover does not exceed EUR 2 million;
- total annual balance sheet value is under EUR 2 million.

On June 28, 2007, the Cabinet of Ministers approved the *Programme on Promotion of Entrepreneurship Competitiveness and Innovation for 2007-2013*.

The programme covers activity policy for promotion of business competitiveness, innovative activities and industrial development setup, describing the vision of competitiveness, innovation and industry development for the next 7 years. The main objectives of the programme are to provide favourable conditions for business development, to promote the increase of capacity and efficiency of the *National Innovation System*, to achieve substantial growth of industrial competitiveness and productivity, fostering increased volumes of manufacturing products with high added value.

The programme aims to introduce politics based on the best practices of developed countries according to the scope of activities stipulated in the *European Charter for Small Enterprises* and other documents of EU, at the same time also taking into account problems related to development of SMEs specific for Latvia.

Box 6.15

Activities of the EU for promoting entrepreneurship

On June 25, 2008, the European Commission approved the statement *A Small Business Act for Europe*, mainly aimed at integrating the use of *"Think Small First"* principle in preparation of political documents, improving overall political approach to business activity, particularly promoting development of small and medium-size enterprises, and helping to eliminate obstacles preventing its development. The Act includes proposals for 10 politically binding guidelines and several specific regulations.

In order to reach the aims set out in the *Act,* in the year 2009, the European Commission commenced an extensive campaign – *European SME Week*, thus providing the current and future entrepreneurs with information about activities of the European Union, Member States, regional and municipal authorities for 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 until 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 entrepreneurs, conferences, contact exchanges, regional and thematic seminars were organized in the context of *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 – LLC "Madara Cosmetics" – was honoured during these events. In general, more than 15 informative events for entrepreneurs were organized in Latvia, engaging over 3000 entrepreneurs.

On October 30, 2009, the Cabinet of Ministers approved the *Conception of Support Measures for Micro Enterprises* with the aim of creating the necessary preconditions to encourage unemployed people to start business activity, improving business environment fostering operations of micro-enterprises, reducing the unemployment level, as well as developing the skills of an entrepreneur, thus increasing the share of entrepreneurs in the total number of employed citizens. In order to implement the aim of the Conception, the following fields of activity are necessary:

- reducing the costs related to launching commercial activity of micro-enterprises;
- implementing a tax policy, which is friendly for micro-enterprises;
- ensuring that the micro-entrepreneur is able to do their own accounting;
- ensuring availability of funding for micro-enterprises;
- ensuring availability of complete information for micro-enterprises.

Currently the Conception is being successfully implemented and amendments to relevant normative acts are being made. Relevant measures implemented within the year 2010 are the following: reduction of the state duty to be paid when registering an enterprise in the Register of Enterprises by 50% in order to decrease costs of business start-up, provision of possibility to establish an enterprise with reduced equity capital, introducing the tax of micro-enterprises, establishing the possibility to apply patent fees to economically active persons, and provision of an accounting programme for micro-enterprises free of charge.

As amendments to the *Commercial Law* came into force in May 2010, the costs for business start-up were significantly reduced, stipulating that a limited liability company can be founded with an equity capital below LVL 2000. At the same time, it was stipulated that the following applies when registering the afore-described limited liability company:

- the state duty is LVL 15, charge for an advertisement LVL 12.60;
- there will be no state duty for registering changes in equity capital and advertisements related to increase of equity capital.

The total number of enterprises with a reduced equity capital registered in the Register of Enterprises (from May 2010 until October 2010 including) amounts to 3203, which is 52% of the total number of limited liability companies.

As from January 1, 2010, as an optional rule, an individual person performing economic activity in particular trades or activities can choose to pay a patent fee. The patent fee is a final tax payment which includes the personal income tax and mandatory state social insurance contributions for the economic activity of the individual person in a particular profession. The patent fees apply to more than 60 professions (mostly to craft services), their monthly payments are particularly stipulated for each group and they amount to LVL 30-70 per one calendar month. Persons paying the patent fee are provided with appropriate social guarantees.

As from September 1, 2010, individual merchant, individual proprietorships, agricultural and fishing farms, individual persons registered in the State Revenue Service as persons performing economic activities, as well as limited liability companies can obtain the status of the payer of micro-enterprise tax if they comply with the following criteria:

- members are individual persons;
- the turnover does not exceed LVL 70 thousand per calendar year;
- the enterprise employs less than 5 employees.

The tax rate applying to micro-enterprises is 9% of the turnover or income from economic activity. The micro-enterprise tax comprises mandatory 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 enterprise for the income part of the economic activity of the micro-enterprise. 1166 micro-enterprise tax payers were registered in the State Revenue Service from September 1, 2010 until November 5, 2010, and 308 will obtain this status as from January 1, 2011.

Box 6.16

Forum for discussions of owners of small and medium-sized merchants

In order to provide communication with SMEs and hear the opinion of entrepreneurs, moreover, to achieve that this way of communication would be productive for all interested parties, the Ministry of Economics has established SMEs discussion platform.

In this forum, the entrepreneurs are welcome to participate in solving issues relevant to development of SMEs and adopting recommending decisions regarding these issues, as well as to identify problems which impede development of SMEs in Latvia, jointly elaborate solutions for improving the situation, and discuss specific issues directly referring to small and micro-enterprises.

In order to integrate also regional entrepreneurs, the meetings are organized as e-seminars (webinars) as well taking online, and each interested person, by previously registering and enabling the unique link, can view the materials presented by the lecturer on the screen, follow the discussion, and ask questions verbally or in writing.

There were two such seminars organized in the second half of the year 2010, where the participants discussed support instruments for small and medium-sized enterprises – services and possibilities provided by the Business Incubators and ALTUM support programmes of the Mortgage and Land Bank of Latvia for SMEs, as well as support measures for micro-enterprises.

The Ministry plans to communicate with entrepreneurs, organizations and public through e-seminars (webinars) also further in order to inform entrepreneurs, public and other interested parties about the latest events, as well as to ensure mutual communication.

The Mortgage Bank of Latvia, which is the only 100% state owned bank in Latvia and performs the functions characteristic for a development bank, plays a substantial role in trading support instruments.

Box 6.17

Transformation of the Mortgage Bank into a Development Bank

In December 2009, the Cabinet of Ministers accepted the conception *Transformation of State Joint Stock Company "The Mortgage and Land Bank of Latvia" into Development Bank*. The aim of the conception was to select the optimal versions for transformation of the Mortgage Bank into a development bank, reducing the number of transactions of a commercial bank and focusing the work of the bank on directions currently crucial to national economy.

In accordance with the decision of the Cabinet of Ministers, the 1st model of the conception was approved providing foundation of a development bank on the base of the Mortgage Bank and gradual discontinuation of commercial functions not later than until December 31, 2013. The Mortgage Bank will phase out the amount of commercial loan portfolio and at the end of 2013 will implement the remaining unpaid commercial loan portfolio or transfer it for servicing to other financial institution according to the situation of that particular moment. 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 small and medium-sized enterprises, financing of business activity start-up, promotion of micro-enterprises and self-employment, financing of innovative, technologically intensive, and high added value projects, funding for production of goods and rendering of services competitive in the international market, implementation of energy efficiency measures, development of agriculture and rural areas, particularly focusing on fostering and engaging the specific socially sensitive population groups (for example, the disabled, unemployed, new families, national minorities) in self-employment and commercial activity.

In 2010, the Mortgage Bank continued the implementation of both existing and new development programmes, in the framework of which specific groups of merchants and citizens are supported:

- co-financed by ERDF *Support Programme on Improvement of Competitiveness of the Enterprises*;
- co-financed by ESF *Support Programme on Support for self-employment and business start-ups*
- Micro Crediting Programme of Latvian Small and Medium-Sized Enterprises;
- SME Growth Loan Programme;
- Programme of Agricultural Current Assets.

Currently, the most significant support programme implemented by the Mortgage Bank is the *Support Programme on Improvement of Competitiveness of the Enterprises* approved by the Cabinet of Ministers in May 2008. The support within the programme is provided to small, medium-sized, and large enterprises registered in Latvia, which have economically reasonable further activity plans, but cannot receive funding from credit institutes due to the increased risks. Under the programme, loans for investment will be granted (up to LVL 5 million) and current assets loans (up to LVL 2.5 million), with a 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*, 356 loans have been allocated in the amount of LVL 145.3 million, among which loans in

[1] Currently, the total amount of programme resources amounts to LVL 128.8 million. Programme funding comprises resources of Northern Investment Bank (NIB) (LVL 70.2 million), ERDF (LVL 43.3 million), as well as funding of the Mortgage Bank (LVL 15.3 million).

the amount of LVL 90.9 million have already been granted. 48 loans in the amount of LVL 57.4 million were granted from the part of the programme funded by ERDF, including loans amounting to LVL 19 million[1]. The fields receiving most funding are timber processing, metal working, electricity production, and food production.

The programme *Support for self-employment and business start-ups* co-funded by ESF*,* approved by the Cabinet of Ministers in March 2009*,* **provides complex support to business start-ups and newly established companies, i.e. consultations, training, and financial loans** (up to LVL 54 thousand) **and grants**[2] **for starting an economic activity.** Support may be granted to persons of the working age, including unemployed persons, who have expressed the wish to start commercial activity or self-employment, as well as to the newly established companies. For the purposes of this programme, newly established companies are companies that have lawfully registered their activity not earlier than 3 years before requesting the support under the programme. The amount envisaged in a business plan may not exceed LVL 60 thousand, and at the same time the beneficiary must provide co-financing in the amount of at least 10% from the total amount of the plan for projects with the loan amount exceeding LVL 5 thousand for implementing 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 17.5 million is envisaged for loans, while LVL 4 million – for grants, training and consultations. It is planned that during implementation of the programme 1200 start-ups will be trained by the end of 2013, while funding (loans and grants) will be granted to 600 persons.

The practical implementation of the programme was launched in August 2009. Since launching of the programme, cooperation agreements with 1091 entrepreneurs have been concluded, 432 clients have submitted business plans, including 226 start-ups projects have already been funded for the total loan amount of LVL 3.24 million. For 210 projects, grants for the total amount of LVL 986 thousand have been awarded. 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[3] since January 2010. Training is available for persons wishing to start economic activity or for persons, who have started it during the preceding year. Training according to a modular approach is available on such modules as *basics of business activity (organisation of a small business), management basics, legal framework for entrepreneurship, finance management of an enterprise, economic activity accounting and taxes, and marketing basics.* So far, 786 participants have been trained in 69 training groups. *Inter alia*, 57 groups have already completed the course, thus the number of participants having completed the training is 489 people. Training so far has been organized in Riga, Jelgava, Kuldīga, Valmiera, Cēsis, Rēzekne, Balvi and Daugavpils.

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 starting a business activity or developing it. The micro credits up to the amount of LVL 3 thousand are intended for implementation of business projects – loans for investments and current 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, the Mortgage Bank has allocated 272 loans for the total amount of LVL 745 thousand, of which loans in the amount of LVL 710 thousand have already been granted. 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 consisting of loans that have already been repaid.

In September 2009, the Cabinet of Ministers adopted regulations *On Loans for Promotion of Development of Micro, Small and Medium-Sized Enterprises and Agricultural Services Cooperatives*. In accordance with these regulations, in February 2010, the Mortgage Bank launched implementation of the *SME Growth Loan Programme*. It is aimed at improving the access to funding of persons performing economic activity and registered in Latvia, thus fostering economic development. It is envisaged that within the framework of the programme, until December 2013, loans of liquid assets and investments in the amount of LVL 142 million will be available for promoting development of micro, small, and medium-sized enterprises and agricultural services cooperatives. The maximum loan amount per person performing economic activity cannot exceed LVL 300 thousand;

[1] Information in this case and in case of other described programmes is given according to the situation on May 23, 2010.

[2] 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).

[3] In the Riga region, training is provided by company incorporation "Riga College of Accounting and Finance" and "Biznesa komplekss"; in the regions of Vidzeme and Latgale – incorporation of LLC "Mācību un konsultāciju centrs ABC" and LLC "Mensarius"; in the regions of Kurzeme and Zemgale – LLC "Stockholm School of Economics in Riga".

the maximum loan amount for liquid assets is LVL 200 thousand. According to the conditions of the programme, the total amount of the loan for one entrepreneur of micro-enterprises in service branch within this programme may not exceed LVL 30 thousand. So far, 129 loans have been granted in the amount of LVL 7.6 million within the programme, and the total amount of loans provided within its framework has reached LVL 5.8 million.

In May 2010, the Mortgage Bank launched the *Programme of Liquid Assets Loans for producers of agricultural produce*. Producers of agricultural produce, agricultural service cooperatives, as well as groups of 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 Funds may be attracted to the loans. It is planned that the liquid assets loans will be granted until December 31, 2011. Although the programme was launched relatively recently, 179 loans in the amount of LVL 5.6 million have already been granted within its framework.

On July 20, 2010, the Cabinet of Ministers approved the *Procedure of administration and control of state and European Union support for agriculture, development of agricultural and fishing farms by establishing a Credit fund,* which is provided to grant loans for funding projects[1] approved by the Rural Support Service. It is planned to grant loans with terms of up to 15 years for investments in agricultural enterprises – for construction, purchase of fixed devices, equipment, and construction materials, as well as for elaboration of a technical project. The Mortgage Bank has approved 3 projects in the amount of LVL 1.43 million so far.

The Mortgage Bank is planning also further development and implementation of new support programmes. In March 2010, for instance, in accordance with the Informative Report *On Undistributed Funding of Latvian and Swiss Cooperation Programme* revised in the Cabinet of Ministers, the Mortgage Bank in cooperation with the Ministry of Finance and with involved related ministries has been entrusted to prepare a summary of *Micro Crediting Programme*, which in November 2010 was harmonized with the government of Switzerland, which, in turn, is willing to allocate CHF 6.68 million co-financing for implementation of the programme. It is envisaged that within the programme micro enterprises will be able to receive micro credits of up to LVL 10 thousand, provided that the loan term does not exceed 5 years. Currently, the Mortgage Bank is preparing further programme elaboration documents, and it is planned that the micro crediting programme will be launched in the third quarter of the year 2011 and will be valid for the next four years.

SIA **"Latvian Guarantee Agency"** (LGA) is a state-owned company with the aim of supporting accessibility to funding for enterprises registered in Latvia. LGA offers two guarantee programmes for improvement of competitiveness:

– *Loan Guarantees*, with the aim to help enterprises attract credit resources in cases when their security 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 Improving Competitiveness of the Enterprises* of 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 projects by ensuring guarantees in situations when the guarantee at the disposal of the enterprise is not sufficient to attract the credit resources in the necessary amount and when the banks evaluate the enterprise as too risky, as well as to facilitate competitiveness of businesses, to promote absorption of new markets and consolidation in the existing ones.

On April 20, 2009, the LGA and the Ministry of Economics signed a contract on implementation of the OP project *Guarantees for the Improvement of the Enterprise Competitiveness* of activity 2.2.1.3 *Guarantees for Improving Competitiveness of the Enterprises* of measure 2.2.1 *Access to Financial Resources* of priority 2.2 *Access to Finances* of Supplement *Entrepreneurship and Innovations*. The ERDF financing accessible in the framework of the activity is LVL 60 million.

On March 24, 2009, the Cabinet of Ministers adopted *Regulations on Guarantees for the Improvement of the Enterprise Competitiveness* stipulating that LGA provides guarantees for such financial services as investment loans, liquid assets loans, financial leasing and local factoring. The guarantees cover up to 80% of the principal amount of the financial service, but not more than EUR 3 million for one enterprise. The maximum term of a guarantee to loans for investments and financial leasing is ten years, and three years for the current assets loans and local factoring.

Since the beginning of the programme, LGA has received applications for guarantees from 277 companies, 179 of the applications have been approved and guarantees for 146 enterprises have already been issued.

[1] Measures of Rural Support Service: *Modernisation of agricultural farms; setting of the added value of agricultural products; Support for establishment and development of enterprises (including diversification of measures not related to agriculture; Promotion of tourism activities; Investments in aquaculture enterprises; Processing of fishing and aquaculture products)*

Guarantees issued from the beginning of the programme until November 23, 2010 within the programme *Loan Guarantee Programme* of the activity 2.2.1.3 *Guarantees for Improving Competitiveness of Enterprises*:

– number of applications (enterprises) – 277 ;
– amount of applications (million LVL) – 145;
– number of the issued guarantees (enterprises) – 146;
– amount of the issued guarantees (million LVL) – 59.2;
– amount of the guaranteed credits (million LVL) – 116.4.

On May 12, 2009, the Cabinet of Ministers adopted *Regulations on Short-term Export Credit* defining coverage of short-term export credit guarantees, beneficiaries, as well as the procedure for granting guarantees and the procedure in accordance with which the guarantor covers the loss. The LGA's export credit guarantee covers up to 90% of the deferred payment amount, but not exceeding EUR 1 million or an equivalent amount in other currencies. The deadline of the deferred payment cannot exceed 2 years.

As from July 1, 2010, there are also guarantees for export transactions available for exporters, where the purchaser comes from an EU Member State, Australia, Canada, Iceland, Japan, Norway, Switzerland, or the United States of America. The guarantees for the EU Member States and OECD are issued until July 30, 2011, however currently negotiations are held with the European Commission about the possibility to extend the term for issuing these guarantees by one year more.

Guarantees issued from the beginning of the programme until November 30, 2010 within the programme in the framework of activity 2.2.1.3 *Guarantees for Improving Competitiveness of the Enterprises* within the *Export Loan Guarantee Programme*:

– number of applications – 106 enterprises;
– number of the issued guarantees – 38 enterprises;
– amount of the issued guarantees – LVL 1.9 million.

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, thus ensuring a choice of various goods and services of good quality to all consumers. In order to raise the overall public awareness about the positive impact of fair competition on public welfare, for it to be able 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*, and 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.

In 9 months of 2010, merger controls of 5 enterprises, 9 inspections regarding observance of prohibition against the abuse of dominant position in retail trade, as well as 15 investigations of the most serious breaches of the *Competition Law* (prohibited agreements and abuse of dominant position) were carried out.

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 Latvian Association of Certified Auditors (see Box 6.18).

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 *Competence 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 mergers as a result of which a dominant position is created or strengthened, or which may significantly reduce the competition in any relevant 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, determining binding provisions for the relevant market participants.

Box 6.18

The CC identifies a breach in the action of the Latvian Association of Certified Auditors

On August 26, 2010, the Competition Councils adopted a decision on imposing a legal obligation and applying a fine in the amount of LVL 7718.9 to the Latvian Association of Certified Auditors (LACA). The CC found out that LACA has continuously committed a serious violation of the Competition Law – a prohibited agreement – setting the minimum charge for an annual report audit which can be applied by its members.

The Competition Council initiated the inspection of the LACA activities on the basis of the complaint by the Traders Association of Latvia, which pointed out that upon conclusion of agreements, certified auditors refer to the LACA decision on the minimum charge for annual report audit. Only some enterprises have the right to choose whether or not to use the corresponding certified auditor services, as the opinion of a certified auditor regarding annual report audit is mandatory for enterprises corresponding to at least two out of three criteria:

– the total amount of its balance is at least LVL 250 thousand;
– net turnover – LVL 500 thousand;
– the average number of employees in reporting year is at least 25.

According to verified information, the minimum charge for certified auditor services performing an annual report audit in the amount of LVL 500 was fixed by a decision of the LACA General Meeting adopted on May 16, 1997 .This decision was binding to the LACA members, who all are certified auditors of Latvia – in April 2010, 159 natural persons, 90% of them were members of the association also at the moment the decision was adopted in 1997.

Such agreement could promote artificial price increase in cases when price for smaller-scale services might be below LVL 500. The certified auditors had a limited possibility to compete on price, setting it below LVL 500. The CC by its decision has imposed a legal obligation to LACA to cancel the unlawful decision of 1997 and to inform all member of association about it.

The imposed fine is calculated as a percentage of the LACA net turnover of the previous financial year. Taking into account the role of the law-breaker, gravity, duration and caused or potential consequences of the violation, the amount of the fine in relation to net turnover of the violator is one of the biggest fines applied by the CC for similar violations.

A permit to merge, by complying with and observing the binding provisions set by the CC, was obtained also by enterprises of electronic communications: IZZI group, Baltkom group and LLC "EST Risinājumi" (see Box 6.19).

Box 6.19

The CC adopts a decision to permit the merger of the Baltkom group, IZZI group and LLC "EST Risinājumi"

With a merger of the given market participants, a holding company is planned to be established which will be the holder of capital shares of the Baltkom group (a total of 13 enterprises), IZZI group (a total of 16 enterprises) and LLC "EST Risinājumi".

The CC evaluated the impact of the potential merger on the markets, where the merging participants are operating and concluded that it could have significant negative impact on pay television service market in Riga, Jēkabpils, Ludza and Balvi, as well as on wholesale market of pay-per-view television channels in Latvia. However, the impact of the merger on voice telephony market in Latvia and on internet data transmission market in the above-mentioned towns was evaluated as insignificant.

In addition to the negative consequences of the merger – increased market power, higher market transparency from the view of merging participants, and the risk of coordinated activities – positive impact was also considered (for example, resource merging that could promote development of new services, increase in competiveness of the joint market participant in markets, where it causes no threat to competition, for example, internet data transmission and voice telephony market), along with factors reducing the potential threats to competition (for example, dynamic development of technologies, strong competition of LLC "Lattelecom", and the fact that this competitor uses the most technologically advanced platforms).

Having regard to the information on disadvantages observed so far, the CC has imposed extensive binding provisions regulating the operations of the merged market participant and directed towards maintenance of competition and protection of interests of consumers and suppliers – local pay-per-view TV channels. The binding provisions envisage that the participants of the merger shall include quality requirements for pay-per-view television services in contracts with new subscribers, as well as unified provisions on the compensation mechanism in case a service is not provided in compliance with quality standards.

Taking into consideration the specific character and dynamics of the particular market, the permit for a merger compliant with the above-mentioned provisions is valid until April 15, 2011 – if the merger is not completed by this date, the enterprises must re-apply to the Competition Council.

Competition promotion

This direction of activities includes market supervision and research, as well as development of the competition culture in the society. The task of the CC is to focus on gathering and analysing comprehensive information on competition situation in 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.

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*.

As during the economic downturn the CC recognises the necessity to ensure legal environment for development of entrepreneurship, which currently is difficult, as well as is aware of the necessity to timely detect distortion of competition in sectors affecting a wide range of consumers, in 2010, rather broad market control activities were carried out, allowing to obtain and analyse information about the competition situation in markets important to regarding consumers, as well as to find solutions for improvements thereof. In 9 months of 2010, the CC has completed seven market controls in such sectors as pay-per-view television, road construction, vehicle service and repair, electronic communication services and other.

As a result of specific controls, cases have been initiated regarding breaches of competition rights. Among the controls affecting a wide range of consumers, control of non-food goods – textiles, household chemistry etc. – should be noted (see Box 6.20).

Box 6.20

Results of non-food goods market supervision by the CC

In the framework of supervision of such goods as cosmetics, household chemistry, textiles and similar production widely sold in daily consumer goods supermarkets and specialised household goods shops in Latvia were examined. The structure of the market was considered and the principles of price formation were analysed. No breaches of competition rights were detected.

Information included in the final report of the supervision shows that the examined non-food goods are characterised by considerable mark-ups. For example, the average textile mark-up exceeds 200%, comparing to producers price, but the mark-up of particular cosmetic goods exceeds 1000 percent.

The significant mark-ups to a great extent are explained with the small Latvian market, as well as with the high logistics and marketing expenses. The market is characterized by historically developed application of mark-ups for imported goods, and the majority of goods evaluated in the framework of the market control are imported.

It is concluded, that the market participants have independently set the price level, with no prohibited agreement – price for the same brand productions differs up to 40% in different shops. Prices for several, especially the cheapest, brand production often are identical in different shops, however, that is mainly due to the price tracking practice applied by retail networks, responding to demand of the consumer group, the activity of which is most affected by the price differences.

During the control, the CC concluded that in 2007, 2008, and 2009, the prices for examined goods stated by producers and foreign distributors have not been significantly changed. Thus, in this period, the price increase observed in Latvia has been mainly based on the wholesaler and retailer mark-up increase, which was similar at these two trade levels.

As the extensive mark-ups have been set without violating the effective legal acts, a decrease in prices could promote increase in competition – new enterprises enter the market – or decline in demand, which during the recession has not been high enough, thus indicating the shadow economy maintaining the consumption level.

In the framework of the control, limited competition was found at the wholesale level of some famous brands – only some wholesalers are operating in the market distributing goods from the most famous international brands. Thus, this particular market has development perspectives and enterprises could choose to invest in Latvia.

The CC in cooperation with the Latvian Agricultural Cooperatives Association developed guidelines describing competition regulation for agricultural cooperative societies. The purpose of theses guidelines is to give a general insight in organisation of horizontal cooperation agreements for cooperative societies of horizontal agricultural services, indicating the agreements, which do not cause competition difficulties and comply with Latvian competition rights, as well as describing those agreements, which may contradict with the Latvian competition rights. These guidelines describe agreements concluded horizontally between two or more market participants, which are considered to be competitors, both existing and potential, as well as describing the mergers, when cooperative gains determinant influence over other market participant or obtains assets of other market participant or the right to use them.

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 cases examined, surveys and market supervision carried out, latest laws and other important issues included in the ECN newsletter. It is prepared every 2 months and is available at the Competition Council home page (*http://www.kp.gov.lv/?object_id=522*) and the European Commission home page.

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 for economically reasonable prices and to ensure the possibility for enterprises providing public services 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 annual net 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 in the regulated sectors, structural units are operating in Latgale, Kurzeme, and Vidzeme regions located correspondingly in Daugavpils, Saldus, and Cēsis.

<u>Situation and policies of the regulated sectors</u>

Electricity and gas supply (see also Chapters 3.2.3 and 6.3.2)

The dominant role in power supply is played by the JSC "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 carried out by the JSC "Augstsprieguma tīkls" fully owned by the JSC "Latvenergo", but as from July 1, 2007 the functions of a distribution system operator are carried out by the JSC "Sadales tīkls" fully owned by the JSC "Latvenergo".

Electricity is also generated by about 139 small hydropower stations, 26 wind power stations and 64 cogeneration plants, biomass and biogas stations. About 30 other enterprises have received licences to distribute and sell electricity.

Latvian electricity market is fully opened to competition from July 1, 2007 and since the second half of 2008, the largest electricity users buy electric power at an agreed price, while several electricity users have changed their power supplier.

On July 13, 2009, the European Parliament approved a body of laws aiming at promoting higher competition and therewith – a wider choice, energy efficiency and power supply safety, and lower prices in the power market. It provides new requirements for network operator decoupling and investment supervision, independence of member states regulators, as well as provides establishment of a cooperation organisation for energy regulators at the European scale. Requirements of the given body of laws must be transposed into national legal systems of the member states by March 3, 2011.

On May 7, 2010, the Commission approved differential tariffs for electricity transmission services of the JSC "Augstsprieguma tīkls", which will come into force on January 1, 2011.

On October 8, 2010, the JSC "Sadales tīkls" submitted a new draft to the Commission concerning tariffs of electricity distribution system services, envisaging an increase in the distribution system service tariffs by 8 percent.

Supply of natural gas in Latvia is ensured by a vertically integrated enterprise JSC "Latvijas Gāze".

In July and August 2010 excise duty was applied to natural gas used as fuel or petrol. In accordance with amendments to the *Law on Excise Duties* approved in August 25, 2010, application of excise duty to natural gas was revoked on September 1, 2010 until July 1, 2011.

Electronic communications and postal services

394 enterprises were registered and actively operated in the sector of electronic communications as of November 25, 2010. In the postal sector, the state JSC "Latvijas Pasts" provides general postal services, while approximately 50 service providers operate actively in the sector of express mail.

On September 20, 2010, the European Commission *Recommendation 2010/572/EU on regulated access to Next Generation Access Networks* (NGA) was approved. The aim of the recommendation is to promote development of a single market, improving legal certainty and encouraging investment, competition and innovations in broadband service market, especially during the transitional period to the next generation access (NGA) networks. The recommendation envisages that national regulatory authorities take regulatory measures regarding access to optical networks, including extending the existing regulation regarding unbundled access with access to fibre loop, as well as regulatory measures on common use of civil engineering infrastructure, especially common use of cables and network terminating segment.

The recommendation also explains that a state must introduce a data base of civil engineering containing information on geographical location, available capacity and other physical characteristics of all civil engineering infrastructure to be projected or already built which could be used for the deployment of optical fibre networks in a given market or market segment. Such information should be accessible to all operators.

Having regard to the Recommendation, the Commission developed a consultation document *On Regulated Access to Next Generation Access Networks* aimed at finding out the point of view of sector participants on regulation of next generation access networks.

On October 5, 2010, JSC "Latvijas Pasts" submitted a draft to the Commission concerning tariffs for domestic postal packages. The Commission evaluated and approved the new tariffs, which will enter in force on January 1, 2011. Setting new tariffs for domestic postal packages was necessary to ensure the service profitability because the existing tariffs approved in 2005 do not cover the actual costs of package delivery.

Railway

In the railway sector, the state JSC "Latvijas Dzelzceļš" ensures maintenance of the public railway infrastructure. Domestic passenger transportation is carried out by the JSC "Pasažieru vilciens" and LLC "Gulbenes – Alūksnes bānītis". In the sector of cargo transportation, there are also several operators, such as LLC "LDz Cargo", JSC "Baltijas ekspresis", and JSC "Baltijas tranzīta serviss". LLC "LDz Cargo" carries out also international passenger transportation.

On November 29, 2010, the Commission approved the charge for using the public railway infrastructure for transport in 2011, on the basis of data and an auditor opinion submitted by the state JSC "Latvijas Dzelzceļš". The calculated charge for railway infrastructure in 2011, comparing to the charge applied in 2010, for cargo transportation increased by 4.7%, but for passenger transportation – on average by 7.9%.

Heating, 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 must take over the regulatory functions in the sectors of heating, municipal waste management and water management from local government regulators or local government councils (boards) by November 1, 2009. Since takeover of regulatory functions from the local municipalities, the Commission has reviewed and approved tariffs for 7 enterprises in the heat supply sector, 4 enterprises in the water management sector and 1 enterprise in the waste management sector.

On October 28, 2010, the new *Waste Management Law* was adopted, which unlike the previous law does not envisage regulation of 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.

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 policy and in attraction of foreign investment. The guidelines define three main directions of action:

– increasing export competitiveness
– support instruments;
– contractual security.

Concrete measures in these directions of action are envisaged in the framework of *Action Plan for Export Promotion of Latvian Goods and Services and Attraction of Foreign Investment in 2010-2011*.

In 2010, in the framework of the abovementioned plan, several measures have been implemented in order to increase the export competitiveness of enterprises by supporting development of new products and their introduction in the market, producing high value-added products, improving qualification of labour force, improving the quality of transport infrastructure, as well as providing accessibility of particular finance instruments both for producers of industrial and agricultural goods.

Promotion of export and investments is implemented via **direct export promotion measures**. Furthermore, in 2010, a wide range of support services was available to the Latvian exporters in order to increase export capacities and to promote exports of Latvian goods and services. Enterprises are offered to receive consultations about issues relating to export, including issues of foreign markets and specific trade requirements; moreover, seminars on export skills, informative seminars on external markets, as well as trade missions and individual business trips to visit potential cooperation partners abroad are organised. Identification and implementation of export and investment projects has been carried out as well.

In order to compete successfully in the market of investment attraction and 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 methodology *Polaris*,** which envisages unified and coordinated activity from ministries, municipalities, infrastructure companies, and public institutions in implementing strategically important domestic and foreign investment projects, as well as involvement of the private sector, universities and research institutions.

In order to ensure coordinated inter-departmental cooperation for successful implementation of investment projects, the **Coordination Council of Large and Strategically Important Investment Projects** has been established comprising ministers of economics, transport, finance, foreign affairs, environment, agriculture, regional development and local government, education and science, as well as representatives of state and municipal authorities, nongovernmental organizations, infrastructure companies and other experts. On August 10, 2010, the Regulation of the *Coordination Council of Large and Strategically Important Investment Projects* was adopted in the Cabinet of Ministers.

In 2010, ten **External Economic Representations of Latvia** are currently operating in Germany, United Kingdom, Sweden, France, Russia, the Netherlands, Denmark, Norway, Japan, and Poland promoting exports and the flow of investment projects to Latvia, providing support to Latvian enterprises in establishing and maintaining business contacts, providing information about the requirements of the respective foreign market, implementing the marketing measures of export promotion and attracting investment abroad, as well as the measures of finding cooperation partners by identifying the potential investors and business partners. The activity of representations is coordinated by the **Council on Activity Coordination of External Economic Representations of Latvia,** which deals with topical issues regarding the work of External Economic Representations of Latvia and the development of the Representation Network.

In the framework of the measure *Business Support Activities* of the EU Structural funds activity programme *Business and Innovations* for 2008-2013 the activity 2.3.1.1 *Access to International Trade Markets – External Marketing* was implemented and the activity of export credit insurance system is ensured. Within the framework of activity *Access to International Trade Markets – External Marketing*, enterprises are provided with a wide support for the implementation of external marketing measures, for example, participation in exhibitions, contact exchanges, trade missions, organization of seminars and conferences. **In the framework of sub-activity *Access to International Trade Markets – External Marketing*, financing in the amount of LVL 6 million is available in the year 2010.**

Export credit guarantees are provided to improve competitiveness of Latvian enterprises for activities with the deferred payment period not exceeding 2 years. Implementation of this system allows for increase in the total export volume (particularly to countries with a high risk level), extension of the export markets (CIS region, economies with rapid economic growth, etc.), as well as consolidation in the existing markets.

Since July 1, 2010, exporters can receive guarantees for their activities when the buyer is from the EU Member State, Australia, Canada, Iceland, Japan, New Zealand, Norway, Switzerland, and the United States of America. Guarantees to the EU and OECD member countries will be issued until December 31, 2010 for deliveries carried out by July 30, 2011, yet negotiations are currently in process with the European Commission regarding the possibility to extend the term of issuing guarantees for another year.

From the moment of implementing the programme until November 30, 2010, the Latvian Guarantee Agency has received 106 applications of export-credit guarantees from 33 enterprises. From all the received applications, 53 guarantee projects have been approved for the total amount of LVL 3.4 million, 38 of the agreements for the total amount of LVL 1.9 million have already been concluded. Since the conclusion of the first export credit guarantee agreement with guarantee coverage, deliveries for the amount of LVL 10.4 million have been performed/declared. Enterprises that have concluded the agreements represent the manufacturing industry (production of communications equipment, household electric appliances, veneer plates and wood panels, soaps, cleaning and polishing agents, and foodstuffs). Guarantees have been issued for export to such countries as Russia, Nigeria, Belarus, Azerbaijan, Somalia, Georgia, Kazakhstan, Lithuania, Finland, and Germany.

From May 1, 2010 until October 31, 2010, Latvia participated in the **international exhibition *World Expo 2010*** in Shanghai in the People's Republic of China (PRC). The theme of Latvia's presentation *World Expo 2010 – Flying Latvia, where East meets West* was chosen in order to attract Expo visitors with non-traditional solutions using innovative technologies, and at the same time introducing Latvia and Riga as a centre of regional international flights, as venue of Eastern and Western business. The Latvian pavilion and its key exposition element – A*erodium*, a vertical wind tunnel, gained attention of global mass media and exposition visitors and was recognized as one of the most popular among the pavilions of 192 countries. During the entire exposition 1.6 million visitors came to see the Latvian pavilion, thus having the opportunity to get acquainted with Latvia and its business environment, culture, and tourism possibilities, etc.

October 21, 2010 was the National day of Latvia in the exhibition *World Expo 2010* coinciding with the visit of the State President V. Zatlers and the Minister of Economics A. Kampars in China. Within the framework of the National day, a Latvia-Shanghai business forum took place, where 23 Latvian entrepreneurs participated, representing such sectors as transport and logistics, automotive and metal processing industry, finance and consultations, food industry, IT, education, medical sector, culture, etc.

Box 6.21

Export and Innovation Award 2010

Already for the sixth year, the Ministry of Economics, in cooperation with the Investment and Development Agency of Latvia, organizes annual contest *Export and Innovation Award*. The goal of the Award is to contribute to competitiveness of Latvian enterprises in Latvian and foreign markets, to promote growth of the export quantity and quality, to generate products with high added value, as well as to promote innovation by evaluating the results of the enterprises and by approving the most successful enterprises and products thereof in the following award categories:

- best exporter in large/medium enterprises group;
- best exporter in small enterprises group;
- import substitute product;
- innovative product;
- industrial design.

The title *Leading Exporter* is nominated by evaluating the key exporters of Latvia on the basis of data and contribution to sustainable growth.

100 applications were received for participation in the contest *Export and Innovation Award 2010*, most of them – 29 applications were submitted in the award category *Innovative Product*.

Winners of the Export and Innovation Award 2010 are:
In category *Best Exporter* in large/medium enterprises group:
1. JSC "**Valmieras Stikla šķiedra**" (chopped strand of glass fibre, glass fibre yarn, glass fibre fabric, glass fibre sieves, glass fibre felt);
2. JSC "**Balticovo**" (eggs in shells, eggs without shells, egg powder, egg products, day-old chicks and hatched eggs);
3. LLC "**TTS-AVIO**" (automatic line industry, conveyer systems, mechanization of transport processes).

In category *Best Exporter* in small enterprises group:
1. LLC "**Biosan**" (laboratory equipment);
2. LLC "**Brabantia Latvia**" (ironing boards);
3. LLC "**UnitedPress Tipogrāfija**" (magazines, catalogues, book printing).

In category *Innovative Product*:
1. LLC "**Baltic Scientific Instruments**" (X-ray fluorescent analyzer CON-X 02 for non-stop analysis of ore and other material composition on a conveyer belt);
2. LLC "**Autonams**" (VLC 5501);
3. LLC "**Jaunpagasts Plus**" (Baltiprot – 50).

In category *Import Substitute Product*:
1. LLC "**Silvanols**" (Faringo Spray);
2. LLC "**DARO Cesis**" candied quince, black currants and carrots "Hortus" succades – sweetened dried fruits);
3. LLC "**DINEX LATVIA**" (exhaust systems and their components).

In category *Industrial Design*:
1. LLC "**PAA**" (wash basin "Claro");
2. LLC "**VARIS Toys**" (VARIS LABYRINTH);
3. LLC "**Angel Glass Design**" (glass and crystal dish set: "Northern Lights", "Black&White", "Mirror-Mirror").

Winner in the category *Leading Exporter* in 2010 is JSC **Grindeks**.

6.11. Protection of Consumer Rights and Market Surveillance

The consumer rights protection system in Latvia is in a constant process of becoming stronger and developing in order to ensure efficient market surveillance and protection of consumer rights.

Improvement of the Normative Base

On October 28, 2010, the Saeima adopted amendments to the *Consumer Rights Protection Law*, thus changing the procedure for granting credits, and confirming competences of the Consumer Rights Protection Centre (CRPC). The amendments to the law stipulate that when assessing the credit repayment ability, the creditor shall analyze the information provided by the consumer and, if necessary, use data bases containing information about the person's income and fulfilment of payment obligations. The law is supplemented by regulations on consumer's right of renunciation – the consumer is entitled to withdraw from the credit agreement without stating the reasons within 14 days from the day of concluding the contract. The amendments to the law also stipulate that in order to provide a credit service to consumers, the creditors of the non-bank sector will have to receive a licence in CRPC by October 30, 2011. The amendments to the law will also contribute to a faster response in case the consumer submits an application to CRPC asking for information or consultation concerning his rights – further the consumer will be able to choose the most convenient way of response – via phone, e-mail or an official written response. In order to transpose the requirements of the *Directive 2008/48/EC* of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing *Directive 87/102/EEC,* draft regulations of the Cabinet of Ministers *Consumer Credit Regulations* were announced in the meeting of State

Secretaries on November 4, 2010 aiming to increase consumer protection when entering into credit agreements. The draft regulations prescribe specification of requirements concerning the contents of advertisement of credit services for consumers. Furthermore, the draft regulations also set forth information to be received by the consumer before entering into a credit agreement, as well as provide a special standard form for submitting the aforementioned information. The draft regulations also specify requirements of consumer credit agreements and information to be included therein, as well as the method of calculating the annual interest rate. In addition, the draft regulations envisage the legal framework concerning consumer credit against collateral of movable property or pawn credits in order to adjust pawn credit market, which as of now has no particular legal framework.

On September 14, 2010, a draft law *Law on Out-of-Court Debt Recovery* was approved in the Cabinet of Ministers and was submitted to the Saeima for a further review. This draft law aims to provide a fair and reasonable out-of-court debt collection from the debtor – an individual person. In order to ensure fair practice during the proceedings of out-of-court debt collection, the draft law envisages to:

– define the procedure for organizing communication by the creditor or provider of debt collection services during out-of-court debt collection;
– solve the issue of reimbursing expenses resulting from debt collection;
– solve the issue of using data of individual persons during out-of-court debt collection;
– establish the requirement for providers of debt collection services to receive a special permission (licence) for rendering debt collection services.

In December 2010, the EU Council of Ministers came to an arrangement of the proposal for the **Directive of the European Parliament and of the Council on consumer rights**, which was approved in the European Commission on October 30, 2008. The proposal was prepared after revision of consumer *acquis,* which was commenced in year 2004. Originally it was planned that the draft directive, which integrates four valid directives in the field of protection of consumer rights, will regulate aspects of consumers' contractual rights in purchase and service agreements concerning purchases in shops, distance selling agreements and agreements concluded outside of company premises. The draft directive envisaged establishment of single definitions, single requirements concerning information to be provided to the consumer before entering into agreement, the information to be included in the agreement, the right of renunciation, as well as the regulation of sellers' liability for goods which do not comply with provisions of the agreement, and 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 protection of consumer rights regarding issues harmonized in the draft directive, 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 agreement provisions, thus establishing only a regulation on distance agreements and agreements entered into outside of company premises. The European Parliament could express its opinion about the draft directive in the first reading at the end of the year 2010.

Supervision of Consumer Rights

In nine months of the year 2010, the CRPC has reviewed 1959 consumer complaints and applications of consumers and has provided 38 862 consultations, 35 177 of which were provided to consumers, but 3685 – to legal persons.

Out of all complaints reviewed in nine months of the year 2010, in 351 cases (18%) the solution was favourable to the consumer, in 126 cases (6%) a decision favourable to the customer has been adopted, 52 complaints (3%) were unjustified, an explanation has been provided to the consumer regarding 899 complaints (46%), 118 complaints (6%) were forwarded to other institutions according to their competence, 42 complaints (2%) have been withdrawn by consumers requesting termination of case examination, in 100 cases (5%) CRPC has refused to review the complaint, and 270 complaints (14%) are currently being reviewed.

In nine months of the year 2010, CRPC has received 467 complaints regarding the purchase of goods which do not comply with the agreement provisions for the amount of LVL 286.1 thousand. The majority of complaints refer to footwear (27%), appliances (17%), and cell phones (14%), followed by complaints of other goods.

467 complaints were received regarding services which do not comply with agreement provisions. The majority of complaints referred to air traffic services (32%), electronic communication services (20%), rent and public facilities (14%), and distance agreements, followed by complaints about other services.

CRPC employees cooperate with employees of various institutions in Latvia and other European Union countries when reviewing consumer complaints.

Supervision of Unfair Commercial Practice and Advertisements

In nine months of the year 2010, investigation of 170 detected cases concerning offences in commercial practice/advertisement was commenced in the field of supervision of unfair commercial practice and advertisement. During the investigation, 142 cases were investigated concerning offences in the field of commercial practice and 34 cases – concerning offences in the field of advertising.

In 73 cases, the investigation was commenced according to applications submitted by individuals, but the investigation of 97 cases – on establishment's own initiative.

The majority of cases were initiated regarding the implemented commercial practice in the fields of electronic communication services, advertisement of finance services (crediting), cosmetics, various mobile services, services concerning job placement, as well as distance agreements.

63 decisions were adopted on offences, mostly concerning unfair commercial practice and advertisements, which do not comply with normative acts.

In nine months of the year 2010, the CRPC has expressed 26 calls/proposals to eliminate the breaches or to undertake in writing to eliminate them within a particular term, and thus 21 offences in fields of advertisement and commercial practice were prevented.

Due to the detected breaches in fields of advertisement and commercial practice, the CRPC has reviewed 53 administrative offences regarding non-observance of procedure for providing or distributing an advertisement or offences regarding providing or distributing an advertisement, which does not comply with the normative acts, or implementation of an unfair commercial practice, and thus has imposed administrative penalties on the offenders in the amount of LVL 46.2 thousand.

Box 6.22

Commercial practice not complying with professional diligence in case the consumers do not receive relevant information regarding unilateral changes in electronic communication service agreements

By changing agreements concluded with the consumers unilaterally, the foreign enterprise "VIASAT AS" did not act according to the requirements of professional diligence (thus engaging in unfair commercial practice), as pursuant to the provisions of the *Electronic Communications Law* it did not provide consumers with information about unilateral changes in electronic communication service agreements, i.e., they did not provide this information within one month before the day the amendments to the agreement came into force and did not inform the consumers about the rights to terminate the agreement without having to pay the penalty, or has not provided such rights to the consumers.

The information on the offered TV channels, published on the VIASAT web site, in the section "TV Channels", and used in advertising materials in terms of its presentation from an average consumer's point of view misled/could mislead the consumer regarding the contents of services offered by VIASAT (available TV channels), and thus consumer's economic behaviour could be influenced negatively, since the consumer could make a decision to enter into agreement which under different circumstances this consumer would not have made.

After assessing the commercial practice of VIASAT, on August 27, 2010, the CRPC adopted the decision No. 7-nk to impose a legal obligation on VIASAT to terminate the unfair commercial practice immediately by stopping the presentation of the misleading information about the offered TV channels in the commercial practice. Meanwhile, as within a period of one year VIASAT was imposed an administrative penalty for an unfair commercial practice and an indication of corpus delicti of criminal offence – a recurrence – was detected, the CRPC sent the case materials to the board of Economic Police of the State Police for a further review within the criminal procedure.

Supervision of E-commerce

In the field of supervision of e-commerce, in nine months of the year 2010, CRPC has commenced investigation of/has investigated 37 cases, 30 cases of which were related to breaches of normative acts regulating information society services.

In 20 cases, CRPC has sent requests to prevent the detected breaches in the field of supervision of information society services amicably, and thus 17 breaches have been prevented voluntarily.

During this period, 5 decisions regarding cases initiated in the year 2009 were adopted which aimed to prevent offences regarding e-commerce (for instance, correction of information about the right of renunciation published on the web site).

Protection of Collective Interests of Consumers and Supervision of Agreements

From January 1, 2010 until September 30, 2010, 414 complaints in relation to protection of collective interests of consumers have been received: 362 complaints concern allegations of possibly unfair agreement provisions and 52 claims concern other alleged consumer rights breaches.

The majority of complaints, i.e. 186, have been received about consumer credit agreements and creditor actions, for instance, cases when disproportionately large penalties are being applied, credit interest payments are being increased and a party withdraws from the agreement unilaterally. 37 complaints were received regarding agreements of electronic communication services, 26 complaints regarding goods or service purchase agreements, 18 complaints regarding provision of other financial services, 11 complaints regarding management agreements, 15 complaints regarding insurance agreements, 5 complaints regarding real estate purchase agreements (preliminary agreements), 1 complaint regarding an agreement on package tourism services, 2 complaints regarding distance agreements, 1 complaint regarding a building service agreement and 61 complaints regarding other agreements.

36 reports of assessing measures regarding protection of consumer rights were drawn up. As a result of the assessment, a decision on initiation of administrative procedures in 29 cases was adopted.

3 decisions have been adopted regarding unequal and unfair agreement provisions in a mortgage agreement, 2 decisions have been adopted regarding unfair agreement provisions in a mortgage agreement, requesting the credit institution to terminate implementation of the unfair provisions incorporated in the agreements concluded with consumers and to implement amendments in the draft agreements offered to the consumers, and 1 decision was adopted regarding unfair agreement provisions in the parking lot agreement.

In 24 cases, the respective producers, sellers, or service providers were asked to make a written pledge to prevent the committed offence regarding consumer rights amicably. A written statement was received in 16 cases, and the offence was prevented amicably.

The most frequent unfair agreement provisions are the following: disproportionately large penalties, unjustifiably restricted liability of the seller or the service provider, unjustifiable imposition of market risk on the consumer, unjustifiable imposition of obligations on the consumer, overly extensive or unjustified rights of the seller or the service provider to withdraw unilaterally from the agreement or to apply a penalty, arbitrage clauses.

Box 6.23

An unfair agreement provision, which imposes an obligation on a consumer, who has failed to fulfil contractual obligations, to pay a disproportionately large penalty

As CRPC reviewed applications submitted by consumers, it noticed the following provision in the contract of pledge of JSC "Privatbank": "In case of a non-fulfilment or unduly fulfilment of the contractual obligations by the pledgor, the pledgor pays to the Bank a penalty in the amount of 0.5% (five tenths of one per cent), but as from the 15th (fifteenth) overdue day – a penalty in the amount of 1% (one per cent) of the principal amount stipulated in the loan agreement for each overdue day".

CRPC considered this provision to be unfair, as the penalty is stipulated not as a part of the outstanding sum which was not repaid duly, but as a part of the total principal amount of the loan irrespective of the repaid principal amount. Thus the penalty for non-fulfilment or unduly fulfilment of contractual obligations stipulated in the pledge agreement remains constant for the whole validity period of the agreement and can be applied irrespective of the principal amount of the loan which is not repaid to the bank by the consumer or the actual amount of the debt. It also follows that in case of non-fulfilment of contractual obligations stipulated in the contract of pledge, the bank is entitled to impose on the consumer a penalty in the amount of 0.5% of the principal amount stipulated in the loan agreement or in the amount of 1%, if the obligations are not fulfilled after 15 days, also if the unpaid principal amount of the loan proportionally equals to or is even less than the amount of the penalty calculated for a few days or even one day. Thus the aforementioned provision of the agreement envisages for the consumer to pay disproportionally large penalties.

With the decision No. 3-lg adopted on August 27, 2010, the CRPC requested that the bank terminates implementation of unfair provisions stipulated in the agreements with the consumers, as well as amends them in the draft agreements offered to the consumers.

In order to prevent cross-border offences in protection of consumer rights, the CRPC has received 2 activity implementation reports (from Lithuania) within the scope of the Consumer Protection Cooperation System (CPCS). Furthermore, the CRPC on its own initiative has sent 6 reports requesting implementation of activities (to Germany, Cyprus, Lithuania, the Netherlands, and Ireland).

The aforementioned activities were mainly implemented in relation to the detected offences in fields of unfair commercial practice, e-commerce, and provision of distance services.

Cross-border Trade

As the amount of population emigrating from Latvia and the amount of tourists visiting Latvia is increasing, a positive solution of the problems of consumers related to the purchased low quality goods and services and cross-border consumer protection is becoming increasingly topical.

The European Consumer Centre (ECC Latvia) is established as a separate CRPC department co-financed by the European Commission.

In nine months of the year 2010, the ECC Latvia has examined 134 complaints, 191 simple complaints, and has provided 217 consultations in relation to solution of consumer cross-border complaints. In case of a cross-border complaint, support is provided to a consumer in order to find the responsible institution to solve the consumer's complaint, but no decisions are made against a foreign entrepreneur.

42% of the received complaints were related to air traffic services, 19% – with e-commerce, 5% – with tourism services, 34% – with other goods and services. 8 claims were handed over to the CRPC for reviewing, 38 – forwarded to the ECC within the framework of cooperation, 67 – solved in favour of the applicant and 21 – are being reviewed.

An informative educational game on consumer rights in the EU *Journey in Consumer Rights* was developed in the year 2009 and distributed in secondary schools of Latvia in the year 2010 in order to educate the consumers on the consumer rights in the EU.

Market Surveillance

In nine months of the year 2010, 1722 inspections were performed, 720 of which were surveys in market situation research in particular groups of goods (personal protective equipment, toys, playgrounds, building materials etc.), 759 were inspections and 243 activities were related to expert examination.

In total, 4520 models of goods were inspected: transportable pressure vessels (gas cylinders) – 3114, toys and children's goods – 502, electronic goods – 287, construction products – 208, personal protective equipment – 137, gas equipment – 100, electronic communications terminals – 74, pressure equipment – 38, other goods – 60.

In the most cases the entrepreneurs eliminate discrepancies voluntarily. However, in some cases it is necessary to adopt decisions on prohibition of sales of goods and/or on conformity assessment. In nine months of the year 2010, 6 decisions were adopted on non-compliance of goods and services with normative acts and safety requirements.

Implementation of projects for improvement of safety and conformity of 8 goods and services has been commenced in CRPC as of September 30, 2010. 3 of these projects (pressure equipment, gas equipment and personal protective equipment) were completed in the accounting period.

Project implementation is continued in fields such as toys, playgrounds, children's beds, building products and electronic goods.

Taking into account the increasing number of complaints regarding breaches in trading places and provision of services concerning indication of prices, at the beginning of this year CRPC performed surveillance of **procedure on how the prices are being indicated.** 242 inspections were performed – discrepancies were detected in 43 trading places, in 42 cases procedures for an administrative offence were initiated. Repeated inspections were performed in 17 trading places. No breaches were detected in any of them.

In the framework of the project of pressure equipment, the CRPC implemented two sub-projects by inspecting transportable pressure equipment (liquefied gas cylinders) and pressure equipment (pressure cookers in household, coffee-machines).

Both enterprises filling gas cylinders on their own and enterprises exchanging gas cylinders only (distribution) were inspected. In 9 months of the year 2010, 41 enterprises were inspected, where 3114 gas cylinders of various volumes offered to consumers in 103 places for filling and selling liquefied gas cylinders were inspected.

Breaches were detected in 10 gas cylinder trading places offering gas cylinders (in total 107) with expired period of validity of periodic technical inspection. The sales of gas cylinders were suspended. In order to perform technical examination, 15 filled cylinders to be sold were taken from 15 different objects. The results showed that 3 gas cylinders cannot be exploited, as there were serious damages detected.

In the framework of the sub-project, 22 inspections were performed; a total of 36 models of coffee-machines and pressure cookers were inspected. Breaches were detected in 6 trading places, 3 models of cookers did not comply with requirements of normative acts. Two enterprises implemented voluntary measures regarding 2 models of cookers by withdrawing them from circulation and destroying them, and a decision was adopted with regard to one enterprise to prohibit distribution of pressure equipment which does not comply with the relevant requirements.

In the framework of the project Personal protective equipment (PPE), conformity of reflectors, reflecting waistcoats and helmets was controlled. 86 inspections were performed and the conformity of 137 models with normative acts was inspected, including 37 models of bicycle helmets, 34 models of reflectors and 19 models of reflecting waistcoats.

61 models out of all inspected PPE models did not comply with requirements. The most discrepancies are related to lack of the CE marking, as well as incomplete or absent assessment documentation and/or instructions of use. 4 models of reflectors out of 10 and 1 model of waistcoats out of 5 delivered for inspection did not comply with safety requirements.

10 PPE models were withdrawn from circulation (2 models out of them were destroyed), and, in order to eliminate discrepancies, voluntary measures were implemented by entrepreneurs regarding 24 models.

Within the gas equipment project, CRPC organized 32 inspections and 56 surveys in trading places. In general, 100 device models using mostly gas fuel were inspected. 6 of these models did not comply with the requirements of normative acts. Distribution of the inadequate equipment (gas cookers and gas burners) was stopped in two enterprises. 4 equipment models not complying with the normative acts were withdrawn from circulation, discrepancies of 2 equipment models were eliminated, and the CRPC allowed continuing their distribution.

CRPC has implemented **a boiler and pressure equipment complex surveillance project** by providing surveillance of hazardous equipment in places they are used. Within this project, inspections in 37 enterprises were implemented in places this equipment is used within, and different discrepancies were detected in 103 inspected devices (55%) in 35 enterprises. The CRPC also commenced an elevator surveillance project. Within this project, inspections were implemented in 7 enterprises, and overall 29 elevators were inspected, 14 (50%) of which did not comply with the requirements.

<u>State Metrological Surveillance</u>

CRPC activities regarding state metrological surveillance within 9 months of the year 2010:

– in order to establish conformity of measuring equipment with normative acts in places where the equipment is used, 5680 measuring devices in 252 enterprises underwent state metrological surveillance, including 661 measuring devices in 176 enterprises (int. al. 239 non-automatic scales in 103 trading enterprises and 42 fuel dispensers in 21 gas stations underwent metrological tests), 5003 measuring devices in

75 production enterprises and 16 measuring devices in 1 state authority. There were discrepancies found in 120 enterprises, and as a result of the inspection, 337 measuring devices or 5.9% of the total number of inspected devices, including measuring devices being used thus not observing periodical verification and exceeding measurement tolerances stipulated in the normative acts, did not comply with metrological requirements. An administrative report on non-observance of metrological requirements was drawn up and decisions according to Section 99 of *Administrative Violations Code* were adopted for 41 natural and legal persons;

– measures regarding control of pre-packed goods envisaged in the action plan of CRPC were implemented by controlling the amount of the contents and conformity of labelling of the pre-packed goods which are intended for distribution in production and wholesale enterprises, including primary product categories such as confection (sweets etc.), bread and meat processing products;
– the pre-packed goods were controlled in 52 enterprises and 382 batches of pre-packed goods were inspected: the actual contents of pre-packed goods did not comply with normative acts in 13 enterprises or 25% – 20 batches of goods or 5.8% of the total inspected batches of goods did not comply with normative acts, and for 10 of them the implementation was suspended; the labelling of pre-packed goods concerning indication of the amount of contents was inadequate in 28 enterprises (in 96 inspected batches of goods or 25.1% of the inspected batches of pre-packed goods). An administrative report on discrepancies of the amount indication with normative acts was drawn up and decisions according to Section 99 of *Administrative Violations Code* were adopted for 7 legal persons.

6.12. Quality Assurance

6.12.1. Quality Structural Policy

The main task in the area of quality assurance is to promote adequate application and observance of requirements of the legislative acts in the regulated and non-regulated sphere, as well as to improve the base of legislative acts in accordance with the EU requirements, taking into account the needs of the national market and economy, hence ensuring compliance of the products and services, and encouraging increase of competitiveness of the enterprises and reduction of obstacles to international trade.

National quality assurance system in Latvia is regulated by the *Law on Conformity Assessment*, *the Standardisation Law*, and *the Law on Uniformity of Measurements*, as well as by the 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 Latvian national economy, in order to protect the consumers and environment from low-quality products and services and to promote growth of competitiveness of enterprises and reliability of products and services provided by Latvian entrepreneurs;
– improvement of the respective informative and consultative base;
– supporting participation of national institutions of accreditation, standardisation, and metrology in international organisations, 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 society from inaccurately performed measurements;
– encouraging introduction of environmental quality management and other voluntary quality systems in enterprises in order to ensure manufacturing of higher-quality products and provision of higher-quality services, as well as competitiveness of Latvian companies 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 enterprises.

The offices (Standardisation Bureau, Latvian National Accreditation Bureau, and Metrology Bureau) forming the Limited Liability Company with share capital "Centre of Standardisation, Accreditation and Metrology" under the supervision of the Ministry of Economics, carry out the functions and tasks of national standardisation, accreditation, and metrology institutions.

6.12.2. Accreditation, Standardisation, Metrology

Since July 1, 2009, Limited Liability Company "Centre of Standardisation, Accreditation and Metrology" has been carrying out the tasks in the field of standardisation, accreditation, and metrology as stipulated in the *Standardisation law*, *Law on Conformity Assessment*, *Law on Uniformity of Measurements*, as well as in other related laws.

Standardisation

The Standardisation Bureau (LVS) of the LTD "Standardisation, Accreditation, and Metrology Centre" manages and coordinates activities of Latvian enterprises and organisations in the field of standardisation in compliance with the *Standardisation Law*.

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 organisations of standardisation.

Since 2004, LVS is a full-fledged member of the European Committee for Standardisation (CEN) and of the European Committee for Electrotechnical Standardisation (CENELEC). LVS is also a corresponding member of the International Organization for Standardisation (ISO) and associated member of the International Electrotechnical Commission (IEC).

In compliance with the approved plans, the priority directions of activity of the LVS in 2010 is distribution of standardisation information, updating and maintaining the fund of Latvian standards, improvement of the electronic trading system of standards, and cooperation with international, European and national standardisation organisations.

Until November 1, 2010, 32 820 standardisation documents have been registered in the LVS, including 27 522 European standards adopted in the status of a Latvian standard. In 10 months of 2010, 50 standardisation technical committees and 4 working groups coordinated by the LVS have adapted 1294 European standards, and 20 mandatory applicable standards have been translated into Latvian. Standardisation information services have been provided to 3500 legal and physical persons.

To continue the on improvement of the electronic trading system of standards, more than 37% of all standards have already been sold via e-shop.

The automatic electronic information notification system introduced by LVS has provided free service to 580 regular clients – the *Monthly Report on the Standards Registered in Latvian Status and Cancelled Latvian Standards* – in the fields concerning the clients.

The LVS participates in the development cooperation projects coordinated by the Ministry of Economics.

The matter on cooperation in the field of standardisation was included in the agenda of the sixth meeting of Latvia-Belarus Intergovernmental Commission that took place in Minsk in September this year. Right now, cooperation of the parties is implemented by exchange of a catalogue of standards to be issued and of standardisation work programmes upon the request of parties. Information about electronic catalogues of standards of both states is also rendered.

An *Economic Cooperation Programme between the Republic of Latvia and Ukraine for 2010-2011* was signed during the 3rd meeting of Latvia-Ukraine Intergovernmental Commission that took place in Riga on July 29, 2010, and this programme foresees to continue cooperation in the field of standardisation within the framework of the signed bilateral agreement (*Agreement between the State Committee of Ukraine for Technical Regulation and Consumer Policy (DSSU) and the LLC "Latvijas standarts",* signed on June 25, 2008) by determining and implementing priority directions and forms of cooperation.

In the framework of the programme promoting business and knowledge-based economy, LVS continues developing technical infrastructure in order to provide enterprises with comfortable access to standardisation information.

Pursuant to the approved plans for the future activity of LVS, the priority directions of LVS activity in 2010 are the following:

– supplementation and update of the fund of Latvian standards;
– improving LVS's information technologies for better client service quality;
– improving the electronic trading system of standards;
– cooperation with international, European and national standardisation organisations.

Accreditation

The Latvian National Accreditation Bureau (LATAK), which is a structural unit of LLC "Standardisation, Accreditation, and Metrology Centre" ensures the operation of the national accreditation system. In compliance with *Regulation No 765/2008* of the European Parliament and of the Council, LATAK acts as a national accreditation institution.

According to the *Law on Conformity Assessment*, the main functions of the LATAK are:

– to evaluate, accredit, and supervise the testing and calibration laboratories and certification and inspection institutions for conformity to the requirements prescribed in the normative acts, Latvian national standards, EU or international standards;
– to organise examination of skills and coordinate inter-laboratory comparative testing in compliance with the international requirements;
– to represent Latvia in international accreditation organisations;

– 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. Although many institutions refuse accreditation due to the economic situation, increasingly more institutions choose to certify their competence by accreditation. Many institutions extend their field of activity as well. At the moment, the status of accreditation is maintained for 210 accredited institutions. New accreditation has been awarded to laboratories in the field of veterinary medicine and medicine, to inspection institutions for carrying out tests on vapour suction in petrol stations, to certification institutions for certification of fuel, measuring instruments and welding processes. The conformity of one institution is maintained in compliance with the *Principles of Good Laboratory Practice*. LATAK continues providing accreditation services in Ukraine, where one institution for personnel certification has been accredited.

LATAK has approved conformity of the accreditation system in six spheres of accreditation to the Multilateral Recognition Agreement (MLA) of the European Co-Operation for Accreditation (EA). In order to constantly conform to these requirements, employees of LATAK participate in several committees – EA Inspection and Certification Committee, EA Laboratory Committee, meetings of the MLA Committee, and General Assemblies.

In the framework of international cooperation, LATAK also collaborates with accreditation institutions of Belarus, Ukraine, and Uzbekistan. Cooperation with the Georgian accreditation institution has been successfully initiated, providing assistance in implementing the European and international requirements, and a cooperation agreement has been concluded.

LATAK has also fostered participation of the national laboratories in the international inter-laboratory comparative testing programmes and organised examinations of skills.

Metrology

Since July 1, 2009, the Metrology Bureau (MB) of LLC "Standardisation, Accreditation and Metrology Centre" is the national metrology institution of Latvia (LATMB) and its aim of operations is to ensure and develop credibility and traceability of measurements in the country. The Metrology Bureau fulfils assignments in the field of metrology determined in the *Law on Uniformity of Measurements*.

Calibration of National measurement unit standards is performed in the EU national metrology institutes (NMI), as well as procedures to maintain standards are carried out in compliance with the schedule.

In October, national calibration of the mass measurement unit standard LNE 08 (*(1÷500) mg, (1÷500) g, (1÷20) kg*) was performed in Denmark's NMI DFM. Follow-up works on calibration, stability and drift control of calibration results, and an uncertainty budget update was performed to these standard weights. National stability analysis and drift evaluation were performed to electrical measurement unit standards LNE 15 and LNE 16 (electrical resistance measures, standard system of direct voltage) within the inter-calibration period. National stability analysis and drift evaluation of measurement unit standards LNE 01, LNE 3, and LNE 06 was performed in the inter-calibration period.

The time standard data (national time scale UTC (LV)) transmission to BIPM (*Bureau International des Poids et Mesures*) is continued, as a result of which it is possible to ensure international traceability of the standard. Time and frequency standard and its technical infrastructure have been successfully relocated to new premises. Furthermore, mutual exchange of time standard data among 15 laboratories in Poland and Lithuania, as well as an update of monthly comparison results in the international data base is continued.

In 2010, correspondence of measurement device types was evaluated and 13 types were certified. Approval of one model type was rejected. Repeated evaluation of measurement device types is performed and certificates for 10 types were prolonged. The list of approved types is regularly updated in the online home page of the Metrology Bureau.

In 2010, preparatory works were performed for the EURAMET project No 672 *Determination of form of high quality flats*.

Quality management system of the Metrology Bureau was presented in the technical committee Quality (TC-Q) of the European Association of National Metrology Institutes (EURAMET). Audit ("peer-review") of the Metrology Bureau quality system assigned by EURAMET was performed in the Metrology Bureau, and it was established that the competence of the Metrology Bureau to perform maintenance and calibration of standards corresponds to the requirements of standard LVS EN 17025. In September, Calibration and Measurement Capabilities (CMC) were renewed in the international BIPM data base KCDB.

In 2010, the Metrology Bureau continued cooperation with EURAMET, as well as with the International Organization of Legal Metrology (OIML) and the European cooperation in legal metrology (WELMEC). The Metrology Bureau has prepared and submitted proposals to WELMEC for extension of the sphere defined in the *Directive 2004/22/EC* of the European Parliament and of the Council of March 31, 2004 on measuring instruments.

A mutual cooperation contract was concluded with the Finnish National Metrology Institute "MIKES". Information exchange was carried out with the Danish National Metrology Institution DFM in relation to calibration methodology of the mass measurement standard. Work in the EURAMET project No 1117 *Time determination and regulation in the European countries* was completed. Information regarding Latvia is placed in the final document and is available for all 33 European Member States involved in the project.

27 references have been performed for LLC LNMC in the field of cooperation with Latvian Metrology Institutions.

6.13. Privatisation

The goal of privatisation is, by changing ownership of a state or local government property, to create favourable environment for operation with private capital in the interests of development of Latvian national economy and to narrow the activities performed by the state and local governments as entrepreneurs.

As the goal of mass privatisation implemented in Latvia is practically achieved, the Saeima adopted the *Law on the Completion of Privatisation of State and Municipal Asset Units and Use of Privatisation Vouchers (Law on the Completion of Privatisation*), which came into force on September 1, 2005 prescribing the procedure of completing the privatisation process and land reform and ensuring completion of the use of privatisation certificates (see Box 6.24).

Box 6.24

Law on the Completion of Privatisation of State and Municipal Asset Units and Use of Privatisation Vouchers

Law on the Completion of Privatisation prescribes:

– the deadline by which every legal or natural person may propose to bring any state or municipal asset to privatisation (August 31, 2006);
– the procedure by which a privatisation proposal submitted by a person is reviewed and a decision is adopted to bring the state or municipal asset to privatisation;
– that the privatisation may be denied and the property may remain in possession of the state or municipality if the property is necessary to perform public administration functions or commercial activity of the state or municipality;
– that the Cabinet of Ministers had to adopt decisions regarding the privatisation of a property owned by the state or municipality 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" will not be privatised or alienated;
– the deadlines by which the persons willing to redeem land allocated for permanent use have to submit land redemption application (August 31, 2006 or November 30, 2007), and by which the land boundary plan or confirmation of the land redemption payment done in privatisation certificates before conclusion of the land redemption contract has to be submitted to the State Land Service (September 1, 2008), as well as by which the application for decision with respect to allocation of the property for payment has to be submitted (August 31, 2010) and the land purchase agreement has to be concluded (December 30, 2010);
– that privatisation vouchers do not have an expiry term, but may be only used in the framework of the privatisation process;
– the procedure of ending issuance of privatisation vouchers. The final deadline by which persons can submit an application for privatisation vouchers (December 28, 2007).

In order to ensure successful and open progress of privatisation completion processes, the Cabinet of Ministers has set the procedure on how the institutions implementing privatisation and land reform have to establish publicly available registers of privatisation proposals and land redemption.

Privatisation of state-owned asset units and land

Privatisation of state-owned asset units or land is carried out and privatisation proposals are summed up by the state joint stock company Latvian Privatisation Agency under the *Law on Privatisation of State and Municipal Asset Units*.

A decision to bring a state-owned asset unit (including capital shares) or vacant land/lot to privatisation is taken by the Cabinet of Ministers, while a decision to bring a built-up land lot (on which there are buildings owned by another person) to privatisation is taken by the Privatisation Agency. The decision is taken on the basis of a privatisation proposal submitted by any natural or legal person.

From September 1, 2005, when the *Law* on the *Completion of Privatisation* came into force, until October 1, 2010, 627 proposals for privatisation of real estate, 57 proposals for privatisation of state capital shares and 4326 proposals for privatisation of land lots have been registered in the Register of Privatisation Proposals of the Privatisation Agency. After August 31, 2006, the Register of Privatisation Proposals registered those privatisation proposals which were submitted by mistake to other state and local government institutions until this date and transferred by pertinence to the Privatisation Agency later.

A natural or legal person eligible to acquire personal or real property in Latvia can be the subject in privatisation of state-owned property (real estate, capital shares, land). Payments for the property units have to be made in lats (LVL) and/or privatisation certificates.

From April 17, 1994 until October 1, 2010, the privatisation regulations had been approved in the statutory procedure for 2464 state property units (excluding land). 94 companies were transformed to public joint stock companies, thus releasing 439.14 million shares into public circulation. The income obtained from privatisation of state property units (excluding land, selling of shares emerged as a result of capitalisation of debts and alienation of capital shares) amounted to LVL 1.666 billion, of which LVL 395.402 million in cash and the nominal value of LVL 1.266 billion in privatisation certificates. New owners took over obligations of privatised state companies (enterprises) for the value of more than LVL 187.2 million. The amount of the specified investments was LVL 146.2 million, while the amount of investments actually invested reached LVL 267.5 million.

The Privatisation Agency carries out privatisation of state-owned land since 1997. 4941 state-owned land lots with the total area of 7423.3 ha were privatised (purchase agreements signed) by October 1, 2010. The total sales price for the privatised state land lots reached LVL 198.5 million, of which LVL 95.6 million in cash and LVL 103 million in property compensation certificates. As of October 1, 2010, income from privatisation of these land lots amounted to LVL 180.2 million, of which LVL 84.5 million in cash and LVL 95.7 million in property compensation certificates

Privatisation of property units and land lots owned by municipalities

A decision concerning real estate owned by a municipality is taken by the council of the municipality (city). The decision is taken on the basis of a privatisation proposal submitted by any natural or legal person.

A natural or legal person eligible to acquire personal or real property in Latvia within the process of privatisation of municipal assets can be the subject in privatisation of municipal asset (real estate, a deemed part of the real estate, enterprise, capital shares, land). Payments for municipal asset units have to be made in lats (LVL) and/or privatisation certificates.

Privatisation of local municipal assets in the municipality area is ensured by the property privatisation commission of the respective municipality (city, district).

Compliance of privatisation projects, regulations, and announcements approved by a municipality with the provisions of the *Law on Privatisation of State and Municipal Asset Units* and the *Law* on the *Completion of Privatisation* is ensured by the Ministry of Economics.

From February 17, 1994 until December 1, 2010, the Ministry of Economics has reviewed and accepted for information 3270 privatisation projects for the total relative price of LVL 157.7 million (*inter alia* payments in certificates for the nominal value of LVL 57.8 million).

From January 1, 1997 until December 1, 2010, the Ministry of Economics has reviewed and accepted privatisation regulations in respect to 1671 built-up and vacant municipality land lots (announcements of privatisation of built-up land lots separately as from September 1, 2005) with the total value of land lots in the amount of LVL 26.4 million (of which LVL 13.3 million to be paid in property compensation certificates).

The Section 41 (2) of the *Law on Privatisation of State and Municipal Asset Units* establishes that the council of municipality submits a decision on approval of privatisation project of property unit owned by the local government and the approved privatisation project to the Ministry of Economics. However, the submission of a decision on approval of regulations (announcements) regarding privatisation of a built-up or vacant land lot 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 Privatisation*, after August 31, 2006 the local governments on a quarterly basis must submit to the Ministry of Economics the data regarding the received privatisation proposals for municipality property units and built-up and vacant land lots, decisions on bringing these property units and land lots to privatisation, the sale price, and the amount of privatisation vouchers to be used for payment.

Privatisation of residential houses

Privatisation of residential houses in Latvia was initiated in 1995. It was implemented by the Central Privatisation 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 – Privatisation Agency), as well as by the residential building privatisation commissions of the local governments in compliance with the procedure stipulated by the *Law on Privatisation of State and Local Government Residential Houses*.

In accordance with information provided by the local governments and national statistics, there are 30 510 residential houses with 504 426 apartments to be privatised in Latvia, including 25 298 local government residential houses with 454 136 apartments and 5212 state residential houses with 50 290 apartments

The privatisation process of the state residential houses – decisions on bringing 5095 residential houses to privatisation have been adopted until December 1, 2010, which amounts to 97.8% of the total amount of state owned residential houses. Privatisation announcements have been sent to 50 072 tenants of state apartments, but 22 853 announcements on conclusion of purchase contracts have been sent to persons who have obtained apartments for ownership until privatisation of the residential house. Ownership of 23 044 apartments was transferred by the decision before privatisation of the residential house. 44 228 state apartments have been privatised until December 1, 2010, which constitutes 87.9% of the total amount of state apartments. In 2010, 11 apartments were privatised.

The privatisation process of local government residential houses – 24 513 local government residential houses have been prepared and offered for privatisation. Privatisation announcements have been sent to 440 347 tenants of local government apartments, but 166 020 announcements on conclusion of a purchase contract have been sent to persons who have obtained the apartments for ownership before privatisation of the residential house. In 2010, 45 residential houses with 302 apartments were offered for privatisation. Ownership of 171 458 apartments has been transferred by local government decisions before privatisation of the residential house. Ownership relations have been sorted out for 43 248 owners of the apartments privatised for the shares of agricultural enterprises, who live in 1723 residential houses privatised for shares. Until December 1, 2010, 402 488 local government apartments have been privatised, which constitute 88.6% of the total amount of local government-owned apartments.

By December 1, 2010, 9904 residential houses were transferred to the **management of apartment owners**, including 6055 local government residential houses and 3849 state residential houses. As a result of this process, 525 apartment owner associations and unions have been established in Latvia, of which 416 are located in seven largest cities, and 109 – in the regions of Latvia. Authorisation agreements for property management by apartment owners have been signed for 3110 residential houses.

Land reform

The principal goal of the land reform is to rearrange the legal, social, and economic relations of land use and ownership from the planned economy to the market economy.

The state land reform includes allocation of free land pertaining to the state for permanent use, restoration of ownership rights, redemption (purchase) of the land allocated for permanent use, and privatisation (alienation) of land owned by the state or local government. Redemption (purchase) of land allocated for permanent use is being carried out with regard to the rural and urban land reform which is to be implemented.

Allocation of urban land for the use to residential building owners or orchard users, who have received the land for establishing 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 City Land Redemption Register. Decision-making regarding land property allocation for payment has been concluded, and the decision making process has been launched concerning the termination of rights to use land and the conclusion of land lease agreements with persons who had conducted the cadastral survey or made a pre-payment by September 1, 2008, but had not submitted a proposal for the decision to allocate land property for payments by August 31, 2009.

Law *Amendments in the* Law on the Completion of Privatisation of State and Municipal Asset Units and the Use of Privatisation Vouchers *(Law on Completion of Privatisation)* came into force on July 1, 2010.

Before the aforementioned amendments, the *Law on Completion of Privatisation* stipulated that those owners of residential buildings and orchard users in towns who had submitted 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 state joint stock company "The Mortgage and Land Bank of Latvia" *("Latvijas Hipotēku un zemes banka")* until December 30, 2009. By December 30, 2009, in accordance with the Regulations No. 686 of the Cabinet of Ministers of August 25, 2008 *Procedure on the Conclusion of Land Redemption (purchase) Agreement* the Mortgage Bank has concluded 72 969 agreements.

Now, the above mentioned amendments to the *Law on Completion of Privatisation* stipulate that those owners of residential buildings and orchard users in towns, who had submitted an application for decision making regarding allocation of land property for payment and had received the decision by August 31, 2009, can conclude the land redemption (purchase) agreement with the Mortgage Bank until December 30, 2010.

The amendments extend the deadline – March 31, 2011 – by which the Mortgage Bank must submit to the local governments the information about persons who have not concluded the land redemption (purchase) agreement by December 30, 2010. Therefore the decision making process has been launched regarding termination of the right to use the land and conclusion of land rent agreements with urban land users who had conducted the cadastral survey or made a pre-payment by September 1, 2008, submitted an application for the decision making regarding allocation of land property for payments by August 31, 2009, and received the decision, but had not concluded the land redemption (purchase) agreement with the Mortgage Bank by December 30, 2010.

In accordance with the information stated in the *Law on Completion of Privatisation*, submission of proposals for redemption of lands in rural areas in the State Land Service (SLS) for the redemption of the land allocated for permanent use has been performed in two application periods – from September 1, 2005 until August 31, 2006 and from August 1, 2007 until November 30, 2007.

After receiving a land redemption proposal, the SLS examined the particular person's rights to acquire ownership of the claimed land for payment. If the person had the rights to redeem the land, the SLS made a decision and included the land unit claimed for redemption in the Rural Land Redemption Register. However, if permanent users of the land had no rights to redeem the land during the period of land redemption proposal reviewing due to restrictions stipulated in normative acts, but such rights could originate before the decision making regarding allocation of land property for payment, the land unit claimed for redemption was included in the Rural Land Redemption Register with the condition that the person shall provide the SLS with the documents confirming the rights to redeem the land before the decision making regarding allocation of land property for payment.

If the land boundary plans have been registered in the Information System of the State Real Estate Cadastre by August 31, 2006, the SLS included cadastral-surveyed land units allocated for permanent usage without the person's request.

A person's proposal for decision making regarding allocation of a rural land property for a payment included in the Redemption Register had to be submitted to the SLS before the following deadlines:

- by May 31, 2010 if the boundary plan of the land claimed for redemption has been submitted for registration in the Cadastral Information System by August 31, 2009;
- by August 31, 2010, if a person has made a pre-payment of land for redemption within the term under the law and if the land boundary plan of the land claimed for redemption has been submitted for registration in the Cadastral Information System by August 31, 2009;
- by August 31, 2010 for persons whose claim to a land unit has been included in the Redemption Register with a condition that documents confirming the rights to acquire land property for a payment and a boundary plan of land claimed for redemption will be submitted for registration in the Cadastral Information System before submitting the proposal or along with it.

All the persons who within the above-mentioned terms had requested SLS to make decisions regarding allocation of land property for a payment and had received it, just like owners of residential buildings and orchard owners, were allowed to conclude the land redemption (purchase) agreement with the Mortgage Bank until December 30, 2010 irrespective of the term for allocation of land property for payment specified in the decision of the SLS.

Overall, the Mortgage Bank has concluded 239 841 agreements (*int. al.* 1869 agreements in the three quarters of 2010) on sale of land for the total area of 1.749 million ha, including 25 272 ha in the three quarters of 2010.

By December 1, 2010, a chance to pay for land and conclude an agreement with the Mortgage Bank was offered for over 37 100 or 22% of rural land units claimed for redemption.

If the land redemption (purchase) agreement with the Mortgage Bank was not concluded by December 30, 2010, the purchaser of both urban and rural land loses the opportunity to redeem the land for its cadastral value, as well as loses the already made pre-payment paid in privatisation certificates before the cadastral survey.

The Article 16 (1) of the *Law On Completion of Land Reform in Rural Areas* envisaged a possibility for the former land owners or their heirs, as well as former land owners who had started to redeem (redeemed) the real estate in Latvia left by German emigrants from the General Agriculture Bank or State Land Bank by July 21, 1940 or their heirs whose ownership rights to the land have not been restored or the compensation certificates have not been granted, to claim for land units of equal value planned for completion of land reform by a decision of local government until December 30, 2009.

If the former land owners or their heirs expressed interest to restore their ownership rights to land, according to the *Law On the Completion of Land Reform in Rural Area* they had to submit proposals 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 No. 1030 of the Cabinet of Ministers *Procedure on Reviewing Requests Submitted to the Central Land Commission* came into force. It envisages the procedure according to which the former land owners or their heirs can restore land ownership rights to land planned for completion of land reform.

Before starting the process of land ownership rights restoration, the State Land Service (SLS) in cooperation with the local governments examined 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;
- proposals on restoration of ownership rights have 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 of applicant's requests.

The former owners or their heirs who had submitted a claim for the restoration of 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 had started to redeem (redeemed) the real estate in Latvia left by German emigrants from the General Agriculture or State Land Bank by July 21, 1940, 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 the restoration of 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 rights or hereditary rights after July 1, 1996.

Out of 1066 claimers for restored ownership rights, for total land area of 12 982.6 ha recognized by the Central Land Commission, 151 claimers correspond to the first priority category of restored ownership rights for the land area of 2474.9 ha, 35 claimers – to the second priority category of restored ownership rights for land area of 407.9 ha, but 880 claimers – to the third priority category of restored ownership rights for land area of 10 099.9 ha. Thus, the first priority claimers constitute 14% of all land claimers planned for the completion of land reform, the second priority claimers – 3%, but the greatest number of land claimers planned for the completion of the land reform is composed by the third priority claimers – 83%.

In order to ensure the process for restoring ownership to land intended for completing the land reform, local government and regional level commissions for completing the land reform have been established in the SLS regional offices, but in Riga a state level commission for completing the land reform has been founded. The established SLS commissions organize distribution of a land unit list among the claimers and summarize the land units selected by the claimers. A representative of the particular local government who is authorized to sign the allocation schemes of land intended for completing the land reform and boundary schemes of land intended for restoring ownership has to participate mandatorily in the work of these commissions.

Until June 1, 2010, the process for restoring ownership rights to the first priority claimers took place. 55 claimers have selected land units at the level of their local government and region, and local government and regional level commissions established by the SLS for completion of land reform have prepared the required documents and submitted them to the CLC to make decisions regarding restoration of ownership. Proposals of the other 91 claimers are being examined by the state level commission for completion of land reform established by the SLS.

If the number of persons in the priority group exceeds the number of available land units, the SLS commission for completion of land reforms organizes an auction in accordance with the Regulations No. 1030 of the Cabinet of Ministers of December 20, 2008 *Procedure on Reviewing Requests Submitted to the Central Land Commission*.

As the number of persons expressing the wish to acquire a land in the territory of former Riga district exceeded the number of available land units, the state level commission for completion of the land reform organized an auction of land units.

Within 10 days after the auctions, the SLS commission for completion of the land reform must send the auction minutes and a land boundary scheme signed by the claimer to the CLC, which must prepare a statement on restoration of ownership and send it to the claimers within two months after the receipt of documents.

The state level commission for completion of land reform plans to complete the examination of proposals of all fist priority claimers by the end of 2010.

The SLS commissions for completion of the land reform will start examining proposals of claimers included in the second priority group as soon as all proposals of the first priority claimers will be examined.

Privatisation certificates

A privatisation certificate is a state-issued dematerialised security that can be used only once as the means of payment for a state or local government property to be privatised.

Privatisation certificates are issued and used according to the *Law on Privatisation Certificates*. By October 1, 2010, a total amount of 104.4 million privatisation certificates have been issued to 2.5 million people for the time they have lived in Latvia, including 794.7 thousand privatisation certificates granted to 41.4 thousand politically repressed persons. 8 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 privatised specialised state agricultural enterprises, 4.9 million for land in rural areas, 969.3 thousand for property 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.

In the three quarters of 2010, 269.4 property compensation certificates have been granted to 6 former owners or their heirs.

By December 1, 2007, in accordance with the provisions set in Article 27 of the *Law on Completion of Privatisation*, 58 thousand persons lost their rights to transfer 1.6 million privatisation certificates to their accounts.

According to the *Law on Privatisation of Land in Rural Areas*, 11 076 decisions have been made by October 1, 2010 about a payment of cash compensations for former land ownership in rural areas. Compensations in the total amount of LVL 17.5 million have been paid to 8411 persons, thus cancelling 0.6 million property compensation certificates.

By October 1, 2010, cash compensations in the total amount of LVL 4.6 million were paid to 26.2 thousand politically repressed persons as a payment for privatisation certificates. In compliance with the provisions prescribed in Article 27 of the *Law on Completion of Privatisation,* 3.2 thousand persons have lost their rights to cancel 15 thousand privatisation certificates.

By October 1, 2010, 106.5 million privatisation certificates or 94.7% of the total number of issued certificates have been used for privatisation of state and municipal asset units (see Table 6.3). From April 1, 2008 until October 1, 2010, 357.8 thousand privatisation certificates have been used instead of 272.1 property compensation certificates.

Table 6.3

Use of Privatisation Certificates
(until October 1, 2010)

Type of property	Amount	Number of privatisation certificates (million)	including property compensation certificates (thousand)
Residential buildings	446 thousand privatised housing units	37.9	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	312.7 thousand land lots	16.8	5140.3
Total:		**106.5**	**6793.5**
% of total certificates issued		94.7%	84.8%

On October 1, 2010, 2.2 million privatisation certificates or 2% of the total number of issued certificates, including 0.1 million compensation certificates were on the accounts of 386 thousand natural persons.

Accounts of legal entities held 1.2 million privatisation certificates or 1.1% of the total number of issued certificates, including 0.01 million property compensation certificates.

In October 2010, holders of privatisation certificates could use services of 14 licensed intermediary capital companies for transactions in the market of privatisation certificates. The total monthly transactions with privatisation certificates (buying from natural persons and selling) performed by intermediary capital companies in three quarters of 2010 fluctuated from 18.5 thousand privatisation certificates in January to 46.7 thousand privatisation certificates in June, and from 0.4 thousand property compensation certificates in July to 1.2 thousand property compensation certificates in May.

6.14. National Economy Council

The National Economy Council of the Ministry of Economics (NEC) is an advisory institution established by its founder organisations – 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, which takes part in the process of solving issues relating to business policy and acts in accordance with Sub-paragraphs 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 Co-operation in the National Economy Council* concluded on February 17, 1999 and *Bylaws of the NEC 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 objectives of the NEC operations are to promote establishment and implementation of policy of favourable environment for business activity in Latvia, to foster introduction of principles of sustainable development of national economy and to encourage the process of sustainable development of the state and participation of society in it, to facilitate fulfilment of the goals set by the *Lisbon Strategy* in Latvia and to involve public institutions, local governments and social partners in fulfilment of these goals, to identify circumstances preventing entrepreneurship and to perform all necessary activities to eliminate them, to participate in developing normative acts promoting commercial activity and policy programming documents, and to promote innovations and external trade.

The NEC reviews and monitors settlement of issues and development of draft normative documents, national economy development concepts, state budget, and other documents, which are important for 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 public institutions and non-governmental organisations.

The decisions adopted by the NEC are of recommending nature.

Box 6.25

NEC personnel and management

In accordance with the decision of the Managing Authority, the NEC personnel are approved by the Minister for Economics.

The NEC Managing Authority is a consulting and co-ordinating institution that takes part in settling issues referring to business policy and is responsible for assessing and approving issues on the agenda of the NEC action plan and NEC meetings, as well as for ensuring and improving efficiency of the NEC operations.

Composition of the NEC Managing Authority is approved by the Minister for Economics. The Managing Authority consists of five representatives of NEC founders, who are also 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 25 experts designated by the NEC Managing Authority, among them the Minister for Economics, NEC Chairman and representatives of entrepreneur organisations, public institutions and other organisations.

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 NEC are made by the NEC founders in meetings of the NEC Managing Authority.

The NEC is chaired by the Chairman elected by the members of the NEC Managing Authority from among the members in a rotation sequence for a term of office of one year.

NEC meetings are held on average once per month.

Work of the NEC is organised by the Secretariat of the National Economy Council, operations of which are ensured by the Ministry of Economics.

In between the NEC meetings, recommending decisions of NEC are taken by the NEC Managing Authority.

The NEC co-operates with the Cabinet of Ministers, ministries, and other public authorities in order to incorporate NEC's proposals that are necessary for improvement of business environment into normative acts prepared by the responsible institutions.

On May 21, 2009, the NEC, the Ministry of Economics, and the Ministry of Finance signed a co-operation memorandum on *Growth, competitiveness, and employment*. The co-operation memorandum is aimed at co-operation and concerted action of the NEC, the Ministry of Economics and the Ministry of Finance in implementation of objectives of *National Development Plan* and *Lisbon Strategy* – promoting growth of the economy, employment, and competitiveness of Latvia, as well as active participation in developing and implementing sustainable strategy of Latvia.

In order to ensure professional representation of the interests of economic sectors in an effective dialogue with the Ministry of Economics, the NEC and other business organisations and public institutions, the Ministry of Economics has set up a model of co-operation with the national economy sectors.

In the National Economy Council proposals for the improving legislation submitted by the institutions – associations representing the entrepreneurs – are reviewed. Sectoral Associations evaluate draft legislation and give opinions. However, the ministry informs the legislative drafters about proposals submitted by the NEC for improving legislation. Other measures to implement programmes for development of national economy and business environment that were accepted in the framework of a government declaration are also performed.

At the moment, 14 Sectoral Associations are represented in the National Economy Council; among them: chemistry and pharmaceutics, finance, transport – transit, logistics, power industry, information and communication technologies, including IT cluster, trade, electrical engineering, electronics, light industry, wood industry, engineering industry and metal working, tourism, hotels and restaurants, foodstuff, polygraphy.

By signing the protocol of agreement, the parties agreed to unite their resources for development of the programming documents, take measures towards implementation of the programmes on improvement of economic development and business environment adopted as a part of the governmental declaration, and that Sectoral Associations will assess and give an opinion on draft legislative acts elaborated by the Ministries.

The NEC members and experts participate in the following boards, committees and working groups:

– Consultative Board for Development Co-operation Policy Issues of the Ministry of Foreign Affairs;
– Supervisory Board of the Lisbon Strategy of the Ministry of Economics;
– Construction Council of the Ministry of Economics;
– Coordination Council of External Economic Representations of Latvia;
– European Union Structural Funds Supervision Committee of the Ministry of Finance;
– Advisory Council of the Investment and Development Agency of Latvia.

In the second half of 2010, 7 National Economy Council meetings have taken place, in which the following issues have been considered:

– *Guidelines for development of a system of state taxes and duties for 2011-2016* (vision of political parties regarding tax policy for further years was also evaluated);
– results of the working group for combating shadow economy and ensuring fair competition;
– draft *Law on Value Added Tax*;
– *Investment Attraction Strategy for Latvia 2011-2013*;
– monitoring the project *Action Plan to Improve the Business Environment for 2010*;
– execution of state budget 2010 and tendencies in the development of national economy;
– barriers to absorption of European Union funds and possible solutions for eliminating these issues;
– restructuring public enterprises (improvement of cooperative management, determination of clear objectives, ensuring political independence and transparency, implementation of single state asset management, etc.);
– proposals from the Investment and Development Agency of Latvia (IDAL) for improvement of financing absorption (EU fund activities);
– direct and indirect impact of the increase of energy costs on competitiveness of enterprises in medium-term;
– structure of final tariffs on the trade of natural gas and factors affecting it.

An Extraordinary meeting of the NEC took place in November 2010, evaluating fiscal consolidation measures that should be introduced in the state budget 2011.

Box 6.26

NEC on priorities of economic policy

NEC's position to the government in relation to approving the state budget of 2011:

– NEC strongly rejects increase in tax burden at the expense of labour force;
– to foresee much greater contributions in the budget from the measures aimed at reduction of shadow economy;
– to perform structural reforms with the objective to implement them starting from the second half of 2011 and continuing in 2012, by concentrating on effective management of state apparatus, in the result of which economy of state expenses would be achieved;
– to introduce more efficient management of state enterprises;
– from the increase in tax collections to gain not more than 1/3 of the amount necessary for consolidation and 2/3 – on the account of expenses reduction;
– to evaluate any tax changes by comparing tax burden in the region (Lithuania, Estonia, Poland) in order not to lower the level of competitiveness of Latvian enterprises and to strengthen internal consumption that ensures further income in the budget and creates work places;
– to perform centralised procurements, first, at the level of ministries and institutions under their subordination, thereby optimising expenses and making the procurement procedure as transparent as possible, and second, at the state level.

Members of the NEC indicate that clear objectives, particular assignments to ensure efficient state management should be defined during the budget preparation. Entrepreneurs do not comply with such principles of consolidation because these principles are not sustainable and delay development of business.

The NEC indicates that normative acts concerning the tax policy, export, salary of labour force and other issues important for the development of national economy should be evaluated within the preparation process in order to identify and eliminate possible breaches of the competition law, technical barriers of trade and discriminating conditions for free circulation of goods and services, and businesses within the company law.

Establishment of efficient and competitive sectoral structure must be facilitated. Research, development, and innovation must be promoted, especially within the private sector. Measures which would facilitate co-operation of education, research, and national economy sectors by ensuring transfer of knowledge and technologies must be elaborated and implemented.

Faster and broader 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 external economic representations, accessibility of financial instruments and support to companies in export marketing must be provided. State structural reforms should be implemented.

The NEC considers that tax policy and administration, education of labour force, macroeconomic stability and inability to predict changes in legal enactments are still among the problematic fields.

7. Recommendations

The rapid economic recession in Latvia has been stopped. Improvement of the economic situation mainly depends on the increase in export volumes and growth of tradable sectors that partially allows compensating for the still weak domestic demand and for development of domestic market-oriented service sectors.

Although the economic disproportions which developed in the years of rapid growth have been reduced during the crisis, due to the remaining budget disbalance of public and private sectors (households and enterprises), the *balance sheet effect* still continues. A risk to financial stability of the public sector is also the deteriorating the demographic situation, as according to forecasts, the number of Latvian working age population will continue to decrease in a medium term.

In order to ensure sustainable development, economic competiveness must be maintained. Development tendencies of the previous years have proven that market mechanisms as such do not ensure restructuring to the model of sustainable growth.

It requires strategic structural policy. First of all, it is necessary to create a knowledge-based economy in Latvia, the development base of which is creation of values by using knowledge (education and research, innovation and creativity, digital economy), secondly, it is necessary to ensure sustainability of the social budget by taking into account the problem of the aging population, thirdly, it is necessary to ensure energy supply diversification, and, fourthly, it is necessary to create environmentally friendly – "greener" economy.

The state support should be targeted and selective in the limited budget conditions. At the same time, Latvia will have to overcome the protracted tense situation in the labour market by using a targeted policy. In the near future, competiveness of Latvia might still be mainly based on low labour force costs. However, it must be taken into consideration that economic development will be to a larger extent determined by the growth in productivity, which implies a relatively slower increase of employment. Thus, a high risk of growing social tension (poverty, exclusion) and labour outflow remains, which may affect not only the population with low professional qualification that was characteristic in the previous years, but also the highly qualified labour force.

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 in the *Economic Stabilisation and Growth Revival Programme of Latvia*;
  - to ensure fulfilment of the Maastricht Convergence criteria, 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 fair entrepreneurs;
  - to draft a fiscal discipline law, which would determine the medium-term fiscal policy objectives, thus facilitating implementation of a responsible fiscal policy;
  - to ensure sustainability of public finance, including raise of retirement age;
- **for improving the business environment:**
  - to restructure tax system, by ensuring that it becomes more socially fair and business-friendly. In the medium-term, it is necessary to transform the tax burden from entrepreneurship and employment to the real estate and consumption;
  - to increase efficiency of the State Revenue Service (SRS) by continuing its restructuration into an institution, which would support entrepreneurs;
  - to ensure introduction of the one-stop shop agency principle in respect to availability of the state and municipal services;
  - to promote development of e-government and e-services. The establishment of the state mega-system ("the list of registers") must be completed, the e-signature must be introduced in all public institutions, functionality of the e-signature must be expanded and the usage of electronic procurements must be facilitated;
  - to create business environment that is friendly for establishment of micro-enterprises by implementing the concept on *Support measures for micro-enterprises*, introducing fixed micro-enterprise tax, and implementing several measures that will facilitate registration, activity, and tax declaration of micro-enterprises;
  - to develop a new construction process regulation providing for reduction in the number of involved public administration and local government institutions and less time spent for Project coordination. To introduce a construction information system;
  - to improve the official statistical information flow at the state level, as well as mutual coordination of data and terms included in the state register and other information systems in order to prevent repeated requests of information from respondents;

- **for ensuring competition and determining administratively regulated prices:**
  - to ensure protection of competition by tackling the most significant competition breaches as efficiently as possible by taking preventive measures and performing inspections for identifying prohibited agreements in the sectors important for the national economy;
  - to promote competition by raising awareness of market members and the public sector about positive influence of fair competition on welfare of the society and by conducting a survey on competition situation in various market sectors paying particular attention to such areas as service provision to inhabitants and trade of specific products. To carry out activities necessary for improving the competition situation on the basis of the survey results;
  - to continue evaluation of the effect of legislative acts and their drafts on the competition situation in various markets in order to reduce the administrative burden;
- **for improving protection and supervision of consumer rights:**
  - to introduce a licensing system of non-bank lenders, while ensuring stricter supervision for them;
  - to strengthen consumer protection in the field of financial services by introducing recommendations laid down in the research of the World Bank of *Consumer protection and financial possibilities in Latvia*;
  - to develop conceptually new regulation for out-of-court settlements for recovery of debts;
  - to continue improving the market supervision system, by developing a planning document of a medium-term policy;
- **for promoting investment, business start-ups, and access to finances:**
  - to promote accessibility to finances for enterprises, by implementing state support programmes and projects co-financed from the EU funds;
  - to pay more attention to the allocation of financing for the development of entrepreneurship in the early stage (measures for the access to the pre-seed and seed capital, opportunities to receive loans with preferential terms) and access to finances in the form of a risk capital;
  - to facilitate the establishment and development of new production units identifying and preparing new potential manufacturing projects and attracting foreign direct investment;
  - to promote sale of new and existing exportable products and services in the internal market of the European Union, by actively educating the local entrepreneurs about their rights and their options for the right to protection in the internal market of the European Union;
  - to address foreign enterprises more actively and to inform them about advantages of Latvia to attract productive long-term foreign direct investments to Latvia, thus causing a positive financial effect on Latvian enterprises-sub-suppliers as well, and to promote creation of qualitative long-term jobs;
  - to develop state support instruments and investment stimuli particularly intended for attraction of foreign investments to compete successfully in the investment attraction market with other European countries by addressing foreign investors;
  - to promote unified and coordinated action between ministries, local governments, infrastructure enterprises, and public institutions with regard to implementation of local and foreign investment projects by involving the private sector, scientific institutions and universities in this process as well;
  - to promote exchange of information between Latvian companies, which are looking for strategic investors, and foreign companies, which are willing to expand their business in the European market;
- **for developing knowledge-based economy:**
  - to support entrepreneurship with high added value;
  - to facilitate cooperation between the scientists and entrepreneurs by creating 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 transfer contact points for purposeful development of the necessary research competence at universities and research institutions and to improve introduction of research results in production;
  - to support development of new products and technologies by fostering enterprises to develop industrial research, introduce new products, services and technologies in production;
  - to improve normative acts that regulate research activity establishing that research institutions can be the owners of the intellectual property resulting from state-funded research;
- **for the application of the EU funds:**
  - to reduce the time necessary for administrative procedures, by simplifying the procedure for developing and approving the conditions of implementation;
  - to direct the EU funds towards viable projects, taking into account priority sectors;

- **for promoting exports:**
  - to continue ensuring access to export credit guarantees in order to increase access to the markets with a higher risk degree and to promote exports of goods and services of Latvian origin;
  - to continue supporting the participation of entrepreneurs and their unions in international exhibitions and trade missions, in order to foster access to new markets;
  - to develop and expand the network of Latvia's foreign economic representation offices by providing a wide and easily accessible range of export support services for Latvian entrepreneurs abroad;
  - to ensure representation of Latvian external economic interests in the framework of a multilateral trading system and negotiations with the third countries to improve contractual condition of international trade, thus fostering accessibility of third-country markets and exportability for Latvian entrepreneurs;
  - to continue tackling the most significant protective measures by eliminating trade barriers faced by Latvian entrepreneurs in export markets;
  - to consistently protect the interests of Latvia in matters of the EU internal market, to promote deeper integration thereof, foster elimination of obstacles and barriers 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 employment by supporting the efforts to obtain suitable higher qualification in accordance with the requirements of the labour market and improving internal mobility of the labour force;
  - to review the regulation of legal labour relations, including obligations related to the payment of premiums and compensations, working time regulation, promoting conclusion of collective agreements at the level of sectors;
  - to reduce undeclared employment by relieving the tax burden on employment and by improving supervision of observance of the labour law provisions, by increasing the awareness level of the society regarding the labour law issues, strengthening the role of trade unions and employers' associations;
  - to improve the regulatory system of labour demand and supply by ensuring preparation of medium-term and long-term forecasts of the labour market, using the population census of 2011 as an important data source for the improvement of this system;
- **for improving energy efficiency:**
  - to promote implementation of measures to improve the heat insulation of residential buildings by ensuring comprehensive and available information and by reducing bureaucratic barriers and duration of procedures;
  - to develop the minimum energy efficiency requirements to be applied to residential buildings;
  - to support improvement measures of heat insulation of multi-residential and social-residential buildings by granting ERDF co-financing;
  - to establish the requirements for construction of low energy consumption buildings.
- **for ensuring efficient, safe, and sustainable energy supply:**
  - to separate ownership on the transmission level in electric power supply, in order to develop activity of the electric power market, to promote investments in infrastructure indiscriminately, to ensure fair access to the network for the new participants and transparency in the market;
  - to create stable environment for long-term investments and to promote long-term production, use and export;
  - to promote use of renewable energy resources by using co-financing of the EU structural funds, mechanisms of mandatory electric energy procurement and other support mechanisms;
  - to develop the base electric power station projects by choosing the types of electric power stations, which will ensure resource supply guarantees and sustainability, as well as to increase the state self-provision of energy;
  - to increase efficiency of end consumption of energy;
  - to promote development of energy services market;
  - to develop the energy infrastructure projects by implementing the *Baltic Energy Market Interconnection Plan*, within the framework of the EU Baltic Sea Region Strategy.

A consistently implemented structural policy will promote revival of the economy of Latvia, which will form the basis for increasing the standard of living of the population. Successful development and economic growth in Latvia will depend not only on the work of public institutions, but also on personal initiative of any person anywhere in Latvia in the conditions of mutual understanding and dialogue within the society.